TRADE talks

Trade Talks, with Soumaya Keynes & Chad P. Bown

A podcast about the economics of trade & policy

Episode 118. Ins and Outs

of the US-China Phase-One Trade Deal

Episode webpage

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Transcript

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Soumaya Keynes 0:00

Hello, you are listening to an episode of Trade Talks, a podcast about the economics of trade policy. I'm Soumaya Keynes, the Trade and Globalization Editor for The Economist.

Chad P. Bown 0:08

And I'm Chad Bown, a Senior Fellow at the Peterson Institute for International Economics.

Soumaya Keynes 0:12

This episode is about the wonderful, magical, transformative trade deal that on Wednesday, January 15th, we finally got to see.

Chad P. Bown 0:23

It's the Economic and Trade Agreement between the United States of America and the People's Republic of China: Phase One.

Soumaya Keynes 0:31

This is a rather long episode, but we have included timestamps so you can skip the bits you're interested in if you'd like. And first of all, you are going to hear from us, delightful.

Chad P. Bown 0:41

And then you're going to hear from two ex-negotiators. The first is Darci Vetter. She's now at Edelman Public Affairs, but in a former life, she was the chief agricultural negotiator for the US trade representative's office. And then we'll hear from Lauren Mandell. Before he joined WilmerHale, which is a law firm, Lauren helped negotiate rules over technology transfer and investment on behalf of the US also at the USTR.

Soumaya Keynes 1:14

Then we're going to talk a bit about why the business community seems to be so happy with the deal. And we will finish with my colleague Simon Rabinovitch, in Shanghai, to tell us about the reaction in China. So, let's begin.

Chad P. Bown 1:30

First, let's recap what's in this deal. And basically, it's what we laid out in our episode from about a month ago when this thing was first announced on December 13. There are new rules on intellectual property and trade secrets. There's some new market access. And China agreed to buy a lot more American stuff.

Soumaya Keynes 1:50

There is a novel enforcement or dispute settlement chapter. And just to give a quick summary of how that works, basically, if there's a complaint that one side hasn't been sticking to the deal, then both sides are supposed to talk to each other. And if they can't resolve the problem, then the accusing side gets to apply some sort of remedy. And then the other side, the one that's just gotten hit by the remedy, presumably the Chinese, they can decide, do I still want to stay in this deal? In which case, they just have to take it, they can't retaliate. Or do they want to hit back? Do they want to retaliate and withdraw from the whole deal? That's how that works. So Chad, is this deal everything you've ever wished for and more?

Chad P. Bown 2:45

No, it doesn't cover industrial subsidies or Chinese state-owned enterprises.

Soumaya Keynes 2:51

Is that an issue that you've mentioned before? Because I feel like you should have brought it up before now.

Chad P. Bown 2:56

I think I did. I'll have to go back and listen to some of the episodes, but I have a feeling that it's something that I've mentioned before.

Soumaya Keynes 3:04

Okay, any other hot takes?

Chad P. Bown 3:06

So the purchase agreements in this deal are massive, and it turns out they're even bigger than what was anticipated back in December when we first heard about the deal. It turns out, for example, that the products that are covered by these purchase commitments – it's only about 73% of US exports to China. So that means this massive export growth, the $200 billion worth of additional exports over the next two years between 2020 and 2021, that's coming off of a much smaller base, and it makes it even less likely that those numeric targets are actually going to be hit. What that also means is there's about $50 billion of American exports to China that aren't covered by this deal, in which China's not going to be penalized if it actually decides to import nothing in those non-covered products.

Soumaya Keynes 3:39

Wait. So it sounds like you want them to manage all the trade and not just 73%?

Chad P. Bown 3:46

So when you go down this path of managing trade, it turns out you need to manage all of the trade.

Soumaya Keynes 3:51

If you say so. Okay, after those flaming hot takes are out of the way, let us dig into the weeds. So, onto our first ex-trade negotiator. Darci, hello.

Darci Vetter 4:24

Hello.

Soumaya Keynes 4:26

Could you tell us a bit first about your experience negotiating with the Chinese, maybe a brief rundown of your CV?

Darci Vetter 4:35

Sure, I have spent or spent at one point a lot of my time negotiating with the Chinese on various agriculture issues. Most recently I was first the deputy undersecretary at USDA that oversaw the foreign ag service and international agriculture at USDA, and then I was the chief agricultural negotiator at USTR from 2014 to 2017. So many of the issues that you see in this phase one China deal were under very active discussion when I was in those roles, and we were trying to negotiate an end to restrictions on a wide variety of agricultural products into the Chinese market.

