



## ITI Comments Submission Outline for USTR-2018-0005-0001 Tariffs Relating to China Section 301 Investigation

### Introduction

The Information Technology Industry Council (ITI) appreciates the opportunity to comment on the proposed tariffs on Chinese products issued in USTR-2018-0005-0001.

ITI represents over 60 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 member companies are comprised of leading technology and innovation companies from all corners of the ICT sector, including hardware, software, digital services, semiconductor, network equipment, internet companies, and companies using technology to fundamentally evolve their businesses. Trade issues are 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 attention to market access barriers and potential for technology transfer that our companies face in China. USTR's March 22, 2018 report provided 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 do not believe that tariffs are an appropriate solution for this problem. Tariffs are effectively a tax on consumers and businesses, creating a chain of negative consequences that ultimately have a greater impact on the United States than China. In this submission, ITI would like to focus on illustrating the impact of USTR's proposed tariffs on consumers, businesses, and supply chains. While ITI highlights numerous product lines in our comments, these examples should not be interpreted as support for a tariffs list that would exclude these products.

### Why Tariffs Are the Wrong Approach

#### Tariffs Don't Work

Tariffs are counterproductive. This has been proven time and again, across numerous administrations. From the era of Smoot-Hawley, the 2002 steel safeguard tariffs enacted by President Bush, and tariffs on tires imposed by President Obama in 2009 tariffs have resulted in negative consequences for U.S. industry and the economy. The 2002 steel tariffs are estimated to have caused the loss of 200,000 American jobs<sup>1</sup>, while the 2009 tire tariffs cost American consumers over \$1.1 billion.<sup>2</sup>

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<sup>1</sup> [http://www.tradepartnership.com/pdf\\_files/2002jobstudy.pdf](http://www.tradepartnership.com/pdf_files/2002jobstudy.pdf)

<sup>2</sup> <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/>



The broad array of products identified by USTR for increased tariffs will have a similar significant negative impact on the U.S. economy across multiple sectors, increasing prices for consumers and businesses.

## Negative Impact on Everyday Products & U.S. Exports

While we recognize that the administration has sought to minimize consumer impact, the structure of the global supply chain and the numerous product inputs from across the globe factoring into final products make it virtually impossible to exempt consumer goods from the increased costs attributable to tariffs.<sup>3</sup> In particular, we identify the following as consumer products that Americans purchase regularly:

- Televisions (HTS 8528.72.64)
- Water filters (HTS 8421.21.00)
- Air purifiers (HTS 8421.39.80)
- Scanners (HTS 8471.60.80)
- Flash drives (HTS 8471.70.60)
- Video projectors (HTS 8528.71.10)
- Handheld radios (HTS 8525.60.10)
- Portable generators (HTS 8502.11.00)
- Remote controls (HTS 8526.92.50)
- Vacuum sealers (HTS 8422.30.91)
- Ink and toner cartridges (HTS 8443.99.20; 8443.99.25, and 8443.99.50)
- Thermostats (HTS 9032.10.00)
- Household dishwashers (HTS 8422.11.00)
- LEDs for light bulbs (HTS 8541.40.20)
- Compressors for HVAC systems and refrigerators (HTS 841430.40 and 8414.30.80)
- and Mini fridges (HTS 8418.69.01).

Tariffs on these items would harm American working families by taxing everyday products. In addition, many key components of televisions, touch-screen devices, lighting, Internet of Things-ready (IOT) appliances, and cameras are all captured by the proposed list of tariffs and, if imposed, will yield increased prices on the final products. For example, in the case of Thermostats (HTS 9032.10.00), consumers will incur costs beyond the product price. The price increase for smart thermostats may deter consumers from purchasing a key IOT device that would otherwise make their homes more energy efficient and reduce their utilities costs. Many of these devices, including smart home devices, are integral to electric utilities consumer rebate programs, which reward consumers for purchasing energy-efficient products. It would also not be practicable for consumers to avoid the tariffs by purchasing smart thermostats produced outside of China. Most U.S. and third-country manufacturers of smart thermostats assemble their products in China and have no alternative production locations. Thus, consumers will be faced with the choice of paying significantly higher prices for smart thermostats or not purchasing them at all.

