US & Multilateral Trade Policy Developments

Japan External Trade Organization

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US General Trade Policy Highlights

Outlook for US Trade Policy and the World Trade Organization in 2019

The year 2018 may be remembered as a turning point for US trade policy and the international trading system. The Trump administration took several unilateral trade actions, including the imposition of global "national security" tariffs and quotas on steel and aluminum and of punitive tariffs on nearly half of all Chinese imports as retaliation for that country's commercial and trade policies. Responsive actions followed in many countries, leading to an unprecedented level of national trade barriers and disputes in the modern "WTO" era. The measures and countermeasures have not only disrupted global supply chains and heightened uncertainty for business, but also have raised doubts about the United States' commitment to the multilateral system and the WTO's continued ability to serve as a negotiating forum and arbiter of disputes.

The uncertainty is likely to persist in 2019. Approval by the US Congress of the agreement to replace the North American Free Trade Agreement (NAFTA) is in question. US "national security" tariffs on automotive goods, potentially dwarfing those now on steel and aluminum, could hinge on the rapid conclusion of bilateral agreements with the EU and Japan, neither of which will be easy. The United States and China have entered negotiations aimed at resolving their ongoing trade dispute, but many doubt whether an enduring solution to fundamental economic and geopolitical differences is possible. Moreover, the WTO Dispute Settlement Body will deal with several high-profile disputes revolving around the sensitive issue of national security, and the Appellate Body could cease to function soon unless demands for reform (especially from the United States) are met. Given the magnitude of these issues, 2019 promises to be another important year for US trade policy and the multilateral trading system. Though the year begins without many clear answers, this report assesses how these and other important trade issues may develop over the coming year.

US-China Trade Dispute

The ongoing trade dispute between the United States and China is one of the most important issues on the 2019 US trade agenda, with implications for businesses, governments, and supply chains around the world. Prompted by the United States' unilateral imposition of tariffs on Chinese imports under Section 301 of the Trade Act of 1974 – purportedly in response to China's alleged unfair practices regarding intellectual property protection and forced technology transfer – the two countries in 2018 implemented a series of "tit-for-tat" tariff actions that now cover approximately $360 billion in annual bilateral trade. On December 1, 2018, the sides agreed to begin negotiations aimed at resolving some of the United States' concerns about China's trade and industrial policies and averting further tariff increases. The United States set a deadline of March 1, 2019 for the negotiations – allowing for only 90 days of discussion – and has stated that, absent a satisfactory outcome, it will immediately increase to 25% the current 10% duty rate on approximately $200 billion in annual Chinese imports into the United States. (Another $50 billion is already subject to additional 25% duties.)

There have been signs of incremental progress on some issues covered by the bilateral negotiations, but progress on structural reforms to China's trade and industrial policies – a demand emphasized by some US officials such as US Trade Representative (USTR) Robert Lighthizer – remains unclear. China has offered the following concessions since the start of the negotiations:

- **"Good faith" concessions.** At the outset of the negotiations, China announced minor "good faith" concessions on market access for automotive goods, purchases of US soybeans and corn, intellectual property rights enforcement, and the "Made in China 2025" industrial policy, but many details regarding these actions remain unclear. US and Chinese officials also are discussing the possibility of reopening the Chinese market to US chicken exports.

- **Long-term goods purchases.** China reportedly has offered to increase purchases of US goods – including energy and agricultural products – by more than $1 trillion over a six-year period, with the goal of eliminating the US trade deficit with China by 2024. Experts have expressed doubt that this target is achievable, noting that US exporters may be unable to meet such a large and sudden increase in demand. However, observers speculate that the proposal may be appealing to the Trump administration, which has emphasized trade deficit reduction as a central goal of its trade policy.

- **Structural reforms.** China's National People's Congress (NPC) on December 26, 2018 released a draft Foreign Investment Law that purports to facilitate various structural reforms sought by the United States, including a prohibition on forced technology transfers, protection of the intellectual property rights of foreign investors, and national treatment of foreign investors. The NPC is expected to approve the law during a session scheduled to open on March 5. However, observers have noted that the current draft law consists largely of broad, aspirational policy statements, and that China's plans for implementing and enforcing the proposed law remain unclear. China has not publicly announced any other proposed structural reforms.

The United States and China held a high-level negotiating round in Washington from January 30-31, led by Chinese Vice Premier Liu He and USTR Lighthizer. Following the meeting, USTR Lighthizer indicated that the talks had focused primarily on structural issues and that the two sides "did make progress on a variety of key issues", but he declined to elaborate on specific areas of progress and noted that "there's a lot more to be done".[1] He further stated that "[a]t this point, it's impossible for me to predict success. But we are in a place where, if things work out, we could have that[.]" He also indicated that the two sides have only just begun drafting a common negotiating document. The White House also issued a vague statement acknowledging "progress" in the talks, but providing few details: "[t]he two sides showed a helpful willingness to engage on all major issues, and the negotiating sessions featured productive and technical discussions on how to resolve our differences. The United States is particularly focused on reaching meaningful commitments on structural issues and deficit reduction. Both parties have agreed that any resolution will be fully enforceable. While progress has been made, much work remains to be done." The reaction of US business groups to the talks has been mixed: they indicated that, while the sides have made progress on market access, intellectual property enforcement, and other issues (e.g., electronic payments), China has not offered substantive concessions on structural issues such as technology transfers and industrial subsidies.

Some observers speculate that the Trump administration, motivated by recent declines in the US financial markets, has recently become more amenable to an agreement that would avert further escalation of the US-China trade dispute. The recent announcement that USTR Lighthizer and Secretary Mnuchin will visit China for further talks in mid-February also has been viewed as a positive signal. However, the Trump administration has not elaborated on the specific outcomes it considers necessary for the negotiation to be successful, beyond general statements (e.g., USTR Lighthizer's statement that the United States seeks "structural changes" (or "an agreement to have structural changes") to the Chinese industrial policies covered by the Section 301 investigation, as well as expanded market access for US goods). Moreover, while President Trump has repeatedly expressed vague optimism regarding the bilateral talks, his deputies have long been skeptical of China's willingness to adhere to its promises and enact fundamental policy reforms in response to pressure from the United States.

The outcome of the bilateral negotiations therefore is uncertain, but there are essentially three possible scenarios:

- **No agreement by March 1.** It is possible that the parties will fail to reach agreement by the March 1 deadline, the United States will refuse to extend the deadline further, and the US Section 301 tariffs on "List 3" goods (worth approximately $200 billion) will increase to 25% on March 2, as scheduled. In this scenario, China would likely retaliate with additional tariffs on US goods (possibly in combination with non-tariff measures), causing the trade dispute to escalate further in 2019. USTR Lighthizer has stated that, should the tariff rate on List 3 goods increase to 25%, USTR will establish a product exclusion process for goods on List 3, similar to the process it established for goods on Lists 1 and 2.

[1] A White House statement on the meeting said that the sides discussed, among other things: "(1) the ways in which United States companies are pressured to transfer technology to Chinese companies; (2) the need for stronger protection and enforcement of intellectual property rights in China; (3) the numerous tariff and non-tariff barriers faced by United States companies in China; (4) the harm resulting from China's cyber-theft of United States commercial property; (5) how market-distorting forces, including subsidies and state-owned enterprises, can lead to excess capacity; (6) the need to remove market barriers and tariffs that limit United States sales of manufactured goods, services, and agriculture to China; and (7) the role of currencies in the United States–China trading relationship. The two sides also discussed the need to reduce the enormous and growing trade deficit that the United States has with China."

- **Extension of negotiations beyond March 1.** The parties may fail to reach agreement by the March 1 deadline, but decide to extend the negotiations and refrain from any tariff increases while the negotiations are ongoing, thus allowing the status quo to persist for weeks or even months. President Trump previously has mentioned the possibility of extending the negotiations beyond the self-imposed March 1 deadline. More recently, the Trump administration has emphasized that March 1 represents a "hard deadline", but this could simply be negotiating bluster.
- **Preliminary agreement by March 1.** In a best-case scenario, the parties could reach a preliminary agreement that postpones or cancels the tariff increase on List 3 goods in exchange for Chinese concessions on market access and possibly structural issues. However, it is unclear how such an agreement might be structured. For example, the United States might agree to postpone the tariff increase, and to cancel it permanently only upon verifying that China has implemented all of its commitments by a specific date. Alternatively – and given the complexity of the structural issues under discussion – the United States could agree to postpone the tariff increase in exchange for some Chinese commitments (*e.g.*, on market access), and to cancel it entirely pending the outcome of further negotiations on structural issues. Other arrangements are possible, but the United States is expected to insist that any agreement must include a mechanism for verifying China's implementation of, and compliance with, its commitments thereunder.

Even in the best-case scenario described above, it is unclear whether the parties will take any action this year to reduce or eliminate the existing Section 301 tariffs and Chinese retaliation, which presently cover $250 billion and $110 billion in annual trade, respectively. Neither party has publicly expressed openness to doing so, and the US government's statements on the negotiation only contemplate cancellation of the planned tariff increase on List 3 goods. There is a strong chance, therefore, that trade restrictions between the two countries will remain at their current levels in 2019, even if the current bilateral negotiations succeed in producing an agreement.

US-Mexico-Canada Agreement (NAFTA 2.0)

One development welcomed by many pro-trade business groups and Members of Congress in 2018 was the conclusion of the negotiations for a US-Mexico-Canada Agreement (USMCA) to replace NAFTA. Major US business groups have expressed concerns about elements of the USMCA (including its limitations on investor-state dispute settlement (ISDS) and restrictive rules of origin for automobiles), but have nonetheless endorsed the Agreement and are seeking its approval in 2019, citing its preservation of duty-free trade among the Parties and its modernized provisions on issues such as digital trade, intellectual property, and services. It is expected that the Trump administration will submit legislation to implement the USMCA to Congress this year and seek its approval under the expedited legislative procedures provided for in the Bipartisan Congressional Trade Priorities and Accountability Act of 2015 (TPA). However, congressional approval of the legislation is far from certain, and any vote could be delayed well into the autumn of 2019, if not later.

Prospects for US Congressional Approval

Several factors will complicate the USMCA's approval in 2019. First, it is unclear whether the Trump administration can secure sufficient support for the USMCA among Democratic Members of Congress. Such support will be particularly important in the House of Representatives, where approximately 20 Democratic votes will be needed to pass the legislation even if every Republican Member votes in its favor (which is not guaranteed).[2] Despite efforts by USTR Lighthizer to address the priorities of certain Democratic lawmakers and labor groups in the USMCA (*e.g.*, on ISDS, automotive rules of origin, restrictions on Mexican trucking, and labor provisions), reactions to the USMCA text among these stakeholders have been largely negative (or at least skeptical):

[2] By comparison, 28 House Democrats voted to grant Trade Promotion Authority to the Obama administration in 2015.

