Testimony in response to the proposed action pursuant to the Section 301 investigation of China's Acts, Policies, and Practices Related to Technology Transfer, Intellectual Property, and Innovation, Docket number USTR-2018-0005

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Mr. Chairman,

Thank you for the opportunity to testify on the Administration's proposed action pursuant to Section 301. I appear today on behalf of the National Foreign Trade Council, which represents over 200 companies, many with significant trade and investment interests related to China.

About NFTC

NFTC is dedicated to making America more successful in the global economy by ensuring the adoption of competitive tax and trade policies, strengthening the global rules-based trading system and opening foreign markets to U.S. products and services. The Council's membership spans the breadth of the national economy. It includes sectors such as energy products, aerospace, capital goods, transportation, consumer goods, technology, healthcare products, services, e-commerce and retailing. Our companies account for more than $3 trillion in total sales worldwide, employ over five million Americans and produce a huge share of our nation's total exports. Our stake in ensuring a healthy national economy and promoting our global leadership is enormous.

NFTC companies have significant concerns about Chinese trade, investment and IP policies and practices

Our member companies have significant concerns about China's growing use of trade, investment and IP policies that deny national treatment and create discriminatory burdens which are unreasonable for American companies, innovators and workers. The Council has outlined these concerns on several occasions, including in comments submitted pursuant to the Federal Register notice published on August 24, 2017 announcing the initiation of USTR's Section 301 investigation into China's acts, practices and policies. While many of our companies have significant trade and investment activities related to China, and while the Chinese market offers significant opportunities, many Chinese government policies are unfair and highly discriminatory against foreign firms. We support USTR's effort to examine these policies and practices and to raise them forcefully in both bilateral and multilateral settings. China must begin to address the legitimate concerns of the United States and other trading partners about these measures. Failure to do so will seriously erode public support in these countries for expanded trade and investment with China and will undermine the legitimacy of an open international trading system.

We must work with our other trading partners to build global pressure on China to reform its discriminatory policies

USTR's report provides convincing evidence of China's unfair and discriminatory practices, and it should be used as a roadmap to convince other trading partners to join us in pressuring China to reform its policies. Chinese government actions leading to forced technology transfer, IP violations and discriminatory investment restrictions, in addition to its extensive subsidies and reliance on state-owned enterprises, are not just a threat to the industrial and technological leadership of the United States, but to many others as well. They are inconsistent with the spirit, if not the letter, of the WTO system, which is predicated upon open markets and market-driven (rather than state-driven) capitalism. USTR should use this report to gain broad acceptance of a strategy among like-minded governments – in the WTO, the G-20 and other bodies – aimed at convincing China of the need to change. Only through such an initiative can we exert sufficient pressure to convince the Chinese that such practices and policies are unsustainable and are out of step with accepted norms in the WTO and other global institutions.

Unilateral imposition of tariffs is unlikely to achieve our major objectives

NFTC supports efforts to investigate and address these discriminatory practices. However, we believe that the imposition of unilateral tariff remedies proposed by the Administration, or the potential investment measures contemplated by the U.S. Treasury Department, particularly prior to achieving any broader global support for such measures or before any substantial effort to negotiate removal of China's offending practices, would do greater harm than good to U.S. economic interests.

Such action is also unlikely to be effective in eliminating China's discriminatory acts, policies, and practices. Imposing and maintaining additional U.S. duties is premature and would cause economic harm to U.S. interests, including manufacturers, service providers and consumers.

Unilateral imposition of tariffs prior to any meaningful negotiations with China will also raise charges that the United States has ignored its international commitments and will turn the focus from China's unjust behavior to the legitimacy of our own action. These tariffs will alienate many of the trading partners we are relying upon to support our cause and may embolden China to resist our efforts.

I would like to highlight some of the ways that tariffs on specific industries and product lines will harm American businesses, workers and consumers.

U.S. tariffs on China will harm the competitiveness of American businesses

The proposed tariffs will harm American companies and U.S. workers in a variety of ways.

