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**SELECTIVE ENGAGEMENT? FUTURE PATH  
FOR US-CHINA ECONOMIC RELATIONS AND  
ITS IMPLICATIONS**

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# Selective Engagement? Future Path for US-China Economic Relations and Its Implications

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**Abstract:** The US-China economic interactions will have profound ramifications for the world. The article explores the following questions: what is the path forward for US-China economic interactions? What are its implications? It argues that selective engagement is the possible future path for US-China economic interactions. Selective engagement involves selective focuses, which currently are an unprecedented emphasis on market access, and delegalized implementation. Selective engagement contrasts sharply with deep free trade agreements that focus on regulatory disciplines and legalized dispute settlement. Selective engagement carries profound implications, ranging from rule vacuum and inconsistency, increased protection and economic disintegration, to the marginalization of multilateralism. Essentially, selective engagement is a “different animal” from previous trade practices, and could be a game changer in international economic order. The US-China interaction is highly mutable, and selective engagement may change over time.

**Key Words:** selective engagement, trade war, US-China Phase One agreement, free trade agreements, the Belt and Road Initiative

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## 1. Introduction

The US-China trade war and COVID-19 crisis are both unprecedented developments. They profoundly affect not only trade between two major economies (the US and China) but also the future of world economy. For trade war, it has been observed that “in its relationship with China, the Trump administration has shown a willingness to act completely outside the framework of the international trade regime,” and “act[ed] entirely outside the framework of its international trade obligations.”<sup>1</sup> Tariff rates decrease under free trade agreements (FTAs). However, tariffs increase substantially in the trade war. This requires turning fresh eyes to the interaction between the US and China, their new pattern, and the profound implications.

The US-China interaction adopts a path of selective engagement, which is reflected in the 2020 US-China Economic and Trade Agreement (Phase One agreement, or Phase One deal),<sup>2</sup> and related measures (e.g., extra tariffs). In particular, the Phase One deal is an important signal change, and is unique in the trading practice of both the US and China. The Phase One agreement has a three-pronged structure: (i) “less common” voluntary import expansion through China’s purchase commitments,<sup>3</sup> a first in China’s trade agreements, (ii) sectoral regulatory rules, which are much narrower than US FTAs, and (iii) unilateral enforcement that abandons the third-party adjudication in FTAs and the law of the World Trade Organization (WTO). As pointed out by the United States Trade Representative (USTR) Robert Lighthizer, the Phase One agreement is unique as “the first agreement like this of its kind.”<sup>4</sup>

Selective engagement occurs mainly in the trading context and is a conscious policy position. Selective engagement reflects selective focuses that currently are: (i) market access over economic integration, and (ii) unilateral enforcement over third-party adjudication. Selective engagement is reflected in the sense of the issues the US and China engage with, and the time period the US and China engage with. Selective focuses are the issues on which both sides engage with. Selective engagement essentially reflects a compromise without which the Phase One agreement would not have been able to be reached. However, selective engagement is really lacking in a lot of points, and can hardly advance the US-China relationship and promote the predictability of international trade as needed. Future US-China interactions may choose the path of selective engagement, unless there is strong political willingness to push through regarding crucial structural issues (such as those related to state-owned enterprise (SOEs)).

The US-China interaction is highly mutable. This helps to explain the distinguishing characteristic of the Phase One agreement as “short-termism.”<sup>5</sup> It is even possible that the Phase One agreement will be cancelled or not properly implemented. President Trump has

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<sup>1</sup> Nicolas Lamp, *How Should We Think about the Winners and Losers from Globalization? Three Narratives and Their Implications for the Redesign of International Economic Agreements*, 30 EUROPEAN JOURNAL OF INTERNATIONAL LAW 1359, 1385, 1388 (2020).

<sup>2</sup> US-China Economic and Trade Agreement (2020).

<sup>3</sup> *Trump’s Trade Deal with China Carries Big Risks*, The Australian(2020).

<sup>4</sup> Kevin Freking & Paul Wiseman, *Read the Full U.S.-China ‘Phase 1’ Trade Agreement*(2020), available at <https://www.pbs.org/newshour/economy/read-the-full-u-s-china-phase-1-trade-agreement>.

<sup>5</sup> Chad P. Bown & Mary E. Lovely, *Trump’s Phase One Deal Relies on China’s State-Owned Enterprises*(2020), available at <https://www.piie.com/blogs/trade-and-investment-policy-watch/trumps-phase-one-deal-relies-chinas-state-owned-enterprises>.

suggested the possibility of “cut[ting] off the whole relationship” with China.<sup>6</sup> Given the existing US-China trade relationship, the complete “cutting off” of the trade relationship is unlikely to happen in the short term. However, such dynamics mean that selective engagement may change. Selective engagement is a moving target and is increasingly subject to (geo)political and (geo)economic considerations. Essentially, the concerns and priorities of the US will largely drive and affect the trajectory of selective engagement.

The paper will analyse crucial but underexplored research questions: What is the path for US-China economic interactions? What are the implications of such a path?

The answers to these questions will inform the contentious debates on the future of the world economy, particularly the implications of the US-China trade relationship for the world (e.g., (de)coupling and (de)globalization). Based on comparative study, it sets out the critical framework of selective engagement. Selective engagement is a new theoretical framework to understand China’s engagement with the US, and explain the US trade policy towards China.

The structure of the article is as follows: Part II identifies selective engagement as the path forward for US-China trade, and explores the current special focuses of selective engagement: (i) unprecedented emphasis on market access, and (ii) delegalized implementation (unilateral enforcement). This part contrasts selective engagement with comprehensive engagement reflected in deep FTAs, which are traditionally advanced by the US and other advanced economies. Part III critically examines the implications of selective engagement for the world. Selective engagement not only changes the rules of the game between the US and China, but also affects the world economic order. Part IV concludes with observations on the potential future nature of selective engagement.

## **2. What Is Selective Engagement? Selective Engagement v. Deep FTAs**

Selective engagement involves selective focuses: (i) an unprecedented emphasis on market access, and (ii) unilateral implementation. The Phase One agreement contains purchase commitments and sectoral regulatory rules with delegalized enforcement to promote market entry (selective proactiveness), which contrast sharply with the avoidance of certain issues like technological coupling and non-trade concerns (selective passiveness). Selective engagement addresses prioritized issues and concerns, and does not focus on deep integration. Overall, selective engagement focuses more on trade than investment. Such narrow focusses are due to the limited consensus between the US and China, the sharp divide between the Chinese and US trade approaches, and their underlying (geo)economic and (geo)political considerations.

Selective engagement contrasts with comprehensive engagement under deep FTAs, which emphasize economic integration by defining rules for wide-ranging behind-the-border issues (including labor standards and environment regulation),<sup>7</sup> and third-party adjudication. Selective engagement means totally different directions compared with previous trade agreements. The Comprehensive and Progressive Agreement for Trans-Pacific Partnership (CPTPP), and the EU-Canada Comprehensive Economic and Trade Agreement (CETA) are representative deep FTAs. Comprehensive engagement is plain not only in their rules but also in their names, which both include “comprehensive.” The narrow focuses of selective engagement may not advance the US-China relationship and the predictability of international

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<sup>6</sup> Demetri Sevastopulo, *Trump Threatens to Cut off Relations with China*, Financial Times(2020), available at <https://www.ft.com/content/cfbba6bf-3de5-458d-92d1-a62fb958a354>.

<sup>7</sup> World Bank, *Regional Trade Agreements*(2018), available at <https://www.worldbank.org/en/topic/regional-integration/brief/regional-trade-agreements>; World Trade Organization, *World Trade Report 2011*, 9, 45, 110 (2011).

trade as needed. For this reason, the Phase One agreement itself faces challenges in its implementation.

### *2.1 Unprecedented emphasis on market access*

Market access and regulatory disciplines are two useful dimensions for understanding trade agreements. That said, market access and regulatory disciplines are not completely exclusive. Many regulatory rules could further promote market entry, and be combined with market access. Deep FTAs cover “all relevant areas of a regulatory nature that can unnecessarily raise the cost of market access.”<sup>8</sup>

Selective engagement has an unprecedented focus on market access. The comparative study of the Phase One agreement and deep FTAs helps to understand such a focus on market access, since regulatory disciplines rather than market access are the major focus of deep FTAs.

