

Opinion – Negotiating the US-China Phase One Deal

Written by Bashar H. Malkawi

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BASHAR H. MALKAWI, DEC 16 2021

The Economic and Trade Agreement between the Government of the United States of America and the Government of the People's Republic of China, known as Phase One Deal, entered into force on February 14, 2020. Through this agreement, China would, among other things, make structural reforms, open its financial services, and strengthen intellectual property. China pledged to buy at least \$200 billion more U.S. goods and services over 2020 and 2021. However, after almost two years, complaints have arisen about China not meeting its obligations under the Phase One Deal. According to some statistics, China has reached only sixty two percent of that target. As the agreement expires in December 2021, questions arise to its future and enforced compliance.

The Phase One Deal has come at a time when trade war between the largest economies in the world is still raging. It all began back in 2018 when the U.S. imposed US \$34 billions on imports from China such as aircraft parts. In return, China imposed 25 percent in tariffs on imports from the U.S. including agricultural products. In the intervening years, the U.S and China exchanged exemptions for certain goods from the imposition of tariffs. However, in recent months trade war has resumed again as, among other things, the US has extended the ban on US investment in Chinese companies that have ties with the military.

Exemptions from tariff lists and other trade measures of both the US and China seems to work in calming trade relation between them. This piecemeal approach will likely to continue unless the US and China agree to a new deal, something unlikely to happen. In the alternative, the Deal can be renewed with tweaking in the numbers involved, i.e. how much China would import from the US. In this way, the US can rely on a hard fought deal and then shift its focus on enforcement.

According to the Phase One Deal, the US and China agreed to an innovative approach on complying and enforcing their agreement. Chapter seven of the Deal provides for the steps needed to ensure effective implementation of the agreement. The Deal created a Trade Framework Group to discuss the implementation of agreement, led by the United States Trade Representative and a designated Vice Premier of the People's Republic of China, and a Bilateral Evaluation and Dispute Resolution Office for each Party. As in a typical trade agreement, a complaining party can submit an appeal to the Bilateral Evaluation and Dispute Resolution Office of the Party Complained Against when there is an issue regarding the agreement. If this issue is not resolved, the matter can be raised to the designated Deputy United States Trade Representative and the designated Vice Minister.

The Deal states that if the concerns of the complaining party are not resolved both at the United States Trade Representative and the designated Vice Premier of the People's Republic of China level, "the Parties shall engage in expedited consultations on the response to the damages or losses incurred by the Complaining Party. If the Parties reach consensus on a response, the response shall be implemented". But if the Parties do not reach consensus, the Complaining Party may resort to taking action, including by suspending an obligation under this Agreement or by adopting a remedial measure in a proportionate way that it considers appropriate.

The novelty of the Deal comes when Article 7.4 permits either party to unilaterally retaliate by suspending an obligation or by adopting a remedial measure in a proportionate way with the purpose of preventing the escalation of the situation and maintaining the normal bilateral trade relationship, as long as the action was taken in good faith. The language used creates room for wide interpretation such as "proportionate way" and "good faith". Rather than

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achieving the purported goals of the Deal of managing trade in a peaceful manner, the dispute resolution language may lead to escalation of trade tensions between the US and China. This is exacerbated by the fact that according to the Deal, it is the complaining party who makes the determination that there is a violation of the agreement. There is no independent panel or a tribunal that would make that determination. The Deal is not clear on the remedial measures that can be taken by the complaining party, whether it is the suspension of tariff or quota concessions or imposing additional tariffs and for how long these measures can be taken. In sum, the US can unilaterally determine that a violation has occurred and the duration for suspending concessions and determining the level thereof.

This leaves us with the question if it is expected for both parties, but mainly the US, to take unilateral measures to enforce the Deal. Statements made by US officials indicate that this is likely to happen. However, thus far, evidence shows that enforcement under the Phase One Deal may not happen for several reasons. First, when the US takes an action, China can either accept the remedial measure, along with a promise not to retaliate, or withdraw from the Deal. The latter option is more harmful than taking the remedial measure itself. Second, from economics perspective, whatever targets achieved under the deal is better than nothing or reverting to trade wars with China. Third, from a geopolitical perspective, there are few, if any, alternative venues to force China to abide by its trade obligations. The World Trade Organization (WTO) is in bad shape, especially its Appellate Body, which is responsible for the final verdict on trade disputes. Even more, there is doubt if the Deal can be legitimate under WTO rules.

The WTO Agreement on Safeguard, provides that “a Member shall not seek, take or maintain any voluntary export restraints, orderly marketing arrangements or any other similar measures on the export or the import side. These include actions taken by a single Member as well as actions under agreements, arrangements and understandings entered into by two or more Members. Any such measure in effect on the date of entry into force of the WTO Agreement shall be brought into conformity with this Agreement or phased out.” Clearly, measures such as bilateral voluntary export restraints, orderly marketing agreements, and similar measure that limit imports of certain products are prohibited under WTO rules.

Putting aside political rhetoric, opening the Phase One Deal to re-adjustment and negotiations seems the plausible option in the short term. The Deal has been a success, despite the flaws in its text. No country should be forced to import from another country. Nevertheless, China was willing to import from the US in increased quantities. In the short term, both the US and China would continue to exempt on an *ad hoc* basis certain goods and services from harmful tariffs and other trade practices by both countries. Then, the US should give another try for diplomacy and negotiations.

About the author:

Bashar H. Malkawi is Global Professor of Practice in Law at University of Arizona. He received his S.J.D from American University, Washington College of Law, and LLM in International Trade Law from University of Arizona. He is well-versed in teaching and providing legal advice, with more than 20 years experience in both private and public sectors.