First, U.S. manufacturers who rely on imported industrial inputs to support jobs in the United States will see their input costs increase due to tariffs. Tariffs on inputs, which represent 80 percent of the list proposed by USTR, represent a tax on U.S. manufacturers and workers and on the products they build and export.

For example, by imposing tariffs on categories of goods such as parts of machinery, pumps, pump parts, turbine parts, motors, rotors and stators, fluids, jet engine parts, drill collars and lithium batteries, inputs that enter the United States to support American manufacturing will become more expensive, raising the price of finished manufactured goods and potentially destroying U.S. jobs as foreign competitors gain market share.

Other items such as imported hard drives and solid-state drives are essential components in technology products manufactured in the United States. The imposition of tariffs on these items will have a significant negative impact on U.S. manufacturers of high-technology products.

Increased tariffs would provide a cost advantage to their foreign competitors, including Chinese Government-backed competitors, and could have the unintended consequence of prompting manufacturers to move final production outside of the United States. Taxing imported components penalizes U.S. companies who have located their intellectual property and manufacturing operations in the United States.

Second, tariffs would penalize American innovation and investments in advanced technologies and manufacturing. Tariffs will have a negative impact on American innovators in cutting-edge areas where the United States has a competitive advantage including virtual reality (VR), aerospace, Artificial Intelligence (AI), High Performance Computing (HPC), server manufacturing, and Internet of Things (IoT) technologies. American companies in these industries engage in significant manufacturing, design know-how, research and development, marketing and sales operations in the United States but also rely on components and products from China.

As an illustrative example, U.S. companies have led the global smart thermostat market,[1]. The proposed duties risk dampening the thriving market for these products and would negatively impact the U.S. companies developing these products, consumers and the ecosystem of U.S. installers, retailers, utilities, and other partners who have benefited from rapid innovation in the thermostat space.

As another example, proposed U.S. tariffs on $3 billion in medical devices threaten to undermine improving market access for U.S. medical technology manufacturers in China. They are likely to encourage the Chinese Government to consider new localization, regulatory and procurement policies in response to the inclusion of Chinese medical devices on the Section 301 List.

Third, American technology companies will face increased costs for maintaining their technology operations, including data centers, in the United States. The proposed tariffs would affect components and products for server maintenance and security and environmental monitoring utilized by U.S. data centers. It would negatively impact U.S. cloud service providers and online platforms and marketplaces and the small businesses who use these technologies to grow, hire, and trade.

Fourth, tariffs threaten industry sectors and their workers where items are temporarily imported for repair and re-exported. Levying an additional 25 percent duty on China-origin

[1] *Global Smart Thermostat Market Grew 123% in 2015, Indicating Smart Home is Finally Becoming Mainstream*. 8 March 2016. Available at: https://iot-analytics.com/global-smart-thermostat-market-2015-2021/.

parts imported into the United States for repair would deal a devastating blow to industry sectors and their workers dependent on after-market service. Confronted with significantly increased costs, overseas businesses will be incentivized to conduct aftermarket service and repair parts at non-U.S. overhaul and repair shops, which do not face the same punitive duties. For example, tariffs on China-origin commercial aircraft parts would significantly undercut aftermarket activity in the U.S. commercial aerospace industry.

Fifth, American businesses will be doubly-harmed by tariffs stemming from China and the Section 232 process. Several product categories on USTR's proposed list of goods subject to tariffs, including manufacturing inputs such as aluminum can sheet, are subject to a separate 10 percent (aluminum) or 25 percent (steel) duty as a result of tariffs imposed by the President on March 8, 2018 under his Section 232 authority. Input costs for manufacturers who use goods subject to these twin tariffs – for example beverage manufacturers and can producers – will increase substantially under this proposed action.

Finally, U.S. manufacturers and farmers will experience additional harm from tit-for-tat retaliation. Some American manufacturers will face dual shocks to their competitiveness from the imposition of U.S. tariffs on inputs from China to their American-made products as well as from the imposition of retaliatory tariffs by China on exports of their goods.