First, deep FTAs are regulatory in nature, and prioritize regulatory issues over market access. The primary reason is that preferential market opening is not sufficient for dealing with “distortions of unilateral policy-making.”<sup>9</sup> It is observed that deep economic integration “may be sustainable only with constraints on other areas of policy.”<sup>10</sup> To illustrate, in the context of Article 50 of the Treaty on European Union that is related to the possible EU-UK FTA negotiation, the EU emphasizes safeguards “against unfair competitive advantages through, inter alia, tax, social, environmental and regulatory measures and practices.”<sup>11</sup> Deep FTA rules that break new ground, compared with the WTO law, all address regulatory issues (such as environment and labor standards for US FTAs, and competition policy for EU ones).<sup>12</sup> The new issues covered by deep FTAs are also actually “regulatory in nature”, and go beyond traditional market access issues (often reflected in tariffs).<sup>13</sup>

Second, deep FTAs aim to set new regulatory standards for future trade rules that will produce precedential effects,<sup>14</sup> and require significant domestic law changes in developing-country parties. The TPP seeks out ‘gold’ or even ‘platinum’ regulatory standards,<sup>15</sup> and was described at the time as the “highest-standard and most progressive trade deal ever negotiated.”<sup>16</sup>

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<sup>8</sup> JACQUES PELKMANS, et al., *TOMORROW'S SILK ROAD: ASSESSING AN EU-CHINA FREE TRADE AGREEMENT* 9 (Centre for European Policy Studies. 2016).

<sup>9</sup> World Trade Organization, 112 (2011).

<sup>10</sup> Emily Lydgate & L. Alan Winters, *Deep and Not Comprehensive? What the WTO Rules Permit for a UK–EU FTA*, 18 *WORLD TRADE REVIEW* 451, 460 (2018).

<sup>11</sup> *Id.* at, 460, footnote 17.

<sup>12</sup> Henrik Horn, et al., *Beyond the WTO? An Anatomy of EU and US Preferential Trade Agreements*, 33 *THE WORLD ECONOMY* 1565, 1587 (2010).

<sup>13</sup> Bernard Hoekman & Petros C. Mavroidis, *Regulatory Spillovers and the Trading System: From Coherence to Cooperation*, 1 (2015).

<sup>14</sup> David A. Gantz, *The United States-Mexico-Canada Agreement: Overview and Analysis*, BAKER INSTITUTE REPORT, 3 (2018).

<sup>15</sup> Evelyn S. Devadason, *The Trans-Pacific Partnership (TPP): The Chinese Perspective*, 23 *JOURNAL OF CONTEMPORARY CHINA*, 476 (2014).

<sup>16</sup> Ben Otto, *U.S., China Intensify Trade Competition on APEC Stage*(2015), available at <http://www.wsj.com/articles/u-s-china-intensify-trade-competition-on-apec-stage-1447849577>.

Deep rules like the TPP rules demand “deeper domestic administrative, regulatory, and legal reforms.”<sup>17</sup> Earlier in the history of deep FTAs, regulatory reforms under the North American Free Trade Agreement (NAFTA) attempted to harmonize North American law, at least to some degree.<sup>18</sup> Relatedly, deeper regulatory cooperation and coherence are distinctive characteristics of recent FTAs involving OECD members (like the CPTPP, USMCA<sup>19</sup>) and TTIP negotiations.<sup>20</sup>

Third, deep FTAs seek to develop an improved investment climate through systematic regulatory rules rather than preferential market access.<sup>21</sup> This is arguably driven by the “trade-investment-services-intellectual property” nexus in trade practice, which is the intertwining of (i) trade in parts, (ii) investment in production facilities, technical and managerial personnel, IP, and business relationships, and (iii) services that coordinate the production.<sup>22</sup> Trade practices concern two new necessities: connecting factories (requiring, inter alia, capital flow), and doing business overseas (demanding addressing behind-the-border barriers, including competition policy, pre-establishment national treatment, SOE behaviour, IP protection, and investment protection).<sup>23</sup> Deep FTAs here are “not really about market access” (“exchange of market access”), but are about “helping foreign companies connect production facilities internationally, and do business locally” (“foreign factories in exchange for domestic reforms”).<sup>24</sup> From this perspective, the global value chain and globalization appear to be the basis for the development of deep FTAs.

In contrast, market access is the essence or core of the Phase One agreement. The priority of selective engagement is to enhance market access in prioritized areas rather than develop wide-ranging and systematic regulatory disciplines. Market access is obviously less difficult than systematic regulatory disciplines. Simon Lester observed that the Phase One agreement is close to an “orderly marketing arrangement.”<sup>25</sup>

The Phase One agreement, as a short-form agreement, is much less developed in regulatory disciplines. Embodying a selective nature, selective engagement has a narrow focus generally in rule design and specifically in the application scope of rules. Foremost, the Phase One agreement reveals a sectoral and narrow pathway, and contrasts with comprehensive engagement under deep FTAs that are “omnibus instruments characterized by extensive

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<sup>17</sup> Jing Tao, *TPP and China: A Tale of Two Economic Orderings?*, in MEGAREGULATION CONTESTED: GLOBAL ECONOMIC ORDERING AFTER TPP 92, (Benedict Kingsbury, et al. eds., 2019).

<sup>18</sup> Stephen Zamora, *NAFTA and the Harmonization of Domestic Legal Systems: The Side Effects of Free Trade*, 12 ARIZONA JOURNAL OF INTERNATIONAL AND COMPARATIVE LAW 401, 402 (1995).

<sup>19</sup> *Singapore Fintech Fest Showcases Innovations in Payments* (2018), available at <https://www.finextra.com/newsarticle/32959/singapore-fintech-fest-showcases-innovations-in-payments>.

<sup>20</sup> Hoekman & Mavroidis, 8 (2015).

<sup>21</sup> Richard Baldwin, *21st Century Regionalism: Filling the Gap Between 21st Century Trade and 20th Century Trade Rules*, 2011, at 19, available at Centre for Economic Policy Research (CEPR).

<sup>22</sup> Richard Baldwin, *21st Century Trade and the 21st Century WTO*, available at [http://www.rieti.go.jp/en/special/p\\_a\\_w/014.html#note8](http://www.rieti.go.jp/en/special/p_a_w/014.html#note8).

<sup>23</sup> Id. at.

<sup>24</sup> Baldwin, 16. 2011.

<sup>25</sup> Simon Lester, *So Many Questions About the U.S.-China Trade Deal* (2020).

commitments in areas referred to as ‘trade-plus’.”<sup>26</sup> Even for market access, there is a separation of trade from national security, and thorny market access issues (e.g., market access in cloud services) have therefore been left for future negotiations.<sup>27</sup> In the same vein, market access related to advanced technology is unlikely to be promoted in selective engagement.

Second, regulatory disciplines in the Phase One agreement usually target specific market access issues, and do not apply to the whole sector. They reflect a narrow approach. Financial services provide a good example. The broad rules in insurance services on removing discrimination and red tape<sup>28</sup> contrast with “only specifically identified barriers” being provided for removal in other financial services.<sup>29</sup> The commitment to the expeditious approval of licences in financial services only applies to the narrow field of insurance services.<sup>30</sup> “[O]nly specifically identified barriers are slated for removal” regarding non-insurance financial services,<sup>31</sup> which contrasts with the broad commitments for insurance services to “remove any business scope limitations, discriminatory regulatory processes and requirements, and overly burdensome licensing and operating requirements for all insurance sectors...”<sup>32</sup>

Third, the focus on market access over regulatory disciplines explains the limited impact of the Phase One agreement on Chinese law. The Phase One agreement has had impact on China’s legislative reform particularly regarding IP, but such impact is not significant.<sup>33</sup> The narrow and limited progress in regulatory rules also means limited impact on the regulatory latitude of governments. As discussed below, the focus on greater market access is found throughout the Phase One agreement.

### 2.1.1 Measurable target outcome

Purchase commitments include voluntary import expansion to reduce the US trade deficit with China, unprecedented in China’s trade agreements. As a measurable target outcome, China’s commitment to purchase US goods and services worth around \$200 billion is regarded as “the centrepiece” of the Phase One agreement.<sup>34</sup> Purchase commitments include manufactured goods (e.g., electronic equipment and machinery), energy, and services (including cloud and related services, and charges for use of IP).

Purchase commitments are a focus of the Phase One agreement. It is observed that “[t]he bulk of China’s commitments are on ‘expanding trade’ and take up more than a quarter of the

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<sup>26</sup> Kathleen Claussen, *Reimagining Trade-Plus Compliance: The Labor Story*, 23 JOURNAL OF INTERNATIONAL ECONOMIC LAW 25, 25 (2020).

<sup>27</sup> Karishma Vaswani, *US-China Trade Deal: Five Things That Aren't in It*, BBC(2020), available at <https://www.bbc.com/news/business-51130434>.

<sup>28</sup> US-China Economic and Trade Agreement Article 4.6.2. 2020.