Chad P. Bown 5:22

What have been some of the main frustrations when it comes to agriculture and getting those products into China?

Darci Vetter 5:28

Well, I think sanitary and phytosanitary measures, so animal and plant health and human food safety, have been particularly vexing when it comes to China and how it forms its regulations. In part, because with a country like China, you see that some of the overly burdensome licensing or registration or inspection or multiple layers of scientific review that they require, it's hard to tell whether it is overt protectionism, lack of capacity with their technical experts, lack of person power to be inspecting equally at all ports and to administer in a very large country with a very high trade volume, if it is responding to the fact that they have had serious food safety scandals and lack of trust in their own system. So in an attempt to clamp down domestically, they also over-index on what they do on imports. And so peeling back the layers and trying to get consistent treatment and having them obey or follow international trade rules and best practice has always been difficult. And just when you think you've worked through it, sometimes they enact a whole other series of regulation. So it's trying to say the least.

Soumaya Keynes 7:11

So what struck you in terms of the long standing problems that this deal could resolve?

Darci Vetter 7:17

There's actually a fair amount of good and solid technical work in the agriculture section of this text. I think that the text around new and expanded access for beef and for meat and processed meat products are probably the provisions that seemed the tightest. Simply that China will, in fact, recognize the safety assessment of the United States and will in a very certain period of time allow those products entry. In 2017, a protocol was negotiated that allowed entry of US beef for the first time since BSE, a very long-standing negotiation and issue. But it's still had a lot of complications to it, it was relatively onerous, it only recognized beef from cattle under 30 months. This gets rid of a lot of those remaining restrictions.

Chad P. Bown 8:16

And so BSE is essentially the mad cow disease and that was an outbreak in 2003-2004. So a long, long time ago.

Darci Vetter 8:23

Yes, 2003 initially, so very long standing restrictions. China, really one of the few remaining countries that had not reopened to US product.

Soumaya Keynes 8:33

What else?

Darci Vetter 8:35

I think there is some new access for poultry, for dairy products. We saw the announcement before this deal was signed that did open the market to US poultry. This provides even more specificity around that. For dairy products, it looks like it's making registration processes and reopening the market for some specialty milk products that have been difficult to get in. There're some language in the dairy annex that looks like it allows for some additional inspections, some questioning around infant formula. How certain that access will be, I don't know. But certainly progress and getting rid of just some of the really bureaucratic steps additional, again, registration licensing, onerous processes are dealt with throughout. The problem with all of these technical regulations is there's nothing that says China might not come up with some brand new regulatory process or registration or new way of implementing a food safety law that has the potential to put us back at square one. But given the existing playing field, I do think this is progress.

Soumaya Keynes 9:59

One thing I heard was a very welcome part of the deal was a bit about approvals for agricultural biotechnology products. Can you tell us a bit about that?

Darci Vetter 10:12

I do think there are some procedural advances in this text, some very common sense treatment of how these applications would be processed. That's really positive. There's language in there that says that it will be an average of 24 months for China to review and make a decision to either approve or disapprove a biotech event. The word average gives me some pause. That may mean individual applications could take much longer. And there's really nothing that would be out of compliance for that. How many approvals have to be approved before you establish what the average is? There're some questions about how that will operate. One of the biggest concerns that US biotech developers have had about China's system is that they won't start reviewing an application until that event has been approved in its country of origin. So a company might submit their dossier, their scientific information, to the US and Chinese authority, on the same day, but the United States would have to run its complete application process and approve it before China would consider that application eligible for review. That is not addressed in this text. And so that still could be many months to years of process that a company would have to wait before China even begins their process.

Soumaya Keynes 11:49

So if I had to ask for your overall hot take on the extent to which this this deal resolves trade issues between the US-China in agriculture and then the more structural trade issues, what would your take be?

Darci Vetter 12:04

Overall, I think this deal does make progress and it does make progress on removing barriers for a number of products that are of great export importance to the United States. What I question however, is whether there is an adequate mechanism to then enforce these protocols. Whether the language is tight enough in some of it to really be able to assure follow through. And whether it was worth it for this outcome, i.e., to endure a period of more than a year when our exports to our largest export market were cut in half. There's been a pretty big cost to the agriculture industry of the trade war that brought us to the table to discuss this, and time will tell whether there is ultimately a benefit.

Soumaya Keynes 12:59

Okay. And I suppose from the perspective of the Trump administration that they would respond to some of those concerns by saying, well look, we've also got a ton of Chinese purchases of agricultural products. So, even if some of these structural barriers don't get removed, we've hard-coded in the outcome that we want, which is this huge increase in the value of purchases. So let's talk about those, the American lurch towards managed trade. What caught your eye in this section?

