USCBC Analysis of the Phase One Trade Agreement

By USCBC Staff

The US-China Business Council congratulates US and Chinese negotiators for the signing of a Phase One trade agreement earlier this morning. The full text is available here.

We are hopeful that Phase One will serve as a stable foundation for building a stronger, more prosperous US-China relationship. Our initial analysis of the most impactful commitments for our member companies is below.

USCBC is also soliciting comments from members on what you would like to see addressed in "phase two" discussions. Please send your feedback to Matt Margulies (mmargulies@uschina.org.cn).

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1. Intellectual Property Protection

Several new commitments are fairly substantive, including those on strengthening deterrence against IP infringements, judicial enforcement, pharmaceutical-related IP, and counterfeits. Some, though not all, of the commitments on trade secret protection are repackaged from existing Chinese laws and regulations, though those were likely still achieved due to pressure from bilateral trade talks over the past year. USCBC will closely follow China's IP action plan to implement its promises, set to be released 30 working days after enactment of the Phase One agreement.

Obligations of the Chinese government

- **Enact stronger deterrence and enforcement measures against IP infringements:** In the near term, China has committed to impose higher penalties for IP infringements near the current statutory maximum, and at a later stage, increase and broaden the range of punishments allowed under China's laws. China has promised timely enforcement of court judgments and decisions on IP cases and increased transparency of such enforcement measures.
- **Lower threshold for criminal and civil proceedings against IP infringements:** In addition to lowering thresholds, China will expand the types of trade secret misappropriation that will be subject to criminal penalties. These commitments will need to be incorporated into any future revision of China's Criminal Law, which is expected to be on China's 2020 legislative agenda. Administrative bodies will be mandated to transfer cases of IP infringements to the criminal enforcement authorities should there be "reasonable suspicion" of criminal violation. On civil procedures, China has promised to remove the high requirements that have impeded US companies' ability to pursue civil litigation for IP infringements.
- **Positive commitments on pharmaceutical-related IP issues:** China has committed to establish a patent linkage system for pharmaceutical products, including biologics. The agreement is light on specifics, simply noting that China agrees to provide "adequate time and opportunity" for a patent holder to seek available remedies prior to the marketing of an allegedly infringing product. While China does not promise any specific remedies, it does agree to provide procedures such as preliminary injunctions "or equivalent effective provisional measures." With regards to patent term extension, the agreement contains language that protects "first in China" products, thereby eliminating previous restrictions of patent term extension to only those products with a simultaneous global launch.
- **Eliminate conflict of interest in expert panel reviews:** Addressing the trade secret vulnerability in administrative licensing processes, the agreement calls for narrowly tailoring regulatory information requests and prohibiting experts or advisors with a competitive or financial interest from accessing information as part of a regulatory review. This should improve IP protection in expert panel reviews.

- **Strengthen enforcement mechanisms on combating counterfeit products:** China has agreed to publish regular updates and data on enforcement measures against counterfeit goods. The agreement also expands the authority of China's Customs to destroy counterfeit goods. The agreement also addresses the concerns raised in the Section 301 report regarding China's inadequate enforcement mechanisms—in both civil and crisminal enforcement—against counterfeiting by stipulating that China follow explicit civil and criminal procedures for counterfeit cases in a consistent manner. Another significant commitment is the permission given to China's judicial authorities to exempt materials from destruction that could be used as evidence in any civil or administrative case on IP infringement.
- **Address problems with China's "notification and take-down" system for ecommerce.** Under the agreement, China will extend the time frame for IP right holders to respond to counter-notifications under the *Ecommerce Law* to 20 days from 15 days as well as remove punishments for erroneous notifications made in good faith.
- **Commitments are made on preventing market-access barriers that might result from protection granted for geographical indications (GIs).** The agreement stipulates explicit protection for US exports against market access barriers that might result from lists of protected GIs agreed to between China and any other trading partner, commonly known generics or protected GIs that might become generics over time, and generic individual components of GI protected multi-component products.

What is missing?

