



Before the
Office of the United States Trade Representative
Washington, D.C.

In re:

Section 301 investigation of China's Acts,
Policies, and Practices Related to Technology Transfer,
Intellectual Property, and Innovation.
Notice of determination, request for comments,
and notice of public hearing

Docket No. USTR-2019-0004

**COMMENTS OF
INTERNET ASSOCIATION**

Internet Association represents over 40 of the world's leading internet companies.¹ IA is the only trade association that exclusively represents leading global internet companies on matters of public policy. IA's mission is to foster innovation, promote economic growth, and empower people through the free and open internet. The internet creates unprecedented benefits for society, and as the voice of the world's leading internet companies, we ensure stakeholders understand these benefits.

American-based internet companies are a significant driver of the U.S. economy and U.S. exports. Small businesses and entrepreneurs in every state and every community use the internet to sell and export across the globe. Internet-connected small businesses are three times as likely to export and create jobs, grow four times more quickly, and earn twice as much revenue per employee. Digital trade and digital trade-enabled businesses contribute more than \$440 billion in exports annually, which helps account for the U.S. having a \$172.6 billion trade surplus in digital services.²

In China, many U.S. internet companies are either blocked from operating or are severely restricted. China's ongoing intellectual property rights violations, forced technology transfer policies, and state interventions harm U.S. companies, workers, and consumers. Barriers to digital trade in China continue to present significant challenges to U.S. exporters. The Chinese government forces U.S. companies to transfer valuable U.S. intellectual property, surrender use of their brand names, and hand over operation and control of their business to a Chinese company, effectively barring U.S. companies from fairly operating or competing in China.

While we have serious concerns about China's trade practices and support the U.S. government's efforts to address them over the last two years, the imposition of new tariffs on key consumer technology products will harm U.S. consumers, cost U.S. jobs, and undermine U.S. technology companies in the fight for global leadership in the digital economy, risking serious collateral damage to the administration's underly.

The objective of USTR's Section 301 investigation is to preserve the U.S. as the world's leader in high-tech industries and jobs by combating unfair Chinese trade practices. But tariffs on key digital technologies will directly increase the cost and challenge of growing the U.S. technology sector and will raise costs for U.S. businesses of all sizes that rely upon the internet to export to global customers.

¹<https://internetassociation.org/our-members/>

²<https://internetassociation.org/new-report-reveals-digital-trade-contributes-more-than-1-5-million-jobs-and-460-billion-in-exports-to-american-economy/>



Although aimed at combating China, these tariffs will undermine the 301 investigation's expressed goal by hurting U.S. technology industries and consequently helping Chinese companies, including China's tech giants.

Tariffs remain the wrong solution to real problems. The U.S. government should not undertake policies that stifle growth as tariffs are hidden, regressive taxes that will be paid by the U.S. consumer in the form of higher product prices. This will impact the ability of U.S. companies to invest in future technology. Instead of punishing China for its trade violations, tariffs will penalize innovative U.S. companies -- and their employees.

Increasing tariffs on U.S. technology companies will diminish American technology companies' leadership role. According to a recent study, 25 percent tariffs on an additional \$300 billion in imports would result in the loss of more than 2 million U.S. jobs, add \$2,300 in costs for the average American family of four, and a reduction in U.S. GDP of 1.0 percent.³ Furthermore, the digital industry has seen that tariff increases and uncertainty around these negotiations have created turmoil in the markets, threatening the U.S.' historic economic growth.

For all of these reasons, we ask that the administration refrain from imposing duties on the following key technology products and instead work with Internet Association and the member companies we represent on alternative approaches to strengthening U.S. leadership on these critical issues.

High Tech HTS Codes (more information on specific HTS codes follows)

U.S. companies produce a range of phones, laptops, and other connected devices for Americans consumers. Targeting these specific consumer technology products with 25 percent tariffs would directly hurt the competitiveness of U.S. firms across a range of industries, slowing down U.S. innovation and resulting in price hikes for consumers and enterprise customers. The primary beneficiaries of this action would be competitors to the U.S. technology sector throughout the Asian region.

The key challenge that U.S. producers of consumer technology devices face under proposed 25 percent tariffs is the difficulty of shifting production out of China in line with the proposed time frame for List 4 without suffering significant economic harm. These devices and products are extremely complex to manufacture and rely on just-in-time input from a large range of suppliers across many different technologies. For example, producing a phone requires cameras, displays, memory, sensors, and printed circuit board assemblies, as well as producer-specific equipment to assemble. Compelling U.S. producers of these devices to immediately shift supply chains would be an undue hardship because it would throw off planning efforts and sourcing for already-in-progress production cycles, which would threaten the profitability of low-margin consumer tech businesses in the United States.

