China-US Trade Disputes (XXI)

FUNG BUSINESS INTELLIGENCE

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US to raise tariffs on US$200 billion of Chinese imports

On Wednesday, the USTR filed a Federal Register notice implementing the threatened tariff hike (from 10% to 25%) on US$200 billion worth of Chinese imports. We believe that the move is aimed at exerting greater pressure on China during this week's trade talks. However, it also heightens the risk that the bilateral trade talks break down altogether. We will continue to closely monitor developments in this regard.

USTR confirms tariff hike on Chinese imports

On 8 May, the Office of the US Trade Representative (USTR) filed a formal Federal Register notice (to be published on 9 May) implementing the threatened tariff hike by US President Donald Trump on US$200 billion worth of Chinese imports.[1] The increase in tariff rate from 10% to 25% is scheduled to take effect at 12:01am (US Eastern daylight time) on Friday (10 May). However, it is noteworthy that Chinese goods exported before midnight Thursday would only be subject to the 10% extra tariffs currently in place, not the 25% extra tariffs, according to the Annex to the Federal Register notice.

The tariff hike was previously scheduled to kick in on 1 January and then on 2 March, but was twice postponed amid progress in the bilateral negotiations between China and the US.

The tariff increase will affect a wide range of consumer goods including 'apparel and clothing accessories made of leather, fur, plastic and rubber', footwear made of crocidolite and asbestos, hats and headgear, handbags, travel goods, lighting products and furniture.

[1] https://federalregister.gov/d/2019-09681

It is noteworthy that the Federal Register notice does not address Trump's separate threat of additional 25% tariffs on US$325 billion of Chinese imports that are not currently subject to the Section 301 tariffs.

China's response

China's Ministry of Commerce (MOFCOM) announced on Tuesday that that Chinese Vice Premier Liu He would visit the US for trade talks on 9 May and 10 May.[2] After the USTR's filing of the Federal Register notice, the MOFCOM said in a statement on Wednesday night that 'if the US tariff measures are implemented, China will have to take necessary countermeasures'.[3]

Hurdles in trade talks

The Federal Register notice states that 'in the most recent negotiations, China has chosen to retreat from specific commitments agreed to in earlier rounds', but it does not elaborate. According to media reports, several points of disagreement have arisen in recent days:

- First, in each of the seven chapters of an edited draft trade deal from Beijing, China reportedly deleted its commitments to change domestic laws to address US concerns, which include the theft of US intellectual property and trade secrets, forced technology transfers, competition policy, market access to the service sector, etc. China offered to fulfil its pledges through administrative and regulatory changes instead, but the US viewed the move as an attempt to renegotiate. (However, Chinese law experts said that the key to effective law enforcement in China actually lies in administrative and regulatory actions, and thus China's suggestion should not be regarded as backpedaling on commitments on legal changes.)
- Second, China reportedly continues to resist concessions on some US demands on industrial subsidies, intellectual property rights, data localization, cloud computing, and biotechnology.
- Finally, it is said that China seeks the full and immediate removal of punitive tariffs on US$250 billion worth of Chinese imports, while the US would like to keep some of the tariffs in place as leverage.

Sources also said Chinese President Xi Jinping earlier vetoed extra concessions proposed by his negotiators. President Xi reportedly told them 'I'll be responsible for all possible consequences', according to a *South China Morning Post* report dated 7 May.

[2] http://www.mofcom.gov.cn/article/ae/ag/201905/20190502860421.shtml
[3] http://www.mofcom.gov.cn/article/ae/ag/201905/20190502861184.shtml

Our take

1. The scheduled tariff increase marks a sudden re-escalation of the yearlong trade war between China and the US. We believe that the latest US move is aimed at exerting greater pressure on China and extracting extra concessions from China during this week's trade talks. However, the tariff hike, if implemented as scheduled, also heightens the risk that the trade talks break down altogether, as China might be reluctant to engage in further negotiations, at least in the very near term.

   Trump's latest shift in stance might also highlight his own political problems as he tries to fend off criticisms that he has not been tough enough on China, as well as stay out of troubles regarding the Mueller Report. If Trump's decision to re-escalate trade tensions with China is indeed a political calculation, the already-difficult bilateral trade negotiations could be facing additional complications.

   Although a comprehensive trade deal is unlikely to be concluded this week, it remains possible that China and the US will reach an agreement to postpone the scheduled tariff increase, as witnessed before. Besides, the annex stating that Chinese goods exported before midnight Thursday would not be subject to the extra 25% tariffs also means that the US will not be collecting the extra tariffs on Chinese goods until several weeks later, which leaves open the possibility of withdrawing the tariff hike if there are breakthroughs in the trade talks over the next few days.

   In the longer term, however, even if the two countries can reach a trade agreement to end the trade war, broader uncertainties and tensions (such as the escalating technology war) between the two countries are likely to remain for a long time, as the key issue between China and the US is geopolitical rivalry instead of trade.

2. The latest US tariffs will bring the total amount of imports from China that face 25% additional tariffs to about US$250 billion as soon as this Friday. Given that Trump has threatened to impose 25% additional tariffs on another US$325 billion of Chinese imports 'shortly', all Chinese imports, including all items of apparel and footwear, could eventually be subject to extra tariffs.

   Against this backdrop, sourcing businesses need to get prepared for a full-fledged China-US trade war and carry out strategic planning and re-planning for their supply chains, to mitigate potential negative impacts on their business. This includes exploring alternative sources of supply, redirecting shipments, restructuring production chains, as well as conducting country of origin management, tariff engineering and customs valuation planning.

FUNG BUSINESS INTELLIGENCE

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

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Fung Business Intelligence was established in the year 2000.

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