- **Labor.** Several of the largest US labor unions have stated that they cannot support the agreement in its current form, and several others have declined to take a firm position while urging improvements to the deal. The AFL-CIO stated that "[w]ithout major improvements, this supposed overhaul will prove to be nothing more than a rebranded corporate handout. Any progress made by this deal is meaningless without swift and certain enforcement tools to safeguard key labor protections. Real steps forward start with changes in the text, comprehensive labor law reform from Mexico and a strong implementation bill from the United States." The United Autoworkers Union stated that "we are concerned the agreement as currently written does not go far enough in addressing the US-Mexico auto and auto parts trade imbalance", and that "[w]e encourage all parties to go back to the bargaining table[.]" The International Association of Machinists and Aerospace Workers stated that "NAFTA 2.0, as currently written, does not represent the fair trade principles we continue to demand…unless major changes are made so that outsourcing by corporations seeking Mexico's suppressed labor costs are adequately addressed, the IAM cannot support NAFTA 2.0." The United Steelworkers Union and the International Brotherhood of Teamsters also have issued statements suggesting that improvements, mostly relating to labor provisions and their enforcement, would be required to earn their unions' support of the USMCA.

- **Congressional Democrats.** House Speaker Nancy Pelosi (D-CA) stated in December that "while there are positive things in this proposed trade agreement, it is just a list without real enforcement of the labor and environmental protections." She did not commit to holding a vote on the USMCA in 2019, stating only that "[w]orking with our Chairman Richard Neal through the auspices of the Ways & Means Committee, we will be hosting meetings to brief Members on the provisions in the proposal and to hear from various stakeholders as Members make their judgments." Several other Democratic Members have expressed similar concerns, including Members with relatively pro-trade voting records: Rep. Ron Kind (D-WI) stated that "I continue to have serious questions for the Administration about the recently finalized USMCA agreement…These issues include enforceability of labor and environmental standards[.]" Senate Finance Committee Ranking Member Ron Wyden (D-OR) stated that "[w]hile there are elements of the revised NAFTA agreement that are clear improvements over the status quo…I remain concerned about the enforceability of the president's deal." He was particularly concerned with the lack of reforms to NAFTA's state-to-state dispute settlement system, which "is widely viewed as a failure since it enables a party to block the establishment of a panel of experts who would adjudicate NAFTA trade disputes." Without such changes, Sen. Wyden questioned whether the new NAFTA obligations on labor rights and other issues "can ever be effectively enforced."

  These and other concerns have led some Democratic Members – including Ways and Means Committee Members – to call for further negotiations to amend the USMCA, or for the inclusion of unspecified provisions on labor and enforcement in the USMCA implementing legislation. However, the current Mexican administration has rejected the possibility of renegotiation: Luz María de la Mora, Mexico's Undersecretary of Economy, stated in late January that "[f]or us, this agreement is closed." USTR Lighthizer also reportedly has rejected the possibility of reopening the Agreement.

Given these reactions and broader political dynamics, it is unclear whether the Democratic leadership in the House of Representatives will cooperate with the Trump administration's efforts to approve the USMCA in its current form by allowing a vote on the implementing legislation. Though the expedited legislative procedures provided for by TPA require each chamber of Congress to hold a final vote on the implementing legislation within a set time period (60 "in-session" days in the House), they operate as procedural rules of each chamber, and each chamber retains the authority to modify or override the rules at any time.

Congressional override of TPA's "fast track" process has a particularly noteworthy historical precedent: in 2008, during her previous term as House Speaker, Rep. Pelosi introduced a resolution that changed House rules to specify

that expedited legislative procedures would not apply to implementing legislation for the US-Colombia trade agreement. The House approved the resolution, and the agreement therefore stalled in Congress even though it was submitted under the 2002 TPA law. The FTA was only approved years later during the Obama administration. The USMCA could face a similar obstacle.

Furthermore, even assuming the USMCA implementing legislation receives a vote in 2019, its passage is uncertain. In addition to the aforementioned concerns expressed by Congressional Democrats, some Republican Members of Congress have expressed reservations about the Agreement, including its limitations on ISDS, 16-year "sunset" provision, restrictive automotive rules of origin, and failure to remove the Section 232 tariffs on steel and aluminum from Canada and Mexico. At least one Senate Republican (Sen. Pat Toomey (R-PA)) has said he will oppose the agreement on these grounds. In addition, Members of both parties, including House Ways and Means Committee Ranking Member Kevin Brady (R-TX), have indicated that they are unwilling to consider the USMCA unless the Section 232 tariffs on steel and aluminum from Canada and Mexico are removed (something the administration thus far has been unwilling to do). On the other hand, most Republicans are expected to support the Agreement, and Members of both parties will face significant pressure from the business community and domestic constituencies to ensure its passage (both to realize specific benefits of the Agreement and, more generally, to restore predictability to North American trade relations).

Timing

A possible US Congressional vote on the USMCA is unlikely until at least the second half of 2019. The statutory deadline for the US International Trade Commission to deliver its economic assessment of the Agreement (not required before the implementing legislation is submitted, but viewed as a prerequisite for any vote) is March 15, but will likely be delayed due to the US government shutdown that occurred from December 22, 2018 until January 25, 2019. Moreover, at least 30 days before submitting the implementing legislation, the administration must submit to Congress its draft Statement of Administrative Action (SAA) for the Agreement. Even assuming a highly ambitious timeline, wherein the ITC report and the implementing legislation are submitted on March 14, a final Congressional vote on the implementing legislation would not be required until approximately November 8, 2019 (*i.e.*, 90 "in-session" days from the date of introduction, based on the current House and Senate legislative schedules). Congress is free to expedite the process by voting more quickly than the TPA timelines require, but it is not obligated (and may be reluctant) to do so, and several Members of the Ways and Means Committee have expressed doubt that a vote can occur before June 2019. If a USMCA vote is indeed delayed into the late summer or autumn of 2019, it may face even greater political uncertainty due to the 2020 presidential election, which will be in full swing by that time.

Possibility of attempted US withdrawal from NAFTA

The uphill battle facing the USMCA in Congress has heightened concerns that President Trump may seek to unilaterally notify Canada and Mexico of the United States' withdrawal from NAFTA (pursuant to Article 2205 of that Agreement[3]) in 2019 in an effort to force Congress to approve the USMCA during the six-month period before the withdrawal takes effect. President Trump has publicly threatened to take such action, stating after the signing of the USMCA that "I'll be terminating [NAFTA] within a relatively short period of time…And so Congress will have a choice of the USMCA or pre-NAFTA[.]" However, the president's attempt to withdraw from NAFTA without congressional consent would create major uncertainty for North American business, and would likely engender widespread opposition from the business community and Members of Congress (some of whom have warned publicly, in response to President Trump's statements, that the President lacks the authority to withdraw from NAFTA without congressional approval). Moreover, some within the administration – including USTR Lighthizer – reportedly oppose

[3] Article 2205 provides that "[a] Party may withdraw from this Agreement six months after it provides written notice of withdrawal to the other Parties. If a Party withdraws, the Agreement shall remain in force for the remaining Parties."

the withdrawal strategy on the grounds that it would decrease rather than increase the USMCA's prospects for approval. Nevertheless, this scenario cannot be ruled out, and is another source of uncertainty for North American and global supply chains in 2019.

Section 232 Actions

US government actions under Section 232 of the Trade Expansion Act of 1962 ("Section 232") will feature prominently in 2019. Section 232 authorizes (1) the Bureau of Industry and Security (BIS) within the Department of Commerce to investigate the effects of certain imports on US "national security" and to issue findings and recommendations based thereupon; and (2) the President to negotiate agreements to limit or restrict imports, or to "take such actions as the president deems necessary to adjust the imports of such article so that such imports will not threaten or impair the national security." The statute places no limit on the nature of the restrictions or the height of tariffs.

Two Section 232 proceedings will be completed in 2019:

- **Automotive goods.** The administration's Section 232 investigation of automotive goods was initiated on May 23, 2018 and is now close to being completed. Assuming the deadline for DOC's final report is not tolled due to the US government shutdown, it will be transmitted to the President by February 19, 2019 (270 days after initiation, as required by law). According to industry sources, the report, which had undergone multiple revisions and interagency reviews, finds a national security threat and offers three different recommendations for the President: (1) blanket tariff on autos and auto parts ranging from 20-25 percent; (2) narrowly tailored tariffs on automated, connected, electric and shared (ACES) vehicle technologies; and (3) a middle ground option between the first two options. A previous version included only the blanket tariffs option. The release of the report and the President's decision to take action could depend on the status of ongoing US trade negotiations with Japan and the EU, the initiation of which paused the United States' imposition of any new tariffs. Canada and Mexico, meanwhile, negotiated a substantial exception from any future Section 232 tariffs on their automotive exports through the USMCA. Combined, these exemptions leave Korea and China as the largest automotive exporters to the United States without some public assurance that their goods would not be subject to new trade restrictions.

- **Uranium.** The Section 232 investigation of Uranium was initiated on July 18, 2018, and the final report is due by April 22, 2019 (unless tolled). BIS has reportedly conducted site visits and issued surveys to various US stakeholders. The outcome of the investigation is unclear, complicated by the unique nature of the product, the lack of viable near-term domestic supplies, and the end-2019 expiration of US legal measures (*e.g.*, Agreement Suspending the Antidumping Investigation on Uranium From the Russian Federation of 1992) that already restrict imports of uranium from Russia, one of the world's largest producers.

Although the shutdown created confusion as to whether the Section 232 deadlines will be tolled, it appears at the time of this report's publication that each will be transmitted to the President by its respective original deadline, though neither DOC nor BIS has provided official public instructions on this point. Regardless of the tolling issue, the administration may delay the public release of the reports until after the respective statutory deadlines, for example to keep the report on automotive imports from interfering with the early-March deadline for a trade deal with China. Although the statute's 270-day deadline for report delivery is firm, it is murky as to when the report must be actually published: sections without classified or business proprietary information must be published in the Federal Register, but there is no deadline for doing so. Along with each report's publication, the President might also delay any final measures until later in the year. The President has 90 days from receipt of a Section 232 report to make a final determination as to whether he concurs with the report's findings and will take "action" (*e.g.*, impose tariffs) to "adjust" the imports at issue. However, this deadline may also be extended by an additional 180 days where the "action" is

the negotiation of an agreement which limits or restricts the subject imports. These provisions could extend Presidential action on autos or uranium into late 2019.

Meanwhile, the **steel and aluminum** Section 232 tariffs, imposed in March 2018, remain in place, as does the process for interested US parties to apply for and eventually receive an exclusion from the tariffs. Prior to the US government shutdown, BIS had approved only 14,301 of 44,958 steel exclusion requests (denying 4,727 others) and only 1,191 of 6,159 aluminum requests (denying 205). In 2019, BIS will continue processing the remaining exclusion requests and new requests (including those from applicants who received one-year exclusions in 2018), but the substantial backlog is expected to worsen due to the shutdown. Although the impact and administration of the tariffs and exclusions have been widely criticized, the President appears committed to the measures for the foreseeable future. Indeed, the USMCA negotiations were widely expected to end Section 232 tariffs on Mexican and Canadian steel and aluminum, but that has not yet happened. The EU has also repeatedly sought an exemption from the tariffs as a precondition for initiating bilateral FTA negotiations, but the administration has given no indication of supporting that request.