By targeting components such as screens and printer cartridges, the proposed tariffs would directly raise prices on everyday products for households and businesses. Television prices would rise by an estimated 4.1 percent, costing American consumers an additional \$711 million.<sup>4</sup> Given that U.S. businesses rely on affordable printing equipment every day, a 4.1 percent price increase for ink and printer cartridges (as well as higher prices for scanners) would have a direct impact on businesses of all sizes.

<sup>3</sup> <https://www.federalregister.gov/documents/2018/04/06/2018-07119/notice-of-determination-and-request-for-public-comment-concerning-proposed-determination-of-action>

<sup>4</sup> [http://tradepartnership.com/wp-content/uploads/2018/05/China301Tariffs TVs Monitors Cartridges Batteries.pdf](http://tradepartnership.com/wp-content/uploads/2018/05/China301Tariffs_TV%20Monitors_Cartridges_Batteries.pdf)



Many of the items proposed by USTR are product *inputs*, which are supplied and assembled across the globe. Often, the final product is finished in the United States and then *exported* all over the world. Placing tariffs on inputs only increases the cost of the finished product, affecting everyday Americans, business sales, and the U.S. economy.

Examples of such inputs include:

- Hard drives (HTS 8471.70.40)
- Parts/accessories of printed circuit assemblies (HTS 8473.30.20)
- Board Mount Pressure Sensors (HTS 9026.20.40, HTS 9027.90.59)
- Heavy Duty Pressure Transducers (HTS 8538.90.60, HTS 8481.10.00)

Solid State Drives (HTS 8471.70.60), Hard Disk Drives (HTS 8471.70.40), and Heavy Duty Pressure Transducers and Sensors (HTS 8538.90.60, HTS 8481.10.00; HTS 9026.20.40, HTS 9027.90.59) demonstrate how products exported from China are often not produced by Chinese manufacturers. Instead, they are more commonly supplied by American, Korean, and Japanese companies with manufacturing facilities in China. While these companies may have manufacturing facilities in other countries, not all facilities are equipped or designed to manufacture every product. Shifting production outside of China may be costly for the suppliers and would take months or even years. Ultimately, these items are also incorporated into servers and storage products that are manufactured in the United States and exported worldwide.

#### Adverse Impacts on Small Businesses, Workers, and Community and Health Services

Tariffs not only affect consumers and multinational companies, but they also affect American workers and small businesses at the local level. Many small businesses rely on Chinese inputs in order to maintain cost-effective operations, and they may not have the capacity or funds to easily obtain an alternate supplier.

These products and inputs are also widely used by providers of community and health services, emergency response, and public goods. For example, Board Mount Pressure Sensors (HTS 9026.20.40, HTS 9027.90.59) are critical to many items in the medical field, including:

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|-----------------------|------------------------|
| • Anesthesia machines | • Oxygen concentrators |
| • Blood gas analysis  | • CPAP / Ventilators   |
| • Gas chromatography  | • Respiratory machines |
| • Dialysis machines   |                        |

These sensors are also vital to industrial uses<sup>5</sup> as well as to the operation and distribution of utilities. A tariff on such sensors would not only have negative implications for the price of final products but also would likely affect the prices of services dependent on these products.

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<sup>5</sup> Flow calibrators, gas chromatography, variable air volume (VAV) used in HVAC, pneumatic controls, and HVAC transmitters are just some of the industrial applications for board mount pressure sensors.



Heavy Duty Pressure Transducers (HTS 8538.90.60, HTS 8481.10.00) are another such example with industrial applications as well as uses in public goods that would be negatively affected by the imposition of tariffs. These transducers are sold to original equipment manufacturers and used in industrial applications to monitor pressure in HVAC systems and evaluate humidity. Heavy duty pressure transducers are also used by the transportation and aerospace industries to measure and control humidity and fluid pressure – key factors of brake systems and engines. While transducers are a product *input*, they have broad applications across sectors and factor into components that nearly all Americans rely on for safety and comfort.

