China-US Trade Disputes (XXXII)

FUNG BUSINESS INTELLIGENCE

Fung Business Intelligence
Global Sourcing
24 February 2020

China-US trade updates – February

- **US and China grants tariff exemptions on imports from each other**
- **China cuts tariffs on US imports**
- **US removes China from list of developing countries and revokes WTO subsidy preferences for China**

US announces additional exclusions on Chinese imports

The Office of the US Trade Representative announced on 20 February additional tariff exclusions for 47 items of Chinese imports that are on 'List 3' (i.e. the US$200 billion tariff action),[1] which came two days after China announced a similar move. Affected products include leather mobile device covers, wood flooring, desk accessories, various fabrics, wooden toddler beds, wooden fireplace mantels, office furniture parts, etc. The product exclusions will be retroactive to 24 September, 2018, the effective date of the US$200 billion tariff action, and remain in place till 7 August, 2020.

China to grant tariff exemptions on US goods

China will grant exemptions on retaliatory tariffs imposed against 696 items of US goods, according to a statement released by the Customs Tariff Commission of the State Council on 18 February.[2]

[1] http://www.federalregister.gov/d/2020-03377
[2] http://gss.mof.gov.cn/gzdt/zhengcefabu/202002/t20200218_3470901.htm

Enterprises can start submitting their applications on 2 March, and any exemptions granted will be valid for one year. US goods eligible for tariff exemptions include major agricultural products such as pork, beef and soybeans, and energy products such as liquefied natural gas and crude oil. Other products eligible for exemptions include medical devices, pharmaceutical products, and metals.[3]

China emphasized that tariff exemptions will be granted to Chinese enterprises which make purchases of US goods based on market conditions and commercial considerations. The announcement is the third round of tariff exemptions China has offered on US imports.

Tariff cuts on US goods take effect on 14 February

Earlier, the Chinese government on 6 February announced that it would halve additional tariffs on billions of US goods, effective from 14 February. Tariffs on 916 items of US products are cut from 10% to 5%, and from 5% to 2.5% on 801 items, according to a statement from the Customs Tariff Commission of the State Council.[4] Products benefiting from the reduced tariff rates include crude oil, meat products and soybean, which are part of product lists worth a total of US$75 billion announced in last August. The tariff adjustments took effect from 1:01 p.m. from 14 February.

Chinese officials said that the tariff cuts correspond with those announced by the US, which earlier agreed to cut the tariff rate on US$120 billion of Chinese products to 7.5% from 15%, also effective from 14 February.

US removes China from list of developing countries and revokes WTO subsidy preferences for China

In a related development, the US has removed China, Hong Kong and 23 other economies[5] from its internal list of developing and least-developed countries when it comes to international trade, according to a US Trade Representative notice on 10 February.[6]

The USTR said that it revised its developing country methodology for countervailing duty investigations because the previous guidance – which dates back to 1998 – is now obsolete.

[3] For the full list of eligible US goods, see: http://gss.mof.gov.cn/gzdt/zhengcefabu/202002/P020200218404642439190.pdf
[4] http://www.gov.cn/zhengce/zhengceku/2020-02/06/content_5475214.htm
[5] Other economies removed from the list are Albania, Argentina, Armenia, Brazil, Bulgaria, Colombia, Costa Rica, Georgia, India, Indonesia, Kazakhstan, the Kyrgyz Republic, Malaysia, Moldova, Montenegro, North Macedonia, Romania, Singapore, South Africa, South Korea, Thailand, Ukraine, and Vietnam.
[6] https://ustr.gov/sites/default/files/Designations_Notice_2020-02524.pdf

Our take

1. While the tariff exemptions announced by both China and the US could be seen by some as a gesture of goodwill to improve the bilateral trade relations, they are probably aimed at reducing the impact of the tariffs on domestic enterprises, in our view. Actually, as of 24 February, the US has announced a total of 20 exemption lists, granting tariff exclusions for 477 Chinese goods on 'List 3' (i.e. the US$200 billion tariff action), 269 items on 'List 2' (i.e. the US$16 billion tariff action), and 730 items on 'List 1' (i.e. the US$34 billion tariff action). Meanwhile, China has also offered three rounds of tariff exemptions on US goods.

