July 23, 2018

ITI Comments Submission for USTR-2018-0018-0001 Response to Annex C ("List 2") Tariffs on Chinese Goods Imports

Overview

The Information Technology Industry Council (ITI) welcomes the opportunity to comment on the proposed tariffs on Chinese products issued in USTR-2018-0018-0001.

ITI appreciates the administration's focus on China's unfair trade practices; however, the continued escalation of tariffs, including the recently proposed ten percent tariffs on $200 billion worth of Chinese goods, accelerates harm to all American consumers, workers, and businesses - both large and small - with no end in sight. In this submission, ITI would like to focus on illustrating the deleterious impact of USTR's proposed List 2 tariffs on American consumers, businesses, and supply chains. While ITI highlights several product lines in our comments, we do not support the imposition of tariffs on any of the proposed products, particularly as a method of resolving the issues identified through the Section 301 investigation.

Introduction

ITI represents over 67 of the world's leading information and communications technology (ICT) companies. We are the global voice of the tech sector and the premier advocate and thought leader in the United States and around the world for the ICT industry. ITI's membership comprises top innovation companies from all corners of the technology sector, including hardware, software, digital services, semiconductor, network equipment, and internet, as well as "technology-enabled" companies that rely on ICT to evolve their businesses. Trade is critical to ITI members, and China is always a subject of much concern and interest.

Since the launch of USTR's August 2017 investigation into China's unfair trade policies and practices, ITI has supported the administration's efforts to address the market access barriers and technology transfer pressures that our companies face in China. USTR's Section 301 report provides a comprehensive illustration of the myriad of policies, laws, regulations, and strategies that impede fair competition in China and enable coercive practices towards non-Chinese companies. We fully acknowledge that the U.S.-China bilateral trade relationship needs to be rebalanced; however, we continue to believe that tariffs are not a solution for the problems outlined in the Section 301 report. Tariffs are effectively a tax on consumers and businesses, creating a chain of negative consequences that ultimately have an extremely adverse impact on American consumers, workers, businesses, and jobs.

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Tariffs Are the Wrong Approach

Tariffs Create Market and Job Uncertainty

Tariffs are counterproductive. This has been proven time and again, across numerous administrations. The 2002 steel tariffs enacted by President Bush led to the estimated loss of 200,000 American jobs[1], while the 2009 tire tariffs under President Obama cost American consumers over $1.1 billion.[2] The imposition of 25 percent tariffs on the 818 products in List 1 of the Section 301 trade action will likely disrupt the otherwise steady growth of U.S. jobs and the U.S. economy. While their full impact has yet to be realized, the July 6 imposition of tariffs alone has created significant market uncertainty and is unnecessarily jeopardizing steady and strong growth of U.S. jobs that we have observed so far under this administration.

Tariffs Inflate Consumer Price Tags

List 2 contains many consumer products, despite the administration's stated intent to avoid doing so. "Miscellaneous electric machines and apparatuses" (HS 8543.70.99) is a catch-all line for a variety of electronic devices, many of which are final consumer products, including remote controls, hair removal devices, and travel humidifiers. Some other key examples with direct consumer impact are thermometers (HS 9025.19.80), temperature and motion sensors (HS 8543.70.45), and smart light switches (HS 8536.50.70).

Tariffs on thermometers would negatively affect nearly every American household, from outdoor and window thermometers to kitchen tools and appliances, and even the digital or handheld thermometers we use when we or our children fall ill. The tariff line also covers temperature sensors, a key part of household thermostat systems. Americans purchase 17 million thermostats each year to help manage energy costs, and automatic thermostats are already subject to a 25 percent tariff as of July 6. Similarly, smart light switches help American households and businesses save on electricity and energy costs by turning lights on and off only when they are needed. Americans would suffer not only from higher prices on thermostat systems, but also from higher energy bills because energy-efficient smart thermostat systems and smart light switches would be less affordable.

Increased tariffs from List 2 would also raise costs on sensors that are used in the security systems that ensure the safety of millions of Americans. Motion sensors are a key input of home security systems, a consumer product that reached $4.69 billion in U.S. sales in 2017. Tariffs would not only hurt consumers, but also the retailers who sell these consumer goods, especially small businesses that sell and install these systems. List 2 would exacerbate the

[1] http://www.tradepartnership.com/pdf_files/2002jobstudy.pdf

[2] http://www.aei.org/publication/2009-tire-tariffs-cost-us-consumers-926k-per-job-saved-and-led-to-the-loss-of-3-retail-jobs-per-factory-job-saved/

added costs from List 1 on these systems, as List 1 has already placed 25 percent tariffs on transducers and other sensors that allow both HVAC and security systems to operate.

