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Trade, Labor and EU Law Perspectives

US-China Phase One Deal: A Brief Account

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The full text of the US-China Phase One Deal, officially titled 'Economic and Trade Agreement between the Government of the United States of America and the Government of the People's Republic of China', was released on 15 January 2020.

This 96-page agreement includes seven major chapters which cover the following matters respectively: (1) intellectual property, (2) technology transfer, (3) trade in food and agricultural products, (4) financial services, (5) macroeconomic policies and exchange rate matters and transparency, (6) trade expansion, and (7) dispute resolution.

Chapter 1 Intellectual Property

Chapter 1 uses 36 provisions to set out rules aiming at strengthening the protection of intellectual property rights (IPRs) and enforcement. These rules predominantly target China, requiring China to improve the existing level of protection and enforcement to a level equivalent to that afforded under existing US measures. The areas covered seem to be selected deliberately to tackle some of the major concerns of the US, including trade secrets and confidential business information, pharmaceutical patent, piracy and counterfeiting in sales on e-commerce platforms, the impact of China's recognition of geographical indications on US exports, manufacture and export of pirated and counterfeited goods particularly those posing health and safety risks with a focus on reinforcing enforcement actions and penalties, bad faith trademark registrations, and enforcement of copyright and related rights in civil, administrative and criminal proceedings. This chapter also includes a separate section to mandate China to strengthen criminal enforcement, increase the level of penalties and expeditiously enforce judicial decisions and related penalties in general. China is required to release an Action Plan within 30 working days after the agreement takes effect.

How much China needs to do to implement the above obligations is hard to determine without a careful assessment of the existing Chinese legislation. An enhanced level of IPR protection and enforcement would not only benefit China (as it creates a better regulatory environment for technological advancement and innovation) but also China's other trading partners especially those having strong technology-intensive industries and firms doing business in China. China's commitments tend to be WTO-consistent as they seem to provide a more detailed and higher level of protection than those commitments under the TRIPs Agreement and China's WTO accession instruments. Furthermore, China has the flexibility to apply its commitments on an MFN basis, that is, not to the US only. By doing so, China could ensure that its implementation of the deal does not

violate this fundamental principle of the WTO.

Chapter 2 Technology Transfer

Chapter 2 seeks to reaffirm the position that technology transfer must occur on a voluntary basis and on market-based terms. While the provisions are written in ways that apply to both Parties, they are clearly aimed at addressing US longstanding concerns about the issue of 'forcing' technology transfer in China. China's obligations include not to require or pressure transfer of technology in the admission of foreign investment via administrative decisions and procedures, and not to use outbound investment as a vehicle to acquire foreign technology in the pursuit of industrial policies.

Under the WTO, China has made a general commitment to not force technology transfer. Before the promulgation of the new Foreign Investment Law 2019, the relevant Chinese legislation did not explicitly mandate technology transfer as a condition for approval of foreign investment. However, the US has constantly complained about the practice of Chinese authorities which has had the effect of mandating the transfer of technology by foreign investors to Chinese counterparties.

The agreement clarifies that China's obligation covers "forcing" technology transfer in both formal and informal ways. However, this obligation does not seem to add anything to Article 22 of the Foreign Investment Law 2019 which has already prohibited administrative organs and their employees at all levels of government from "forcing" technology transfer through administrative means. One major addition of the agreement concerns China's obligations to ensure transparency in the enforcement of law and administrative proceedings and to provide due process for US investors/right holders in such proceedings. It remains to be seen whether these obligations would be sufficient to provide the transparency needed to detect and deter abuse of administrative power and process in the admission of foreign investment. To avoid any potential breach of the MFN rule, China would need to provide the same level of transparency and due process to other WTO Members.

Chapter 3 Trade in Goods and Agricultural Products

The chapter on agricultural goods sets out a range of cooperative activities to promote bilateral agricultural trade, communication on agricultural policies and related issues, and discussions on certain SPS matters, the utilization of digital technologies in the agriculture sector and other matters. These activities are merely intended, rather than mandated, to be carried out. However, the chapter then imposes an array of obligations on China to provide enhanced market access for the imports of a wide range of US agricultural goods including dairy products and infant formula, poultry, beef, live breeding cattle, port, and processed meat, aquatic goods, rice, certain feed, feed additives and grains, pet food and certain animal food. Depending on the goods involved, China's obligations vary between the removal of certain import restrictions, the relaxation of certain substantive and procedural requirements on sanitary and safety inspection, product standards, labelling requirements and approval process, and the facilitation of importation from qualified US manufacturing facilities. In addition to these obligations that benefit US exports only, China undertakes some general obligations such as no discrimination between state trading enterprises (STEs) and non-STEs in the allocation of tariff rate quotas for wheat, rice and corn, implementation of "a transparent, predictable, efficient, science- and risk-based regulatory process for safety evaluation and authorization of products of agricultural biotechnology" and simplification of the relevant approval process.