Darci Vetter 13:36

Well, I think the major thing that caught my eye was the same thing that caught the eye of many others, which is just the sheer numbers and the short period of time to get to those numbers. Obviously, we're looking at $12.5 billion above a high baseline of $24 billion in one year. And, frankly, we're down at $9 billion because of the impacts of the trade war. And I think the question is, how do you achieve that, and which products will see the benefit? The other thing that caught my eye, of course, is the discussion that within different categories of products, there are limits, but those limits are not being made public. So we don't know in which products we should expect the biggest gains. But the tariffs remain, and there are no commitments for China to remove the tariffs on US products, most of which are not competitive going into China now because of the retaliatory tariffs. So to hit those benchmarks, those high numbers of exports, they will have to exempt some products from tariffs. There's a lot of control we have ceded to China, about which products will be exempted. Who will get the exemption? Will it be all state traded enterprises? Will it be private companies? Will they try to drive products to particular regions? Will they wait until periods of time when US products are selling at a discount before they open up those markets? How will they game that system? And will all products actually see the benefits? Will they take the retaliatory tariffs off almonds but not walnuts? Will they only let in certain cuts of pork or beef to try and lower the prices for particular populations? We don't really know how they will administer tariffs in a way that will let those products flow. What I worry about is that there will be some decisions made to simply meet to those export targets in a way that could actually prevent us from forming the kinds of relationships with end users in China where, over the long haul, we would have seen stronger relationships and stronger exports. For example, if the tariff exemptions are granted only to SOEs, if they make big purchases and simply put them in stocks for the sake of meeting a target, and so our exporters aren't actually working with the end users of the product, forming relationships, tailoring our product, meeting certain specifications that go directly to what users need. I think about groups like the US Soybean Export Council, who were in China for decades before they ever sold any soybeans. But their work with aquaculture experts in China has really developed that industry with our soybeans as the feed source. And so we're delivering to them soybean, soybean meal that really meets what they need, where they need it and in a more sustainable way than had they develop their industry without us. That's what we want.

Chad P. Bown 17:02

I want to know, how are American farmers supposed to feel about this deal? Are they supposed to do anything differently now?

Darci Vetter 17:09

I think there is optimism that we aren't going to be ratcheting things up and making matters worse with China and that this represents a truce. What I'm hearing is a bit of relief, but also a dose of skepticism. And I think the way farmers feel is in part the way the market reacted when this deal came to light. And it wasn't this big spike in soybean prices. It was in fact some concern that there wasn't a clear numerical target for soybeans that they could count on immediately. I would also note that all of the purchases could take place in December of next year and China would still be in compliance. Now, that's not likely to happen. But with the lag in trade data, we won't know if we hit any of those benchmarks until March of next year, at which point farmers will have already purchased their seed for the year after and made those planting decisions. While the purchase numbers are a hopeful sign for them that things will go back to normal that maybe we'll see some new opportunities in China. I don't know that I would be ordering my seed or planning I'm going to plant based on that.

Soumaya Keynes 18:33

Darci, thank you very much.

Darci Vetter 18:35

Thank you.

Chad P. Bown 18:37

That was Darci Vetter, the former chief agricultural negotiator at USTR.

Soumaya Keynes 18:44

Next we spoke to Lauren Mandell, who is currently at WilmerHale, and we should give the disclaimer that he is not representing the views of any of his clients. Before joining WilmerHale, he was involved in negotiations with China. We asked him how.

Lauren Mandell 18:59

Up until May of 2019 I was the USTR staff lead on foreign investment, i.e., inbound and outbound foreign investment policy. And in that capacity, I was involved both in the Section 301 investigation of China of forced technology transfer, and then, beginning in December of 2018, when there was this bilateral negotiation, I was involved for those five months. And so I was part of the broad team of USTR negotiators and advisers participating in negotiations. My focus given my expertise on foreign investment was largely on the forced technology transfer issues as well as investment market access. As you know, the tech transfer issues are addressed, in part at least, in phase one, whereas investment market access is largely absent with the exception of financial services market access at this point.

Chad P. Bown 20:01

Tell us a bit about the history of these negotiations.