Significant Adverse Impacts on U.S. Industry and Growth

List 2 includes products necessary for innovation in manufacturing. For example, tools for 3D printing (HS 3916.90.30) are included. 3D printing has the potential to revolutionize production in the U.S. – particularly for small, innovative American businesses. Increasing tariffs on key elements of 3D printing equipment would raise costs associated with utilizing this technology, which in turn, would limit the potential competitive benefits for American small business. Along with implicating future technologies, many of the products included on List 2 support a large swath of U.S. economic activity, as they are essential inputs in manufacturing a wide range of products. Applying additional tariffs on these items would effectively hamper growth by dramatically increasing costs throughout the supply chain, as component prices rise and affect costs for distributors and original equipment manufacturers (OEMs). The below lines have significant broad and deep impacts across the U.S. ICT sector as well as the U.S. economy:

- Semiconductor manufacturing equipment (HS 8486.10.00, 8486.20.00, 8486.30.00, 8486.40.00, and 8486.90.00)
- Non-light emitting diodes (HS 8541.10.00 and 8541.40.60)
- Integrated circuits (HS 8542.31.00, 8542.32.00, 8542.33.00, 8542.39.00, and 8542.90.00)

Tariffs on integrated circuits and other semiconductor equipment would be especially counterproductive. Semiconductors are America's fourth largest export, with a worldwide trade surplus of over $6 billion in 2017.[3] U.S. semiconductor companies also lead the industry globally. Tariffs on such goods would not help rebalance trade between the U.S. and China; instead, as explained in detail below, they would have a deleterious effect on the U.S. semiconductor industry and the economy at large. List 1 implementation has already raised costs on semiconductor manufacturing by placing tariffs on lithographic equipment, a key part of imprinting in the production process.

Tariffs on semiconductors would be particularly pernicious in light of the structure of value creation in the semiconductor business. The majority of a semiconductor's value is created in the design and front-end manufacturing stage, or fabrication, including the majority of wafer manufacturing in the United States.[4] This industry employs Americans across nineteen states, from Arizona to Idaho and Texas, through the design and manufacture of products.[5]

[3] Official U.S. government trade data, U.S. Department of Commerce, obtained from the U.S. International Trade Commission, Dataweb: https://dataweb.usitc.gov/

[4] Wafers are typically a thin piece of crystalline silicon that has been sliced into a disc, serving as the foundation for fabricating electronic integrated circuits to be implanted and etched for conductivity.

[5] https://www.semiconductors.org/clientuploads/Industry%20Statistics/SIA_One_Pager_May_2018.pdf

The assembly, test, and packaging (ATP) stage of semiconductor manufacturing is the final and lowest cost stage in the manufacturing process, and almost all of this low value-added activity takes place in Asia, including China. American semiconductor companies often design and/or manufacture these components in the U.S., contributing a majority of the value to these products. These are then exported to China primarily for simple, low-cost ATP, where the value added is only about 10 percent of the value of the final product.[6] Finally, the finished chips are reimported into the United States. This means that the pain of a tariff on semiconductors falls not on the small portion of value created in China, but rather on the large portion of value created in the United States.

U.S. companies have built their leadership in the global tech sector in part through innovation in semiconductor design and manufacturing. U.S. companies currently retain half of all global market share for semiconductors, while Chinese companies trail significantly behind.[7] The U.S. semiconductor industry also takes the lion's share of global revenue due to the significant value that U.S. companies have contributed in designing these components. Given these factors, tariffs would only hurt U.S. semiconductor leadership and render U.S. companies less competitive. Moreover, the ICT sector as a whole would suffer because of the widespread use of these components in products exported from the United States.

Tariffs have extensive second and third order effects on the cost of many consumer products, especially for inputs such as sensors and integrated circuits, which are fundamental components of many conveniences of modern American life. From automobiles to phones, industrial machinery to household appliances, and consumer electronics to critical medical devices, all of these products use various types of semiconductors and sensors to function. By applying tariffs to inputs as prolific as semiconductors, everyday items that Americans use would become more expensive. Should these tariffs be implemented, higher prices will force both semiconductor firms and ICT firms more broadly to consider cutting costs through reduction of workers and supply.