<sup>29</sup> Martin Chorzempa, *Did the US-China Phase One Deal Deliver a Win for US Financial Services?*(2020), available at <https://www.piie.com/blogs/trade-and-investment-policy-watch/did-us-china-phase-one-deal-deliver-win-us-financial>.

<sup>30</sup> US-China Economic and Trade Agreement Article 4.6. 2020.

<sup>31</sup> Chorzempa. 2020.

<sup>32</sup> US-China Economic and Trade Agreement Article 4.6.2. 2020.

<sup>33</sup> Feng Wang, et al., *China and the United States Announce “Phase One” Trade Deal - Key Issues and Takeaways for Business*(2020), available at <https://www.kwm.com/en/us/knowledge/insights/china-and-the-us-announces-phase-one-trade-deal-key-issues-and-takeaways-for-business-2020>.

<sup>34</sup> Geoffrey Gertz, *‘Phase One’ China Trade Deal Tests the Limits of US Power*(2020), available at <https://www.brookings.edu/opinions/phase-one-china-trade-deal-tests-the-limits-of-us-power/>.

agreement.”<sup>35</sup> The longest chapter of the Phase One agreement is on expanding trade in prioritized domains, ranging from manufactured and agricultural goods, energy products, to services, whose increased amount for each product category is provided in annex tables with the subcategory amounts being confidential.<sup>36</sup>

Purchase commitments are a blunt tool for increasing market access by managing trade. Selective engagement is outcome-driven as it highlights a measurable target outcome. Why does selective engagement emphasize purchase commitments? First, a measurable target outcome reflects recent US trade preferences. It echoes the Trump administration’s measurement of the “health” and fairness of trade relations mainly through bilateral trade deficits,<sup>37</sup> and the Trump administration’s preference for assessing trade agreements’ legitimacy according to the outcome than “the justifiability of the processes” that lead to such outcome.<sup>38</sup> Purchase commitments set a concrete target, and are the most “direct” way of addressing trade deficits. Second, purchase commitments may partially address the difficulties in measuring the use and enforcement of vague non-tariff measures (NTMs).<sup>39</sup> That said, it is not easy to understand the reasons behind purchase fluctuation (e.g., demand drop affected by COVID-19, or NTMs). Third, purchase commitments could be a trigger strategy by “conditioning punishment on trade volume” and serve as a way of implementing the agreement.<sup>40</sup>

### 2.1.2 Targeted regulatory disciplines

Target regulatory disciplines are sectoral provisions in the rules section of the Phase One agreement.<sup>41</sup> The Phase One agreement consists of eight chapters, covering intellectual property (IP), technology transfer, food and agriculture products, financial services, macroeconomic policies and currency (currency), expanding trade, and dispute settlement (as discussed below). Most of these chapters concern rules, excluding the chapter on expanding trade and dispute settlement.

Target regulatory disciplines address select NTMs to enhance market access. These rules do not explore wide-ranging regulatory improvements, although they provide certain “regulatory certainty”<sup>42</sup> through provisions like due process.<sup>43</sup> The Phase One agreement focuses more on trade barriers than investment barriers. For trade barriers, the Phase One agreement covers a much narrower range of areas compared with FTAs. Unlike many FTAs, the Phase One

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<sup>35</sup> Fatih Oktay, *The Phase One Trade Deal: What’s in It for China?*, The Diplomat(2020), available at <https://thediplomat.com/2020/01/the-phase-one-trade-deal-whats-in-it-for-china/>.

<sup>36</sup> EY, *US and China Sign Phase One Economic and Trade Agreement Though Tariffs Remain*, (2020).

<sup>37</sup> Lamp, EUROPEAN JOURNAL OF INTERNATIONAL LAW, 1385 (2020); Naoise McDonagh, *A Phase One Deal, but for What Purpose?*(2020), available at <https://iit.adelaide.edu.au/news/list/2020/01/16/a-phase-one-deal-but-for-what-purpose>.

<sup>38</sup> Lamp, EUROPEAN JOURNAL OF INTERNATIONAL LAW, 1371 (2020).

<sup>39</sup> Josh Ederington & Michele Ruta, *Non-Tariff Measures and the World Trading System*, POLICY RESEARCH WORKING PAPER 7661, 50 (2016).

<sup>40</sup> Id. at, 51.

<sup>41</sup> Wendy Cutler, *Coronavirus outbreak may force US, China to rework trade deal implementation*(2020), available at <https://thehill.com/opinion/international/486489-coronavirus-outbreak-may-force-us-china-to-rework-trade-deal>.

<sup>42</sup> Duane W. Layto & Timothy J. Keeler, *US-China Phase One Trade Deal—Key Provisions*, Mayer Brown(2020), available at <https://www.mayerbrown.com/en/perspectives-events/publications/2020/01/us-china-phase-one-trade-deal-key-provisions>.

<sup>43</sup> US-China Economic and Trade Agreement Article 2.4. 2020.

agreement does not address goods other than agriculture and food, services other than financial services, or social issues, amongst other areas. Neither does the rules section of the Phase One agreement address the manufacturing sector or other sectors.

Target regulatory disciplines address narrow prioritized issues, which range from agricultural and food approvals and regulatory processes to the restrictions on financial services.<sup>44</sup> As a concrete example of IP, measures on geographical indications (GI) in connection with an international agreement shall not undermine US market access.<sup>45</sup> For financial services, both China and the US address market access barriers in financial sectors in the Phase One agreement, particularly those faced by the US firms.<sup>46</sup> For instance, China commits to allowing US financial services providers to apply for provincial licenses that enable them to secure non-performing loans directly from Chinese banks,<sup>47</sup> and allowing US credit rating service providers to rate all types of domestic bonds sold to international and domestic investors.<sup>48</sup> Another example is a relaxed sharing holding requirement, permitting a US credit rating services provider to acquire a majority stake in its existing joint venture in China.<sup>49</sup> In respect of agriculture, the Phase One agreement targets, among others, China's ban against US poultry since 2015 after an avian flu outbreak by requiring the recognition of US Department of Agriculture Food Safety and Inspection Service inspections,<sup>50</sup> and permitting importation as per bilateral import protocols.<sup>51</sup> The practice of targeted regulatory disciplines, such as China's application of its commitments to treat foreign and domestic businesses equally in financial services, is crucial for market access that will affect the US-China rapprochement.<sup>52</sup>

The rules on technology transfer and currency look different from other sectoral disciplines (e.g., agriculture, financial services and IP), but also serve to expand market access. The prohibition of forced technology transfer and government support to certain outbound investment related to acquiring foreign technology will help US products and services to maintain their competitiveness when they enter into foreign markets. The Trump administration has argued that the WTO law, the only trade agreement joined by both China and the US, fails to deal with "what the administration sees as the most objectionable 'mercantilist' policies and practices of the Chinese government – in particular, various forms of forced technology transfer."<sup>53</sup> It helps to explain why the Phase One agreement focuses on the prohibition of technology transfer rather than the promotion of technology transfer. In the same vein, the agreement prohibits the provision of government support to outbound investment which aims to acquire foreign technology that could "create distortion" in sectors and industries.<sup>54</sup> The rules on currency help to ensure market access: the manipulation of exchange rates will distort the pricing in international economic transactions.

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<sup>44</sup> Lindsay B. Meyer, et al., *United States and China Sign Long-Awaited "Phase One" Trade Agreement*(2020), available at <https://www.lexology.com/library/detail.aspx?g=a2a63173-5227-4147-9670-07b04d2ffadd>.

<sup>45</sup> US-China Economic and Trade Agreement Article 1.15.1. 2020.

<sup>46</sup> Chorzempa. 2020.

<sup>47</sup> US-China Economic and Trade Agreement Article 4.5.2. 2020.

<sup>48</sup> Id. at, Article 4.3.1.

<sup>49</sup> Id. at, Article 4.3.2.

<sup>50</sup> Michael Collins, et al., *What's in Trump's 'Phase One' trade deal between the U.S. and China?*(2020), available at <https://www.usatoday.com/story/news/politics/2020/01/15/trump-trade-agreement-china-what-in-phase-one-agreement/4434624002/>.

<sup>51</sup> US-China Economic and Trade Agreement Chapter 3, Annex 3, Article 2. 2020.

<sup>52</sup> Vaswani. 2020.

<sup>53</sup> Lamp, *EUROPEAN JOURNAL OF INTERNATIONAL LAW*, 1388 (2020).

<sup>54</sup> US-China Economic and Trade Agreement Article 2.1.3. 2020.

Why does selective engagement develop targeted regulatory disciplines? First, non-tariff barriers are deemed to create “blameful” trade deficits from the US perspective, which are attributable to “inappropriate source of behavior rather than the natural course.”<sup>55</sup>

Second, the narrow scope makes it easier to reach an agreement, since it is not feasible or economical to agree on all rules in short time given the numerous sectors and policy instruments involved.