Finally, a ruling from the Court of International Trade is expected in the coming weeks with respect to the American Institute for International Steel (AIIS) challenge to Section 232 as an unconstitutional delegation of Congress' tariff powers under Article I, Section 8 of the US Constitution (*American Institute for International Steel, Inc. et al v. United States et al*, Court No. 18-00152). Oral argument in that case took place in December 2018 before a rare three-judge panel, and an opinion is expected as soon as February (though there is no hard deadline for releasing the opinion). Regardless of the outcome, the opinion is widely expected to be appealed, thus having little immediate impact on the current or pending Section 232 import restrictions.

Bilateral Trade Negotiations with Japan, the European Union, and the United Kingdom

The Trump administration has notified Congress of its intention to negotiate bilateral trade agreements with Japan, the EU, and the United Kingdom. The administration has indicated that it will seek to use the recently-completed USMCA as the "template" for much of these potential agreements, but many questions remain about the timing, scope, and prospects for each negotiation. We discuss the outlook for each negotiation below.

US-Japan Trade Agreement

Having published its negotiating objectives for the proposed US-Japan Trade Agreement on December 21, 2018, the Trump administration has completed the pre-notification requirements set forth in TPA and therefore can begin formal trade negotiations with Japan. However, the parties have not yet begun formal negotiations, nor have they announced a date on which they will do so. The formal launch of negotiations appears to have been delayed in part by the recent US government shutdown, which caused USTR to furlough more than 70 percent of its staff. It is therefore unclear when formal negotiations between the two countries will begin, but observers speculate that the implementation of competing trade agreements (*i.e.*, the Comprehensive and Progressive Agreement for Trans-Pacific Partnership (CPTPP) in December 2018 and EU-Japan Economic Partnership Agreement (EPA) in February 2019) will motivate the Trump administration to move quickly – especially given that the United States abandoned the CPTPP in 2017. It is therefore possible that the US-Japan negotiations will begin in early 2019.

It remains unclear how the bilateral negotiations will be structured, including whether the negotiations in 2019 will be aimed at reaching an "early harvest" agreement covering only trade in goods or, alternatively, a comprehensive FTA covering all the issues discussed in USTR's negotiating objectives. The United States has indicated that it might seek to conduct the negotiation in stages, beginning with an early harvest agreement on trade in goods, but this approach would likely encounter opposition from certain Members of Congress and US business groups who fear that their sectors might be abandoned once an early harvest is achieved. It also is questionable whether such an

approach would be deemed consistent with TPA and WTO rules governing "interim agreements" and free trade areas, and whether the Japanese government will be willing to participate in a staged negotiation.

Regardless of their structure, completing negotiations in 2019 on all of the issues contemplated by USTR's negotiating objectives will be difficult, and completing even an early harvest agreement on goods this year could prove challenging. Though the USMCA and TPP texts overlap significantly and could serve as useful templates in some areas, completing the negotiations quickly will be difficult given the broad range of issues under discussion, the sizes of US and Japanese economies and their importance in global trade, and the long history of bilateral trade frictions in sensitive areas such as agriculture and automotive trade. Moreover, controversial US proposals (*e.g.*, for a "sunset" provision or limitations on Japanese automotive exports to the United States) are expected to add further complexity to the negotiations. It is therefore questionable whether any US-Japan agreement can be reached in 2019, and whether Japan will be able to secure a long-term exemption from any potential Section 232 restrictions on automotive goods as a result. Senate Finance Committee Chairman Chuck Grassley (R-IA) has expressed skepticism that a US-Japan trade agreement can be completed in 2019.

US-EU Trade Agreement

The United States and the EU agreed in 2018 to pursue formal bilateral trade negotiations, but the start of these talks remains in limbo given major disagreements between the parties regarding their scope. In a joint statement issued in July 2018 by President Trump and European Commission President Jean-Cleaude Juncker, the two leaders agreed to pursue negotiations toward "zero tariffs, zero non-tariff barriers, and zero subsidies on non-auto industrial goods", as well as "to reduce barriers and increase trade in services, chemicals, pharmaceuticals, medical products, as well as soybeans." However, in January 2019, the two parties issued significantly different negotiating objectives for the proposed trade agreement:

- In keeping with the July 2018 joint communique, the EU negotiating mandates propose a narrow negotiation that is limited to the elimination of tariffs for industrial goods and an agreement to facilitate the mutual acceptance of conformity assessment results for industrial goods.
- By contrast, the US negotiating objectives seek a comprehensive agreement covering trade in goods (including agricultural products), services, government procurement and intellectual property that would be similar in scope to the Trans-Atlantic Trade and Investment Partnership (TTIP) negotiations with the EU that were placed "on hold" in 2016 at the end of the Administration of President Obama.

The EU has ruled out negotiating on trade in agriculture because of opposition from France and southern EU member states to any reduction in the protection of EU farming. The United States, however, is aiming for comprehensive market access for its agricultural exports in the EU market through the elimination of EU tariffs and non-tariff barriers with a particular focus on changing EU sanitary and phytosanitary (SPS) measures that are not based on scientific risk-assessment. Although the EU claims that President Trump agreed that the negotiations should cover only industrial goods, the importance of the inclusion of trade in agriculture has been emphasized repeatedly by United States' farm lobbies and their allies in Congress. Chairman Grassley has expressed serious doubt that a draft trade agreement with the EU that excluded agriculture would be approved by the US Senate: "The notion that some people in the EU think there could be an agreement that doesn't address the many ways they block our good agricultural products from being sold in Europe is ridiculous". Given these differences and the political dynamics of both parties, it is unclear whether the parties can reach agreement on the scope of the negotiations in 2019.

Some observers speculate that the Trump administration's proposal to conduct the negotiations in "stages" could allow the US and the EU to begin negotiations in 2019 without resolving the impasse over agriculture.[4] They note that the parties could begin a bilateral negotiation for an agreement to eliminate tariffs on industrial goods, as envisioned in the EU negotiating mandates, while leaving the remaining issues to be addressed in subsequent stages. However, this approach would likely engender significant opposition from the US agricultural community and other business groups, as well as Members of Congress, who fear that agriculture and other priorities will not be addressed in the subsequent stages of the negotiation. Rep. Kevin Brady recently expressed strong doubts about an early harvest agreement that excludes agriculture, stating that "from the US standpoint I don't know how you make that sale at all." Moreover, such an approach would raise questions regarding the consistency of the "early harvest" agreement with TPA and WTO rules.

The impasse over the scope of the bilateral negotiations has heightened concerns that President Trump may impose (or threaten to impose) Section 232 restrictions on automotive imports from the EU in 2019. Though the United States assured the EU that it would be excluded from any such restrictions while the negotiations are ongoing, President Trump could seek to use Section 232 tariffs, or at least the threat of such tariffs, as leverage to pressure the EU to engage in negotiations on agriculture. The EU, for its part, has said it will suspend negotiations if the United States imposes new Section 232 measures on EU goods, and EU trade officials stated in January that the EU is prepared to impose retaliatory tariffs on $22.7 billion of US goods in response to any Section 232 measures on EU automotive goods. Thus, while the July 2018 statement by Presidents Trump and Juncker was welcomed as a sign of improvement in US-EU trade relations, 2019 begins without much assurance that the current "truce" will hold, and with increasing concerns about the prospect of further US Section 232 tariffs and EU retaliation on a larger scale than that which took place in 2018.

US-UK Trade Agreement

The United States and the UK have announced their intention to start negotiations on a free trade agreement, but the timing of those negotiations is still unclear because the UK's draft Treaty of withdrawal from the EU has not yet received parliamentary approval. For the time being other Brexit outcomes cannot be ruled out, such as a "hard" Brexit where the UK withdraws from the EU without an agreement or even a second referendum on EU membership.

If the draft withdrawal Treaty is approved in the next few weeks, the UK is expected to leave the EU formally on March 29, 2019. The UK will stay in the EU Customs Union and Single Market and be subject to EU trade law for a transition period until December 2020 (extendable for one or two years until no later than December 2022). During the transition period, the UK can negotiate and ratify an FTA with the United States (and with other third countries) although the agreement cannot enter into force until the transition period ends. At the same time, the UK will negotiate its new trade agreement with the EU.

For the UK, conducting two such significant trade negotiations in parallel could prove challenging, particularly where trade-offs between the two need to be made. The United States may face similar challenges, as its planned bilateral negotiations with Japan (and possibly the EU) and its efforts to secure congressional approval of the USMCA may constrain its ability to conduct simultaneous negotiations with the UK. Thus, while the two countries may be able to launch formal trade negotiations in 2019, rapid progress appears unlikely.

Congressional Trade Agenda

The 115th Congress generally took a passive approach to trade policy, reacting to (and at times criticizing) the Trump administration's aggressive unilateral trade actions but not asserting its Constitutional authority to curtail them

[4] USTR's negotiating objectives state that "[w]e may seek to pursue negotiations with the EU in stages, as appropriate, but we will only do so based on consultations with Congress", and do not elaborate further.

through legislation. This pattern should continue in 2019 despite Democrats assuming the majority in the House of Representatives, unless certain unilateral actions by the Trump administration prompt Congress to consider new limitations on the President's trade authority. In particular, the potential application of Section 232 tariffs to finished automobiles, or an attempt by President Trump to unilaterally withdraw the United States from NAFTA, could cause Congress to consider legislation to prevent these actions and the serious political and economic turmoil they would create.

Some Members already have introduced legislation in the new Congress that would curtail the President's authority to impose trade restrictions under Section 232. One such bill, the Bicameral Congressional Trade Authority Act, would require the President to obtain Congressional approval before imposing import restrictions under Section 232, and for any Section 232 actions imposed within the last four years (including the steel and aluminum tariffs). In addition, it would clarify Section 232's definition of "national security" and limit the types of products that can be investigated under the law. The bill was introduced in the Senate by Sens. Pat Toomey (R-PA) and Mark Warner (D-VA) and presently has nine Senate co-sponsors; Reps. Ron Kind (D-WI) and Mike Gallagher (R-WI) have introduced an identical bill in the House. Although the bill appears unlikely to advance in the near term, it or similar legislation could gain momentum should the Trump administration announce plans for further significant trade restrictions under Section 232, particularly on automobiles. A wide range of influential US business groups and think tanks have endorsed the bill, including the US Chamber of Commerce and more than 40 organizations representing the retail, agriculture, automotive, energy, and manufacturing sectors, among others. Following the bill's introduction, a spokesman for Chairman Grassley stated that the Senator "has said he supports some of the ideas being discussed by members of the committee, but he hasn't endorsed any particular bill[.]"

