THE U.S.-CHINA PHASE ONE TRADE AGREEMENT - SIGNIFICANT STRUCTURAL CHANGES

Following over a year of on-again, off-again negotiations and U.S. imposition of tariffs on a growing array of imports from China and retaliations from China, fueled by President Trump’s erratic statements and persistence, the U.S and China say they have reached a partial agreement that includes many structural reforms as well as a partial rollback of tariffs. The structural reforms address China’s treatment of intellectual property, technology transfer, expanded trade, financial services, and dispute resolution.

The final agreement, which the Chinese government-controlled Xinhua News Agency says will include nine chapters that presumably will include a lot of detail, has not yet been finalized and published. The details of the final agreement will provide critical insight into the structural aspects of the agreement and their lasting impact.

Clearly, the tariffs and trade policy uncertainties have harmed global trade and growth, particularly business investment (Tariffs and monetary policy: a toxic mix, September 27, 2019), and we have been critical of President Trump’s heavy reliance on tariffs and threats of higher trade barriers as levers to force changes in China. If this Phase One Agreement and subsequent agreements simply were to roll back the tariffs imposed since mid-2018, the economic harm to date would be larger than the benefits of any rebound in trade and it would represent a net loss to global economic performance.

Yet, official statements from both the Chinese leaders and the U.S. Trade Representative Office (USTR) emphasize up front that the agreement includes many dimensions beyond tariffs and trade. These structural changes may provide significant longer-run benefits, not just to the U.S. but also to global trade flows, international business practices, and finance. Details and time will tell.

From China’s official statement:

“The text of the agreement includes nine chapters: preamble, intellectual property, technology transfer, food and agricultural products, financial services, exchange rates and transparency, expanded trade, bilateral assessments and dispute settlement, and final clauses...The implementation of the relevant content of the agreement will help strengthen intellectual property protection, improve the business environment, expand market access, and better safeguard the legal rights and interests of various enterprises, including foreign companies, in China.”

The U.S. Trade Representative’s Office statement:

“The United States and China have reached an historic and enforceable agreement on a Phase One trade deal that 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...Importantly, the agreement establishes a strong dispute resolution system that ensures prompt and effective implementation and enforcement.”

The agreement also rolls back some tariffs, but certainly not all of them. In addition to cancelling additional tariffs in mid-December, the U.S. will reduce the tariff rate to 7.5% from 15.0% on the $120 billion of Chinese imports imposed in September, but it will maintain 25.0% tariffs on approximately $250 billion of Chinese imports assessed...
earlier. Our hope is that the implementation of the final agreement will eventually involve a complete rolling back of tariffs and trade barriers.

China’s leaders, who must maintain open channels that facilitate the international flows of goods, capital, labor and human capital, concluded their statement on a promising note:

“After the agreement is signed, it is hoped that the two parties can abide by the agreement and strive to implement the relevant contents of the first phase of the agreement, do more things that are conducive to the development of bilateral economic and trade relations and global economic and financial stability, and maintain world peace and prosperity.”

We certainly hope President Trump allows and facilitates the implementation of the agreement in its full intent.

Additional Observations

To date, the tariffs have had only a minor impact on U.S. consumers, but the trade policy uncertainties have depressed global trade volumes, industrial production, and capital spending. In recent months, measures of policy uncertainty have improved. A critical question is whether any further reductions in policy uncertainties stemming from this agreement—its announcement, the final details, and implementation—will lead to a rebound in trade and business activities. We hope so, but our optimism is tempered by China’s very weak economy independent of the tariffs that reflects its slowing potential and daunting internal challenges. Do not count on a V-shaped rebound.

Second, we expect that pundits and the media who downplay this will be surprised at the detail and length of the final U.S.-China agreement. President Trump’s erratic communications and divisive behavior have overshadowed the literal 100s and 1000s of U.S. government officials working behind the scenes who have a deep understanding of the details of U.S. and global relations and activities with China, and have been hammering out disagreements and details with their Chinese counterparts. In a longer-term context, the Administrations of Presidents Clinton, Bush, and Obama all tried to deal with various aspects of China’s unfair practices. The cumulated knowledge of U.S. government officials across these administrations, and the full knowledge by Chinese leaders that it is imperative that they reach an agreement in order to keep international channels operational presumably will be reflected in the final agreement.

Implementation of this Phase One Agreement will determine whether the economic harm generated by the tariffs and threats yields positive structural improvements. Stay tuned.
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