- **Some of the commitments on trade secret protection are not new:** The scope of acts and actors that will be held liable for trade secret misappropriation covered under the agreement follows what has already been implemented by the 2019 amendment to *China's Anti-Unfair Competition Law*. The provisions on protecting unauthorized disclosure by government officials are repackaged from existing laws—such as the *Foreign Investment Law* and its implementing regulations as well as the *Administrative Licensing Law*.
- **No specifics on protection against bad faith trademark infringements:** It remains to be seen if revisions to China's *Trademark Law* and the law's implementation regulations —both finalized last year—as well as administrative enforcement campaigns China announced last year against bad faith trademark registration will effectively address the issues US companies face in acquiring trademark rights in China. However, on other issues relating to trademark infringements, the provisions on combating counterfeit goods via ecommerce platforms, customs, and judicial channels should have a positive impact.
- **Commitments on protection of copyrights are shallow and do not resolve some of the sticking issues:** The agreement addresses some of the difficulties US companies face in pursuing administrative and enforcement actions against copyright violations but leaves many other issues regarding copyright protection—like copyright protection for sports broadcasts—unaddressed. It

remains to be seen how many of the remaining issues will be addressed by any future revision of *China's Copyright Law,* which is also expected to be on China's 2020 legislative agenda.

2. Technology Transfer

Key technology transfer fixtures of the Section 301 investigation are addressed through principles-based commitments to not "*require or pressure*" technology transfer in the Phase One text. However, without specifics, the effectiveness of the commitments will likely be conditional upon specific—but unlikely—company complaints.

Obligations for US and Chinese governments

- **Forbidding tech transfer related to joint ventures, administrative and licensing processes, and legal proceedings:** China has signaled plans for addressing many of these avenues for technology transfer through language in the *Foreign Investment Law* (FIL) and its implementing regulations. While USCBC acknowledged progress on limiting technology transfer via the FIL, we hope regulations with greater specificity to implement the FIL's technology transfer protections will also be introduced.
- **No state-directed outbound investment for tech acquisition:** Neither government will support or direct overseas technology acquisition in sectors supported by industrial policy. This commitment could be difficult for China given the state's dominant role in the banking system, and the role of state-owned enterprises and state-backed funds in advancing industrial policy in key industries like semiconductors. It is also unclear if this applies to third-country acquisitions in strategic sectors.

What is missing?

- **Unclear how commitments will be enforced:** Greater detail on changes to specific provisions in laws and regulations (or administrative and licensing processes) would strengthen the ability to monitor enforcement of technology transfer concerns.
- **Unclear how to monitor intangible actions:** The technology transfer section makes frequent reference to not *"require or pressure"* technology transfer, but it is unclear how pressure—especially if verbal or as informal window guidance—could be evaluated.

3. Agriculture

One of the most lengthy and detailed chapters, the agriculture portion of the deal covers a range of dairy, meat, aquatic, animal feed, pet food, and plant products, as well as commitments on tariff rate quotas (TRQs), domestic support, biotechnology, and food safety. Many of China's commitments eliminate market access barriers, shorten the time it will take for US products to get to market, increase transparency, and encourage the use of international standards. However, there were some areas where it appears agreement was not reached and the only commitment was to continue talks.

Product-specific obligations of the US and Chinese governments

- **Poultry trade facilitation:** Both countries made openings in poultry last year, and the agreement includes several commitments to facilitate bilateral poultry trade. The two sides will sign a poultry disease protocol to reduce uncertainty in the case of future outbreaks, and China has committed their poultry measures will be consistent with international standards.
- **Improved market access for US beef:** China will eliminate cattle age requirements for US beef products, recognize the US beef traceability system, and adopt maximum residue limits (MRLs) based on international standards for three widely-used hormones, which will make a larger portion of the US herd eligible for export.
- **Increased bilateral market access for aquatic products, plant products, and pet food:** China has approved 26 species of seafood for import in a side letter associated with the agreement and the two sides will discuss further openings.The agreement also allows both sides to export new plant products. China has committed to lift its ban on US pet food containing ruminant ingredients, animal origin ingredients legally imported into the United States, and poultry ingredients, and will approve pending registrations for 24 US pet food facilities.
- **Quicker approvals for animal feed products:** China has agreed to waive site visits and export protocols for feed products such as feed additives, premixes, and compound feed products that are normally part of the registration process. It has committed to complete product reviews for new feed products within nine months of receiving an application. For distillers' dried grains with solubles (DDGS), China has committed to speed up license renewals, which had caused export delays. China has also updated its list of approved feed products with 23 specific products in a side letter associated with the agreement.