The obligations covered in this chapter are predominantly imposed on China for the benefits of US farmers and exporters. While one can argue that the one-sided obligations on intellectual property and technology transfer are reasonable as the US has maintained a higher level of protection and does not mandate technology transfer in law or in practice, the commitments on the importation of agricultural goods are purely non-reciprocal and have failed to enhance the access for Chinese agricultural or other exports to the US market. The commitments applicable to US agricultural exports only seem to be primarily aimed at relaxing various non-tariff barriers associated with administrative approval and procedures, which would facilitate importation and enhance certainty for US farmers and exporters. However, they may create issues of WTO-consistency. For example, unless China extends these commitments or the associated benefits to other WTO Members, China's implementation of these commitments may be challenged under the MFN rule.

Chapter 4 Financial Services

This chapter covers six types of financial services: banking, credit rating, electronic payment, financial asset management, insurance, and securities, fund management and futures services. These are areas where the US investors have long complained about the lack of market access, discriminatory treatments and burdensome regulatory requirements. And many of these are addressed in the deal. China's commitments include the relaxation and removal of foreign equity cap and the allowance of wholly foreign owned financial service suppliers, expansion of business scope for US investors, and easing of licensing requirements for US firms such as the consideration of the assets and qualifications of their parent institutions in the evaluation process.

China also agrees to give favourable considerations to pending applications from US firms. The US also agrees to consider requests from Chinese financial institutions "expeditiously", but there are no requirements for the US to change its review method or substantive requirements, like what China has agreed to.

The commitments on electronic payment services appear to be designed to complete the unfinished business of the WTO case of China — Certain Measures Affecting Electronic Payment Services (DS 413). China lost the case in 2012 and was supposed to liberalize its electronic payment services as per the WTO ruling. For many years, however, American service providers were unable to make inroads into the Chinese market. This problem seems to be solved for now with the inclusion of specific wording for China to accept the application of US suppliers such as Mastercard, Visa and American Express and to approve an application or explain why an application is rejected in a timely manner.

Chapter 5 Macroeconomic Policies and Exchange Rate

As the shortest chapter in the deal, the chapter on macroeconomic policies and exchange rate includes only 4 articles over three pages. It addresses a thorny issue in the bilateral relationship – exchange rate manipulation – which has been one of President Trump's favourite pet peeves against China. Despite the bickering, over the past 25 years, the US has been very careful in not formally labelling China a currency manipulator. This only changed in August 2019, when, at the height of the trade war, the US formally named China a currency manipular. Then on 13 January 2020, two days before the bilateral deal was signed, the US removed China from the list.

Another interesting feature of this short chapter is that, unlike all other chapters which are filled with one-sided commitments of "China shall", this is the only chapter where the commitments are

truly equal and mutual with all commitments start with “the Parties”. This may be because the commitments in the chapter mainly consist of reaffirmation of their existing undertakings under international instruments such as the G20 communiques and the IMF. The Parties also agree to have regular communication and to disclose their macroeconomic and exchange rate data on a timely basis. Disputes between the Parties may be referred to the dispute settlement mechanism under Chapter 7, or even to the IMF if the Parties cannot reach mutually satisfactory solutions.

Chapter 6 Expanding Trade

The massive trade deficit with China has always been high on President Trump’s trade agenda and is what prompted the trade war in the first place. This chapter provides some solution to the problem by requiring China to greatly expand its purchase of American products. At 28 pages, the chapter is the longest in the agreement due to the inclusion of a lengthy annex spelling out the products on the massive shopping list of China. Altogether, China was supposed to increase its imports by at least $200 billion over the 2017 baseline amount during the two-year period from January 2020 to December 2021, with the detailed breakdown as follows:

32. Manufactured goods: a $32.9 billion increase in 2020, and a further $44.8 billion in 2021;
33. Agricultural goods: an additional $12.5 billion in 2020, and a further $19.5 billion in 2021;
34. Energy products: a $18.5 billion increase in 2020, and a further $33.9 billion in 2021;
35. Services: additional $12.8 billion and $25.1 billion in 2020 and 2021 respectively.