Lauren Mandell 20:03

There was, of course, the WTO accession negotiations, which took over 15 years and 18 sessions, culminating in 2001. Before those negotiations, before there was even a WTO, the United States and China were engaged in the initial bilateral investment treaty (BIT) negotiations in the 1980s. At the time, these were unsuccessful, and they resumed again under the George W. Bush administration, and they significantly intensified under the Obama administration in the second term. I was involved in those negotiations, there were 35 rounds of negotiations under Obama and Bush. These negotiations have been on ice since 2017. But clearly you can see a bit of a through line in terms of the subject matter and focus of those discussions and these more recent discussions. One more point in terms of the trade and investment negotiations and dialogue: alongside the WTO and the BIT, more formal discussions, there have been the sustained dialogues in the Strategic Economic Dialogue, the SED, which was begun by Treasury Secretary Hank Paulson on the US side, and then the S&ED, the Strategic and Economic Dialogue under Obama. And so there's been lots of talks and I think it's important to view these talks as a continuation of those previous discussions, albeit achieving quite a different objective in some respects.

Chad P. Bown 21:28

Let's turn now to talk about the deal that the US got with China. So in your view, how is it different from the others that the United States has negotiated in the past?

Lauren Mandell 21:34

It's really a unique deal in many ways – in terms of the scope of the deal, some of the specific provisions in the deal, the drafting approaches in the deal are all somewhat unique. I will offer some comments on the similarities and differences. On the differences, in terms of scope, the scope of the deal is much narrower than the typical US free trade agreement, which covers essentially all sectors across the economy. It's also in the area of investment, for example, much narrower than we cover in our bilateral investment treaties. Largely the phase one deal covers issues the two parties have discussed for years, and both sides have expressed some flexibility for years. In terms of the specific provisions, some of the pieces of the deal are grafted directly from US free trade agreements, including in the most recent US-Mexico-Canada (USMCA) agreement. For example, if you look at the intellectual property chapter, there's language requiring "fair, adequate and effective protection of IP rights." This is very similar to language that we just recently negotiated in the USMCA and other agreements. But then there are other rules in this new phase one deal that the US has never negotiated in a trade agreement to my knowledge, but which reflects long standing US asks of China, for example, the provision requiring parties to provide in their domestic law, that if plaintiffs make a prima facie civil case for trade secret misappropriation, then the burden of proof shifts to the other side. That's something that we've asked China in foreign dialogues, in the S&ED, for example, but where we've never achieved that in a formal binding agreement or another FTA with another party.

Soumaya Keynes 23:13

I'm just going to interject for listeners that this burden shifting thing is kind of a big deal. It means that the company that you are accusing of stealing your secrets has to prove that they're not stealing our secrets. So essentially, it makes those cases easier to win.

Lauren Mandell 23:32

Then on the drafting, the approach from a trade law perspective is really very different. There's been a lot made of the of the depth and length of this deal, over 80 pages and nine chapters. But when you look at the deal, you don't see a lot of the features, including definitions and clarifications that you have in many of our free trade agreements, such as the USMCA. If you had those additional bells and whistles, the deal would be probably three or four or five times longer. My view is that the intention on the US side, in particular, was to sacrifice some legal precision for a more plain-English drafting approach. I think there may have been a view that because the agreement doesn't include traditional state-to-state dispute settlement decided by third party arbitrators that we don't need all that language we can say to China, you know what we meant. We can enforce our rights as we see fit. We don't need to worry about the risks of third party interpretation or misinterpretation. And now clearly there are potential downsides of a perceived lack of legal precision. It may make it more likely that you'll have compliance issues in the future. One final comment in terms of comparing old and this new agreement, there are very few exceptions in this agreement. In most of our agreements, on the US side, you have national security exceptions, you have exceptions for areas like procurement, exceptions that carve out sub-central actors, for example, in the US case, the states, but here you don't have many of those exceptions. You have rules that are cleanly clearly stated in plain English. There is an attempt evidently to avoid circumvention on the Chinese side. Now, again, that may be effective in addressing concerns about circumvention and also the lack of clarity but could also create their own risks of likelihoods of disputes over compliance. Clearly, whether there's a national security exception in the agreement or not, China's not going to hesitate to violate the agreement if it feels it's necessary to do so for security reasons, and same thing on the United States side. And you can look at other exceptions and see that, regardless of the presence of the exception, some of those sacred cow policy areas, will likely predominate in terms of the implementation and compliance of this agreement.

Chad P. Bown 25:44

Digging through the details of the deal, which do you think are the most important provisions that represent essentially Chinese concessions that are going to improve the life for American companies that are working in operating in China?