### Tariffs and the Global Supply Chain

ITI understands that there is a view within the administration that products included on the tariffs list can be sourced from other countries, including by manufacturing more products in the United States. This is easier said than done and does not account for the global nature of the supply chain. Even if products can be sourced from another country, the product may not be available at a similar price, with similar terms and contracts, or the supplier may not have the capacity and resources necessary to meet the company's needs. For example, there is no U.S. source for hard drives; while they can be sourced from South Korea, Thailand, and Japan, these suppliers are already operating at capacity and would need to significantly adjust their own operations in order to take on the increased demand.

Additionally, drives and cable assemblies (HTS 8544.70.00) are essential to the massive storage needs of the digital economy. Technologies such as supercomputing and machine learning are storage intensive. Cable assemblies are essential components for the U.S. ICT industry. Many of these products are specialized for use in data centers, which form the backbone of some of the world's most important processes, including those related to the Internet, wireless applications and data storage. While often assembled and sourced from China, these products feature key components made in America. If these products are hit with a 25 percent tariff, this will negatively affect U.S. telecom equipment manufacturers that supply the rapidly expanding data center industry.

Creating new plants to accommodate this need would be neither fast nor easy, and relying on an expansion of these operations or plans to relocate production of these products elsewhere would not be cost-effective. For example, roughly 95 percent of motherboard parts originate in China. While some other countries have the capability to produce enterprise-class motherboard parts, current supply from those countries could not meet U.S. companies' demand.

The notion that product component supply lines can be shifted overnight underestimates the complexity and interconnectedness of the global supply chain. Companies often spend months negotiating contracts with suppliers and determining how to assemble products in the most cost-effective way. Terminating a relationship with a supplier and establishing a contract with another will result in significant resource, labor, and consumer costs. This would in turn decrease U.S. exports of finished products where the supply line for inputs has been disrupted. It may also result in the loss of American jobs, as the need for American workers to assemble and finalize products for export from the U.S. may be significantly altered and require an adjustment of human resources.



Further, forcing U.S. companies to restructure supply lines would undoubtedly cause them to lose to competitors who do not require additional time to identify new suppliers. This lost opportunity would have an impact for years, if not decades to come, depending on the product design cycle. For instance, aerospace components often have up to 30-year lifecycles, meaning if a company loses a bid at the beginning of the design cycle they are effectively locked out of the competition until the next design cycle begins.

Finally, in order to prevent this massive restructuring and potential layoffs, companies may decide to pay the increased tariffs instead, thus continuing to source products from China. Such a business decision would – while protecting jobs and company stability – ultimately yield higher prices for the consumer and have no discernable impact on the Chinese supplier.

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

## The Impact of Retaliation & Government Protection

ITI expects that China would respond to implementation of U.S. tariffs with their own tariffs as well as regulatory restrictions and enforcement actions targeting U.S. companies. These retaliatory measures would further limit ICT market opportunities.

While ICT issues are the focus of the 301 investigation and remedies, we encourage USTR to be mindful of the second order impact to key segments of the U.S. economy – including, farmers, small businesses, and workers. Fear of another country's response should not, in itself, prevent the United States from taking necessary action; however, China has clearly demonstrated that it understands how to target middle-class Americans in sectors such as manufacturing and automobiles.

ITI understands that the Administration has offered to subsidize certain sectors that may be affected by retaliatory tariffs from China. However, we must be realistic about the U.S. government and the Chinese government's ability to protect segments of our respective economies. As a state-run economy, China has much more flexibility to subsidize and restructure key sectors. The United States, on the other hand, would require congressional funding in order to provide subsidies – and these would only soften the initial blow of retaliatory tariffs. Once a company loses some or all access to a particular market, it is exceptionally difficult to restore that access. The time required to restructure business operations and find alternative markets (assuming they exist) would result in significant costs and a decrease in longer term profitability, if not a loss of the business entirely.