   What is of more significance is China's tariff cut on US imports. The Chinese government said that the move was in response to the tariff cut by the US on US$120 billion of Chinese goods, but it is not known whether China's tariff cut is a mutually agreed-upon move or a unilateral move to reduce the tariff burden on Chinese enterprises. Regardless, the tariff cut will help encourage imports from the US, as China seeks to fulfill the US$200-billion-worth purchase commitments made in its phase one trade deal with the US.

   However, even after the tariff cuts by both countries take effect from 14 February, US tariffs still cover about two-thirds of all US imports from China, and Chinese tariffs still cover over half of all Chinese imports from the US. Thus, one important implication is that tariffs will become the 'new normal' in the China-US relations.

2. Theoretically, the US removing China from its list of developing countries will make it easier for the US to launch an investigation into whether China is 'unfairly' subsidizing exports. However, the move would not lead to immediate impact on China, in our view.

   Under WTO rules, governments are required to terminate their countervailing duty (CVD) investigations if the amount of foreign subsidy is *de minimis*, which is normally defined as less than 1% ad valorem. But for developing countries, WTO rules allow a higher amount of subsidy which is 2% ad valorem. Thus, what China needs to do to avoid CVD investigations by the US is simply cutting subsidies from 2% to 1% on affected industries.

   In fact, past CVD investigations by the US usually found that China's subsidy levels were significantly higher than the 2% threshold. For example, the US Department of Commerce determined that producers/exporters of fabricated structural steel from China received subsidies at rates of 27.34%-206.49%, according to a press release on 24 January.[7] As a matter of fact, whether or not China stays in the list of developing countries, the US has already been

[7] https://www.commerce.gov/news/press-releases/2020/01/commerce-finds-dumping-imports-fabricated-structural-steel-canada-china

launching various types of trade investigations against China. The ‘Section 301’ investigation, which triggered the China-US trade war since 2018, is a prominent example. On the other hand, the issue of industrial subsidies is likely to be a main focus in the next round of trade negotiations between the two countries. Hence, the US removing China from its list of developing countries has minimal impact on China on the front of trade investigations.

However, it is possible that allies of the US will follow the US’s lead in declaring China as a developed country, which might lead to added uncertainty and loss of trade preferences for China.

Implications for our sourcing business: We need more diverse and flexible supply chains

The lingering China-US trade tensions have caused disruptions in the global trade landscape, bringing fresh challenges and greater unpredictability to our sourcing business. Under such circumstances, production and supply chains now need to be even more diverse, agile, and technology-driven. Businesses with a strong global supplier network and deep relationships with suppliers will be in the best position to meet the new challenges. To navigate the challenging situation, businesses should continue to carry out strategic planning and re-planning for their supply chains, through diversifying sourcing base, nearshoring and onshoring production, and digitizing supply chains.

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Fung Business Intelligence collects, analyses and interprets global market data on sourcing, supply chains, distribution, retail and technology.

Headquartered in Hong Kong, it leverages unique relationships and information networks to monitor, research and report on these global issues with a particular focus on business trends and developments in China. Fung Business Intelligence makes its data, impartial analysis and specialist knowledge available to businesses, scholars and governments through regular research reports and business publications.

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Fung Business Intelligence was established in the year 2000.

About Fung Group

Fung Holdings (1937) Limited, a privately-held business entity headquartered in Hong Kong, is the major shareholder of the Fung Group of companies, whose core businesses operate across the entire global supply chain for consumer goods including trading, logistics, distribution and retail. The Fung Group comprises 42,000 people working in more than 40 economies worldwide. We have a rich history and heritage in export trading and global supply chain management that dates back to 1906 and traces the story of how Hong Kong and the Pearl River Delta emerged as one of the world's foremost manufacturing and trading regions. We are focused on both creating the Supply Chain of the Future to help brands and retailers navigate the digital economy as well as creating new opportunities, product categories and market expansion for brands on a global scale.

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