By contrast, a small group of House Republicans has introduced legislation that seeks to expand the President's authority to impose tariffs. The legislation, entitled the "United States Reciprocal Trade Act", would authorize the President to increase US tariffs on a particular good upon determining that "the rate of duty imposed by a foreign country with respect to [that good], when imported from the United States, is significantly higher than the rate of duty imposed by the United States on that good, when imported from that country." The legislation would similarly authorize the President to increase US tariffs upon determining that the non-tariff barriers applied by a foreign country with respect to that good "impose significantly higher burdens" than those applied by the United States. White House Trade Advisor Peter Navarro reportedly assisted in the drafting of the bill, which was introduced by Rep. Sean Duffy (R-WI) and has 18 Republican co-sponsors. It is very unlikely that Congress will enact the legislation, however, as there is little congressional support in either Party for further expanding the President's trade authority. Chairman Grassley has rejected the proposal (stating that "[w]e ain't gonna give [the President] any greater authority…We've already delegated too much") as has Ranking Member Wyden. US business groups also have expressed strong opposition to the bill, noting that it would ignore the United States' WTO obligations and invite retaliation against US exporters.

Other items on the congressional trade agenda this year will include consideration of the USMCA implementing legislation, consultations with the Trump administration under TPA concerning the planned bilateral negotiations with Japan, the EU, and the UK, and continued oversight of the administration's Section 232 and Section 301 product exclusion processes. Primary responsibility for these activities will lie with the House Ways and Means and Senate Finance Committees, both of which will have new leadership and members in the 116th Congress, as discussed in greater detail below.

House Ways and Means Committee

The makeup of the House Ways and Means Committee has shifted significantly in the new Congress. The Committee is now comprised of 25 Democrats and 14 Republicans, compared to 24 Republicans and 16 Democrats during the previous Congress. The incoming Democratic majority on the Committee generally has been less

supportive of trade liberalization measures than its Republican predecessors: for example, just 5 of the 19 Democratic Members on the Committee who were present for the 2015 vote on TPA voted in favor the legislation, even though a Democrat (Obama) was president at the time. By contrast, all 24 Republican Members of the Committee in 2015 voted for TPA. The full list of Members of the House Ways and Means Committee for the 116th Congress is provided in the table below.

House Ways and Means Committee Members, 116th Congress			
Democratic Members (25)	**TPA 2015 Vote**	**Republican Members (14)**	**TPA 2015 Vote**
Richard Neal, Chair (MA)	N	Kevin Brady, Ranking Member (TX)	Y
John Lewis (GA)	N	**Devin Nunes (CA)**	**Y**
Lloyd Doggett (TX)	N	***Vern Buchanan (FL)***	**Y**
Mike Thompson (CA)	N	Adrian Smith (NE)	Y
John Larson (CT)	N	**Kenny Marchant (TX)**	**Y**
Earl Blumenauer (OR)	**Y**	Tom Reed (NY)	Y
Ron Kind (WI)	**Y**	Mike Kelly (PA)	Y
Bill Pascrell (NJ)	**N**	**George Holding (NC)**	**Y**
Danny Davis (IL)	**N**	**Jason Smith (MO)**	**Y**
Linda Sanchez (CA)	N	**Tom Rice (SC)**	**Y**
Brian Higgins (NY)	**N**	**David Schweikert (AZ)**	**Y**
Terri Sewell (AL)	**Y**	Jackie Walorski (IN)	Y
Suzan DelBene (WA)	**Y**	Darin LaHood (IL)	NA
Judy Chu (CA)	N	Brad Wenstrup (OH)	Y
Gwen Moore (WI)	N		
Dan Kildee (MI)	**N**		
Brendan Boyle (PA)	N		
Don Beyer (VA)	**Y**		
Dwight Evans (PA)	NA		
Brad Schneider (IL)	NA		
Tom Suozzi (NY)	NA		
Jimmy Panetta (CA)	**NA**		
Stephanie Murphy (FL)	**N**		
Jimmy Gomez (CA)	NA		
Steven Horsford (NV)	NA		
Note: **Bold** indicates Members of Subcommittee on Trade; *italics* indicates Chairman/Ranking Member of Subcommittee on Trade**;** "NA" indicates that the Member did not vote on TPA 2015			

The new Ways and Means Committee Chairman, Rep. Richard Neal (D-MA), has a mixed record on trade issues, having voted for some FTAs (KORUS, Panama, Peru) while opposing others (Colombia, DR-CAFTA, NAFTA) and the 2002 and 2015 iterations of TPA. Chairman Neal has criticized the Trump administration's execution of some of its more controversial trade actions (*e.g.*, the trade dispute with China and the Section 232 tariffs on steel and aluminum), but has been less critical of the underlying policies. For example, he described the Trump administration's initial Section 301 tariffs on Chinese goods as "substantial and aggressive enforcement actions" that "can be an important tool in re-setting the US-China trade and economic dynamic", expressing concern only about "the apparent lack of coherence in the Administration's approach" with China. In January 2019, he discouraged the administration from lifting the Section 301 tariffs in exchange for "a quick and easy deal" with China. Regarding the Section 232 tariffs on steel and aluminum, he stated that the measures "could, if implemented and designed thoughtfully, bring about a recovery of US steel and aluminum production", though he later criticized their application

to imports from Canada, Mexico, and the EU. These comments suggest at least some alignment with the Trump administration's approach to trade policy.

Chairman Neal has not identified trade policy as a priority for the Committee in 2019, focusing instead on other issues as tax and infrastructure policy. He has not yet taken a position on the USMCA, stating upon its signing that "I will continue to scrutinize the details of this deal...My assessment will focus on the content of the commitments that have been put on paper and whether those commitments, especially on worker rights and environmental protections, are enforceable[.]"

Senate Finance Committee

The makeup of the Senate Finance Committee remains largely unchanged from the previous Congress. It will be comprised of 15 Republicans and 13 Democrats (compared to 14 Republicans and 13 Democrats in the previous Congress). Sen. Grassley has assumed the Chairmanship following the retirement of Sen. Orrin Hatch (R-UT). Like his predecessor, Chairman Grassley has largely been supportive of trade liberalization during his career and has been critical of the Trump administration's actions under Section 301 and Section 232. At the same time, he has occasionally expressed openness to the Trump administration's use of unilateral trade actions as negotiating "leverage". For example, Chairman Grassley has made the following statements regarding the 2019 trade agenda:

- Regarding Section 232, he stated that "I do not believe that we should alienate our allies with tariffs disguised as national security protections", and that "I strongly disagree with the notion that imports of steel and aluminum, automobiles, and auto parts somehow could pose a national security threat. I intend to review the President's use of power under Section 232 of the Trade Act of 1962[.]" He also referred to a bill introduced by Sen. Rob Portman (R-OH) to narrow the President's Section 232 authority as "a prudent starting point for the discussion we need to have on Section 232 authority in the next Congress." On the other hand, he stated that the President's threat to impose tariffs on EU automotive goods under Section 232 "may be an effective tool" and is "probably the only thing that will bring Europe to the table in a reasonable way" to negotiate a trade agreement with the United States involving agricultural market access.

- Regarding the USMCA, he stated that he will "continue to work with the Trump administration toward implementation [of the Agreement]" and that "I'm committed to working with the Administration to ensure that US farmers, ranchers and businesses face minimal uncertainty from updating NAFTA." On the other hand, he subsequently stated that if Congressional Democrats insist that the USMCA be renegotiated, "I would encourage the president to pull out of NAFTA and hope that they're smart enough to not let that happen[.]"

- Regarding the US-China dispute, he stated that "I'm not fond of the Section 301 tariffs on products from China, but I agree with the reasons they've been applied. I'll continue to engage with the Administration on the ongoing trade dispute with China in hopes that negotiations will result in a change in China's discriminatory policies and practices and an easing of tariffs and tensions."

The comments have raised questions about the extent to which the Finance Committee under Chairman Grassley's leadership will serve as a check on the Trump administration's trade actions.

The full list of Members of the Senate Finance Committee for the 116th Congress is provided in the table below. Notably, the Membership of the Senate Finance Subcommittee on International Trade, Customs and Global Competitiveness has doubled to 20 Members in the 116th Congress. The expanded membership likely reflects a heightened interest in trade policy among Members of Congress and their constituents, brought about by the recent changes in trade policy under the Trump administration.

Senate Finance Committee Members, 116th Congress			
Republican Members (15)	**TPA 2015 Vote**	**Democratic Members (13)**	**TPA 2015 Vote**
Grassley, Chuck (IA), Chair	Y	**Wyden, Ron (OR), Ranking Member**	Y
Crapo, Mike (ID)	Y	**Stabenow, Debbie (MI)**	N
Roberts, Pat (KS)	Y	**Cantwell, Maria (WA)**	Y
Enzi, Michael B. (WY)	Y	**Menendez, Robert (NJ)**	NA
Cornyn, John (TX)	Y	Carper, Thomas R. (DE)	Y
Thune, John (SD)	Y	**Cardin, Benjamin L. (MD)**	N
Burr, Richard (NC)	Y	**Brown, Sherrod (OH)**	N
Isakson, Johnny (GA)	Y	Bennet, Michael F. (CO)	Y
Portman, Rob (OH)	Y	***Casey, Robert P. (PA)***	N
Toomey, Patrick J. (PA)	Y	**Warner, Mark R. (VA)**	Y
Scott, Tim (SC)	Y	Whitehouse, Sheldon (RI)	N
Cassidy, Bill (LA)	Y	Hassan, Margaret Wood (NH)	NA
Lankford, James (OK)	Y	**Cortez Masto, Catherine (NV)**	NA
Daines, Steve (MT)	Y		
Young, Todd (IN)	Y*		

Note: **Bold** indicates expected Members of Subcommittee on Trade; *italics* indicates expected Chairman/Ranking Member of Subcommittee on Trade; "NA" indicates that the Member did not vote on TPA 2015

*Voted yes as a House Member.

WTO Dispute Settlement and Negotiations

Looking to the year ahead, the WTO faces challenges on multiple fronts. The organization's Dispute Settlement Body (DSB) will face several systemic tests in 2019. The first of these is the viability of the Appellate Body (AB). Due to the retirement of previous AB members and the continued refusal of the United States to appoint new ones before its concerns over the AB are addressed by the WTO Membership, there are only three sitting members on the AB. Unless WTO Members can agree to appoint new members, this number will fall to one by December 2019 – at which point the AB will no longer be able to function. At the end of 2018, the EU, China, India and nine other WTO Members proposed modifications to the Dispute Settlement Understanding (DSU) that would, in their view, provide solutions to all of the issues on which the United States has criticized the functioning of the AB for the past twelve months; the United States, however, rejected all elements of the proposal. Some observers believe that the United States may have already decided to put the AB out of business at the end of 2019, and that it has no intention before then of engaging with other Members to try to correct the AB practices about which it has complained.