Tariffs and the Global Supply Chain

ITI understands that the administration drafted List 2 under the assumption that its products could be sourced from other countries or assembled in the United States. However, companies distribute their operations globally because that is how they can produce goods and deliver services more cost effectively, which trickles down to more affordable consumer prices. Global diversification of the supply chains is also necessary for financial market and operational stability in the event of a geological crisis, such as a natural or man-made disaster. Moreover, the notion that product component supply lines can be shifted overnight ignores the complexity and interconnectedness of the global supply chain, as well as underestimates the

[6] *See e.g.*, https://pdfs.semanticscholar.org/1bd2/fe8bfee360c4dc6f28e92fee0c99ebe23e03.pdf, at pp. 285-86
[7] https://www.trade.gov/topmarkets/pdf/Semiconductors_Executive_Summary.pdf

negative impact on U.S. competitiveness. Below are some of the key issues and reasons to refrain from significantly disrupting the global supply chain.

Companies often spend months negotiating contracts with suppliers, analyzing their components and then deciding how to assemble and test products in the most cost-effective ways, customized for specific regions of the world. Terminating a relationship with a supplier and establishing a contract with another of equal quality (assuming one exists) typically results in significant costs associated with shifting capital and workers. Moreover, disrupting supply lines would in turn decrease U.S. exports of finished products. Likewise, companies may be reticent to make long term shifts in their global supply chains when retaliatory tariffs and unpredictable trading relationships make the future uncertain.

Building new plants or reallocating manufacturing sources is incredibly capital-intensive and would be neither fast nor easy. The resulting lag risks U.S. companies losing opportunities to Chinese competitors, who are making increasingly rapid moves to catch up with U.S. industry leaders. The Chinese, for their part, are financing the development and expansion of their technology sector with hundreds of billions of dollars in subsidies, at the same time that the U.S. government is increasing costs on U.S. companies through the imposition of tariffs.

Given the numerous market access and trade issues international companies face in China, it is tempting to conclude that companies would be better off leaving the Chinese market and limiting imports from China. However, China's size and impact on the global supply chain make that impractical, if not impossible. China provides low value-added elements that require significant labor capacity, and technical expertise in semiconductor ATP, for example, is resident primarily in Asia. Should supply chains shift, they would shift to southeast Asia—Philippines, Vietnam, and Malaysia—where this region has global comparative advantage in technical knowledge of this field. Those supply chains would not move to the United States due to the U.S. lack of labor density, preparedness, and competitiveness in this field. To insist on moving supply chains to the U.S. undervalues the comparative advantages that American workers and businesses have in design and innovation.

Disruptions in the supply chain have consequences in the United States, where American jobs involving fabrication and other inputs are put at risk due to increased costs. In order to maintain American jobs, U.S. companies may decide to pay the increased tariffs, thus continuing to source products from China. Such a business decision would perhaps temporarily protect jobs and company stability yet would have no discernable impact on Chinese competitors and suppliers.

The bottom line is that imposing tariffs as a means to force changes in the supply chains of U.S. companies would have the perverse effect of undermining U.S. global competitiveness, which runs counter to the very purpose of the Section 301 investigation.

The Impact of Retaliation & Government Protection

China is clearly willing and able to respond with retaliatory tariffs, as it has demonstrated through tariffs on 545 U.S. products, targeting agriculture, manufacturing, and automobiles. China prepared its own second schedule of tariffs on 114 additional U.S. items that include chemicals, oil and gas products, and medical devices. While China imports fewer U.S. products and thus has fewer products upon which to apply tariffs, China can – and will – find other regulatory and investment restrictions as a means of retaliating against U.S. action.

Given the Chinese government's broad authorities and willingness to exercise industrial policy, China can also manipulate its currency and introduce other measures to subsidize losses. In effect, Chinese companies would bear the burden of tariffs in the short term and ultimately emerge unscathed in the long term. The same cannot be said of the United States, where the U.S. government does not have the capacity to subsidize industries harmed in a trade war, nor can it effectively assist in renegotiating supplier contracts in the longer term.

De-escalating the Trade Conflict and Increasing Market Access

ITI appreciates the U.S. government's focus on market-access challenges in China, such as USTR's Section 301 investigation and subsequent report regarding China's unfair trade policies and practices. The tools that the U.S. government uses to address these issues, however, must be tailored and strategic to avoid causing unnecessary harm to U.S. consumers, businesses, and the economy.

The trade conflict has undeniably escalated with the imposition of the first Section 301-related tariffs list. We encourage the administration to quickly and seriously pursue negotiations with the Chinese on concrete market access commitments with clear accountability mechanisms and timelines for implementation.

