McLarty Update: Trade Overview

July 2, 2018

NAFTA

The outlook for NAFTA's renegotiation was recently complicated as tensions flared between the United States and Canada following the G7 leaders' summit, and a US proposal for a five-year sunset clause remained a sticking point. **The parties have not yet agreed on critical issues** such as autos rules of origin, ISDS, government procurement, trade remedies, etc. Further, President **Trump has recently expressed desire to negotiate bilaterally with Mexico and Canada.**

June 14, Canadian Foreign Minister Freeland met with USTR Lighthizer, agreeing to push forward with NAFTA talks over the course of the summer. **A best-case scenario would be for talks to extend until after the July 1 Mexican elections and the November US midterms** given lack of US flexibility and the distance between the parties.

However, **if it becomes clear that a deal is untenable in the short-term** and the United States is increasingly isolated, President **Trump may double-down on his aggressive approach by triggering US withdrawal from NAFTA.** This would start a **six-month waiting period,** after which US withdrawal would be possible. This would give stakeholders **time to advocate and implement contingency plans, and prepare for a US withdrawal** scenario.

Further complicating talks, on May 31, the Trump Administration confirmed it would impose 232 tariffs on steel and aluminum imports from Mexico, Canada, and the EU due to "national security" considerations. The first time such tariffs were imposed on US allies, this announcement closely followed the US decision to consider new national-security-motivated tariffs on vehicle and auto-parts imports, **casting a further pall over ongoing NAFTA negotiations.**

232 "National Security" Tariffs on Steel/Aluminum

After a lengthy investigation under Section 232 of the Trade Expansion Act of 1962, **the US has applied 25% tariffs on steel imports and 10% tariffs on aluminum imports from most countries in the world, including US allies**. Australia, Brazil, Argentina, and Korea negotiated various types of quotas or carve outs, but the failure to exclude Mexico, Canada and the EU led to immediate steps to retaliate. This came on top of Chinese retaliatory tariffs on a value of $3 billion of US exports, including pork, fruits, steel pipes, and recycled aluminum.

The **Mexican retaliation list** published on June 5 **included tariffs on US imports, including steel, apples, and pork. Tariffs on some products will be implemented gradually**. For example, chilled/frozen pork will be subject to a 10% tariff **until July 5, when it will double to 20%.**

On June 14, reports emerged that Mexican officials may consider additional tariffs on goods reportedly left out to retain leverage as trade talks with the US continue, a decision that could be tied to further US trade actions. Mexican Agriculture Ministry officials have said Mexico is not targeting US grains "right now" but will not rule out such a move in the future. Meanwhile, **Mexico has been seeking alternative suppliers for feed corn and soybeans**, citing Argentina and Brazil as potential substitutes.

Canada has outlined "dollar for dollar" countermeasures against up to USD $12.8 billion in goods. **Effective July 1, Canada imposed tariffs of 25% on a list of US steel and aluminum products and of 10% on a list of mostly prepared foods and consumer goods**. **EU member states June 14 unanimously backed a plan to implement retaliatory tariffs** targeting some $3.3 billion worth of US products. The EU then enacted 25% duties on a **list of US goods, ranging from motorcycles to corn and metals, on June 22.**

Japan, Russia, Turkey and India are also pursuing retaliatory measures under the WTO Safeguards Agreement. Turkey on June 21 applied duties ranging from 5 to 40% on select US products while India announced its duties of 10 to 50% on US agricultural and manufacturing goods will go into effect August 4. Japan and Russia will not be able to take action until they identify their respective retaliation lists.

To date, retaliation has been strategic and pointed on the part of US allies and China, in an attempt to hit key US congressional districts. However, we must expect that more products will be featured on future retaliation lists. A **full overview of current retaliation is provided in the attached** PPT.

301 Investigation of Chinese Intellectual Property (IP) Practices

President Trump announced USTR's findings regarding China's IP practices on March 22. US **retaliation** was to include: **25% tariffs on goods** (primarily linked to "Made in China 2025") worth $50 billion and **limitations on Chinese investment** in the United States. The US also filed a **WTO dispute**.

On June 15, the US announced that it would implement a first tranche of **25% tariffs on $34 billion of goods** (818 tariff lines), to be **applied beginning July 6**. The remaining $16 billion of goods – and perhaps an additional $200 billion – will go through additional public notice, comment, and hearings to consider additional tariff application. The July 6 retaliation list was pulled from the original list of 1333 tariff lines targeted for 301 retaliation by USTR on April 3.

Shortly after Trump's announcement, **China's Ministry of Commerce responded in a** statement **saying it would impose measures of the "same scale and the same strength,"** and that the US tariffs were "undermining the world trade order." It added that **settlements reached in earlier discussions between US and Chinese officials were**

now "invalid." The Chinese State Council then approved 25% tariffs on $50 billion worth of US goods. **China's reciprocal tariffs cover 659 items, and** like the US tariffs announced today, **will be implemented in two steps. Duties on a list of $34 billion worth of US agricultural, auto, and aquatic goods will take effect July 6.** The effective date for a separate tariff list targeting $16 billion of US chemical, medical, and energy products is scheduled to be announced at a later date.