Moreover, it is possible that the crisis over the AB's functioning will come to a head sooner than December. The Chinese AB Member, Zhao Hong, may have to recuse herself from any appeal involving China, and three such appeals could arise in in the first half of 2019: DS511, in which the United States has challenged China's agricultural subsidies for wheat, rice and corn as exceeding China's domestic agricultural support limits; DS517, in which the United States has challenged China's tariff rate quotas for certain agricultural products as being inconsistent with China's obligations in the GATT and in its Protocol of Accession; and DS516, in which China has challenged the EU's use of non-market price comparison methodologies in its anti-dumping investigations against China. If appeals were made but were unable to proceed in these cases, the DSB would not be able to consider adoption of the dispute panel reports and the dispute settlement system could potentially enter a "no-man's land" of uncertainty.

An additional systemic challenge in the DSB concerns prospective developments in a series of disputes concerning national security and trade. The Panel Report in DS512, which concerns Russian measures on traffic in transit from

Ukraine through Russia to third countries, is expected in the first quarter of 2019. The Members who have filed disputes against the United States concerning its Section 232 measures on steel and aluminium have all requested the establishment of a panel in their respective disputes, and composition and selection will likely prove controversial. Likewise, a panel has been established (but not yet composed) in Qatar's case against Saudi Arabia over IP rights, and composed in Qatar's case against the United Arab Emirates regarding the same. All of these cases could test the limits of the DSB, as Members are expected to make arguments related to national security and may invoke Article XXI of the GATT (or its parallel provisions in other WTO Agreements) – long considered the "third rail" of WTO dispute settlement. Additionally, in the first half of January, Venezuela requested consultations with the United States in DS574, which concerns US sanctions against it – suggesting that disputes over national security-related trade measures may continue to dominate discussion.

In addition, the panel report in China's dispute with the EU over "non-market economy" (NME) treatment of China in anti-dumping investigations (DS516) is expected in the first half of 2019. USTR Lighthizer has warned that a WTO ruling in China's favor on the issue of NME treatment would be "cataclysmic for the WTO" – a statement interpeted by some as a threat that such a ruling would cause the United States to withdraw from the WTO.

In terms of negotiations, some progress is possible, albeit in modest increments. More than 70 countries, including the United States, China, the EU, and Japan, have announced their intention to pursue plurilateral negotiations in the realm of e-commerce. The key areas for discussion include the freedom of data flows across borders and bringing an end to data localization requirements. Separately, some WTO Members are seeking to expand disciplines on services, particularly by updating the provisions of the General Agreement on Trade in Services (GATS) regarding domestic regulation of services, with the aim of providing outcomes by the 2020 WTO Ministerial Conference in Astana, Kazakhstan. On the multilateral front, negotiations over fisheries subsidies are expected to continue, with the twin issues of (1) special and differential treatment for developing countries and (2) defining the scope of subsidies subject to such disciplines as the major issues in these discussions. Finally, despite the proposals by some Members to reform the WTO in 2018 (*e.g.*, with respect to agricultural and industrial subsidies, state-owned enterprises, *etc.*), Members appear to be far away from finding common ground on which to start a serious discussion, let alone an eventual negotiation, on elements of WTO reform. Director-General Azevedo will continue to hold consultations on the subject in 2019, but it appears doubtful that Members will be able to forge agreement around a single agenda in the near future.

Conclusion

Uncertainty about the United States' trade policies and the future of the multilateral trading system will likely persist throughout 2019. Congressional debate over the USMCA is likely to be contentious and could last late into the year, leaving businesses unsure of the rules that will govern future trade and investment in North America. The United States and China might reach a preliminary agreement in March to pause their trade dispute, but permanent cancellation of the United States' planned tariff increase might not come until much later and could be contingent on China's implementation of policy reforms, which is not guaranteed. There are many unanswered questions about the scope and structure of the planned bilateral negotiations with Japan, the EU, and the UK, but it appears doubtful they will be completed in 2019, and negotiations with Japan and the EU in particular are expected to be contentious. In addition, the outcome of the Trump administration's Section 232 investigation of automotive goods might not be known until late in the year, and there is potential for new trade restrictions and foreign retaliation on a scale much larger than that which resulted from the steel and aluminum investigations. At the same time, the WTO dispute settlement system will face unprecedented challenges, including the potential inability to resolve disputes in which appeals are brought. It is unclear how such a crisis might be resolved, but a solution is unlikely to come quickly or easily. Thus, while some progress is possible this year, the trade policy environment is likely to remain challenging for businesses, governments, and global supply chains.

US Trade Representative Excludes Certain Products of China from Section 301 Tariffs on "List 1" Goods

On December 28, 2018, the Office of the US Trade Representative (USTR) determined to exclude 31 products from the 25 percent additional tariff imposed by the United States on approximately $34 billion worth of Chinese imports under Section 301 of the Trade Act of 1974. Based on requests from interested parties, USTR determined to exclude 7 HTSUS 10-digit subheadings and 24 additional, narrowly-defined items from the 25 percent tariff until December 28, 2019. These are the first exclusion requests that USTR has approved under the Section 301 exclusion process. We discuss USTR's exclusion determinations and the status of the Section 301 exclusion process below.

Background

On July 6, 2018, the United States imposed an additional tariff of 25 percent on approximately $34 billion worth of annual imports from China, pursuant to Section 301 of the Trade Act of 1974. On July 11, 2018, USTR published a Federal Register notice establishing a process for interested parties to request the exclusion of particular products from the additional tariff. USTR stated that exclusion requests should address the following factors:

- Whether the particular product is available only from China;
- Whether the imposition of additional duties on the particular product would cause severe economic harm to the requester or other US interests; and
- Whether the particular product is strategically important or related to "Made in China 2025" or other Chinese industrial programs.

Properly filed exclusion requests are subject to a review process consisting of, *inter alia*, the following steps:

- Public comment period. Interested persons have 14 days from the date a request is posted on Regulations.gov to respond to the request. If a response is submitted, the requester has 7 days to reply to the response.
- Initial substantive review. After the public comment period closes, USTR conducts an "initial substantive review" of whether the exclusion request should be granted, based on the substantive criteria listed above and in the Federal Register notice.
- Administrability review. If a request passes the initial substative review, USTR consults with US Customs and Border Protection (CBP) to determine whether an exclusion would be administrable. Requests that pass the administrability review are granted.

Exclusion Determinations of December 28, 2018

Scope of Exclusions

USTR announced its decision to exclude certain products from the "List 1" tariffs in a Federal Register notice published on December 28, 2018. The exclusions granted by USTR are established in two different formats: (1) as an exclusion of an existing 10-digit subheading from within an 8-digit subheading covered by the $34 billion action; or (2) as an exclusion reflected in "specially prepared product descriptions" that cover only certain products within a 10-digit HTSUS subheading. In particular, the exclusions take the form of 7 HTSUS 10-digit subheadings and 24 "specially prepared" product descriptions. We provide the full list of excluded 10-digit HTSUS subheadings and three examples of "specially prepared" product descriptions below. The full list of excluded products can be found in the Annex to USTR's Federal Register notice.

Excluded HTSUS 10-Digit Subheading	General Description[5]
8412.21.0075	Linear acting hydraulic motors (cylinders), nesoi
8418.69.0120	Drinking water coolers, refrigerated, self-contained
8480.71.8045	Injection type molds for rubber or plactics, nesoi
8482.10.5044	Radial bearings, single row, having an outside diameter of 9 mm and over but not over 30 mm
8482.10.5048	Radial bearings, single row, having an outside diameter of over 30 mm but not over 52 mm
8482.10.5052	Radial bearings, single row, having an outside diameter of over 52 mm but not over 100 mm
8525.60.1010	Radio transcievers, citizens band (CB) type

Examples of "Specially Prepared Product Descriptions"
Spark-ignition engines for marine propulsion, outboard, each rated at not less than 29.83 kW but not more than 44.74 kW (described in statistical reporting number 8407.21.0080)
Welded hydraulic linear acting (cylinders) engines and motors, each with piston bore of 12.7 mm or more but not over 34.6 mm, with stroke not over 11.43 m, overall length not over 15.24 m and rod diameter not over 1.219 m (described in statistical reporting number 8412.21.0030)
Roller machines with dies for embossing paper, manually powered (described in statistical reporting number 8420.10.9080)

According to USTR, the granted exclusions cover approximately 1,000 separate exclusion requests. The excluded 10-digit subheadings cover 918 separate requests, and the 24 specially drafted product descriptions cover approximately 66 separate requests. However, USTR has clarified that the scope of each exclusion is governed by the scope of the 10-digit HTSUS headings and the specially prepared product descriptions set forth in the Federal Register notice, and not by the product descriptions set out in any particular request for exclusion.

Exclusion Procedures

The granted exclusions will apply retroactively as of the July 6, 2018 effective date of the additional 25 percent tariff, and will extend for one year after the publication of the exclusion determination in the Federal Register (*i.e.*, until December 28, 2019). The exclusions are available for any product that meets the description set forth in the Federal Register notice, regardless of whether the importer filed an exclusion request.

USTR has stated that CBP will issue instructions on entry guidance and implementation of the exclusions. However, the recent lapse in US federal government appropriations appears to have delayed the issuance of such guidance. On December 31, 2018, CBP issued a CSMS message on the product exclusions, stating that "[a]t the conclusion of the government funding hiatus, CBP will issue instructions on entry guidance and implementation. Any updates to the Automated Customs Environment (ACE) will be implemented 10 business days after the shutdown has concluded." The message further states that, until the aforementioned updates are completed, entry and entry summaries must be submitted without the product exclusion number referenced in USTR's Federal Register notice. Entry and entry summaries will be rejected by ACE if the product exclusion number referenced in USTR's Federal

[5] The product descriptions displayed here are those applicable at the HTSUS 8-digit level. For the precise descriptions applicable at the HTSUS 10-digit level, consult the HTSUS.

Register notice is transmitted. Once CBP issues guidance and implements ACE enhancements, a Post Summary Correction (PSC) or a Protest may be submitted for a refund.

Approval Letters

USTR has published letters responding to each approved exclusion request in the Section 301 exclusion docket at Regulations.gov. The approval letters largely reiterate the information contained in the Federal Register notice (*i.e.*, that USTR has determined to grant an exclusion, that the scope of the exclusion is governed by the descriptions in the Federal Register notice, and that the exclusion applies retroactively to July 6, 2018 and for one year after publication of the exclusion determination). However, the letters generally do not state USTR's rationale for granting the exclusion. A sample approval letter is attached for reference.

Status of Other Section 301 Exclusion Requests

To date, USTR has received more than 12,400 requests for exclusions from the Section 301 tariffs on "List 1" and "List 2" goods. More than 10,000 of these requests remain pending, as shown below. USTR has not yet established an exclusion process for products on "List 3", which comprise the vast majority of goods subject to the Section 301 tariffs.