Lauren Mandell 26:00

I think there are a lot of important and interesting nuggets in the deal that could be very valuable for US companies. I'll highlight a few that are in my areas of expertise. In intellectual property, I think the extensive rules on trade secret protection have been a major priority for US companies operating in China. And there're very impressive and very detailed rules and commitments in this agreement, they will require significant judicial reform in China with respect to civil and criminal liability for trade secret misappropriation. They create obligations on China, when China obtains trade secrets, or confidential information from a US company, for example, in an administrative approval scenario, there are obligations on China to keep that information confidential and to refrain from providing it to actors within or outside the government who should not see it. There are provisions on enforcement and on penalties that are novel. I think all of these are quite valuable for US companies. On technology transfer, I should highlight that there's one area that has not received very much attention, but it's quite important, and that is in the area of indigenous innovation. China committed in the deal to refrain from requiring US companies to use local technology in exchange for receiving an advantage such as a subsidy. China has historically used carrots such as subsidies to cajole US companies, and to require US companies effectively, to use local technology, which crowds out US technology exports and causes other distortions in the economy, in trade and in investment. And this was a sticking point, for example, in the BIT negotiations, and so I think it's quite significant that it was achieved in this negotiation. One more area I'd highlight is on financial services. The commitments and financial services feature a level of detail, that's extraordinary and not normally found in US trade agreements, for example, with respect to licensing procedures for electronic payments services providers, and asset management companies. Also, in the areas of insurance, securities, fund management, and futures – these are areas where China has dangled market access, full market access, and no foreign equity caps for quite a long time, but they've often done so with these long phase-in periods of 2-5 years. Here China's committed to drop foreign equity caps by April 1st, which again, it may be that this was inevitable, but to have, a date certain and have that date be just around the corner is quite significant for US companies in those sectors.

Chad P. Bown 28:25

I have a question about how much this deal is going to benefit non-US companies – i.e., companies from Europe or Japan. Where has the US done the rest of the world a favor with this deal?

Lauren Mandell 28:40

I think on rules, assuming Chinese compliance with these obligations, some of the rules will provide direct sort of de facto MFN for European and other companies that operate in China. We've discussed for example, the area of intellectual property protection, it's highly likely that those rules will be drafted in a in a non-discriminatory way and will provide benefits for US companies and other companies alike. If you look at tech transfer, other areas, we've already seen the benefits of these commitments that very recently, I think in anticipation of this outcome of a phase one deal, China has, in their domestic law, codified rules that will prohibit forced technology transfer within their system. Those are rules that now benefit all operators in China, not just US companies. Now clearly there are some areas though, where this deal will be viewed less favorably and has already been viewed less favorably by non US players. Obviously, on purchases – the purchasing commitments here, some outside the United States will fear that this will divert purchases away from their producers and their sellers. On market access, for example, on financial services market access, agriculture market access. It's not at all clear that the benefits on licensing that I've described will be accorded to non-US companies, which could create in the view of non US governments, that could create WTO and consistency MFN considerations. And so again in market access areas, I think you'll see less benefit perhaps for non US companies.

Soumaya Keynes 30:15

Okay. And where are there gaps? The unfinished business?

Lauren Mandell 30:20

I think the most obvious unfinished business is negotiating these commitments in areas where the United States and China have had historically, just fundamental differences of view. And these include the role of state owned enterprises, SOEs, subsidies, data flows, information flows. I think other areas, in terms of most obvious unfinished business, are the broader discriminatory market access limitations faced by US companies. Again, financial services is one area where this deal makes significant progress, but China has a negative list, a list of market access restrictions. The most recent version from July of 2019, which continues to impose broad joint venture requirements, foreign equity caps, other restrictions on foreign investors that make operating in China inhospitable for some companies and impossible for others. One more point in terms of unfinished business would be a lot of the language, the commitments in this phase one deal on IP and tech transfer, other areas, are drafted as general commitments. The United States was seeking specific commitments to repeal and amend problematic laws and regulations. I think clearly in the next stage, to the extent there is a next stage, providing some more specificity in terms of Chinese obligations, to revise, amend, and repeal its laws and regulations will be a huge priority.

Chad P. Bown 31:40

Last question, how easy do you think it will be to agree a phase two deal?

Lauren Mandell 31:46

I think it will not be easy. I think that it's very striking that the one sentence in the deal about phase two provides very little assurance that there will be a phase two now or ever. And all public comments from both the US side and Chinese side have attempted to tamp down expectations on both the timing and likelihood of a phase two deal. Particularly in the next year or so, on the US side where there's an election happening, on the Chinese side where they will have to take a lot of effort internally to seek to educate and to comply with these new phase one obligations, and to immediately go into phase two is a significant ask. I don't think it's impossible that there could be an additional phase two deal or mini phase 1.5 deal that will address some of the unfinished business from phase one, but I think having a fully comprehensive phase two deal that addresses really the systemic issues that were identified in the Section 301 report that have been irritants in the relationship for many years on the trade and investment side, I think the odds are not great at this point.

Chad P. Bown 32:59

And huge thank you to Lauren.