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TRADE UPDATE: Deepening of the US-China Trade War

July 9, 2018

KEY POINTS:

1. **25% US tariffs on \$34 billion worth of Chinese goods went into effect at 12:01 a.m. July 6** as part of the Trump administration's section 301 action to address China's intellectual property and technology transfer practices.
2. **China immediately followed suit by implementing reciprocal 25% tariffs on \$34 billion worth of US agricultural, automobile, and aquatic products.**
3. **On July 6, USTR announced a product exclusion process for the \$34 billion worth of Chinese products** subject to the administration's first tranche of tariffs.
4. **The next exchange of tariff hikes (\$16b-for-\$16b) is expected in August** after completion of the public comment and hearing.
5. **While it remains possible that the initial exchange of tariffs will lead to further dialogue** prior to implementation of the second tranche of punitive tariffs, neither side shows any sign of backing down.

First Shots Fired

The **Trump administration on July 6 implemented 25% tariffs on \$34 billion worth of Chinese goods (818 tariff lines) that contain "industrially significant technologies"** (primarily linked to "Made in China 2025"), as part of the administration's three-pronged approach to address China's theft of American intellectual property and technology. **The 301 action also supplements restrictions on foreign investment in the US** (to be implemented through FIRRMA and not limited to China) **and a WTO dispute action.**

Despite the significant increase in tensions between Washington and Beijing, **both sides show no sign of backing down.** Trump has vowed to impose additional tariffs if China retaliates by imposing new tariffs on US goods or taking punitive actions against US companies in China. Hours before the July 6 tariffs took effect, Trump pointed to the second tranche of tariffs on \$16 billion worth of Chinese goods and threatened tariffs on an additional \$500 billion in Chinese imports.

First **"34 [billion], and then you have another 16 [billion] in two weeks and then, as you know, we have 200 billion in abeyance and then after the 200 billion we have 300 billion in abeyance.** Ok? So we have 50 plus 200 plus almost 300," Trump told reporters aboard Air Force One on his way to a campaign rally in Montana last Thursday. This sum

of \$550 billion in Chinese goods that would be subject to US duties surpasses the roughly \$500 billion in total annual Chinese [exports](#) to the US.

25% tariffs on the remaining \$16 billion worth of Chinese goods are subject to the following [timeline](#) outlined by USTR to further refine the list prior to its implementation:

- **July 23:** Deadline for written comments.
- **July 24:** Section 301 Committee holds public hearing.
- **July 31:** Deadline for post-hearing rebuttal comments.
- **Aug 1:** Possible/probable application of tariffs on \$16 billion.

On June 18, Trump [directed](#) USTR to identify \$200 billion worth of Chinese goods to be subject to additional 10% tariffs “after the legal process is complete,” if China moves forward with its retaliatory tariffs on \$50 billion worth of US goods. He warned further tariff hikes by China would be met with yet another round of tariffs on an *additional* \$200 billion of Chinese goods. **Reportedly, these items would also be subject to an advance notice and comment process.**

Beijing Returns Fire

Shortly after the US began levying its tariffs, **China’s Foreign Ministry spokesman announced China’s reciprocal 25% [tariffs](#) on \$34 billion worth of US products “had taken effect immediately after the implementation of the US tariffs.”** Many of the US goods targeted by China’s tariffs are agricultural products, such as soybeans, corn, beef, and pork, but also include vehicles and aquatic goods. **China’s Ministry of Commerce (MofCom) [issued](#) a statement calling the US tariffs “typical trade bullying” and in violation of WTO rules. The ministry stated it would fight back and file additional claims at the WTO** against the 301 tariffs. Beijing [launched](#) a WTO dispute over proposed 301 tariffs a day after USTR published April 3 its [proposed list](#) of \$50 billion in Chinese products that would be subject to possible tariffs.

“China will not fire the first shot, but is inevitably forced to strike back to defend the core interest of the nation and its people,” the ministry said in its statement. In an earlier statement, a MofCom spokesman [said](#) the US move threatened the “global industry and value chain,” and dismissed concerns that US companies in China would be targeted in the “US-provoked trade war.” **Beijing has previously stated it would respond to US tariffs in kind, using both quantitative (tariff) and qualitative (non-tariff) measures,** which could entail penalties such as customs delays, tax audits, and increased regulatory scrutiny.

China’s counter-tariffs come on top of its retaliatory [tariffs](#) (implemented April 2) on about \$3 billion worth of US goods, including pork, fruits, and nuts, for US 232 tariffs on steel and aluminum imports. **The effective date for a separate tariff list targeting \$16 billion of US chemical, medical, and energy products has not yet been announced** and will likely be enforced after the second tranche of US tariffs goes into effect.

Beijing has [reportedly](#) been pressuring European officials to issue a joint statement against Trump’s trade policies ahead of a July 16-17 Sino-European summit in Beijing. The EU has

reportedly rejected the idea, and the summit is expected to produce a generic communique endorsing the multilateral trading system.

Implications for American Businesses

USTR July 6 [announced](#) a product exclusion process for Chinese products imported under 818 tariff lines (valued at \$34 billion), subject to the administration's first tranche of 25% tariffs July 6 for China's unfair intellectual property and technology transfer practices.

The timeline and features of the exclusion process are as follows:

- The public will have **until Oct. 9, 2018** to submit a product exclusion request.
- Following publication of the filed request, **the public will have 14 days to file responses to the request** for product exclusion. After the 14-day response period, **interested parties will have an additional 7 days to reply to any responses received.**
- **Exclusions will be effective for one year** upon the publication of the exclusion determination in the Federal Register, **and will apply retroactively to July 6, 2018.**
- Exclusions will be made on a product basis, and therefore **a particular exclusion will apply to all imports of the product**, regardless of whether the importer filed a request.

Regarding the determination process, **USTR said that it may consider “whether a product is available from a source outside of China, whether the additional duties would cause severe economic harm to the requestor or other US interests, and whether the particular product is strategically important or related to Chinese industrial programs** including ‘Made in China 2025.’”

An official [notice](#) outlining the criteria and process for requests will be published in the Federal Register this week.

Business and agriculture groups, as well as lawmakers, continue to voice their concerns over the undue burden felt by American workers, businesses, and farmers as a result of the administration's tariffs and global counter-measures adopted in response to those tariffs. The US Chamber [estimates](#) that **approximately \$75 billion worth of US exports will be subject to retaliatory tariffs**, as of this week.

What's Next

As noted, the **next exchange of tariff hikes (\$16b-for-\$16b) is expected in August** as the [second tranche](#) of tariffs on \$16 billion of Chinese goods go into effect after the [Federal Register](#) timeline for public comments. China should immediately retaliate with tariffs of its own on \$16 billion worth of US imports, completing the initial round of tariffs on goods worth \$50 billion. **While Trump could leapfrog the comment period, USTR Lighthizer has expressed a commitment to advanced notice and comment. We believe USTR could reveal as early as this week the list of additional proposed tariffs on \$200 billion of Chinese goods that would be subject to tariff hikes of 10%**, to exert additional pressure on China. MA is informed that a draft list has been prepared.

It remains possible that the initial exchange of tariffs will lead to further dialogue prior to implementation of the second tranche of punitive tariffs. However, this trade dispute has **already produced uncertainty that is leading to shifting trade patterns** and a re-invigorated Chinese push to wean itself from dependence on US companies. Moreover, the escalation of threats between the two economic superpowers make it increasingly difficult to reach a negotiated settlement ahead of the second round of tariffs.

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