Status of Section 301 Product Exclusion Requests			
Product List	**Granted**	**Denied**	**Pending**
List 1 ($34 billion)	984	1,258	8,556
List 2 ($16 billion)	0	0	1,642
List 3 ($200 billion)	N/A (no exclusion process)		

Outlook

The exclusions granted by USTR will provide relief for some US businesses and consumers, but they cover a very small portion of the imports subject to the Section 301 tariffs (*i.e.*, 7 full and 24 partial HTSUS 10-digit subheadings, out of more than 6,800 HTSUS 8-digit subheadings covered by the Section 301 tariffs). The overall economic impact of the exclusions, and their effects on the ongoing US-China trade dispute, are therefore likely to be limited.

USTR has stated that it will continue to issue decisions on Section 301 exclusion requests "on a periodic basis", but has provided no further details on the timing of future determinations. USTR also has not indicated whether it will establish an exclusion process for products on "List 3", though US business groups and Members of Congress of both parties have repeatedly urged it to do so. Moreover, USTR's recent exclusion determinations shed little light on the agency's substantive criteria for granting or denying exlusion requests. USTR's recent actions, therefore, have done little to clarify whether the Section 301 tariffs may be scaled back significantly as a result of the exclusion process.

Update: Impact of US Government Shutdown on US Trade Agency Activities

On December 21, 2018, the US federal government failed to enact appropriations to fund certain federal operations, resulting in a partial government shutdown. In a previous W&C Trade Alert, we summarized the impact of the shutdown on the trade-related functions of the US Department of Commerce and the US International Trade Commission. The operating status of each agency remains unchanged from that described in the alert and in each agency's contingency plan. We summarize here the impact of the shutdown on other trade-related agencies, namely US Customs and Border Protection (CBP) and the Office of the US Trade Representative (USTR).

US Customs and Border Protection

CBP has not issued a formal plan detailing how specific CBP offices and operations will be affected, but the agency has estimated that 54,935 of its 60,109 employees are exempt or excepted from work restrictions during the shutdown and thus will continue to perform certain functions and activities.[6] CBP officials also have conveyed the following information about the shutdown during recent conference calls with industry:

- Ports will be staffed normally, and CBP does not expect interruptions to conveyance, clearance and cargo release.
- CBP's Office of Trade will remain open.
- Customs rulings will not be issued during the shutdown.
- CBP will not process Section 301 product exclusions during the shutdown. CBP on December 31 stated in a CSMS message that "[a]t the conclusion of the government funding hiatus, CBP will issue instructions on entry guidance and implementation" regarding the product exclusions, and that "[a]ny updates to the Automated Customs Environment (ACE) will be implemented 10 business days after the shutdown has concluded."
- CBP is evaluating the impact of the funding lapse on its legal and administrative processes, but has advised industry to comply with any CBP-related deadlines.
- CBP's Quota Branch will remain operational.
- Centers of Excellence and Expertise will be open as normal with drawback and liquidations continuing normally.

CBP also has stated that, due to the lapse in federal funding, the agency's website will not be actively managed and will not be updated until after funding is enacted. CBP has further stated that transactions submitted via its website might not be processed, and that it will not be able to respond to inquiries until after appropriations are enacted.

US Trade Representative

On December 28, 2018, USTR stated on its website that "[u]sing existing funds, USTR personnel continue to conduct all operations, including trade negotiations and enforcement." However, published reports indicate that USTR does not have sufficient funds to continue to conduct all of its operations beyond Monday, January 14. It is expected that USTR will furlough most of its staff, except for senior officials, as of January 14, unless further appropriations are enacted before then. USTR has estimated that 79 of its 265 full-time employees are exempt or excepted from work restrictions during the shutdown and thus would continue to perform certain functions and activities, whereas the remainder would be furloughed.[7] USTR has not specified what offices and activities will be affected, but the expected furlough of approximately 70 percent of the agency's staff will likely compromise its ability to carry out its core functions.

US Trade Representative to Establish Section 301 Exclusion Process for "List 3" Goods if Tariff Rate Increases to 25%

On January 11, 2019, US Trade Representative (USTR) Robert Lighthizer indicated in a letter to Sen. Tim Kaine (D-VA) that USTR will establish an exclusion process for Chinese goods covered by the third tranche of Section 301 tariffs, but only if ongoing trade negotiations between the United States and China fail and the tariff rate on such

[6] The US Department of Homeland Security plan containing CBP's estimate is available at https://www.dhs.gov/sites/default/files/publications/DHS%20Procedure%20Related%20to%20a%20Lapse%20in%20Appropriations%20%2812-20-2018%29%20-%20FINAL%20..._0.pdf

[7] The contingency plan for the Executive Office of the President, which contains USTR's estimate, is available at https://www.whitehouse.gov/wp-content/uploads/2018/12/Memo-to-OMB-EOP-Shutdown-Plan-Lapse-of-Appropriations.pdf

goods is therefore raised to 25 percent (from the current 10 percent). USTR previously had not indicated whether and under what conditions it would establish an exclusion process for goods on the Section 301 "List 3", which covers approximately $200 billion in annual imports. Exclusion processes already exist for goods on the Section 301 Lists 1 and 2 (valued at $34 and $16 billion, respectively).

USTR in December postponed the scheduled tariff increase on List 3 goods from January 1 to March 2, 2019 to allow the two countries to negotiate "structural changes" to China's trade and intellectual property rights practices over a 90-day period. USTR Lighthizer's new letter references the March 2 deadline for the negotiations and states that "[i]f the duty rate on the $200 billion tariff action is raised to 25 percent, USTR will initiate an appropriate exclusion process." It therefore appears that USTR will not establish an exclusion process for List 3 before March 2, 2019, or if the tariff rate on List 3 goods remains at 10 percent as a result of the bilateral negotiations.

There have been signs of incremental progress in the bilateral negotiations in recent weeks, but their outcome remains far from certain, particularly given the lack of clarity regarding the United States' objectives. China has announced minor "good faith" concessions to the United States on market access for automotive goods, imports of US soybeans and corn, intellectual property rights enforcement, and the "Made in China 2025" industrial policy, though many details regarding these actions remain unclear. In addition, China's National People's Congress on December 26, 2018 released a draft Foreign Investment Law that purports to facilitate various structural reforms sought by the United States, including a prohibition on forced technology transfers, protection of the intellectual property rights of foreign investors, and national treatment of foreign investors. However, observers have noted that the draft law consists largely of broad, aspirational policy statements, and that China's plans for implementing and enforcing the proposed law remain unclear.

The United States has not reacted publicly to the concessions offered by China. Following the visit of a US delegation to Beijing from January 7-9, led by Deputy USTR Jeffrey Gerrish, USTR issued only a brief statement noting that the two sides discussed China's commitments to purchase US goods, ways to achieve "fairness, reciprocity, and balance in trade relations", and the need for any agreement to provide for "complete implementation subject to ongoing verification and effective enforcement." US officials also conveyed "President Trump's commitment to addressing our persistent trade deficit and to resolving structural issues[.]"

Some observers speculate that the Trump administration, motivated by recent declines in the US financial markets, has recently become more amenable to an agreement that would avert further escalation of the US-China trade dispute. China's confirmation that its Vice Premier, Liu He, will lead a delegation to Washington from January 30-31 for further discussions also has been viewed as a positive signal. However, the Trump administration has not elaborated on the outcomes it considers necessary for the negotiation to be successful, beyond USTR Lighthizer's prior statement that the United States seeks "structural changes" (or "an agreement to have structural changes") to the Chinese industrial policies covered by the Section 301 investigation, as well as expanded market access for US goods. Moreover, while President Trump has expressed vague optimism regarding the bilateral talks, his deputies continue to doubt China's willingness to adhere to its promises and enact fundamental policy reforms in response to pressure from the United States. It therefore remains unclear whether the negotiations will succeed in delaying or averting altogether a further increase in US tariffs on "List 3" goods, and China's likely retaliation thereto.

President Trump Signs Executive Order on "Strengthening Buy-American Preferences for Infrastructure Projects"

On January 31, 2019, President Trump signed an Executive Order, entitled "Strengthening Buy-American Preferences for Infrastructure Projects", that aims to promote the use of domestic content in infrastructure projects that benefit from federal government financial assistance.[8] It follows an April 2017 Executive Order that directed the

[8] The text of the Executive Order is available **here**.

Secretary of Commerce to submit a report to the President containing, among other things: (1) policy proposals from all federal agency heads "to ensure that, to the extent permitted by law, Federal financial assistance awards and Federal procurements maximize the use of materials produced in the United States"; and (2) recommendations to strengthen implementation of Buy American laws. The Secretary's report was due to the President by November 24, 2017 and was never made public, but it is possible that the new order is based, in part, on the Secretary's recommendations.

The order contains two main requirements: (1) federal departments and agencies must, within 90 days, begin to "encourage" certain recipients of Federal financial assistance awards to utilize domestic content in certain infrastructure projects; and (2) federal agencies must, within 120 days, submit a report to the President analyzing whether existing programs within their jurisdictions would support the imposition of a *requirement* to utilize domestic content in certain infrastructure projects. We provide an overview of the order below.

Scope and Exceptions

The order's requirements apply to any executive department or agency administering a "covered program", defined as "any program for which a focus of the statutory authorities under which it is administered is the award of Federal financial assistance for the alteration, construction, conversion, demolition, extension, improvement, maintenance, reconstruction, rehabilitation, or repair of an infrastructure project in the United States[.]"[9] However, it specifies that a "covered program" shall not include: (1) programs for which providing a domestic preference is inconsistent with law; or (2) programs providing Federal financial assistance that are subject to "comparable domestic preferences". In addition, the order provides for certain general exceptions and requirements, namely: (1) that nothing in the order "shall be construed to impair or otherwise affect…existing rights or obligations under international agreements"; and (2) that the order "shall be implemented consistent with applicable law[.]" The precise implications of these

[9] The order provides that the term "Federal financial assistance" shall have the meaning and shall be interpreted consistent with the definition provided by the Office of Management and Budget's Uniform Administrative Requirements, Cost Principles, and Audit Requirements for Federal Awards, found at section 200.40 of title 2, Code of Federal Regulations. 2 C.F.R. § 200.40 defines Federal financial assistance as follows:

§200.40 Federal financial assistance.

(a) *Federal financial assistance* means assistance that non-Federal entities receive or administer in the form of:

(1) Grants;

(2) Cooperative agreements;

(3) Non-cash contributions or donations of property (including donated surplus property);

(4) Direct appropriations;

(5) Food commodities; and

(6) Other financial assistance (except assistance listed in paragraph (b) of this section).

(b) For §200.202 Requirement to provide public notice of Federal financial assistance programs and Subpart F—Audit Requirements of this part, *Federal financial assistance* also includes assistance that non-Federal entities receive or administer in the form of:

(1) Loans;

(2) Loan Guarantees;

(3) Interest subsidies; and

(4) Insurance.

