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United States and China Announce Limited "Phase One" Trade Deal

Planned U.S. tariffs on $160 billion in Chinese imports suspended; existing additional tariffs on $120 billion in Chinese imports halved to 7.5%

December 13, 2019

International Trade, Public Policy

On December 13, 2019, the United States and China formally announced a limited initial agreement to relieve trade tensions between the two countries that have been ongoing for the past 20 months. Under what the countries call a "Phase One" trade agreement, the United States will lower the rate on some already-imposed additional tariffs on Chinese imports and cancel new duties set to take effect, whereas China agreed to increase purchases of U.S. farm goods and other U.S. products and certain reforms in market access, intellectual property, and other areas.

While the text of the agreement is to undergo legal review, translation, and authentication to be finalized, the phase one agreement is reported to cover intellectual property rights, technology transfer, agricultural products, financial services, exchange rate transparency, trade expansion, and bilateral assessment and dispute settlement. The two countries are expected to sign the agreement in the first week of January, and the deal, including U.S. tariff reductions, is to take effect 30 days after the signing. The text of the agreement will be made public after USTR briefs cleared advisors and Congress.

According to the Office of the U.S. Trade Representative ("USTR"), the Phase One deal "requires structural reforms and other changes to China's economic and trade regime in the areas of intellectual property, technology transfer, agriculture, financial services, and currency and foreign exchange" and "establishes a strong dispute resolution system that ensures prompt and effective implementation and enforcement." The USTR issued a fact sheet that provides details about each of the substantive areas covered in the deal. Notably, it said that the deal includes "commitments from China to import various U.S. goods and services over the next two years" by no less than $200 billion more than China's 2017 levels of imports for those same goods and services. These commitments cover imports ranging from "U.S. manufactured goods, food, agricultural and seafood products, energy products, and services."

For its part, the United States will suspend the imposition of additional tariffs of 15 percent on nearly $160 billion of Chinese imports that were due to take effect on December 15, 2019 (**List 4B**), President Trump said on Twitter. Major consumer products such as laptops, cell phones, and video game consoles had been included on this list. The United States will also cut the 15 percent tariffs on about $120 billion on Chinese goods (**List 4A**) to 7.5 percent. However, the 25 percent tariffs on approximately $250 billion of Chinese imports (**Lists 1-3**) will remain in place.

A draft of the USTR's *Federal Register* notice to modify these tariffs has been circulated, and a final version should be published soon.

China's state-run media confirmed that "with the efforts of the Chinese and U.S. trade negotiating teams, the two sides have reached agreement on the Phase One trade agreement text on the basis of equality and mutual respect." As part of the deal, China has committed to make substantial additional purchases of U.S. goods and services in the coming years. Its statement did not commit to meet President Trump's demand of increasing purchases of U.S. farm goods to $50 billion annually and said that Chinese purchases of U.S. goods would be consistent with WTO rules, market forces, and commercial principles. The Chinese statement also said that the United States had committed to a "phased removal" of additional tariffs on Chinese goods.

The Phase One deal is unlikely to produce significant structural reforms to China's economic and trade regime, although it reinforces recent announcements by China on improving intellectual property protection. The more difficult issues regarding China's industrial policy, subsidies, regulatory regime, and further commitments on technology transfer will likely be left to the next phase of negotiations, during which China will seek commitments to further reduce or remove U.S. tariffs imposed on approximately $370 billion worth of Chinese imports. While President Trump said on Twitter that the parties "will begin negotiations on the Phase Two Deal immediately," meaningful progress in the coming months will likely be difficult.

Companies should closely monitor developments in ongoing bilateral trade talks, which could affect tariff-related actions. Companies should not assume that a de-escalation on trade will lead to an easing of tensions in other aspects of the U.S.-China relationship that could affect business, including sanctions, law enforcement actions, and legislation. National security concerns on both sides and the growing geopolitical rivalry between the United States and China will likely continue to create new compliance risks for companies and threaten disruptions to supply chains and business plans, particularly in the technology sector. Businesses will need to evaluate the specific risks and opportunities for their companies in different potential future scenarios, as the resetting of the U.S.-China relationship continues to unfold.

Further, companies still facing the additional tariffs on approximately $370 billion in Chinese imports should continue to evaluate their supply chain strategies, for example by monitoring product exclusions granted by the USTR; reviewing product classifications; considering alternative sourcing outside of China and diversification of supply chains; ensuring compliance in customs valuation strategies, including first sale; and evaluating whether there are duty preference or duty deferral programs that might mitigate the additional tariffs.

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 developments in the U.S.-China trade and investment relationship, to mitigate negative impacts, and to adapt their business strategies to this changing landscape. We count among our ranks:

- Chris Adams, former Senior Coordinator for China Affairs, U.S. Department of Treasury;
- Marney Cheek, former Associate General Counsel at USTR;
- Alan Larson, former Under Secretary of State for Economic, Business and Agricultural Affairs;

- Timothy Stratford, former Assistant USTR for China Affairs; and
- John Veroneau, former Deputy USTR and former USTR General Counsel

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