In many cases, there is no plausible and commercially reasonable option for U.S. producers to shift production out of China under a feasible time horizon. In cases where mitigation is possible, it will generally take U.S. companies a minimum of 8-10 months to shift production out of China.

There are unique and significant costs and challenges associated with shifting production of consumer technology devices out of China. These costs fall into a few general categories: bill of materials ("BOM") costs; manufacturing value added ("MVA") costs; and other infrastructure-related costs. BOM costs refer to the costs of the raw materials, sub-assemblies, intermediate assemblies, and other components and subcomponents in the final product. MVA costs refer to the costs of sourcing labor and other value-added activities. Infrastructure-related costs include the costs of building or qualifying new factories and assembly lines and the costs of essential inputs such as electricity.

³ <https://tradepartnership.com/wp-content/uploads/2019/02/All-Tariffs-Study-FINAL.pdf>



In practice, companies need to consider BOM, MVA, and infrastructure-related costs in determining whether a given mitigation action is commercially reasonable and justifiable. Shifting production to a new country typically involves increased transportation costs – such as challenges stemming from a lack of direct cargo flights or restrictions on products that can be transported on commercial flights based on lithium battery rules. This may require companies to spend more on chartering flights or additional border crossings that involve increased customs costs. Other countries such as Vietnam may have lower MVA costs but an underdeveloped logistics system and highway infrastructure.

U.S. producers of high tech devices are actively looking for reasonable mitigation options, but the timeline for shifting production must take into account current product launch timelines and sales cycles. For many of these products, the height of the annual U.S. sales cycle is between November 29, 2019 (“Black Friday”) and Christmas, meaning that all stock must be in stores and available for mass purchase by early November. Missing production goals for the critical holiday season can damage not just annual sales goals but also the long-term viability of a given product.

To meet these production goals, a U.S. producer must be far along in its product development process by early May and heading into mass production by June. Forcing a shift in production location at this time of the year, with minimal notice, is simply not feasible for the vast majority of U.S. firms in this sector. Aside from circuit boards, very few components are assembled in a fully automated way, so a U.S. producer cannot simply move equipment to another factory and instantly restart production. Instead, it takes significant time and investment to set up new plants, retrain new employees, reengineer an assembly line, set up new logistics networks, find new sourcing, establish new contracts, and work with partners in unfamiliar locations. Imposing tariffs immediately on consumer technology products would generate a massive shock to U.S. producers that would reverberate into future sales cycles, risking permanent damage to U.S. tech competitiveness.

Finally, there are capacity constraints associated with production moves. Since early 2018, capacity has been filling up in non-China locations, which has led to new stresses on logistics networks, particularly in countries that have experienced a high manufacturing influx and have historically underdeveloped logistics networks.

Giving U.S. producers of these devices a greater period of time to shift production would enable U.S. firms to do detailed BOM/MVA/infrastructure assessments in advance of the next production cycle. Companies in this sector indicate that at least 8-10 months of lead time is necessary in order to avoid jeopardizing the current production cycle while giving sufficient time to analyze and execute on new options. This amount of lead time would save U.S. companies billions of dollars while ensuring that the U.S. tech industry stays ahead of foreign competitors in the sector.

HTS 8517.12.00 - Mobile phones

Mobile phones have become a daily necessity for all Americans and are the main way U.S. consumers and small businesses use the internet. There are a variety of different U.S. producers of phones serving different segments of the U.S. market, including low- and middle-income consumers. The immediate imposition of tariffs on phones would negatively impact the full range of these producers and consumers.

Targeting phones with 25 percent tariffs would fundamentally threaten the business proposition for U.S. firms in this area and increase costs of production, slowing down U.S. innovation and likely resulting in price hikes for consumers and enterprise customers.

Phones and other connected devices are a low-margin, high-risk, and high-investment business for many U.S. firms. Because of low margins in this sector, few if any U.S. firms would be able to absorb a 25 percent surcharge on products. Many smaller U.S. firms in these sectors would simply go out of business, while larger firms would face a devil’s bargain of either wiping out profits on all U.S. sales or



passing costs to consumers and losing significant market share to foreign competitors. In either case, the primary beneficiaries of these tariffs would be firms outside the U.S. Ultimately, if American manufacturers exit key segments within this global market, then the market will be ceded to foreign (increasingly, Chinese) manufacturers.

Furthermore, for devices with particularly complex production processes and timelines, such as mobile phones, the lack of lead time on these new tariffs would significantly compound the negative impact to U.S. companies from shifting production, establishing new supply lines, re-engineering production facilities, and other mitigation steps. Because over 75 percent of imports of phones to the U.S. are from China, there is simply insufficient capacity in the rest of the world to absorb shifts in the short term. Again, this indicates that the primary burden of an immediate increase in tariffs would fall on U.S. consumers of phones.