Multilateral Pressure

Multilateral pressure is one of the few tactics that has historically caused China to change course. For example, in 2004, China proposed an international standard for wireless security, "Wireless Authentication and Privacy Infrastructure (WAPI)." China subsequently tried to make this standard mandatory for wireless LAN equipment imported for use in China. The U.S. government partnered with the European Commission and Japanese government to convince the Chinese government to stand down in requiring compliance with WAPI, rightly pointing out that its requirements were discriminatory and served as a market access barrier to foreign ICT imports containing different wireless technology. Members of the International Standards Organization (ISO) refuted the mandatory status of the standard and slow-rolled its approval as an international standard. With the support of business groups and standards groups around

the world, ISO ultimately rejected the proposal for WAPI to become an international standard in 2006.

In 2009, China required that "Green Dam-Youth Escort" screening software be installed on computers to be sold in China, ostensibly for the purpose of restricting pornographic imagery. However, the Chinese-developed software had clear "censor-ware" capabilities with intrusive surveillance potential; cybersecurity experts also noted serious security vulnerability concerns. The international business community, rights groups and NGOs, as well as governments of the United States, Japan, and EU applied intense pressure on numerous fronts, which led to the ultimate suspension of the program.

Compete with China and Invest in the Future

ITI commends the administration's willingness to address current and historically problematic Chinese behavior. However, punishing China cannot be the sole method to do so and we would encourage the U.S. government to consider proactive approaches that take China's next steps into consideration. To maintain competitiveness, the U.S. must invest in its own future. This means investing in research and development, education, science and technology, artificial intelligence (AI), and incentivizing innovation – all of which are key to future economic and societal prosperity.

The United States must be prepared to compete and maintain comparative advantages in out-innovating and outrunning China. Regardless of whether China plays by the rules or not, Chinese inventors, entrepreneurs, and businesses will continue innovating and will close the technological gap between the U.S. and China if the U.S. does not take the necessary proactive steps to stay ahead. While U.S. companies of course want a level playing field, the United States must also step up its game. China is making a concerted and strategic effort to invest and plan for its economic and technological future. The same cannot be said of the United States; in fact, U.S. federal research & development spending has dropped to an all-time low.[8] According to the World Economic Forum, in 2016 China had 4.7 million recent STEM graduates while the United States had 568,000 graduates. In 2017, China accounted for 48 percent of the total global investment in AI startup funding, while the U.S. accounted for 38 percent. In monetary terms, China invested $7.3 billion in AI while the U.S. invested $5.77 billion.[9]

China is on track to outpace the United States in a number of ICT-related areas. For example, according to a 2018 International Data Corporation (IDC) report, the U.S. will spend $22 billion on smart city development this year. China is close behind with projected spending at $21

[8] https://www.aip.org/fyi/2016/us-rd-spending-all-time-high-federal-share-reaches-record-low)
[9] https://www.technologyreview.com/the-download/610271/chinas-ai-startups-scored-more-funding-than-americas-last-year/

billion.[10] As of 2015, there were 1,000 smart city pilot plans in the works worldwide, 500 of which were located in China.[11]

Made in China 2025 receives a great deal of attention for its ambitious outline of the Chinese government's goals for industry; however, this plan should not be read as a mandate. China has developed and implemented numerous roadmaps for development of cutting-edge technologies over the years. These documents, while important windows into the objectives of the Chinese government, are aspirational in nature. The U.S. government should consider formulating its own strategy and objectives for U.S. competitiveness in the long-term, working closely with industry to identify areas of opportunity and research as well as the best ways to craft policies for the future. ITI and its members welcome the administration's continued leadership on science and technology policy, particularly in strategic emerging technologies.

Conclusion

Market access and technology transfer issues in the Chinese market are complex problems that require a strategic, nuanced, and long-term approach. USTR has appropriately identified the problems of greatest concern to the ICT sector and documented them comprehensively. While the administration's threat of tariffs has achieved the first step of getting China's attention, we have yet to see a change in China's behavior or evidence of serious negotiations. Additionally, the administration continues to proclaim that tariffs will protect and benefit Americans. We urge the administration to study and publish statistics regarding the benefits and harms of tariffs implemented thus far prior to considering implementation of future tariffs. Thank you for your consideration of our views.

[10] https://www.techrepublic.com/article/smart-cities-expected-to-invest-80b-in-technologies-in-2018/
[11] https://www2.deloitte.com/content/dam/Deloitte/tr/Documents/public-sector/deloitte-nl-ps-smart-cities-report.pdf