US and Chinese government regulatory commitments

- **Improved agricultural biotech approval process:** US companies have long struggled with China's opaque, drawn-out biotech approval process. China has committed to make the process more transparent, predictable, efficient, and science- and risk-based. They have committed for the review process to take no more than 24 months, to base their evaluations on international standards, and to extend the authorization period for products to five years. China has also committed not to request information unnecessary to assess the safety of a biotech product, which had created intellectual property concerns among US companies.

- **Streamlined facility registration while China maintains audit rights:** For many of the agricultural products covered in the agreement, China has committed to allow imports from US-inspected and approved facilities with the proper certificates. China will update its lists of approved facilities for many of these products within 20 working days of notification, which will decrease delays in the ability of newly approved facilities to export to China. Most sections also clarify that China maintains the right to audit US agricultural and food shipments on science- and risk-based criteria, and can reject individual shipments and refuse shipments from facilities that present sustained problems.
- **Meat and poultry information system to facilitate customs clearance:** The two sides will establish an electronic meat and poultry information system to allow China to access US export certificates, which will allow Chinese port customs officials to access the relevant information quicker and accelerate customs clearance.
- **Commitment to science and risk-based food safety measures:** China has committed not to implement food safety measures that are not science and risk-based. In a side letter associated with the agreement, China committed not to require certification for low-risk food products like processed, shelf-stable products. In 2017, China released draft measures that would have required food safety export certificates for a wide range of food products that threatened to disrupt normal processed food trade.
- **Improved transparency and administration of tariff-rate quotas:** The United States won a WTO suit in 2019 against China on its administration of tariff-rate quotas (TRQs) for rice, wheat, and corn. TRQs allow for a lower tariff rate within a certain quota and prohibitively high duties outside of that quota. China has promised to improve corn, wheat, and rice TRQ allocation methodology and transparency, and has committed not to inhibit the filling of TRQs and not to discriminate between state trading enterprises and private companies.

What is missing?

- **Uncertainty remains around low-level presence of unapproved biotech traits:** One challenge that US exporters have long faced is China's zero tolerance of unapproved biotech traits. Chinese rejections of US corn shipments for a low-level presence (LLP) of biotech corn brought US corn exports to China to a halt in 2013. The agreement includes commitments by China to handle inadvertent or technically unavoidable LLP incidents case-by-case based on a risk and safety assessment, although it does not go as far as to clarify an acceptable LLP threshold.
- **No agreement on ractopamine:** China has promised to conduct a risk assessment on the use of ractopamine in swine and cattle based on international

standards and the two sides will establish a working group to discuss the results. Ractopamine is a growth drug commonly used in the United States that is banned in China, making many US meat products ineligible for export.

- **Mutual acceptance of pesticide trial data remains unresolved:** Because China does not recognize US testing data, companies must redo trials of new pesticide products in China, extending the time it takes for them to enter the market. While no commitments were made on pesticide registration and trial data and MRLs, the two parties agreed to increase consultations and exchanges on this and a number of other issues.

4. Financial Services

China has made significant commitments on opening its financial services industry to US companies, resolving many long-standing issues they have faced in trying to gain market entry as well as obtaining national treatment in the China market. While in the past year, China has already announced many of the commitments for financial sector openings in the agreement, the inclusion of specific timelines on when these commitments will be implemented is very much welcome and will ensure enforceability of these commitments.