Third, the narrow focuses of selective engagement reflect essential issues in the investigation of the USTR under Section 301 of the Trade Act of 1974<sup>56</sup> (e.g., technology transfer, IP, and outbound investment<sup>57</sup>) and the features of relevant trade (like agriculture). It addresses practices that are from the US perspective “unreasonable or discriminatory and burden or restrict U.S. commerce.”<sup>58</sup> For instance, IP is at the centre of the Section 301 investigations,<sup>59</sup> and so is technology transfer.<sup>60</sup> The emphasis on agriculture is attributable to the fact that China was the second-largest destination for US agricultural and related products and that US agricultural exports to China have decreased since 2017.<sup>61</sup> Agriculture is more heavily regulated than other sectors given its link with health, and is more affected by NTMs (particularly standards) compared with manufacturing.<sup>62</sup>

## 2.2 Delegalized implementation

Implementation in selective engagement, as reflected in the Phase One agreement, essentially relies more on unilateral enforcement, under which one side could initiate complaints to the other side and eventually impose tariffs or exit the agreement if it thinks its grievances remain unsettled.<sup>63</sup> This is regarded as “internationally agreed unilateralism.”<sup>64</sup> The Phase One agreement provides the strongest unilateral authority in dispute settlement amongst US trade agreements.<sup>65</sup> The Phase One agreement lays out a three-tier process for the Bilateral Evaluation and Dispute Resolution Arrangement (the Arrangement). The Arrangement chooses the pathway of bilateral dispute settlement. The three tiers consist of: (i) designated officials of Bilateral Evaluation and Dispute Resolution Office (BEDRO) in each country to address day-to-day matters, regularly meeting at least once a month (functional level of daily work); (ii) a designated Deputy USTR and a designated Vice Minister of China who head the BEDRO, meeting quarterly (vice-ministerial level engagement); and (iii) a Trade Framework

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<sup>55</sup> Lamp, *EUROPEAN JOURNAL OF INTERNATIONAL LAW*, 1369 (2020).

<sup>56</sup> Wang, et al. 2020.

<sup>57</sup> Findings of the Investigation into China’s Acts, Policies, and Practices Related to Technology Transfer, Intellectual Property, and Innovation under Section 301 of the Trade Act of 1974. (2018).

<sup>58</sup> Jennifer Hillman, *What to Look for in the “Phase One” U.S.-China Trade Deal*, Council on Foreign Relations(2020), available at <https://www.cfr.org/blog/what-look-phase-one-us-china-trade-deal>.

<sup>59</sup> Layto & Keeler. 2020.

<sup>60</sup> USTR, Fact Sheet of US-China Economic and Trade Agreement: Phase One Agreement 1 (2020).

<sup>61</sup> Matthew Goodman, et al., *What's Inside the U.S.-China Phase One Deal?*(2020), available at <https://www.csis.org/analysis/whats-inside-us-china-phase-one-deal>.

<sup>62</sup> Ederington & Ruta, *POLICY RESEARCH WORKING PAPER* 7661, 21, 24-25, 29 (2016).

<sup>63</sup> Daniel Tenreiro, *Phase One Trade-Deal Analysis*, National Review(2020), available at <https://www.nationalreview.com/2020/01/china-us-trade-deal-phase-one-enforcement-could-be-problem/>; US-China Economic and Trade Agreement Chapter 7. 2020.

<sup>64</sup> Simon Lester, *Internationally Agreed Unilateralism* (2020).

<sup>65</sup> Goodman, et al. 2020.

Group led by the USTR and a designated Vice Premier of China, meeting every six months (high level engagement).<sup>66</sup>

If the dispute cannot be solved through three-tier consultation, the complaining party could suspend obligations under the deal or subsequently take remedial action.<sup>67</sup> These appear to be a kind of self-help measure. The other party could withdraw from the agreement with 60-days written notice if it thinks that the complaining party suspended the obligations or adopted remedial measures in bad faith.<sup>68</sup> In this context, a withdrawing party is not required to resume obligations under the Phase One agreement, and the other party could continue their responsive actions, both of which are likely to disturb international trade.<sup>69</sup>

This enforcement mechanism of the Phase One agreement is a gatekeeper model.<sup>70</sup> There are regular consultations through bilateral bodies at both working and principal levels. Notably, the Phase One agreement provides that the other party could resort to the suspension of obligations or remedial measures (such as additional tariffs). Some observers regard the Phase One agreement's dispute settlement mechanism as "robust" and "detailed", with "strong procedures."<sup>71</sup> Overall, the enforcement of the agreement is among the "most critical aspects" of the deal.<sup>72</sup>

However, the Phase One agreement shifts towards delegalized dispute settlement, and eschews a third-party adjudicatory system that is common in FTAs. As an important dimension of legalization, delegation means the extent to which the parties to agreements "delegate authority to designated third parties—including courts, arbitrators, and administrative organizations—to implement agreements."<sup>73</sup> Deep FTAs delegate the adjudication to third parties and expand the coverage of third-party dispute settlement (e.g., financial services,<sup>74</sup> government procurement,<sup>75</sup> labor,<sup>76</sup> and commercial consideration requirements on SOEs<sup>77</sup>). The Phase One agreement does not involve delegation to a third party to interpret and apply the rules, but instead allows for unilateral enforcement. Regarding delegation, the Phase One agreement is essentially much closer towards the political end than legal end. Dispute settlement in selective engagement essentially relies on the economic and political heft of the nations.

Unilateral enforcement lacks intervention by a third party. The delegalized dispute settlement procedure is a double-edged sword. The bilateral evaluation and dispute resolution arrangement aims to "effectively implement" the Phase One agreement, and to resolve implementation issues in a "expeditious" manner.<sup>78</sup> Unilateral enforcement gives more control to the parties. However, unilateral enforcement makes it more difficult to reduce

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<sup>66</sup> US-China Economic and Trade Agreement Articles 7.4, 7.2, Annex 7-A. 2020.

<sup>67</sup> *Id.* at, Article 7.4.4(b).

<sup>68</sup> *Id.* at.

<sup>69</sup> David A. Gantz, et al., *The Scorecard of the Phase One Trade Agreement* (2020).

<sup>70</sup> Claussen, *JOURNAL OF INTERNATIONAL ECONOMIC LAW*, 31 (2020).

<sup>71</sup> Layto & Keeler. 2020; SIPS, *PRC – Phase 1 Trade Agreement with US: What's in It for Trademark Owners?*(2020), available at <https://sips.asia/wp-content/uploads/2020/01/SIPS-Memo-PRC-Phase-1-Trade-Agreement-with-US.pdf>.

<sup>72</sup> Meyer, et al. 2020.

<sup>73</sup> Kenneth W. Abbott, et al., *The Concept of Legalization*, 54 *INTERNATIONAL ORGANIZATION* 401, 408, 415 (2000).

<sup>74</sup> CETA Articles 13.20.1; TPP Article 11.21.1.

<sup>75</sup> E.g., CETA Article 19.18.4 (reference to Chapter 29 on dispute settlement).

<sup>76</sup> TPP Articles 19.15.12, 19.15.13.

<sup>77</sup> CPTPP Article 17.15.

<sup>78</sup> US-China Economic and Trade Agreement Article 7.1.2. 2020.

direct confrontation given the lack of possible “buffer” room provided by third party adjudication. Unilateral enforcement is more about direct interaction or even confrontation. Unilateral enforcement echoes the progressive unilateral approach of the US under the Trump administration, which may change in the future.

### 3. What Are the Implications of Selective Engagement?

Selective engagement appears to focus on the preferences of the parties, and the sector regulatory disciplines could lead to certain regulatory responses by China.<sup>79</sup> Selective engagement has advantages including efficiency and flexibility. The Phase One agreement avoids many complex processes. If properly managed, it could focus on prioritized issues and may push through the progress in select issues. Also, flexibility may permit learning by doing and trial by error. However, the preferences of concerned actors may change, and leave the trading order unpredictable. Selective engagement is likely to bring both intended and unintended effects.

