Comments on Proposed Determination of Action Pursuant to Section 301: China's Acts, Policies, and Practices Related to Technology Transfer, Intellectual Property, and Innovation

Raymond J. Keating
Chief Economist
Small Business & Entrepreneurship Council

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The Small Business & Entrepreneurship Council (SBE Council) is pleased to submit these comments. My name is Raymond J. Keating, and I am the chief economist for SBE Council, and the author of assorted studies and books, including *Unleashing Small Business Through IP: The Role of Intellectual Property in Driving Entrepreneurship, Innovation and Investment*. Also, for a decade, I taught a variety of courses to MBA students, including, for example, advanced innovation and entrepreneurship.

SBE Council is a nonpartisan, nonprofit advocacy, research and training organization dedicated to protecting small business and promoting entrepreneurship. With some 100,000 members and 250,000 small business activists nationwide, SBE Council is engaged at the local, state, federal and international levels on policies that enhance competitiveness, and improve the environment for business start-up and expansion, and economic growth. For nearly 25 years, SBE Council has focused its work on private initiatives and policies that strengthen the ecosystem for startup activity and small business growth.

As noted in the Notice of Determination:

> …the Trade Representative proposes that appropriate action would include increased tariffs on certain goods of Chinese origin. In particular, the proposed

> action is an additional duty of 25 percent on a list of products of Chinese origin identified in the Annex to this Notice. For example, if a good of Chinese origin is currently subject to a zero *ad valorem* rate of duty, the product would be subject to a 25 percent *ad valorem* rate of duty; if a good of Chinese origin were currently subject to a 10 percent *ad valorem* rate of duty, the product would be subject to a 35 percent *ad valorem* rate of duty; and so on…
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> The value of the list is approximately $50 billion in terms of estimated annual trade value for calendar year 2018.

The justification for the action was largely summed up this way:

> The Chinese government reportedly uses a variety of tools, including opaque and discretionary administrative approval processes, joint venture requirements, foreign equity limitations, procurements, and other mechanisms to regulate or intervene in U.S. companies' operations in China, in order to require or pressure the transfer of technologies and intellectual property to Chinese companies.

Finally, in the Request for Public Comments, it was noted that among the topics on which the USTR was requesting comments was "whether maintaining or imposing additional duties on a particular product would cause disproportionate economic harm to U.S. interests, including small- or medium-size businesses and consumers." It is largely on this point that SBE Council will focus its comments.

The IP Challenge with China

SBE Council has noted many times in the past the problems facing U.S. businesses, including small firms, when it comes to China's falling short on protecting intellectual property. For example, in *Unleashing Small Business Through IP: The Role of Intellectual Property in Driving Entrepreneurship, Innovation and Investment*, I noted assorted enterprises confronted by the costs and uncertainties of poor IP protections in China, and pointed out:

> Indeed, China remained a land laden with opportunity, along with significant IP risks.
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> Most nations, including the U.S., have gaps in protecting intellectual property, and therefore, need to make improvements that are important to innovation, investment and economic growth. However, certain nations, like China, have much more to do.
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> And each nation's historical and cultural roots must be understood as well. For example, it must be recalled that given China's communist history, the basic notion of "intellectual property" has a thin, at best, background.
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> Writing in the December 15, 2010, *Wall Street Journal*, Tian Lipu, commissioner of China's State Intellectual Property Office, noted: "Before the end of the 1970s, the Chinese people's knowledge about intellectual property was all but nonexistent—there was no concept of linking knowledge to property. It took over a decade, beginning in the 1980s, to enact some core IP-protection laws, including trademarks, patents and copyrights. It was only at the end of the last

> century that the term 'intellectual property' was formally included in the Xinhua Dictionary, which is used by hundreds of millions of Chinese students."
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> No doubt, it's a mighty undertaking to move from communism to an understanding of the importance of intellectual property. But how hard the Chinese government actually is working in that direction remains open to question.

The daunting question then remains: How should the U.S. proceed from a policy standpoint? Imposing tariffs, that is, taxes, on Chinese consumer, intermediate and capital goods imports merely serves to inflict damage on U.S. consumers, businesses – including on small businesses – and workers, thereby undermining U.S. growth.

10 Key Points on Trade

The importance of free trade to the U.S. economy must be kept in mind throughout the discussion on trade policy with China. That free trade is a clear net plus for the economy is one of the few areas where widespread agreement exists among economists. In recent congressional testimony ("The State of Trade and Small Business," Committee on Small Business, U.S. House of Representatives, April 11, 2018), for example, I pointed out some key points about trade that need to be kept in mind:

1) "First, it is important to keep in mind that governments do not trade; rather, individuals and businesses do. There's no difference between trading across town, across the nation or around the globe. Trade occurs between individuals, between businesses, and between individuals and businesses. And parties would not trade – that is, would not buy and sell products – if they were not made better off by such voluntary transactions. Therefore, trade, by definition, makes people better off."