According to the US government, its goods exports to China in 2017 were $129.80 billion. This means that China needs to increase its exports by 35% in 2020, and by 50% over the 2017 level in 2021. It is unclear how this would be achieved, as the US and China have not published the detailed import targets for the specific products. There have been some concerns that this could violate WTO rules such as the MFN obligation under Article I.1, the quota ban under GATT Article XI.1, and the non-discriminatory administration of quota under GATT Article XIII. As the mechanism to boost the imports remains secret, it might be difficult to establish such violations. Nonetheless, the massive purchase will likely lead to trade diversion from other suppliers and intensify trade tensions.

Another related issue is whether China will remove the additional tariffs on these products or even further reduce these tariffs against American imports. The whole agreement does not mention the removal of tariffs, but the Parties have both announced that they would remove some of the tariffs. It is very likely that China will further remove or reduce tariffs on US products on the list, otherwise the aim of boosting US imports will be rather difficult to achieve.

This chapter also includes a rare obligation for the US by requiring it to “take appropriate steps to facilitate the availability of U.S. goods and services to be purchased and imported into China”. However, it is unclear whether the failure of the US to provide such goods or services could be used as justifications when China could not meet the purchase target. It is also unclear as to whether the US would relax its export control on high-tech and sensitive products but an interesting fact is that nuclear reactors are the first category of products on the purchase list.

Chapter 7 Bilateral Evaluation and Dispute Resolution

The dispute resolution chapter is primarily aimed at facilitating the implementation of this agreement and the settlement of disputes over implementation. A Trade Framework Group is to be created to monitor and discuss implementation and related issues, and a Bilateral Evaluation and

Dispute Resolution Office for each Party will be established to facilitate dispute resolution via consultations. More specifically, the complaining Party needs to submit an 'appeal' in writing to provide sufficient information for the Party complained against to assess alleged non-compliance. Once the assessment is done, the Parties will commence consultations. If the consultation does not resolve the dispute, then the complaining Party may suspend an obligation under this agreement or adopt "a remedial measure in a proportionate way that it considers appropriate with the purpose of preventing the escalation of the situation and maintaining the normal bilateral trade relationship." The Party complained against may decide whether the action of the complaining Party was taken in good or bad faith. If it is in good faith, then the Party complained against may not retaliate. If it is in bad faith, then the Party complained against may withdraw from the agreement.

Thus, the bilateral dispute resolution mechanism is essentially based on consultations and does not establish a standard adjudicative framework based on an independent adjudicating body, binding decisions and enforcement in a rules-oriented manner. When consultations fail to resolve disputes, it provides room for the Parties to take the law into their own hands. Given the few obligations that the US undertakes under the agreement, it is most likely that the US will resort to remedial measures (most likely tariffs) rather than suspension of obligations. In such cases, even if China is entitled to decide whether such measures are taken in good or bad faith, China may not retaliate unless it withdraws from the agreement. Of course, if China takes an action (through either suspension of obligations or remedial measures), the US will be in the same situation. The difference, though, is that given the few obligations the US undertakes under the agreement, the US will be unlikely to have implementation issues. This means that most disputes will target China's implementation and will provide a chance for the US to take remedial actions, leaving China to decide whether to address US concerns (by remedying the implementation issues) or opt out of the deal if China wants to retaliate.

Thus, this bilateral dispute resolution mechanism would encourage the abuse of power unfavourable to China. It may lead to the continuation of the existing confrontational approach to the resolution of trade tensions between the two nations and would not reduce the uncertainties in the prospect of the US-China trade relations. It creates a significant fragmentation which would further undermine the central position of the WTO in the resolution of trade disputes.

Wrap up …

The US-China Phase One deal has predominantly targeted Chinese law and practices that affect the interest of US companies and exporters. Most of China's obligations seem to have extended beyond its WTO commitments and would contribute to furthering liberalisation of the Chinese market. However, China will face difficulties in making necessary changes to the relevant legislation and ensuring proper implementation and compliance with WTO rules.

For the US, the major difficulty would be monitoring China's implementation in practice. The deal does not seem to provide any monitoring mechanism but has relied on the bilateral dispute settlement mechanism to resolve issues of implementation. This is why the importance of the dispute settlement mechanism must not be underestimated as it essentially provides the flexibility for the US to use unilateral actions (e.g. re-starting the trade war) as the deterrent to non-compliance. This demonstrates US satisfaction of the effectiveness of unilateral actions in pushing China to change behaviour and its dissatisfaction with the multilateral mechanism.

For other WTO Members having an interest affected by the deal, they may challenge the relevant

Chinese law and practice at the WTO or try to get China to sign similar deals. It is unclear, however, whether any other WTO Member could be as successful as the US in bilateral negotiations.

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