#### 3.1 Rule vacuum and inconsistency

##### 3.1.1 Overview

Under selective engagement, a rule “vacuum” exists in areas other than the narrow issues it covers. The WTO law applies to US-China economic relations. However, it has not been upgraded for quite some time. The Phase One agreement only pushes for limited regulatory harmony. This is the case with agriculture through regulatory cooperation. It eschews systematic regulatory disciplines. The Phase One agreement follows the practice of China’s FTAs in the sense that they are often individually tailored to meet its partners’ varying demands,<sup>80</sup> rather than following “a deliberate policy design”<sup>81</sup> that deals with long-term regulatory issues. The progress brought by the Phase One agreement is more about business opportunities based on market access in narrow areas. It protects the owners of capital through IP rights and investment protections (i.e., the prevention of forced technology transfer).<sup>82</sup>

For across-the-board regulatory disciplines, there is a paucity of these rules. In particular, the Phase One agreement creates more than it relieves the tension between the role of government and market. On the one hand, the Phase One agreement calls for a market-based outcome regarding the agreement and particularly technology transfer,<sup>83</sup> and requires market condition and prices for purchase commitments.<sup>84</sup> On the other hand, purchase commitments are a preset outcome. They embody managed trade and are likely to distort trade. The government’s power in exempting products from extra tariffs also increases the role of government. Purchase commitments are hardly sustainable, and may bring uncertainties in the trading order.

For issue-specific rules, fundamental structural issues and distributive effects of trade rules are not addressed. The Phase One agreement does not cover sensitive issues in deep FTAs such as capital control, data localization and data flow, which are closely related to financial market

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<sup>79</sup> Heng Wang, *How May China Respond to the U.S. Trade Approach? Retaliatory, Inclusive and Regulatory Responses*, 31 COLUMBIA JOURNAL OF ASIAN LAW 151, 180-191 (2018).

<sup>80</sup> Guiguo Wang, *China's FTAs: Legal Characteristics and Implications*, 105 AMERICAN JOURNAL OF INTERNATIONAL LAW 493, 498 (2011).

<sup>81</sup> Axel Berger, *Investment Rules in Chinese Preferential Trade and Investment Agreements: Is China Following the Global Trend Towards Comprehensive Agreements?* at [https://www.die-gdi.de/uploads/media/DP\\_7.2013.pdf](https://www.die-gdi.de/uploads/media/DP_7.2013.pdf).

<sup>82</sup> Lamp, EUROPEAN JOURNAL OF INTERNATIONAL LAW, 1361 (2020).

<sup>83</sup> US-China Economic and Trade Agreement preamble, third paragraph, Chapter 2, chapeau. 2020.

<sup>84</sup> Id. at, Article 6.2.5.

access.<sup>85</sup> It remains to be seen whether these issues will be addressed in the near future. In particular, non-trade concerns (e.g., the environment) are left “unattended” in the Phase One agreement, and both sides fail to promote possible “re-embedding” of the economy and society that often underlies the administration of precaution.<sup>86</sup>

### 3.1.2 Case study: IP rules

There is a lack of progress for regulatory disciplines covered by the Phase One agreement even for its most advanced rules. As a focus of the Phase One agreement, IP rules are regarded as representing high standards.<sup>87</sup> They provide a good example. First, many rules have narrow application scope. The narrow application can be found in, for instance, the disposition of seized counterfeits,<sup>88</sup> and due process provisions that mainly apply to technology transfer.<sup>89</sup>

Second, the Phase One agreement is observed to mainly address many “20th century” IP issues.<sup>90</sup> The Phase One agreement reflects “a relatively narrow range of ‘asks’” regarding IP issues, and centres on trade secrets (e.g., the access to preliminary injunctions provided for trade secrets but not for other IP violations), patents (and pharmaceutical-related IP rights), counterfeiting, and enforcement.<sup>91</sup> In contrast, there are only two provisions specifically provided for piracy and counterfeiting on e-commerce platforms, while open questions include whether “online trade platforms” covers social media platforms.<sup>92</sup> This contrasts with a large number of rules in other FTAs to address new technology-related issues.

Third, and relatedly, the Phase One agreement avoids various crucial issues that are common in FTAs. The Phase One agreement appears to be railroaded through the negotiation process, and it is not well-balanced in terms of different factors (such as traditional knowledge protection and regulatory space). The Phase One agreement does not “carve[] out necessary regulatory space” through provisions on flexibilities, exceptions or limitations (such as compulsory licensing) as is the case with TRIPS or international IP agreements (e.g., Paris and Berne Conventions), and it is unclear whether the judicial authority is allowed to take proportionality safeguards (as provided in other agreements like the TRIPS<sup>93</sup> and US-Peru FTA<sup>94</sup>).<sup>95</sup> One may doubt whether the Phase One agreement has deprived China’s capacity to issue compulsory licences. Also, the Phase One agreement does not refer to any international IP treaties, which differs from many FTAs.

### 3.1.3 No development of jurisprudence

Selective engagement further prohibits the development of jurisprudence. Jurisprudence developed by third-party adjudicators is an important way to develop trade rules, as is the case with WTO dispute settlement. If properly managed, it enhances the predictability of the

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<sup>85</sup> Chorzempa. 2020.

<sup>86</sup> Pascal Lamy, *The New World of Trade: The Third Jan Tumlir Lecture*, JAN TUMLIR POLICY ESSAYS, No. 01/2015, 9 (2015).

<sup>87</sup> USTR, Fact Sheet of US-China Economic and Trade Agreement: Intellectual Property (2020).

<sup>88</sup> SIPS. 2020.

<sup>89</sup> US-China Economic and Trade Agreement Article 2.4. 2020.

<sup>90</sup> James Politi, *What’s in the US-China ‘Phase One’ Trade Deal?*, Financial Times(2020), available at <https://www.ft.com/content/a01564ba-37d5-11ea-a6d3-9a26f8c3cba4>.

<sup>91</sup> SIPS. 2020.

<sup>92</sup> Id. at.

<sup>93</sup> Agreement on Trade-Related Aspects of Intellectual Property Rights Article 47 (1994).

<sup>94</sup> US-Peru FTA Article 16.11.15 (2006).

<sup>95</sup> Pratyush Nath Upreti & María Vásquez Callo-Müller, *Phase One US-China Trade Deal: What Does It Mean for Intellectual Property?*, 4, 9 (2020).

trading order. However, the Phase One agreement appears to focus on reaching outcomes. The delegatized dispute settlement will not gradually develop jurisprudence on crucial issues (such as those on due processes). It reflects the reluctance to have the rules interpreted by third-party adjudicators, and the preference for possibly faster implementation that largely relies on unilateral enforcement. This echoes the USTR's concerns over alleged ultra vires of the WTO Appellate Body and the delay of appeals.<sup>96</sup> However, the lack of jurisprudence development in selective engagement will exacerbate the rule vacuum or inconsistency.

#### 3.1.4 Rule fragmentation

The unique market access-oriented selective engagement brings an extra layer of rule fragmentation or inconsistency to the existing legal order. From China's perspective, China's trade agreements continue to fall short of a pattern or model. As an example, the Phase One agreement promotes the US approach of trademark protection. In contrast, the EU approach instead emphasizes GI protection. Relatedly, the EU and China have reached a major bilateral agreement on GI in 2019. The EU-China GI Agreement requires that under certain settings, the party shall refuse to register, or invalidate the registration of a trademark, which consists of a GI or its translation or transcription concerning identical or similar products without this origin.<sup>97</sup> The same requirement applies to a trademark indicating that the products originate in a geographical area other than the origin place concerning identical or similar good, if an application to register the trademark is submitted after the date of GI protection or after the date of application for GI protection in the territory concerned.<sup>98</sup> The approaches of the Phase One agreement and EU-China GI agreement are rather different.

More broadly, there could be also competition between different systems of trade regulations like those in e-commerce between the US and China to increase trade volume, promote new strategies, and attract participants.<sup>99</sup>

All these mean the continued fragmentation of rules in the world economy, down the track. Businesses are likely to face different trade rules that are often inconsistent when they conduct international businesses in different contexts. This will affect the predictability of international trade.

### 3.2 Increased protection

#### 3.2.1 Background: A shifting from protection to precaution by deep FTAs?

Protection and precaution are the old and new tasks in trade agreements. As observed by former WTO Director-General Pascal Lamy, deep FTAs have arguably shifted from the administration of the protection of domestic producers from international competition (e.g., quotas, tariffs, and subsidies) to the administration of precaution (reducing the differences among regulations on security, safety, health, and environmental sustainability and so on), which represents "a new version of the old divide" between tariffs and NTMs.<sup>100</sup> Precaution is about risk management and is closely linked to "cultural cognitive differences."<sup>101</sup> Such a

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<sup>96</sup> USTR, *Report on the Appellate Body of the World Trade Organization*, 4-12 (2020).

<sup>97</sup> EU-China Agreement on Geographical Indications Article 6.1 (2019).

<sup>98</sup> *Id.* at, Article 6.1a.

<sup>99</sup> Jie Huang, *Comparison of E-commerce Regulations in Chinese and American FTAs: Converging Approaches, Diverging Contents, and Polycentric Directions?*, 64 NETHERLANDS INTERNATIONAL LAW REVIEW 309, 333 (2017).