Obligations of the Chinese government

- **Remove foreign equity caps in specific financial services sectors by April 1:** China agreed to remove restrictions on foreign equity caps in securities, fund management, futures, and insurance sectors such as life, health, and pension. China will also discontinue all discriminatory practices that have prevented full national treatment for US companies in these specific insurance sectors in the regulatory process, business scope, and licensing and operating requirements.
- **Approve pending credit rating licenses within three months:** Within three months after the agreement goes into effect, China must review and approve all pending credit rating licenses.
- **Approve pending licenses for securities investment fund custody within five months:** Within five months of the agreement's effective date, China will need to allow entry for subsidiaries of US financial institutions seeking to provide securities investment fund custody services and take into account the asset size of these branches' global parent companies.
- **Make decisions on applications for bank card clearing licenses:** The agreement did not set a specific timeframe for when US companies' pending applications for bank card clearing licenses will be approved. It will only hold China accountable for faithful implementation of its regulatory review process for applications for bank card clearing licenses in accordance with the timeline set for the review process in the regulations for bank card clearing institutions.

- **Review pending licenses for type-A underwriters:** China promised to evaluate US financial institutions' applications for type-A underwriting licenses according to international standards—a repeat of the same commitment China made in July 2019.
- **Allow full scope of business in asset management, futures, and credit rating:** For asset management, this would include acquisition of distressed assets from Chinese banks as well as the types of business activities and services that US private fund managers can engage in. China has vowed to allow the full range of investments for US futures companies. For credit rating, China has promised to allow US credit rating agencies to rate all domestic bonds in China. While China's interbank bond market has fully opened, opening of the exchange bond market has yet to materialize.

5. Currency

The chapter on currency largely repackages language from the recent United States-Mexico-Canada Agreement (USMCA), which many experts agree finds the balance between confronting currency manipulation by trading partners and maintaining macroeconomic and exchange-rate independence for the United States.

Obligations for US and Chinese governments

- **Avoid competitive devaluation:** China confirms that under IMF rules, it is bound to avoid manipulating exchange rates or the international monetary system to prevent balance of payments adjustments or to gain an unfair competitive advantage, particularly through competitive devaluations. While this has been a big talking point from the US side, China has worked to strengthen its currency, not weaken it, for the past few years.
- **Enforcement mechanism to involve IMF:** Any exchange rate policy or transparency issues will be referred by either the US Secretary of the Treasury or the Governor of the People's Bank of China to the dispute resolution mechanism laid out in Chapter 7. If this mechanism fails to satisfy either party, either may request that the IMF offer its own surveillance and analysis of the requesting party.

What is missing?

- **Transparency promises are not new, lack key component of USMCA:** China's pledge to release relevant data do not go beyond its existing IMF and G-20 commitments. Additionally, the agreement to publish information on monthly interventions in spot and forward exchange markets—considered a critical component of USMCA—was left out of the Phase One agreement.

6. Expanding Trade

Both parties acknowledged that the structural changes outlined in the agreement will expand trade flows between China and other countries, and with the United States. This is ostensibly to ensure the agreement is WTO-compliant, a principle the Chinese have emphasized throughout the negotiations.

Obligations of US and Chinese governments

- **China will import no less than $200 billion of US goods and services on top of the 2017 baseline over the next two years:** China has committed to import US goods and services across four broad categories. These will be made from January 1, 2020, through December 31, 2021, but the trajectory of these increases is also expected to continue after the two-year period, through 2025. Continued increases will likely be contingent on implementation of the structural changes in the agreement and removal of tariffs.

  The agreement provides annual purchase targets by category, along with an annex of over 500 product lines with corresponding 4-digit HS-codes. Purchases will be made at "market prices based on commercial considerations and market conditions," particularly, for agricultural goods.

- **Manufactured goods:** By far the largest category, the agreement includes a two-year total of $77.7 billion in purchases and imports of US manufactured goods over the 2017 baseline. This includes over 300 product lines across industrial machinery, electrical equipment, pharmaceutical products, aircraft, vehicles, optical and medical instruments, iron and steel, and "other manufactured goods," which includes a variety of chemical products, lumber, and integrated circuits manufactured in the United States.
- **Agricultural products:** The $32 billion total two-year target to increase agriculture product purchases over 2017 levels of $24 billion will reach the $40-50 billion annual purchase commitment that Trump administration officials have touted. The agreement additionally includes a note indicating that at the request of the United States, China will strive to purchase and import an additional $5 billion per year of US agricultural products on top of the minimum amounts specified. In addition to soybeans, meat, dairy, and cereals, the agreement also specifies that ethanol will be included in agricultural goods. It was clear during the signing ceremony that many senators had lobbied President Trump to include ethanol in the agreement.
- **Energy products:** The two-year total for energy purchases is $52.4 billion on top of the 2017 baseline. Products include liquified natural gas, crude oil, refined products, and coal, including metallurgical coal.
- **Services:** The two-year total of no less than $37.9 billion on top of 2017 levels in purchases and exports of US services includes both the crossborder supply of services, such as IP royalties, tourism, and education travel, as well as the supply