(c) *Federal financial assistance* does not include amounts received as reimbursement for services rendered to individuals as described in §200.502 Basis for determining Federal awards *expended,* paragraph (h) and (i) of this part.

exceptions are not clear, but they may be intended to exclude from the scope of the order procurements that are covered by the following laws and regulations:

- Buy American Act requirements (41 U.S.C. § 8302; 48 C.F.R. §§ 25.201 & 25.202) or Buy America Act requirements (49 U.S.C. § 5323(j); 49 C.F.R. § 661.5(a)), because these may constitute already-in-place "comparable domestic preferences"; and
- The "waiver" provisions from the Trade Agreements Act (19 U.S.C. § 2511; 48 C.F.R. §§ 25.400 through 25.408), because these arise from "existing rights or obligations under international agreements" and "applicable law".

Application of Buy-American Principles to "Covered Programs"

By May 1, 2019, the head of each executive department and agency administering a covered program must, "as appropriate and consistent with law, encourage recipients of new Federal financial assistance awards pursuant to a covered program to use, to the greatest extent practicable, iron and aluminum as well as steel, cement, and other manufactured products produced in the United States in every contract, subcontract, purchase order, or sub-award that is chargeable against such Federal financial assistance award." The order does not specify the means by which an agency or department may "encourage" the recipient to utilize materials produced in the United States. The head of each agency administering a covered program must submit a report to the President by May 31, 2019 that includes, among other things, "a detailed explanation of the strategy, plan, or program developed" to implement this requirement.

The order establishes a specific rule for determining whether iron and steel products qualify as "produced in the United States", *i.e.*, "all manufacturing processes, from the initial melting stage through the application of coatings" must have occurred in the United States. No such rule is provided for aluminum, cement, or other "manufactured products" (which are defined as "materials composed in whole or in part of non-ferrous metals such as aluminum; plastics and polymer-based products such as polyvinyl chloride pipe; aggregates such as concrete; glass, including optical fiber; and lumber.")

Identification of Opportunities to Maximize the Use of Buy American Principles

By May 31, 2019, the head of each agency administering a covered program must identify in a report to the President "any tools, techniques, terms, or conditions that have been used or could be used, consistent with law…to maximize the use of iron and aluminum as well as steel, cement, and other manufactured products produced in the United States in contracts, sub-contracts, purchase orders, or sub-awards that are chargeable against Federal financial assistance awards for infrastructure projects." In preparing the report, the agency head must analyze whether covered programs within their jurisdiction "would support, through terms and conditions on new Federal financial assistance awards under such covered programs, the imposition of a *requirement* to use iron and aluminum as well as steel, cement, and other manufactured products produced in the United States in contracts, sub-contracts, purchase orders, or sub-awards that are chargeable against such Federal financial assistance awards" (emphasis added). The order does not direct agencies to impose any such requirements, nor does it state that the report will be made public.

Outlook

Though the order's general objective is clear, the extent to which it will impact procurement activities is uncertain at this stage. First, and as noted above, the order does not specify how its requirements will interact with existing requirements under the Buy American Act and the Buy America Act, or with US obligations under the WTO Government Procurement Agreement and various FTAs as they have been incorporated into US law. It also provides no guidance as to the specific measures that agencies and departments might take in order to "encourage"

the use of domestic content in the covered programs. Moreover, the order directs agencies to assess their ability to require the use of domestic content in covered programs, and to report to the President on their findings, but it is unclear whether this will lead to further executive actions (*e.g.*, directing agencies to take additional steps with respect to domestic preferences for infrastructure projects). It will be important, therefore, to monitor further announcements from the Trump administration regarding implementation of the order's requirements and "Buy American" preferences generally.

Free Trade Agreements

US Trade Representative Publishes Summary of Negotiating Objectives for Proposed US-Japan Trade Agreement

On December 21, 2018, the Office of the US Trade Representative (USTR) published a summary of the Trump administration's negotiating objectives for the proposed US-Japan Trade Agreement (USJTA).[10] USTR published the summary in accordance with Section 105 of the Bipartisan Congressional Trade Priorities and Accountability Act of 2015 ("TPA"), which requires the administration to publish a "detailed and comprehensive summary" of its specific negotiating objectives at least 30 days before initiating formal negotiations with a foreign country. USTR's release of the objectives follows a public comment and hearing process during which USTR received input from US companies, industry groups, non-governmental organizations, and other stakeholders regarding their interests and priorities for the negotiation.

Overview of the objectives

The Trump administration's objectives for the USJTA closely resemble the objectives it published in advance of the renegotiation of the North American Free Trade Agreement (NAFTA) and the outcomes contained in the resulting US-Mexico Canada Agreement (USMCA). Despite prior speculation that the United States might seek to negotiate a narrow agreement with Japan focused primarily on trade in goods, the USJTA objectives cover the full range of issues addressed in the USMCA and other recent US trade agreements, including trade in goods and services, investment, digital trade, intellectual property, regulatory practices, sanitary and phytosanitary measures, technical barriers to trade, state-owned enterprises, labor and environment, currency, and government procurement, among others. Most of the US objectives for the USJTA are generally aimed at trade liberalization, but some appear to reflect the Trump administration's protectionist goals or replicate controversial elements of the USMCA. We summarize the objectives below.

<u>Objectives generally aimed at trade liberalization</u>

USTR's summary initially discusses the United States' "chronic" trade imbalance with Japan, as well as the administration's desire to "improve the U.S. trade balance and reduce the trade deficit with Japan," but most of the specific negotiating objectives that follow are aimed at reducing barriers to trade between the two countries. Indeed, most of the negotiating objectives reflect the US government's longstanding pro-trade consensus:

[10] Click **here** to view USTR's summary of its negotiating objectives for the USJTA.

- The specific negotiating objectives regarding trade in goods are, among other things, to secure additional market access for US industrial and agricultural goods in Japan by reducing or eliminating tariffs, and to pursue further liberalization through regulatory cooperation and the elimination of non-tariff barriers and subsidies.
- In most of the remaining areas that USTR aims to cover in the negotiations – including sanitary and phytosanitary measures, technical barriers to trade, customs and trade facilitation, regulatory practices, services, digital trade, data flows, state-owned enterprises, intellectual property, labor, and the environment – the objectives broadly mirror the NAFTA renegotiation objectives (many of which were based on the Trans-Pacific Partnership (TPP)) and generally appear consistent with the negotiating objectives set forth in TPA.
- Some of the objectives appear to reference longstanding US concerns about specific Japanese measures and policies. For example, a new objective concerning trade in agricultural goods seeks to eliminate "unfair or trade-distorting activities of state trading enterprises or state-owned enterprises (SOEs) and other administrative mechanisms". Regarding pharmaceuticals and medical devices, the United States will seek to ensure that government regulatory reimbursement regimes are transparent, provide procedural fairness, are nondiscriminatory, and provide full market access for US products "particularly under relevant Japanese measures."

The objectives discussed above are likely to receive support from pro-trade Members of Congress and the US business community, who have supported similar objectives in the context of the TPP and the USMCA.

Objectives not clearly aimed at trade liberalization

By contrast, some of USTR's objectives for the USJTA appear to reflect the Trump administration's protectionist goals or are so ambiguous as to allow for the pursuit of such goals during the negotiations themselves. Some of these objectives indicate that USTR will seek to replicate controversial elements of the USMCA in the proposed trade agreement with Japan.

- **Automotive goods.** In addition to seeking tariff reductions, the United States will seek to "[s]ecure additional provisions as necessary to obtain fair and more equitable trade in the motor vehicle sector, including provisions designed to address non-tariff barriers in Japan as well as to increase production and jobs in the U.S." While ambiguous, this objective could signify that the United States will seek to maintain existing automotive tariffs (*e.g.*, the 25 percent US tariff on pick-up trucks) or will seek other limitations on Japanese automotive exports to the United States, particularly given the Trump administration's stated interest in automotive import restrictions.
- **Rules of origin.** The objectives regarding rules of origin mirror those that USTR published in advance of the NAFTA renegotiation (*i.e.*, the United States will seek to "[d]evelop rules of origin that ensure the Agreement's benefits go to products genuinely made in the United States and Japan" and "[e]nsure that the rules of origin incentivize production in the Parties, specifically in the United States." Though these objectives are vague, they suggest that the United States might again seek restrictive rules of origin for certain products, namely automotive goods, as it did successfully during the renegotiation of NAFTA.
- **Investment.** Whereas the US objectives for the NAFTA renegotiation envisioned an investor-state dispute settlement (ISDS) mechanism, the USJTA objectives make no reference to ISDS (the objectives are to "[s]ecure for U.S. investors in Japan important rights consistent with U.S. legal principles and practice, while ensuring that Japanese investors in the United States are not accorded greater substantive rights than domestic investors", and to "[e]stablish rules that reduce or eliminate barriers to U.S. investment in all sectors in Japan.") This omission and the Trump administration's stated objections to ISDS suggest that the United States may seek to avoid including ISDS in the USJTA or significantly limit its scope, as it did in the USMCA.

- **Sunset provision.** The United States will seek to "[p]rovide a mechanism for ensuring that the Parties assess the benefits of the Agreement on a periodic basis." The US objectives for the NAFTA renegotiation contained identical language. This suggests that the United States will seek a "sunset" provision similar to that included in the USMCA, which provides for automatic termination of the Agreement 16 years after its entry into force unless each Party confirms that it wishes to continue the agreement for another 16-year term.

- **Currency.** The objective on currency practices is to "[e]nsure that Japan avoids manipulating exchange rates in order to prevent effective balance of payments adjustment or to gain an unfair competitive advantage." The US objectives for the NAFTA renegotiation contained identical language. This objective suggests that the United States will seek currency provisions similar to those included in the USMCA, which imposed binding obligations regarding reporting and transparency but not regarding a Party's macroeconomic and exchange rate practices.

- **FTAs with non-market countries.** The United States will seek to "[p]rovide a mechanism to ensure transparency and take appropriate action if Japan negotiates a free trade agreement with a non-market country." This objective indicates that the United States will seek a provision similar to Article 32.10 of the USMCA, which requires, among other things, that a Party seeking to negotiate a trade agreement with a non-market country (i) give the other Parties three months' notice of the talks, with as much information as possible on the objectives; and (ii) provide the text of the agreement for Parties' review at least 30 days prior to signing.

- **Dispute Settlement.** The objectives on dispute settlement largely mirror the NAFTA renegotiation objectives. Among other things, the United States will seek to "[e]stablish a dispute settlement mechanism that is effective and timely", and to "[p]rovide mechanisms for ensuring that the parties retain control of disputes and can address situations when a panel has clearly erred in its assessment of the facts or the obligations that apply." The inclusion of the latter objective has caused some observers to speculate that the United States will seek to make dispute settlement rulings non-binding or otherwise limit the effectiveness of the mechanism, as it initially sought to do during the NAFTA renegotiation, on the view that resolution of trade disputes through alternative means such as negotiation will produce more favorable outcomes for the United States.