In a statement, Trump noted that **the US will "pursue additional tariffs" if China engaged in retaliatory measures, such as imposing new tariffs on US goods, services, or agricultural products**; raising non-tariff barriers; or taking punitive actions against US exporters or US companies doing business in China.

Meeting with members of Congress **June 26, Trump said the investment restrictions linked to the 301 action will not be limited to China**, echoing Secretary Mnuchin's earlier statement that the restrictions would apply to all countries engaged in IP/technology theft. Ahead of the June 30 deadline, Trump issued a statement announcing that the Committee on Foreign Investment in the US (CFIUS), combined with the FIRRMA legislation to expand its purview, would provide the best means to combat "predatory investment practices" that threaten US technology, national security, and economic prosperity. Upon enactment of the CFIUS reform bill, Trump pledged its prompt implementation and enforcement. If Congress fails to pass a "strong" FIRRMA bill, Trump said his administration would "deploy new tools" to protect US IP/technology. The statement also noted that Secretary Ross would lead a review of existing US export controls to further strengthen the defense of US technology and intellectual property.

This announcement **does not reflect a softening** of restrictions on China as Trump and his aides continue to develop the form and scope of investment and export controls.

It **remains possible that the initial exchange of tariff hikes will lead to further dialogue** prior to implementation of the second tranche of punitive tariffs. However, this trade skirmish 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.

232 on Auto Imports

At Trump's direction, the **Commerce Department on May 23 launched a Section 232 investigation into the impact of automobile/parts imports on US national security.** Commerce has **up to 270 days** to complete the investigation, which **includes a hearing and a public comment period that will last until July 20.** Secretary Ross indicated last week that Commerce is still in the early stages of the investigation but should conclude the probe by late July or August.

The Administration has indicated it is **likely to move forward on a determination and possible trade actions before the US midterms**, opening another front of retaliatory risk from US trading partners. Last week, Trump threatened to levy a 20% tariff on European auto imports unless EU trade barriers were removed. France's finance minister responded by pledging another round of EU reprisals if the US followed through on the threat. "We don't want an escalation, but we are the ones being attacked," Le Maire said.

Generalized System of Preferences

GSP was reauthorized in the recent omnibus spending bill - renewed until December 31, 2020 and retroactive to Dec 31, 2017. In April, the Trump Administration announced it would review India, Indonesia, and Kazakhstan's eligibility in the GSP program. Later, in May, USTR accepted a petition challenging Thailand's eligibility in the GSP program. These eligibility reviews come after USTR announced in October 2017 that there will be a new triennial review process to assess eligibility, with the first review covering 25 Asian and Pacific Island beneficiaries.

For India, the GSP country eligibility review is based on concerns related to its compliance with the GSP market access criterion; this was a self-initiated case by USTR, but with supporting petitions from the dairy and medical devices industries (price controls).

For Indonesia, the review – also self-initiated by USTR – is based on concerns related to its compliance with the GSP market access criterion and the GSP services and investment criterion. Kazakhstan's eligibility review is based on concerns related to its compliance with the GSP worker rights criterion and was based on a petition submitted by the AFL-CIO, while Thailand's status is being reviewed due to a National Pork Producers Council petition. A public hearing was held on June 19 to review these four countries.

The next assessment process will take place in Fall 2018 and will cover Eastern Europe, the Middle East and North Africa, and the Western Hemisphere. **The trend line is that the US should become more demanding on GSP compliance, as well as to examine eligibility from a development perspective.**

Russian Countersanctions

On June 4th, President Putin signed into law Bill No. 441399-7 – On Measures (Countermeasures) in Response to Unfriendly Actions of the USA and (or) other Foreign States. The new law **authorizes the Russian executive branch to impose sanctions on any organizations or individuals associated with "unfriendly foreign states,"** as well as to **ban selected exports to the United States**. While the original version of the bill had explicitly included industry-wide import bans of pharmaceuticals, agricultural products, alcohol and tobacco products, the current law does not specify which goods or sectors will be affected, instead allowing the president to make these determinations on a case-by-case basis.

The bill was substantially diluted following an outcry from the Russian business sector over concerns that it would hurt Russian consumers and industries. As it stands, the new law does little more than formalize the existing status quo, given that the government already had the power to unilaterally impose these kinds of sanctions. The efficacy of the legislation may soon be tested - on June 12th, Russian Deputy Minister of Foreign Affairs Sergei Ryabkov announced that Russia would retaliate against a new wave of US sanctions by imposing its own counter-sanctions on US individuals and entities.

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