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Phase One Trade-Deal Analysis

Daniel Tenreiro

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President Trump held a ceremony on Wednesday with senior officials from the American and Chinese governments to celebrate the signing of a bilateral trade truce. The agreement requires the U.S. to reduce tariffs from 15 percent to 7.5 percent on $120 billion of Chinese imports and refrain from further tariff escalations. In return, the agreement requires China to reform its intellectual-property practices and financial markets and to purchase an additional $200 billion of American goods and services. It's a political victory for the president, at least on his own terms of narrowing the trade deficit.

Yet as a "phase one" deal in what is sure to be a continuing series of negotiations, the agreement defers the more pressing issues of Chinese subsidies and industrial policy to later rounds. With tariffs still in place on $360 billion of Chinese imports, the next phase of talks will determine whether the bilateral relationship can be mended without further escalation.

"People should understand this is a political deal, not an economic deal," Derek Scissors of the American Enterprise Institute tells National Review, pointing to the focus on reducing the bilateral trade deficit, as opposed to combating anticompetitive Chinese practices. To that end, China agreed to purchase $40 billion of agricultural products over the next two years but made no promises following 2021. While the language of the deal guarantees these purchases, Chinese vice premier Liu He said during the White House press conference that they must be "based on market conditions," and the unprecedented scale of the purchases has led some observers to doubt whether they are practicable.

The agricultural chapter of the agreement also contains reductions of non-tariff barriers, such as restrictions on hormone-treated beef and genetically modified organisms. Though relatively minor, those provisions represent meaningful structural reforms to China's trade policies, as opposed to temporary adjustments.

More significant from an economic standpoint are new provisions on intellectual-property theft. The central rationale for confronting China was the U.S. Trade Representative's Section 301 report, which found that U.S. firms incurred significant costs due to forced technology transfers. Wednesday's agreement requires that China combat the production of counterfeit goods and grant patent protections to foreign firms, as well as publish an action plan explaining how it will enforce and deter IP violations.

The Cato Institute's Simon Lester tells National Review that these are "new, more detailed rules than exist at the World Trade Organization (WTO)" but cautions that "we'll have to wait and see in practice what that means for China's governing behavior." China has agreed to IP protections in the past — specifically to the WTO's Agreement on Trade-Related Aspects of Intellectual Property Rights — yet China has consistently violated IP rights since acceding to the WTO. While the inclusion of IP provisions is encouraging, their enforcement is a thornier issue.

Unlike most trade agreements, which use neutral panels to resolve disputes, the phase-one deal includes a unilateral enforcement mechanism whereby either party can bring complaints to the other party. If one side feels its grievance has not been redressed, it can impose tariffs or exit the agreement. Though the dispute-resolution mechanism will be useful in fostering dialogue, it is unclear how it differs from current bilateral talks. Lester argues that "we would have done that anyway — I don't know why we need a specific provision." He says Trump's disdain for the WTO may have led negotiators to pursue unilateral enforcement as an alternative to the WTO model. Scott Kennedy of the Center for Strategic & International Studies calls it "a very simple enforcement mechanism for a very large, complex, nuanced deal."

China also has strategic leverage to evade enforcement, since Trump has a political incentive not to enforce the agreement so long as the trade deficit closes, according to Scissors. Even if China violates IP provisions, the harm to farmers from unraveling the deal will be too tough a pill for the Trump administration to swallow. The editor of China's state-owned *Global Times* said on Thursday, "There cannot be a new outburst of the trade war, otherwise U.S. farmers will be implicated again." With farm bankruptcies reaching a record high in 2019, Trump emphasized benefits to farmers during negotiations. "Go out and buy a larger tractor. Buy a little more land," Trump said during his White House remarks.

Additionally, Scissors says, China's corporate model provides a major loophole, because the Chinese government can penalize firms while simultaneously providing them with subsidies and state support. Thus, IP provisions may be enforced *de jure* but not *de facto*.

So while the agreement is a step in the right direction, whether China will abide by key provisions on IP theft is an open question. Moreover, the administration's willingness to accept a deal well short of its initial ambitions may undermine its credibility in future talks. As Kennedy explains, "It signals that the administration will engage in a great deal of bluster and generate an immense amount of uncertainty, yet eventually they come around to accepting half a loaf."

Meanwhile, Americans may wonder whether the economic loss imposed by tariffs has been worthwhile. In a report published last month, the Federal Reserve found "that tariff increases enacted in 2018 are associated with relative reductions in manufacturing employment and relative increases in producer prices." As long as tariffs remain in place, Americans will continue to eat those costs, and uncertainty will not likely abate any time soon. Trade authorities will have to spend the next few months implementing this deal, and the Chinese will be hesitant to negotiate with the administration until after the 2020 presidential elections.