Outlook

USTR's publication of the USJTA objectives is noteworthy because it: (1) satisfies one of the pre-negotiation requirements set forth in TPA, and thus permits USTR to begin formal negotiations with Japan as of January 20, 2019; (2) indicates that the United States intends to negotiate a comprehensive trade agreement with Japan (the approach favored by the US business community), rather than a narrow agreement covering only trade in goods; and (3) indicates that the United States intends to use the USMCA as a template for much of the proposed agreement with Japan (and likely other US FTAs in the future).

On the other hand, many of the US objectives for the USJTA are ambiguous and provide little insight into USTR's specific goals, including on key issues such as automotive trade and agriculture where the United States is expected to table aggressive proposals (*e.g.*, for "TPP-plus" market access for US agricultural goods). Given these and other potential points of controversy, as well the wide range of issues to be addressed in the negotiations, concluding the talks quickly – a Trump administration priority due to the implementation of competing trade agreements (*i.e.,* the Comprehensive and Progressive Agreement for Trans-Pacific Partnership (CPTPP) in December 2018 and EU-Japan Economic Partnership Agreement (EPA) in February 2019) – will be difficult.

Moreover, it remains unclear how the United States intends to structure the negotiations with Japan. USTR's summary states that "we may seek to pursue negotiations with Japan in stages, as appropriate," suggesting that it might seek to conclude multiple agreements with Japan in succession (*e.g.*, an "early harvest" agreement on trade in goods followed by separate agreements on the remaining issues). This approach would be a departure from recent US practice, as most US trade agreements have been negotiated as "single undertakings". A staged approach also

would likely encounter opposition from certain Members of Congress and US business groups who fear that their sectors might be abandoned once an early harvest is achieved. The summary does not explain how USTR would seek to structure a staged negotiation with Japan, and states that USTR would only pursue this approach "based on consultations with Congress." TPA does not expressly authorize or establish procedures for the negotiation of an agreement in stages. It could be argued that the law permits the completion of an early harvest agreement covering tariffs only, followed by an agreement covering non-tariff barriers with the same country or countries, but the law is not clear on this point. In addition, it is unclear whether an early harvest agreement covering tariffs only would qualify as a WTO-consistent "interim agreement" under GATT Article XXIV, which permits "the formation of a customs union or of a free-trade area or the adoption of an interim agreement necessary for the formation of a customs union or of a free-trade area", provided certain conditions are met. While such concerns might not be an obstacle for the current US administration, they could present an impediment for the Japanese government.

The Trump administration also has not indicated when it intends to begin formal negotiations with Japan, but observers speculate that the aforementioned competing FTAs will motivate the administration to move quickly – especially given that the United States abandoned the CPTPP in 2017. US business groups, particularly in the agricultural sector, have advocated for the expedited completion of the bilateral negotiation with Japan, noting that they face an imminent loss of market share in Japan to their competitors – including those in the EU, Canada, Australia, and Mexico – who will soon enjoy significant advantages in the Japanese market under the Japan-EU EPA and the CPTPP. Some agricultural industry groups present at USTR's recent hearing on the US-Japan negotiation indicated that failure to conclude the negotiation quickly could have lasting negative effects for US agriculture. It is therefore expected that the Trump administration will seek to initiate the negotiations quickly, and to pursue an early harvest agreement, if possible.

Overview of Chapter 19 (Digital Trade) of the US-Mexico-Canada Agreement

The US-Mexico-Canada Agreement's (USMCA) Chapter 19 on Digital Trade represents a wholesale overhaul of the treatment of e-commerce and digital trade under the North American Free Trade Agreement (NAFTA), which only addressed these issues tangentially in other chapters. Chapter 19 draws heavily from the Trans-Pacific Partnership (TPP) but also goes beyond those disciplines in several important respects, as indicated by a comparison of the chapters' titles - "Digital Trade" (USMCA) versus "E-commerce" (TPP).

Because NAFTA was negotiated long before the proliferation of e-commerce and digital trade, the only agreement disciplines covering these issues came from general provisions on trade in goods and services. As a result, NAFTA did not address many important digital trade issues that have only emerged in the last decade or so, as technologies like social media and cloud computing (and government responses thereto) proliferated. The USMCA Chapter – by incorporating not only TPP disciplines, but also additional input from US stakeholders – is meant to bring the trilateral trade relationship into the 21st century and more in line with international best practices and current domestic law. This report summarizes the Chapter's key provisions.

Article 19.1: Definitions

The Chapter's definitions essentially incorporate the TPP's definitions of computing facility, covered person (including investments, investors, and service suppliers, but excluding financial services), digital product, electronic authentication, personal information, trade administration document, and unsolicited commercial electronic communication ("spam"). The Chapter adds definitions for algorithm, electronic signature, government information, information content provider, and interactive computer service (e.g., social media). As noted below, some of these terms/issues were not specifically covered in the TPP.

Article 19.2: Scope

The Chapter's scope is the essentially the same as that for TPP but changes "electronic commerce" to "digital trade." Like the TPP, the Chapter expressly excludes government procurement, confidential government data and measures excepted from other USMCA disciplines on trade in services and investment.

Article 19.3: Customs Duties

This Article, like its TPP equivalent, prohibits "customs duties, fees, or other charges on or in connection with the importation or exportation of digital products transmitted electronically, between a person of one Party and a person of another Party." It also expressly clarifies that the aforementioned requirement does not prohibit internal taxes or fees that are imposed in a non-discriminatory manner and in an otherwise consistent manner with the Agreement.

Article 19.4: Non-Discriminatory Treatment of Digital Products

Like the TPP, this Article (i) prohibits a Party from according "less favourable treatment" to a digital product originating in, or produced by a person of, another Party than it accords to other "like" digital products; and (ii) does not apply to subsidies or grants provided by a Party.

Article 19.5: Domestic Electronic Transactions Framework

This article is essentially the same as its TPP equivalent, requiring each Party to maintain a "legal framework governing electronic transactions consistent with the principles of the *UNCITRAL Model Law on Electronic Commerce 1996*" but not prescribing that framework, other than to note that the Parties will "endeavor" to avoid unnecessary regulatory burdens on e-commerce and to facilitate public input on the development of the aforementioned "framework."

Article 19.6: Electronic Authentication and Electronic Signatures

Like the TPP, this provision requires Parties to recognize the validity of electronic signatures and prohibits them from restricting certain authentication practices related to electronic signatures where parties to an electronic transaction have agreed to those practices.

Article 19.7: Online Consumer Protection

This Article mirrors the TPP in requiring Parties to adopt or maintain consumer protection laws against fraudulent or deceptive online activities, and including hortatory provisions on consumer protection and international cooperation. It does not, however, prescribe the content of these laws.

Article 19.8: Personal Information Protection

Like the TPP, the USCMA requires each Party to adopt or maintain a "legal framework" protecting the personal information of users of digital trade, but does not prescribe these laws' content (though it does include certain publication requirements). The USMCA Chapter also adds certain "key principles" that Parties should consider when developing these laws, and encourages the Parties to promote compatibility and information exchange.

Article 19.11[11]: Cross-Border Transfer of Information by Electronic Means

Similar to TPP Art. 14.11, this Article (1) bars the Parties from prohibiting or restricting the cross-border transfer of information by electronic means where this activity is for business purposes; but (2) permits such prohibitions or restrictions if they achieve a "legitimate public policy objective" and are non-discriminatory and not unnecessarily burdensome.

[11] Articles 19.9 and 19.10 contain hortatory provisions on "paperless trading" and "Principles on Access to and Use of the Internet for Digital Trade" that were also present in the TPP. The USMCA also removes TPP Article 14.12 on "internet connection charge sharing."

Article 19.12: Location of Computing Facilities (Data Localization)

This Article strengthens the TPP's prohibition on "data localization" requirements, creating an unqualified ban on "require[ing] a covered person to use or locate computing facilities in that Party's territory as a condition for conducting business in that territory." This same prohibition is also applied to financial services in Article 17.20 of the Financial Services Chapter – another important change from the TPP.

Article 19.13: Unsolicited Commercial Electronic Communications ("Spam")

This Article incorporates the TPP's requirement that Parties maintain "anti-spam" laws that (1) limit unsolicited commercial electronic communications; (2) require suppliers of these communications to allow recipients to block them; (3) require recipients to consent to such communications; and (4) provide legal recourse against suppliers of such communications.

Article 19.16[12]: Source Code

This provision expands upon the TPP's prohibition on conditioning access to a Party's market on the disclosure of source code of software owned by a person of another Party, by extending this rule to "algorithms expressed in that source code." However, the USMCA also expands the TPP's exception to this rule, permitting such requirements were disclosure was required by a regulatory body for a "specific investigation, inspection, examination, enforcement action, or judicial proceeding[.]"

Article 19.17: Interactive Computer Services

This Article, not present in the TPP, bars Parties from holding "interactive computer service" providers (e.g., social media) liable for the actions of their users or liable for their "good faith" efforts to police content available through their services. The Article also contains significant exceptions for a Party's enforcement of intellectual property rights or criminal laws.[13]

Other Digital Trade Issues

The USMCA also addresses some digital trade issues in other Chapters. As noted above, the Financial Services chapter prohibits data localization requirements for that sector. Moreover, Chapter 20 (Intellectual Property) expressly applies its enforcement provisions to the "digital environment" (Article 20.J.1.2) while establishing in Articles 20.J.10 and 11 "safe harbors" precluding legal claims against "Internet Service Providers for copyright infringements that they do not control, initiate or direct". (Annex J to that chapter also contains exceptions to the general safe harbor rules.) Finally, other general USMCA provisions may apply to digital trade issues. Articles 11.4 and 11.6 of the Chapter on Technical Barriers to Trade, for example, could require changes to a current Mexican requirement that testing and certification of hardware products be administered by local labs.

Conclusion

The USMCA's Digital Trade Chapter and related USMCA provisions covering digital trade are widely, though not universally, considered to be a marginal improvement over the TPP Chapter covering similar issues. Technology groups and outside experts note, in particular, that the USMCA digital trade-specific provisions, if implemented, would likely not require significant changes to current law and practice in the three USCMA countries but instead would establish restrictions on future actions that change current practice (*e.g.*, preventing a country from passing a broad data localization law). Although some non-governmental groups, particularly in Canada, have expressed concern about the trade-liberalizing aspects of the USMCA digital trade chapter, these criticisms will likely not be a focus of any political opposition to implementing the deal in 2019.

[12] Articles 19.14 and 19.15 contain aspirational provisions on cooperation and cybersecurity, respectively. TPP contained similar provisions.

[13] Article 19.18 ("Open Government Data") contains new, but aspirational, provisions encouraging Parties to publish government data in machine readable and "open" format.