## Why We Can't Afford to Give up the Chinese Market

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 cannot be ignored. In 2017 alone,



the U.S. exported \$23 billion worth of ICT goods to China<sup>6</sup>. And, as of 2015, China was the second largest export market for U.S. commercial ICT services exports in Asia. Put simply, companies cannot be truly global if they give up 20 percent of the global market.

Customer retention is another important factor. Customers operate globally, and they expect leading international companies to offer services where they need them. If U.S. companies cannot operate in China, they risk ceding to Chinese companies in the global market, as customers – particularly those that depend on services such as cloud – will seek out companies that provide services in all markets in which they operate.

Ultimately, companies face two unappealing options: loss of the Chinese market and diminished global competitiveness OR operating in a risky and highly-restricted but profitable and important market.

### What the U.S. Government Can Do to Change the Status Quo

ITI appreciates the U.S. government's focus on market-access challenges in China and is working to take steps to address those problems, including through 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. Below are a few alternative tactics to consider.

#### Leverage International Pressure and Coalitions

Multilateral pressure is one of the few tactics that has caused historically 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 in China. 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 software had clear "censor-ware" capabilities with intrusive surveillance potential; cybersecurity experts also noted serious security vulnerability concerns. The international community across businesses, rights groups and NGOs, and the United States, Japanese, and EU governments combined intense pressure on numerous fronts, which led to the delay and ultimate suspension of the program.

Thus far, China has not faced any real consequences for its actions. The U.S. must encourage the international community to stand united and tell China that its market access restrictions will no longer be tolerated.

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<sup>6</sup> U.S. GDP was \$19.739 trillion in the fourth quarter of 2017.



### Improve Enforcement Measures for IP Holders

Under Section 337, companies with domestic investments in commercial intellectual property can seek protection against imported infringing substitutes at the U.S. International Trade Commission. Exclusion Orders can be issued to U.S. Customs and Border Protection to prevent the importation of products determined by the ITC to infringe patents. These orders can be targeted against infringing substitutes originating from China. A number of ITI members have leveraged 337 matters to protect their intellectual property investments. The Administration could focus on sharpening the existing enforcement measures under Section 337 by supporting increased cooperation between U.S. Customs and Border Protection and IPR holders and increasing the penalties against manufacturers and importers repeatedly involved in Section 337 enforcements. By improving Section 337 enforcement options, the Administration would be taking steps to protect existing investments and would further encourage IPR holders to maintain or expand those investments in the US market.

### Compete with China and Invest in our Future

Punishing China and restricting Chinese investment in the United States alone will not help us achieve our goals. The U.S. must invest in our 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 our future economic and societal prosperity.

We must be prepared to step up and compete with 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. While our 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.<sup>7</sup> 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.<sup>8</sup>

China is also on track to outpace the United States in other 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 billion.<sup>9</sup> As of 2015, there were 1,000 smart city pilot plans in the works worldwide, 500 of which were located in China.<sup>10</sup>

These are just a few examples. The bottom line is that the United States is failing itself by not seriously investing in our country's technological and economic future.

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<sup>7</sup> <https://www.aip.org/fyi/2016/us-rd-spending-all-time-high-federal-share-reaches-record-low/>

<sup>8</sup> <https://www.technologyreview.com/the-download/610271/chinas-ai-startups-scored-more-funding-than-americas-last-year/>

<sup>9</sup> <https://www.techrepublic.com/article/smart-cities-expected-to-invest-80b-in-technologies-in-2018/>

<sup>10</sup> <https://www2.deloitte.com/content/dam/Deloitte/tr/Documents/public-sector/deloitte-nl-ps-smart-cities-report.pdf>





## 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. ITI encourages USTR and the administration to leverage the Section 301 report, common frustrations among allies, and industry knowledge to devise a similarly comprehensive and tailored solution that does not punish Americans for China's bad behavior. Thank you for your consideration of our views.