<sup>100</sup> Lamy, JAN TUMLIR POLICY ESSAYS, No. 01/2015, 4 (2015); Ederington & Ruta, POLICY RESEARCH WORKING PAPER 7661, 54-55 (2016).

<sup>101</sup> Wang Tianyu, *Former WTO Chief: Globalization to Look Different After Covid-19*(2020), available at <https://pascallamy.eu/2020/05/04/former-wto-chief-globalization-to-look-different-after-covid-19/>.

shift is most obvious in the TTIP, although its negotiations have been put on hold.<sup>102</sup> Protection and precaution co-exist in trade agreements. A grey zone exists between protection and precaution such as the SPS and the TBT measures, and the precaution could be abused as a form of trade protectionism.<sup>103</sup>

Protection is mostly about tariffs, and its administration is usually discriminatory. The administration of protection pursues preferential treatment, for instance, to products of different origins (such as preferential tariff rates under an FTA, the exclusion of FTA parties from global safeguard measures<sup>104</sup>). Levelling the playing field involves reducing and eliminating such protection.<sup>105</sup> Tariff rates decrease under FTAs. Protection is also linked with precaution,<sup>106</sup> since behind-the-border policies could be “a substitute form of protection.”<sup>107</sup>

Precaution is concerned with myriad NTMs (e.g., incompatible standards, certification, conformity assessment processes, measures concerning health and environment), and the great multiplicity of NTMs increases costs (such as the cost of compliance with different regulatory systems and requirements, and fixed costs).<sup>108</sup> NTMs impose more restrictions on trade flows than tariffs.<sup>109</sup>

Precaution often involves the protection of consumers from risks (e.g., safety, environment, health, and security) and social welfare in the context of transnational production and global value chains.<sup>110</sup> The administration of precaution in deep FTAs does not involve reducing the measures per se, but reducing the dissimilarities between NTMs, and between various systems of precaution (like the TTIP’s focus on precautions as to regulatory convergence).<sup>111</sup>

The administration of precaution often involves non-trade concerns, and is non-discriminatory. Environment, competition, labor, and health are quintessential examples of non-trade concerns.<sup>112</sup> These regulations usually apply to all parties regardless of their nationality.<sup>113</sup> The non-discriminatory nature of precaution is due to the public-good nature of regulatory reforms provided in deep agreements, the unwillingness of governments to differentiate between foreign businesses, and the difficulties in designing the system to favour specific partners (such as being costly and cumbersome in identifying the nationality of firms and services, rules embedded in wider non-discriminatory regulatory frameworks).<sup>114</sup> The shallow administration of protection also generates demands for

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<sup>102</sup> Lamy, JAN TUMLIR POLICY ESSAYS, No. 01/2015, 8-9 (2015).

<sup>103</sup> Id. at, 8.

<sup>104</sup> World Trade Organization, 14 (2011).

<sup>105</sup> Lamy, JAN TUMLIR POLICY ESSAYS, No. 01/2015, 4 (2015).

<sup>106</sup> Ederington & Ruta, POLICY RESEARCH WORKING PAPER 7661, 2, 54, 55 (2016).

<sup>107</sup> Id. at, 49.

<sup>108</sup> Lamy, JAN TUMLIR POLICY ESSAYS, No. 01/2015, 4-5 (2015); Ederington & Ruta, POLICY RESEARCH WORKING PAPER 7661, 30, footnote 17 (2016).

<sup>109</sup> Ederington & Ruta, POLICY RESEARCH WORKING PAPER 7661, 29 (2016).

<sup>110</sup> Lamy, JAN TUMLIR POLICY ESSAYS, No. 01/2015, 4 (2015); Ederington & Ruta, POLICY RESEARCH WORKING PAPER 7661, 2, 55 (2016).

<sup>111</sup> Lamy, JAN TUMLIR POLICY ESSAYS, No. 01/2015, 4, 9 (2015).

<sup>112</sup> Andrew T. Guzman, *Global Governance and the WTO*, 45 HARVARD INTERNATIONAL LAW JOURNAL 303, 306 (2004).

<sup>113</sup> Richard Baldwin, et al., *Beyond Tariffs: Multilaterising Deeper RTA Commitments*, 30 (2007).

<sup>114</sup> Baldwin, 16, 30. 2011; World Trade Organization, 44, 168 (2011).

governance.<sup>115</sup> Much of precaution is focused on non-market institutions (particularly legal and social ones) and “supranational public goods” (like common policies) that cannot be provided by the market itself or national governments, and are important for the market to operate properly.<sup>116</sup>

Deep FTAs increasingly highlight precaution, partially because of the low average level of tariffs and small preference margins (the difference between the lowest preferential tariff and most-favoured nation rate applied to other nations).<sup>117</sup> The thrust of deep FTAs appears to promote a level playing field, which reduces differences in national regulatory systems and sometimes promotes the harmonization of trade regulation.<sup>118</sup>

In particular, deep FTAs have much firmer obligations on non-trade concerns than their WTO counterpart. To illustrate, with the deepening of market opening, businesses want to ensure “reasonably equivalent market conditions for non-traded inputs” such as labor.<sup>119</sup> Deep FTAs often incorporate labor and environment protections like the expansion on general exceptions, and conflicts clauses to enable the prevailing of other agreements, and a “menu” of provisions on social obligations.<sup>120</sup> Relatedly, the new US model bilateral investment treaty contains provisions on labor and the environment, which go beyond the model proposed by the Organization for Economic Cooperation and Development (OECD) and used by many states as a template.<sup>121</sup>

### 3.2.2 *The unique path of selective engagement: Increased protection?*

The Phase One agreement appears to increase protection in respect of goods (through increased tariff rates and possible quota) rather than reduce protection or shift to the administration of precaution. Selective engagement reflects the efforts to reverse economic liberalization, utilize trade restrictions (particularly extra tariffs) to address the unfair practices in the US view, and reduce the trade deficit.<sup>122</sup> Selective engagement has arguably embraced increased tariffs<sup>123</sup> and new quotas compared with the pre-trade war period, both of which protect domestic businesses (more so US businesses in the context of purchase commitments) from international competition. The Phase One agreement “does not directly address any of the U.S. tariffs currently effective against Chinese goods, which are expected to remain in place for the foreseeable future.”<sup>124</sup> The high tariff rates apply to a high percentage of the US-China trade and to wide-ranging areas.

In contrast with lowered tariffs in economic integration, the tariff rates in US-China trade have been much higher. It appears that the US imposes extra tariffs on Chinese goods to increase its bargaining position in negotiating better market entry to China. The Phase One

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<sup>115</sup> World Trade Organization, 10 (2011).

<sup>116</sup> *Id.* at, 111, 113.

<sup>117</sup> *Id.* at, 15, 48.

<sup>118</sup> Asif H Qureshi, *International Legal Aspects of Free Trade Agreements in Northeast Asia*, 16 MANCHESTER JOURNAL OF INTERNATIONAL ECONOMIC LAW 2, 22 (2019).

<sup>119</sup> Lydgate & Winters, *WORLD TRADE REVIEW*, 460 (2018).

<sup>120</sup> Lorand Bartels, *Social Issues: Labour, Environment and Human Rights*, in *BILATERAL AND REGIONAL TRADE AGREEMENTS: COMMENTARY AND ANALYSIS* 384, (Simon Lester, et al. eds., 2016).

<sup>121</sup> Chris Devonshire-Ellis, *Prospects for a 2020 US-China Bilateral Investment Treaty*(2020), available at <https://www.china-briefing.com/news/prospects-2020-us-china-bilateral-investment-treaty/>.

<sup>122</sup> Lamp, *EUROPEAN JOURNAL OF INTERNATIONAL LAW*, 1361-1362, 1364 (2020).

<sup>123</sup> To fulfil the purchase commitment, some products may be exempted from extra tariff rates imposed during trade war. This remains to be seen and such exemption is temporary.