As detailed above, many U.S. phone producers are already heavily invested in current production cycles for the critical fall sales season, including Back-to-School and Black Friday. Shifting production for this cycle to a new location is no longer feasible.

Removing the 8517.12.00 tariff lines from List 4 would have a meaningful impact on American tech competitiveness as well as American consumers who might otherwise buy their phones from foreign competitors. In the alternative, providing U.S. producers with lead time of 8-10 months to shift production and to diversify supply chains would be massively beneficial in avoiding undue hardship on U.S. producers and consumers.

HTS 8517.62.0090 - Connected devices (smart speakers, smart displays, digital media streaming devices, smart watches, optics, etc)

So-called connected devices -- devices under the HTS 8517.62.0090 -- cover a range of products that Americans use in their homes to connect to the internet. This key category covers products that are becoming ubiquitous in the connected home: smart displays and speakers, smart watches, streaming devices for television sets, and other Bluetooth-enabled devices.

U.S. companies that sell and produce connected devices are competing to drive down prices for American consumers, enabling lower-income Americans to gain access to the internet through cutting edge smart tools. An increasing number of U.S. households are buying connected devices. These products have also become critical productivity tools for a wide range of traditional U.S. industries including agriculture, financial services, healthcare, manufacturing, and other key parts of the U.S. economy.

Placing a 25 percent tariffs on connected devices would give a leg up to competitors in Korea, China, and elsewhere, raising prices for U.S. developed devices while making it harder for traditional U.S. industries to leverage these innovative U.S. technologies.

With connected devices, the costs of mitigation are significant and exacerbated by the challenges of having to shift production to a new country with less documented expertise in high tech manufacturing as well as higher logistics costs due to lack of support for large scale manufacturing, supply chain issues, and stress on existing infrastructure. The average time to move production of a connected device ranges from 4-10 months, depending on the complexity of the product, whether contract manufacturing partners are able to support non-China manufacturing operations, and other factors. Again, these moves become more difficult once the product development cycle has already begun, given the multi-month lead time from prototyping to mass market production.



Removing 8517.62.0090 tariff lines from List 4 would have a positive impact on American technology sector's competitiveness as well as American consumers who might otherwise buy their connected devices from foreign competitors.

HTS 8471.30.0100, HTS 8542.70.87 - Laptops, tablets, and e-readers

U.S. technology companies are constantly competing to drive down prices for American consumers, enabling lower-income Americans to gain access to the internet through cutting-edge devices. Laptops and tablets have become critical productivity tools for a wide range of traditional American industries. Proposed tariffs on laptops and tablets would be a drag on innovation. Forcing U.S. laptop makers to focus their engineering energies on mitigating tariffs rather than innovating, potentially leaves others to take the next steps forward in device innovation. Additionally, supply chain disruptions also make it harder to bring great new ideas to fruition.

Raising the cost of laptops and tablets will also harm productivity of small businesses, as they may delay upgrading to newer machines. The impact of more expensive laptops is also acute for schools and students who depend on them for enhancing educational outcomes. For students today, a laptop -- like a phone -- is more a necessity than a luxury good, and higher prices are hardest to bear for lower income students. In this way, tariffs on laptops, tablets, e-readers, and other consumer technology items exacerbate the digital divide.

Putting a 25 percent tariffs on laptops will harm small businesses and would give a leg up to competitors in other countries. Laptops and tablets require complex production processes and timelines and the lack of lead time on these new tariffs would significantly compound the negative impact to U.S. companies from shifting production, establishing new supply lines, re-engineering production facilities, and other mitigation steps.

Removing 8471.30.0100 and HTS 8543.70.87 tariff lines from List 4 would have a positive impact on the American technology sector's competitiveness as well as American consumers who might otherwise buy their laptops from foreign competitors.

HTS 9504.50.0000, HTS 8526.92.1000 - Video Game Consoles and Accessories

Video games are an integral part of life for millions of Americans – for leisure, educational, and therapeutic purposes. A 25 percent tariffs on these items will put these benefits out of reach for those with lower incomes. A decline in demand for games will have significant negative impact across an ecosystem of independent developers that supports tens of thousands of jobs across the U.S., and a broader video gaming industry that supports hundreds of thousands of U.S. jobs.

Removing 9504.50.0000 and HTS 8526.92.1000 tariff lines from List 4 would have a positive impact on American electronic gaming as well as American consumers who might otherwise buy their devices from foreign competitors.