of services through commercial presence, such as financial services, insurance and data hosting, telecommunications, and cloud services.

- **United States agrees to facilitate the availability of US goods and services for Chinese purchases:** It is unclear what this will mean in practice; if it is simply ensuring supply of agriculture products or reducing export restrictions on certain manufactured goods. However, if China believes that US actions, inactions, or "other circumstances" are affecting its ability to fulfill purchase obligations, then China can request consultations with the United States.

What is missing?

Unclear if China will remove tariffs: The agreement specifies that purchases will be made at market prices based on commercial considerations and market conditions, but is vague about how China will actually complete these purchase commitments. While this provides China some flexibility, it also leaves open the question of whether China will remove tariffs on US goods or offer tariff waivers to facilitate purchases.

7. Dispute Resolution

Described by officials as the "key to the agreement," the bilateral evaluation and dispute resolution chapter establishes two new bilateral dialogues and a mechanism for ensuring full implementation of each side's commitments. The dispute settlement process might be a valuable tool for ensuring compliance, but questions remain about the appetite of foreign companies to raise concerns that may lead to retaliation in China.

- **Two new dialogue mechanisms established:**
  - A Trade Framework Group will be jointly led by USTR and a Chinese vice premier to focus on implementation of Phase One, managing dispute resolution, and setting the agenda and negotiating future commitments, including "phase two."
  - A second dialogue, called the "macroeconomic meeting," will be led by Treasury and a Chinese vice premier, be independent of the trade talks, and discuss global and bilateral macroeconomic issues.
- **Dispute resolution process includes escalation:** If one side believes the other side is not acting in accordance with the agreement, first, working-level officials will discuss the concern at a scheduled monthly meeting. If not resolved, deputies will discuss at the quarterly meeting. Failing that, principal-level officials will be consulted at a scheduled biannual meeting. If urgent, an issue can also be raised at the principals level without prior discussions at lower levels. A dispute resolution timeline allows for a maximum 96 calendar days from initial working level consultation to resolution before remedial action can be taken.

- **Remedial measures can be taken unilaterally without retaliation:** If concerns are not addressed, the concerned party can unilaterally impose remedial action in a proportional way. The other side is not allowed to retaliate, but can withdraw from the agreement if they believe the action was taken in bad faith. The scope of remedial action is not specified in the agreement, but conversations with USCBC sources indicate tariffs, export controls, and other unspecified actions are possible.

8. US Commitments

US commitments re-affirm the openness of the US market and pledge continued access and fair treatment for Chinese companies under various US laws and regulatory systems. Additional commitments largely center around:

- **Renewing or starting bilateral technical dialogues and consultations:** The United States has committed to bilateral dialogues and consultations with China across the various topics covered in the Phase One text, including on issues like: IPR criminal enforcement, technological cooperation, agricultural biotechnology, maximum residue levels, food security, and seafood.
- **Attention to license applications of Chinese companies in the US:** Chinese financial services companies including CITIC Group, China Reinsurance Group, and China International Capital Corporation have various applications before the US government or regulatory agencies, which the US has pledged to review expeditiously.

What is missing?

- **Further US tariff drawdown:** The agreement includes no reference to existing US tariffs on Chinese imports, or indication that the United States will remove those tariffs going forward. During the signing ceremony, President Trump affirmed the United States would maintain tariffs on some $300 billion worth of Chinese imports as leverage for subsequent negotiations on "phase two," and those tariffs would only be removed once that is completed. USTR released a draft federal register notice, set to be published in the coming days, that reduces the List 4A tariffs from 15 to 7.5 percent with a target implementation date around February 14.