<sup>124</sup> Meyer, et al. 2020.

agreement only stops tariff rates from further increasing. For the commonly found tariff cuts in trade agreements, the Phase One agreement has not reduced pre-existing tariffs imposed by the US and China in bilateral trade.<sup>125</sup> Related to the Phase One agreement, the US commits to cut by half its extra tariff rate (“List 4A” tariffs of 15%) on \$120 billion Chinese products to 7.5%, which was imposed on September 1, 2019; both sides also suspend imposing additional tariffs that were scheduled to enter into effect on December 15, 2019, which originally targeted Chinese goods of nearly \$160 billion (“List 4B” tariffs that apply to clothing, cell phones, laptops, and toys) and US-made autos.<sup>126</sup> Tariffs imposed under Section 301 of the Trade Act of 1974 (Section 301) have been partially reduced or suspended under the Phase One agreement.<sup>127</sup> It is noteworthy that for the US and China, “average tariffs on both sides are still up about 20% from pre-trade war levels – six times higher than when the dispute began.”<sup>128</sup>

Purchase commitments may constitute a quota. Jennifer Hillman, a former member of the WTO Appellate Body, argues that purchase commitments under the Phase One agreement could constitute a quota, which may be at odds with Article XI of General Agreement on Tariffs and Trade 1994 (GATT 1994) that prohibits quantitative restrictions<sup>129</sup> or most-favoured-nation obligation under GATT Article I to grant all WTO members the same advantage.<sup>130</sup>

The Phase One agreement addresses precaution only to a limited extent by narrowing differences in NTMs in prioritized areas (e.g., agriculture and finance). The rules on NTMs in the Phase One agreement are more about increased benefits for businesses rather than protecting consumers from risks (e.g., environment and health risks).

On the one hand, the Phase One agreement tightens up rules on NTMs only in a narrow range of select areas: IP, agriculture, technology transfer, financial services, and even currency. This is because differences in rules across jurisdictions increase the costs of trading.<sup>131</sup> As an example of the progress regarding NTM, China’s IP measures will “better aligned with western standards” if the Phase One agreement is implemented smoothly.<sup>132</sup> Such an administration of precaution under the Phase One agreement narrows the differences in NTMs in select areas.

On the other hand, the Phase One agreement does not address non-trade concerns. The “re-embedding” of the economy and society often underlies the administration of precaution.<sup>133</sup> The administration of precaution arguably reflects the complementarity between trade and governance, which is at the centre of successful trade agreements and should enhance efficiency.<sup>134</sup> Due to the limited administration of precaution, the Phase One

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<sup>125</sup> EY, (2020).

<sup>126</sup> David Lawder, et al., *What's in the U.S.-China Phase 1 Trade Deal*(2020), available at <https://www.reuters.com/article/us-usa-trade-china-details-factbox/whats-in-the-us-china-phase-1-trade-deal-idUSKBN1ZE2IF>

<sup>127</sup> Layto & Keeler. 2020.

<sup>128</sup> Vaswani. 2020.

<sup>129</sup> Hillman. 2020.

<sup>130</sup> Id. at.

<sup>131</sup> Ederington & Ruta, POLICY RESEARCH WORKING PAPER 7661, 3 (2016).

<sup>132</sup> Eugenia Kolivos & Lara Nurick, *Intellectual Property, Technology Transfers and the US-China Trade Deal: Key Takeaways for Australia*(2020), available at <https://corrs.com.au/insights/intellectual-property-technology-transfers-and-the-us-china-trade-deal-key-takeaways-for-australia>.

<sup>133</sup> Lamy, JAN TUMLIR POLICY ESSAYS, No. 01/2015, 9 (2015).

<sup>134</sup> World Trade Organization, 10 (2011).

agreement has made limited progress in improving governance, and falls short of re-embedding the economy and society.

In the near future, it will not be likely for extra tariffs and purchase commitments to completely disappear unless there is strong political will. The Phase One agreement neither provides for the reduction of existing tariffs nor the removal of purchase commitments. Instead, the parties of the Phase One agreement “project that the trajectory of increases in the amounts of manufactured goods, agricultural goods, energy products, and services purchased and imported into China from the United States will continue in calendar years 2022 through 2025” after the original two-year period (2020-2021) of purchase commitments.<sup>135</sup> From the perspective of purchase commitments, this reflects the US preference for increasing voluntary import expansion and for increased protection.

### 3.3 Disintegration

Selective engagement is likely to bring less economic integration between the US and China and the decoupling may continue. First, there is decoupling between the US and China. The US and China are actually decoupling in key areas such as high technology. It is worth noting that the Phase One agreement is uncommon in focusing on the prohibition of forced technology transfer rather than the promotion of technology transfer, as in other FTAs.<sup>136</sup> It does not provide for usual investment protection and liberalization clauses. Moreover, the longer the high tariffs exist in US-China trade, the more difficult it will be to remove such tariffs as there are possible stakeholders for such high tariffs. This may lean towards disintegration.

Second, selective engagement has no objective of establishing a free trade zone. In contrast, FTAs usually aim to establish a free trade area and strengthen economic integration (e.g., tariff cuts). Notably, the US position appears to deviate from traditional FTA pathway. As an illustration, the Trump administration endeavoured to “force” businesses to invest in the US in the USMCA negotiations.<sup>137</sup>

Third, voluntary import expansion helps to maintain coupling only to certain extent and in the short term if there is an intention to implement the agreement. However, it is hard to maintain purchase commitments in the long term, as they are subject to geopolitical dynamics. The distinctive characteristic of the Phase One agreement is “short-termism.”<sup>138</sup> A lot of uncertainties remain in the US-China relationship and trade. Also, purchase commitments are one-sided. This reflects the Trump Administration’s efforts to reverse or prevent further trade liberalization of the US market,<sup>139</sup> and does not promote two-way integration.

Fourth, regulatory disciplines have made limited progress in strengthening economic integration. The rules section of the Phase One agreement demonstrates a limited intention to avoid a decoupling, such as by avoiding a decoupling in capital markets due to protectionism in financial services.<sup>140</sup> The chance of decoupling is likely to be reduced if the rules on crucial structural issues (e.g., those related to market competition) are formulated. However, the potential unintended effects of selective engagement may bring uncertainties in producing deep regulatory rules: Will the purchase commitments lead to overcapacity in downstream industry if Chinese businesses import more than they need to meet the purchase targets? Since purchase comments largely rely on businesses, will the Phase One agreement rely on

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<sup>135</sup> US-China Economic and Trade Agreement Article 6.2.3. 2020.

<sup>136</sup> Nuno Limão, *Preferential Trade Agreements*, in HANDBOOK OF COMMERCIAL POLICY 291, (Kyle Bagwell & Robert Staiger eds., 2016).

<sup>137</sup> Lamp, EUROPEAN JOURNAL OF INTERNATIONAL LAW, 1387 (2020).

<sup>138</sup> Bown & Lovely. 2020.

<sup>139</sup> Lamp, EUROPEAN JOURNAL OF INTERNATIONAL LAW, 1384 (2020).

<sup>140</sup> Politi. 2020.

SOEs and therefore make further negotiations on SOE rules more challenging?<sup>141</sup> With China probably becoming the top destination for US exports following the purchase commitments, China's leverage on the US "would increase immensely" which could negatively affect its incentives to negotiate deeper regulatory issues.<sup>142</sup> The unclear relationship between the government and market is another challenge. Managed trade could eventually prevent the further development of regulatory disciplines.

Also, regulatory disciplines in the Phase One agreement do not address crucial aspects of economic integration such as trade in parts and components and institutional harmonization. It is observed that "a larger share of parts and components between two countries relative to their total trade" increases the probability of deep integration and deep FTA rules between two states.<sup>143</sup> Moreover, deep FTAs serve primarily as a vehicle for undertaking deeper forms of integration to achieve institutional harmonization with other economies (such as on labor market regulations and innovations policy), rather than lowering trade barriers as such.<sup>144</sup> Selective engagement does not highlight such institutional harmonization given the rule vacuum.

Finally, the increased protection (e.g., high tariff rates) in selective engagement is not helpful for economic integration. The administration of precaution promotes deep integration by reducing the differences in NTMs, and it is based on transnational production and global value chains. However, the administration of precaution in selective engagement is rather limited. Why? Global value chain and coupling are arguably the "soil" in the world economy that have promoted deep integration (e.g., deep FTAs). Such soil has profoundly changed given the backlash against globalization as seen in "America First" policy and Brexit. The trade war (like tech war, national security issues, and the efforts of the Trump Administration to have US firms return to the US) and COVID-19 crisis (e.g., its disruption of the global value chains) further challenge globalization and coupling. The COVID-19 outbreak is likely to accelerate decoupling as countries may seek to avoid overreliance on one country. Decoupling reduces the global value chain which drives the administration of precaution. This appears to be a vicious circle.

Selective engagement fails to form a strong bond between the US and China, and there is limited progress in respect of economic integration. Given a lack of a strong bond and integration, selective engagement may make the violation or abandonment of a trade agreement more likely in the long run.

### 3.4 *The marginalization of multilateralism*

Selective engagement is likely to further reduce the future role of multilateralism. Although the Phase One agreement affirms the rights and obligations under WTO rules,<sup>145</sup> the reality is that the WTO seems to play an increasingly weak role in US-China interactions. There are concerns regarding the Phase One agreement's relationship and consistency with WTO rules, particularly GATT 1994.<sup>146</sup> Purchase commitments could constitute a quota, and violate

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<sup>141</sup> Bown & Lovely. 2020.