Overall, the proposed tariffs, combined with retaliation proposed by China, would reduce U.S. GDP by almost $3 billion and destroy four jobs for every one gained, according to an April 2018 report.[2]

U.S. tariffs will harm American consumers and working families

American consumers are likely to see higher prices on everything from everyday consumer goods to high technology and smart goods.

Working families will pay more for everyday products, including flat screen televisions, HVAC and refrigerator equipment, dishwashers, water filters, air purifiers, remote controls, batteries, beer, ink cartridges and soda are likely to cost more as a direct or indirect result of the tariffs. One estimate suggests that the price of batteries, ink and cartridges and flat screen televisions made in China will each increase around 23 percent after the tariffs are applied.[3]

Tariffs will also discourage the adoption of U.S.-designed, cutting edge technologies by American consumers. The proposed tariffs will discourage adoption of U.S.-led advanced technologies, including IoT devices and AR/VR products. Tariffs are likely to depress U.S. consumer demand for sophisticated smart thermostats and undermine nationwide electric utility rebate programs encouraging the adoption of energy-efficient thermostats.

[2] Tariffs on Imports from China: The Estimated Impacts on the U.S. Economy. Trade Partnership Worldwide. 30 April 2018. Available at: https://nrf.com/media/press-releases/study-shows-tariffs-against-china-would-destroy-thousands-of-american-jobs

[3] Estimated Impacts of Proposed Tariffs on Imports from China: Televisions, Monitors, Batteries and Printer Cartridges. Trade Partnership Worldwide. 11 April 2018. Available at: http://www.cta.tech/CTA/media/policyImages/China301Tariffs_TVs_Monitors_Cartridges_Batteries.pdf

Recommendations in case 301 tariffs are imposed

NFTC urges the Administration to resolve the issues raised in the Section 301 investigation without resorting to these tariffs. To the extent that the Administration decides to proceed with tariffs, we offer the following recommendations.

The Administration should:

1. **Take into account feedback received through this process and engage in additional consultations with affected U.S. businesses.**

2. **Exempt from tariffs those products that cannot feasibly be replaced by alternative, non-Chinese sources**.

3. **Eliminate or defer the implementation of tariffs when a business provides evidence that locating a qualified alternative supplier for a given product on the tariff list will take time.**

4. **Exempt from tariffs those products that would harm U.S. innovation, competitiveness or jobs.**

5. **The Administration should permit duty drawback on parts that ultimately go into U.S. finished goods and aftermarket parts that are then exported from the United States,**

6. **Exempt related party transactions.**

Limiting the impact of trade and investment restrictions

Finally, we are concerned about the potential escalation of trade and investment tensions, which would be further inflamed by the imposition by the United States of up to $100 billion in new tariffs on trade or by the addition of new products to the existing list of $50 billion as contemplated by the April 6 Federal Register notice.

We believe the imposition of these additional tariffs will not be effective in getting China to change its behavior. Additional tariffs are extremely likely to increase the harm to American manufacturers, service providers, consumers and working families in their own right and by further escalating trade tensions with China and the rest of the world.

NFTC also remains concerned about the separate process governing potential “reciprocal investment restrictions” on Chinese investors in the United States as part of its response under Section 301. Any new investment restrictions should be the subject of extensive consultations with U.S. companies and Congress.

Conclusion

The overall focus of the Section 301 investigation should be to bring China to the negotiating table for a meaningful resolution of specific, sector-by-sector issues with the ultimate goal of obtaining an agreement to remove the offending practices and policies. It is critical for the Administration to identify and outline the specific actions it seeks from China to resolve the Section 301 investigation to the maximum benefit of U.S. trade and investment interests. The

United States should work with its allies and major trading partners to devise a strategy to increase pressure to guarantee that traders and investors receive fair treatment in these areas by China.

Section 301 was designed to be used a means to an end, not as an end in its own right. It must be part of a carefully orchestrated, deliberate and defensible effort to dissuade other countries from engaging in unfair behavior. For this to work effectively, the Administration should focus its efforts on resolving other frictions with our key trading partners in Asia, North America and Europe, and then should use all aspects of bilateral and multilateral diplomacy to highlight China's unfair behavior and mobilize global support for change.