2) "Second, thanks to lower barriers to trade, competition is expanded and resources are allocated more efficiently. In turn, consumers experience a wider choice of products and lower prices."

3) "Third, entrepreneurs, businesses and workers experience greater opportunity, as more markets are open to their goods and services. Of course, just over 95 percent of the world's population reside outside the United States."

4) "Fourth, as individuals and businesses specialize in those areas where they have a comparative advantage – that is, their largest advantage – and then trade with others, economic, productivity and income growth are boosted."

5) "Fifth, international trade is deeply integrated in and vital to the U.S. economy. Consider, for example, that real total trade (exports plus imports) in 1955 equaled 6.1 percent of real U.S. GDP. That grew to 29.3 percent in 2017. U.S. exports as a share of the economy jumped from 2.7 percent of GDP to 12.8 percent over this period, and imports from 3.4 percent of GDP to 16.5 percent. Indeed, growth in trade equals or accounts for a significant portion of U.S. economic growth, at least 40 percent in recent times."

6) "On the imports front, growing imports correspond with expanding domestic production. That is, when the U.S. economy is growing, it is natural that imports of consumer, intermediate and capital goods commensurately increase. Also, imports aid the economy by boosting competition, which drives domestic businesses to be more innovative and to improve productivity."

7) "Keep in mind that more than 55 percent of all U.S. goods imports in 2017 were inputs for U.S. businesses, that is, they were intermediate goods or capital goods. So, increasing tariffs or establishing quotas on imports is in effect imposing a tax increase on a wide array of U.S. small businesses, such as manufacturers. In turn, among U.S. manufacturing employer firms, 74.6 percent have less than 20 employees, 93.5 percent less than 100 workers, and 98.5 percent less than 550 employees. It then follows that workers and consumers suffer accordingly."

8) "Meanwhile, an expanding U.S. trade deficit usually signals strong U.S. economic growth. That is, periods of higher U.S. economic growth generally coincide with shrinking trade surpluses or mounting trade deficits, and economic slowdowns and recessions line up with declines in trade deficits… Why is this? First, as noted previously, strong economic growth naturally drives demand for imports by both consumers and businesses. Second, a current account trade deficit (that is, a deficit in terms of goods and services) means there must be a capital account surplus (that is, a surplus in terms of investment moving into and out of the U.S.). That is, foreigners are viewing the U.S. favorably in terms of investment opportunities."

9) "In fact, a growing U.S. economy is fed by investment, including from foreigners, and by expanding exports, with economic growth also reflecting and being further fed by being open to imports. In the end, when U.S. exports and imports are both growing, that's good news for the U.S. economy, no matter what the trade deficit might be."

10) "Just as there are clear positives derived from free trade, there are clear negatives from protectionist measures that increase governmental costs and barriers to trade. Consumers, of course, are confronted by fewer choices and higher costs due to the fact that protectionism shields companies from competition, which reduces efficiency, diminishes quality, and limits innovation. For good measure, protectionism not only limits opportunities in the international marketplace for U.S. entrepreneurs, businesses and workers as other nations inevitably retaliate, as we are seeing now, but U.S. businesses and workers pay more for whatever product is being shielded from competition thanks to protectionist policies."

The Role of Small Business

But there's actually much more to consider including the critical role that small businesses play on the international trade front.

In terms of both exports and imports, most U.S. businesses involved in trade are small and midsized firms. As noted in Table 1, 76.1 percent of U.S. exporters (2016 latest Census Bureau data) have fewer than 20 employees, 86.6 percent fewer than 50 employees, and 91.8 percent fewer than 100.

Table 1: U.S. Exporters 2016
Percent of Employer Firms by Number of Employees

# of Employees	Percent
Less than 20	76.1%
Less than 50	86.6%
Less than 100	91.8%
Less than 500	97.5%

Data Source: U.S. Census Bureau

As for U.S. importers, 76.1 percent of importers have fewer than 20 workers, 86.1 percent fewer than 50 workers, and 91.3 percent fewer than 50 employees.

Table 2: U.S. Importers 2016:
Percent of Firms by Number of Employees

# of Employees	Percent
Less than 20	76.1%
Less than 50	86.1%
Less than 100	91.3%
Less than 500	97.3%

Data Source: U.S. Census Bureau

Given the prominent role that small businesses play on the trade front, it follows that the burdens of increased governmental costs on and obstacles to trade, such as via tariffs or quotas, will fall heavily on small businesses and their employees.