<sup>142</sup> Oktay. 2020.

<sup>143</sup> Ederington & Ruta, POLICY RESEARCH WORKING PAPER 7661, 42 (2016).

<sup>144</sup> Pravin Krishna, *Preferential Trade Agreements and the World Trade System: A Multilateralist View*, in GLOBALIZATION IN AN AGE OF CRISIS: MULTILATERAL ECONOMIC COOPERATION IN THE TWENTY-FIRST CENTURY 134, (Robert C. Feenstra & Taylor Alan M. eds., 2013).

<sup>145</sup> See, e.g., US-China Economic and Trade Agreement Article 7.6.1. 2020.

<sup>146</sup> See, e.g., *EU Warns of WTO Challenge If China-US Deal Creates 'Distortions'*(2020), available at <https://www.france24.com/en/20200117-eu-warns-of-wto-challenge-if-china-us-deal-creates-distortions>.

GATT Article XI, which prohibits quantitative restrictions, or the most-favoured-nation obligation under GATT Article I to grant all WTO members the same advantage.<sup>147</sup> As a kind of commonly used measure in selective engagement, the imposition of additional tariffs for US-China trade is at odds with WTO rules.<sup>148</sup> It remains to be seen whether the regulatory improvements will be applied in a non-discriminatory manner.

For dispute settlement, the WTO Appellate Body is in crisis. It is likely that the unilateral enforcement under selective engagement rather than the WTO dispute settlement system will be utilized to settle the US-China trade disputes.<sup>149</sup> These disputes include Phase One agreement violations that are not inconsistent with WTO rules.<sup>150</sup> There is no requirement in the Phase One agreement to go through WTO dispute settlement system for WTO-covered issues. More broadly speaking, the FTA dispute settlement system may be utilized more than before, and the WTO jurisdiction faces the risk of being incrementally “carved out.”<sup>151</sup>

In a broader context, the Trump administration appears to be intending to shift away from multilateralism and comprehensive FTAs with a large number of regulatory rules. The US appears to be pursuing mini or smaller trade agreements at least as the first step, which often reflect a sectoral approach. This might enable reaching an agreement in a short time. However, the regulatory coverage remains limited in these agreements. This is the case not only with the Phase One agreement, but also with the 2019 US-Japan trade agreement,<sup>152</sup> the 2019 US-Japan Digital Trade Agreement,<sup>153</sup> and the possible US-India trade deal.<sup>154</sup>

### 3.5 Other implications

Other ramifications may arise. For instance, the effects of selective engagement on third countries remain to be seen. Will the Phase One agreement apply to third countries? There could be different interpretations regarding whether the Phase One agreement will eventually extend to non-parties. On the one hand, the Phase One agreement provides for the treatment of other jurisdiction on rare occasions. For instance, China’s “trading partners, including the United States” shall have reasonable opportunities to raise oppositions against GIs listed in any agreement with another jurisdiction.<sup>155</sup> Meanwhile, there is a view that China will give the same standards of treatment to other countries.<sup>156</sup> On the other hand, most of the Phase One agreement rules do not explicitly refer to non-parties differing from ordinary agreements. Furthermore, the names of specific firms are provided in certain provisions of the agreement such as the provision on the time limit regarding electronic payment services

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<sup>147</sup> Hillman. 2020.

<sup>148</sup> Lamp, *EUROPEAN JOURNAL OF INTERNATIONAL LAW*, 1388 (2020).

<sup>149</sup> SIPS. 2020.

<sup>150</sup> Hillman. 2020.

<sup>151</sup> World Trade Organization, 174 (2011).

<sup>152</sup> Paul Wiseman & The Associated Press, *Trump Signs Japan Mini Trade Deal With No Change in Auto Tariffs*, *Fortune*(2019), available at <https://fortune.com/2019/10/07/us-trade-deal-japan-auto-tariffs-us-farmers-trump-signs-mini-trade-deal-with-japan/>.

<sup>153</sup> USTR, *Fact Sheet on U.S.-Japan Digital Trade Agreement*(2019), available at <https://ustr.gov/about-us/policy-offices/press-office/fact-sheets/2019/october/fact-sheet-us-japan-digital-trade-agreement>.

<sup>154</sup> Trevor Cloen & Irfan Nooruddin, *The U.S.-India Trade Deal Fell Through. What Happens Now?*, *The Washington Post*(2020), available at <https://www.washingtonpost.com/politics/2020/03/05/us-india-trade-deal-fell-through-what-happens-now/>.

<sup>155</sup> US-China Economic and Trade Agreement Article 1.15.2. 2020.

<sup>156</sup> Chorzempa. 2020.

licence application approvals.<sup>157</sup> In this context, it indicates a narrow scope of rule application to promote market access.

The Phase One agreement is likely to have spill-over effects for non-parties. One may argue that such effects could be stronger than that of ordinary FTAs given the economic heft of two major economies. There are concerns about possible trade diversion under the Phase One agreement.<sup>158</sup> The purchase commitments may reduce the demands for good and service imports from third countries. As another example, the Phase One agreement prohibits a government from supporting outbound investment whose aim is to acquire foreign technology that may “create distortion” in sectors and industries selected by its industrial plans.<sup>159</sup> This provision could affect third countries in which the potential acquisition of technology may occur.

The Phase One agreement, like bilateral and plurilateral agreements, may also breed concerns regarding its inclusiveness as the rules are formulated among a small number of parties. Broader engagement with other stakeholders, rather than selective engagement between the US and China, will be needed.

#### 4. Concluding Remarks

Selective engagement is a “different animal” from deep FTAs. It neither has a plan for establishing an FTA, nor focuses on developing systematic regulatory rules with legalized dispute settlement arrangements. Instead, selective engagement currently has an unprecedented focus on market access and has a delegalized enforcement mechanism. A piecemeal and pragmatic approach is adopted.

Selective engagement could be a game changer: it lacks systematic regulatory rules and legalized dispute settlement. This movement towards a power-based system deviates from the rule-based system in the WTO and various deep FTAs. Selective engagement seems to essentially depend on the political and economic clout of the parties, and is likely to lean towards delegalization and jungle rules. Managed trade exists in FTAs. However, it is substantially strengthened through purchase commitments under the Phase One agreement, which are unprecedented in China’s trade practice, and which are highly pragmatic and blunt outcome-oriented tools. Unilateral enforcement under the Phase One agreement may largely rely on unilateral power. (Geo)economic and (geo)political factors make the US-China trade much more complex than before. The America First policy leads to more unilateral measures when hegemonic stability appears to fade. There is the also weaponization of trade in (geo)economic tensions.<sup>160</sup> All these developments appear to mean that there is likely to be increasingly less consensus and a greater lack of trust between the US and China. This makes it difficult to develop systematic regulatory disciplines. It is possible that there will be decoupling between the US and China at least to some extent.

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<sup>157</sup> US-China Economic and Trade Agreement Article 4.4.2. 2020.

<sup>158</sup> See, e.g., Naomi Powell, *'Canada Should Be Worried': Canadian Exporters May Become Collateral Damage of U.S-China Trade Deal*, Financial Post(2020), available at <https://business.financialpost.com/news/economy/canada-should-be-worried-canadian-exporters-may-become-collateral-damage-of-u-s-china-trade-deal>.

<sup>159</sup> US-China Economic and Trade Agreement Article 2.1.3. 2020.

<sup>160</sup> Jack Thompson, *Trump and the Weaponization of International Trade*, in STRATEGIC TRENDS 2019: KEY DEVELOPMENTS IN GLOBAL AFFAIRS 11-26, (Jack Thompson & Oliver Thränert eds., 2019); Abraham Newman, *US and China Are Weaponising Global Trade Networks*, Financial Times(2019), available at <https://www.ft.com/content/a8ab8cd2-c99c-11e9-af46-b09e8bfe60c0>.

We are facing a complex and uncertain landscape for the world economy. Selective engagement in narrow issues can hardly provide sufficient predictability for the world economy. Selective engagement between the US and China, the two major economies, will have long-term implications for the world. These implications range from rule vacuum and inconsistency, increased protection and economic disintegration, to the marginalization of multilateralism.

The US-China interaction is a moving target and highly mutable. Many questions remain open. The future of selective engagement is yet to be known given its early stage of development. For instance, will new trade agreements follow the pattern of selective engagement? What is the future direction of trade? Will the shift from protection to precaution continue? Black swan events such as COVID-19 outbreak may bring uncertainties. What is clear is that the Phase One agreement does not depict the full picture of the US-China interaction and that many issues can hardly be addressed through the traditional parameters of international economic law. Further research is needed.