HTS 8525.80.4000 - Digital Still Image Video Cameras

IA's member companies produce products and rely on products that require digital cameras. These products both help to deliver services and are instrumental to the branding of products.

Digital cameras cannot be sourced elsewhere at a reasonable cost due to the investment made to manufacture them product in China such as a manufacturing line, tooling, employees hired to oversee production and quality, etc. The start-up costs for digital cameras are exceptionally high and cannot be incurred a second time in a profitable manner.



The products in this code, like many consumer electronics goods, have low unit product margins. A tariff like the one proposed would lead to negative margins on this product. In the face of negative margins, companies could either be forced to shut down production altogether or pass the tariff directly on to the consumer in the form of a price increase. Whether a company pursues either of these options, sales of these products in the U.S. would drop, and the cost of this would be U.S. R&D and sales & marketing jobs that are directly associated with the development and distribution of this product.

IA requests that HTS 8525.80.4000 be removed from the final List 4.

HTS 8471.41.0150, 8525.50.10, 8517.62.0090, and 9504.50.000 - Augmented Reality and Virtual Reality Products and Components

Digital companies are investing in R&D around augmented reality (AR) and virtual reality (VR) products and components. AR adds digital elements to a live view often by using the camera on a smartphone, while VR implies a complete immersion experience that shuts out the physical world.

The imposition of a 25 percent additional duty on these products would significantly impact the ability of U.S. companies who develop and sell them to remain leaders in AR/VR, stifling their growth and market share, diminishing U.S. product adoption, and undermining their ability to invest and innovate to drive the industry forward and grow U.S. market share. Industries across the U.S. are just beginning to adopt AR/VR products for use in advanced research, worker training, healthcare, commerce, communications, and many other high-value economic and social uses. If duties are imposed on U.S. companies' products, competitors in Asia and the EU would gain a significant competitive advantage in the U.S. market that they would use to wrest industry leadership from the U.S.

The duties would also have a significant negative impact on highly-skilled U.S. workers who are employed in this nascent U.S. industry. If U.S. companies are unable to gain and maintain market share, they may be forced to shutter their operations and eliminate jobs. For those companies that are able to maintain their operations, they will find it harder to compete for talent, resulting in further loss of U.S. dominance in the AR/VR industry.

It is a sensitive time for the industry as consumers decide whether to adopt this emerging technology. The duties would significantly raise the costs of AR/VR products, frustrating the U.S. industry's efforts to encourage adoption, and in particular of U.S. products by reducing prices, and hurting sales. The resulting lower installed-hardware base of AR/VR products in the U.S. would discourage independent app developers and software designers from creating new content for the products of U.S. AR/VR companies, making it harder to compete against foreign products with higher sales levels and exacerbating the harm from the duties themselves.

It would be difficult for U.S. AR/VR companies to source their products from the U.S. or from third countries outside of China, as the necessary production facilities do not currently exist and not all countries have an appropriately specialized workforce in place. It would take an extensive amount of time to move existing operations, and it would cost significant amounts of capital that U.S. companies could otherwise invest in research and development and creating additional U.S. jobs. In addition, given the cutting-edge and rapidly changing nature of AR/VR products, the resultant delay in bringing new U.S. products to the market would be extremely harmful for U.S. competitiveness. This harm, in turn, would benefit other countries' AR/VR companies, contrary to the goals of the Section 301 investigation.

IA urges the administration to remove augmented reality and virtual reality (AR/VR) products and components (HTS 8471.41.0150, 8525.50.10, 8517.62.0090, 9504.50.000) from the final list of products that will be subject to increased duties.



Additional High Tech Products: HTS 8528.72.64 (Smart TVs), HTS 8471.60.2000 (Keyboards), HTS 8471.41.0150 (Other ADP Machines), HTS 8518.30.2000 (Stereo Headset), HTS 8526.92.1000 (Wireless Gaming Controller), HTS 8543.70.8700 (Media Remote), 8521.90.00 (Video recording devices), HTS 9105.21.80 (Wall Clocks), HTS 8528.52.00 (Computer Monitors)

High tech and consumer electronic products on this list require complex production processes and timelines and the lack of lead time on these new tariffs would significantly compound the negative impact to U.S. companies from shifting production, establishing new supply lines, re-engineering production facilities, and other mitigation steps.

IA requests that the HTS codes featured in this section are removed from List 4. The removal of the HTS codes (HTS 8528.72.64, 8471.60.2000, 8471.41.0150, 8518.30.2000, 8526.92.1000, 8543.70.8700, 8521.90.00, 9105.21.80, 8528.52.00) in this section would have a positive impact on American consumers who might otherwise buy these devices from foreign competitors and on American companies that sell these products.