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Tentative Deal Extends Pause in U.S.-China Trade Tensions

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Trade Policy

On Friday, October 11, 2019, President Donald Trump announced that the United States and China reached agreement on "Phase One" of a U.S.-China trade deal. The U.S. Administration agreed to suspend the increase in the tariff rate on $250 billion worth of Chinese products that was set to rise 5 percent from 25 to 30 percent on October 15, 2019, while the agreement is formalized in writing over the coming weeks.

According to the Administration, China agreed to ramp up purchases of U.S. agricultural products to $40-$50 billion annually in two years, as well as address non-tariff barriers for trade in agriculture and biotechnology. Secretary Mnuchin stated that progress was made on currency, including greater transparency around intervention in foreign exchange markets, as well as the further opening of China's financial services sector. Phase One is reported to also address some of the U.S. concerns regarding intellectual property and technology transfer, while the bulk of the technology transfer concerns will be addressed in subsequent phases. The Administration also indicated that progress was made towards an agreement on a mechanism to enforce the deal, which would include bilateral dispute settlement consultations.

A statement from China's Ministry of Commerce simply noted the conclusion of talks in Washington, and stated that "substantive progress" was made on agriculture, intellectual property rights protection, currency, financial services, expanding trade cooperation, technology transfer, and dispute settlement. The statement said that the two sides discussed next steps and agreed to "make efforts toward ultimately reaching agreement."

The Trump Administration indicated that finalizing Phase One could take three to five weeks, which would coincide with an opportunity for Presidents Trump and Xi Jinping to meet on the margins of the Asia Pacific Economic Cooperation summit in Chile. President Trump said that negotiations on Phase Two would begin after Phase One is finalized in writing, and the talks could include a third phase. The White House also posted a message from President Xi to Trump that acknowledged the importance of agriculture to President Trump and urged further progress on each side's concerns.

Uncertainty Remains Despite De-Escalation

While this progress indicates continued de-escalation in the trade tensions between the United States and China, we believe uncertainty will remain for companies doing business with China as the interim deal is tentative and not yet formalized. In addition, most of the additional Section 301 tariffs remain in place, and new tariffs on Chinese imports, which represent products in which China's share of US imports is 75% or more, remain scheduled to take effect on December 15.

The progress announced in Phase One includes mostly items on which progress was previously announced, or those that China had already indicated it would address for its own purposes. It remains to be seen whether further progress can be made on the more contentious issues that separate the negotiators, such as China's industrial policies. Companies should watch for confirmation by the other side when specific claims of agreement or further progress are made by one side. Meanwhile, progress in the trade negotiations does not ensure a pause in other actions that can disrupt business, such as U.S. sanctions on Chinese entities or non-tariff retaliation by China.

Suspension of 5 Percent Tariff Increase

While the suspension of the 5 percent increase announced on Friday creates some relief, the lion's share of the tariffs are still in place. A 25 percent additional duty is still being imposed on $250 billion worth of Chinese imports (the aggregation of Section 301, Lists 1, 2 and 3). Additionally, USTR has increased duty from 10 to 15 percent on the first tranche of $300 billion worth of Chinese imports (List 4), which was effective on September 1, 2019. Although future tariff increases could be bargaining chips in the negotiations, USTR has not announced any change in plans to increase the duty for the second tranche of List 4 from 10 to 15 percent, scheduled to take effect December 15, 2019.

Therefore, we recommend that companies with trade with China should continue to examine U.S. country of origin requirements, review their supply chains, and determine whether alternative sourcing is available in order to mitigate the ongoing 25 percent additional duty as well as the expected increase on List 4.

Section 301 Exclusion Requests for List 4 Implications

The U.S. Administration's increase in duty from 10 to 15 percent for tranche one of List 4 and the planned increase for tranche two impacts a significant amount of consumer products such as laptops, cell phones, and video game consoles. Although an exclusion request process has not yet been announced, we recommend that companies prepare for the possibility of a List 4 exclusion request process.

We believe that an exclusion request process for List 4 would be similar to List 3 and focused on whether the product is available only from China, the economic harm to U.S. interests, and whether the product is strategically important to Chinese industrial programs such as "Made in China 2025." We expect that the List 4 exclusion process would likely utilize the electronic portal and have similar questions and requests for data.

Covington's diverse trade policy teams in Washington and Beijing, which include former senior government officials, are uniquely positioned to provide thoughtful strategic advice to clients seeking to monitor, prepare for, and react to the evolving Section 301 developments. We count among our ranks:

- Chris Adams, former Senior Coordinator for China Affairs at the U.S. Department of Treasury and Minister Counselor for Trade Affairs at the U.S. Embassy, Beijing;
- Marney Cheek, former Associate General Counsel in the Office of the USTR;
- Alan Larson, former Under Secretary of State for Economic, Business and Agricultural Affairs;
- Timothy Stratford, former Assistant USTR for China Affairs; and
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