Trade with China and Small Business

Zeroing in on U.S. trade with China specifically, the role of small business, again, becomes quite clear.

In the aforementioned congressional testimony, I noted, "As for trade with China… consider that U.S. goods exports to China from 2001 (the year that China was admitted to the WTO) to 2017 grew by 579 percent. And over the same period, U.S. imports from China – goods for consumers, and intermediate and capital goods for businesses, including for small businesses – grew by 394 percent. That's strong growth – far outdistancing the rise in overall U.S. trade and economic growth."

Most U.S. firms involved in trade with China, again, are small and mid-sized businesses. As noted in Table 3, 53.8 percent of U.S. exporters to China have fewer than 20 employees, 68.7 percent fewer than 50 workers, and 78.4 percent fewer than 100 employees.

Table 3: U.S. Exporters with China 2016:
Percent of Firms by Number of Employees

# of Employees	Percent
Less than 20	53.8%
Less than 50	68.7%
Less than 100	78.4%
Less than 500	92.1%

Data Source: U.S. Census Bureau

And regarding the role of small business and imports, as noted in Table 4, 74.3 percent of U.S. importers relating to China had fewer than 20 employees, 84.9 percent fewer than 50 workers, and 90.2 percent fewer than 100 employees.

Table 4: U.S. Importers with China 2016:
Percent of Firms by Number of Employees

# of Employees	Percent
Less than 20	74.3%
Less than 50	84.9%
Less than 100	90.2%
Less than 500	96.7%

Data Source: U.S. Census Bureau

Trade with China very much is about American small business. And in terms of the growth in the number of employer firms involved in trading with China, it has been nothing less than breathtaking, with the number of U.S. firms exporting to China increasing from 15,054 in 2001 to 115,602 in 2016 – a rise of 668 percent.

This brings us back to the question: What is the best path forward on constructive trade policy with China? Once more, it is not to impose tariffs and quotas that will only hurt U.S. consumers and small businesses, and hinder our economy. Rather, the U.S. needs to re-engage as a global leader for free trade, and in doing so, serve as an example for China.

I refer to two points from my congressional testimony:

• "Rather than playing tit-for-tat protectionism, the U.S. would be far better off in standing up clearly for free markets, free trade and property rights, and showing other countries, like China, what the real path to economic growth is. It is critical, and far more constructive, to make clear to China that its intellectual property violations only serve to undermine its own investment and economic growth."

• "Rather than raising costs to trade with China, the best path forward would be to enter into serious discussions that lay the groundwork for a China-U.S. free trade agreement. Through that process, the U.S. would be able to constructively advance the cause for open markets and property rights in China. And a free trade accord between the world's two largest economies would considerably expand opportunities for entrepreneurs, small businesses and workers in both nations."

As noted in the SBE Council book *Unleashing Small Business Through IP*, a "free trade agenda must include treaties and other joint efforts at improving IP rights, protections and enforcement in other nations. Not only will such improvements in other nations benefit U.S. businesses and workers competing internationally, but it also will improve economic growth in those nations."

In the end, these proposed tariffs on imports from China "would cause disproportionate economic harm to U.S. interests, including small- or medium-size businesses and consumers." The U.S. should step back from this proposal for increased tariffs, and instead, engage with China in a productive way through, if necessary, a multi-year effort of agreements that make real progress in reducing trade barriers and enhancing property rights, with the ultimate goal being a China-U.S. free trade agreement. Such an effort would generate confidence among entrepreneurs, businesses, investors and in the markets, and generate significant benefits and opportunities for U.S. small businesses, workers and consumers.

Thank you for your time and attention. I look forward to your questions and further discussion.

About Raymond J. Keating

Raymond J. Keating is chief economist for the Small Business & Entrepreneurship Council. Keating is the author of several books, including *Unleashing Small Business Through IP: Protecting Intellectual Property, Driving Entrepreneurship*, *"Chuck" vs. the Business World: Business Tips on TV*, and a series of thrillers. He also is a regular columnist with RealClearMarkets.com, and for more than two decades was a weekly newspaper columnist with *Long Island Business News*, *Newsday*, and the *New York City Tribune*. For a decade, Keating also was an adjunct professor in the MBA program at the Townsend School of Business at Dowling College. His work has appeared if additional periodicals, including *The New York Times, The Wall Street Journal, The Washington Post, New York Post, Los Angeles Daily News, The Boston Globe, National Review, The Washington Times, Investor's Business Daily, New York Daily News, Detroit Free Press, Chicago Tribune, Providence Journal Bulletin,* and *Cincinnati Enquirer*.

Small Business & Entrepreneurship Council
301 Maple Ave. West
Suite 100
Vienna, VA 22180
703-242-5840
www.sbecouncil.org
Twitter: @SBECouncil