Dear Members of the Committee, on behalf of the Software & Information Industry Association and its members, I would like to thank you for the opportunity to testify before you today regarding the proposed modification of action pursuant to Section 301 tariffs applied to China, the so-called “List 4”.

My name is Jesse Spector, I am the Director of Technology Policy at the Software & Information Industry Association (SIIA). SIIA is the principal trade association for the software and digital information industries. The more than 800 software companies, data and analytics firms, information service companies, and digital publishers that make up our membership serve nearly every segment of society including business, education, government, healthcare and everyday consumers. As leaders in the global market for software and information products and services, our members are drivers of innovation and economic strength – software alone contributes $425 billion to the U.S. economy and directly employs 2.5 million workers and supports millions of other jobs. For more information, please visit the SIIA Policy Home Page at www.siia.net.

There is no doubt that China does not provide a level playing field for the kinds of technology and information companies that SIIA represents, and so it is clear to us that Chinese trade and commercial practices require sustained attention. SIIA therefore supports the Trump Administration’s emphasis on changing the paradigm for U.S.-Chinese economic relations. However, SIIA opposes the use of tariffs as a means of changing other countries’ practices because they are ineffective in achieving that aim, impose heavy costs on U.S. businesses, and hurt American consumers.

With regards to the “List 4” proposed tariffs, my comments today will focus specifically on those that concern mobile phones, connected devices, and laptop and tablet computers (HTS 8517.12.00, HTS 8517.62.0090, and HTS 8471.30.0100 respectively). I will also address the proposed tariffs on printed
books (HTS 4901.91.00, HTS 4901.99.00, HTS 4903.00.00, and HTS 4911.10.00). My testimony will explain that were these tariffs to be implemented, they would have a direct, significant, and negative impact on the businesses of our members, forcing them to reduce production lines, raise prices, and cut American jobs. There is no doubt that the application of these tariffs would cause harm to American consumers and damage American competitiveness in the global market. We therefore request that these items be removed from the “List 4” tariffs. And if removal is not possible, at a minimum we request that the implementation timeline be adjusted to allow reasonable time to undertake mitigation measures to safely shift production.

“List 4” Tariffs Hurt American Consumers and Damage American Competitiveness

Mobile phones have already established themselves as a daily necessity for most Americans. And laptop computers, tablets, and connected devices have proven their worth as critical productivity tools for a wide range of traditional U.S. industries – from agriculture and financial services, to healthcare and manufacturing. U.S. companies in the business of supplying these high-demand devices, are in fierce competition with global rivals to drive down prices for American consumers. Lower prices enable lower-income Americans to access and benefit from these cutting-edge devices. Applying a 25% tariff on U.S. producers of mobile phones, connected devices, and laptop computers would lead to price increases, making it more difficult for traditional U.S. industries and lower-income Americans to access and leverage these innovative technologies. Furthermore, such tariffs would effectively give a competitive advantage to producers in Korea, China, and elsewhere, who would not face such additional costs.

It’s important to be aware of the complexity of the processes and time required for the production of these highly technical devices. The lack of lead time to prepare for these new tariffs to take effect significantly compounds the negative impact on U.S. companies having to shift production, establish new supply lines, re-engineer production facilities, and take other mitigation steps necessary to maintain production at a volume and standard to meet American consumer demands. U.S. mobile phone producers and consumer hardware firms are already heavily invested in current production cycles for the critical fall sales season, therefore shifting production to a new location for this cycle is no longer feasible without American companies and consumers incurring losses. Since consumer demand would remain unchanged, the application of these tariffs would effectively drive U.S. consumer business to foreign competitors.

In the low-margin and high-risk consumer hardware business, few if any U.S. firms would be able to absorb a 25% surcharge on products without losing significant market share to foreign competitors. The reality is that many smaller U.S. firms in these sectors would simply go out of business, while larger firms would become less competitive globally in the fast-moving space.

Removing these tariff lines (HTS 8517.12.00, HTS 8517.62.0090, and HTS 8471.30.0100) from “List 4” would have a meaningful impact on preserving American competitiveness in this critical sector.
Shifting Production of Mobile Phones out of China Would Take a Minimum of 8-10 Months

As explained, the key challenge that U.S. producers of mobile phones and connected devices would face under the proposed 25% tariff is the difficulty of shifting production out of China in line with the proposed timeframe without suffering significant economic harm. These highly technical 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 mobile phones to meet consumer expectations requires cameras, displays, memory, sensors, and printed circuit board assemblies. Compelling U.S. producers of these devices to immediately shift supply chains would be an undue hardship insofar as it would derail planning efforts and sourcing for already-in-progress production cycles. In many cases, there is no plausible and commercially reasonably option for U.S. producers to shift production out of China under a foreseeable time horizon. And in cases where mitigation is possible, it will generally take U.S. companies a minimum of 8-10 months to safely shift production out of China.1

To keep pace with demand and stay ahead of competition, U.S. producers of phones and connected devices are actively looking for feasible mitigation options. However, the timeline for shifting production must reasonably take into account current product launch timelines and sales cycles. For phones in particular, the height of the annual U.S. sales cycle is between November 29, 2019 (“Black Friday”) and Christmas. This means that all stock must be in stores and available for mass purchase by early November. Missing production goals for the critical holiday season can not only damage annual sales targets but also compromise the long-term viability of a given product.

To meet these goals, a U.S. producer of mobile phones 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. Because the Administration has previously indicated that consumer technology items such as phones and connected devices would not be subject to tariffs, these firms have not spent significant time searching for alternative production locations in advance of the May 17 announcement of List 4 tariffs. Aside from circuit boards, very few components of a phone are assembled in a fully automated way. This means that a U.S. producer cannot simply move equipment to another factory and instantly restart

1 The long timeframe is required because there are unique and significant costs and challenges associated with shifting production of phones and connected devices out of China. These costs fall into three 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, and intermediate assemblies of 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, as well as the costs of essential inputs such as electricity. In practice, companies need to consider BOM, MVA, and infrastructure-related costs in determining whether a given mitigation action is commercially reasonable and justifiable.
production. Instead, it takes significant time and investment to set up new plants, retrain new employees, reengineer an assembly line, find new sourcing, build new logistics networks, establish new contracts, and work with partners in unfamiliar locations. Imposing tariffs immediately on U.S. phones would generate a massive shock to U.S. producers that would reverberate into future sales cycles, risking permanent damage to U.S. competitiveness in the global market.

Similarly, with connected devices, the costs of mitigation are significant and exacerbated by the challenges of being forced to a new country with less documented expertise in high-tech manufacturing, elevated logistics costs due to lack of support for large scale manufacturing, and increased 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 related factors. Again, these moves become more difficult once the product development cycle has already begun as in the present situation.

Finally, there are capacity constraints associated with production moves. Since early 2018, production capacity has been filling up in non-China locations and has led to new stresses on existing infrastructure and logistics networks. This is especially evident in countries with a high manufacturing influx and historically underdeveloped logistics networks.

Giving U.S. producers of phones and connected devices a longer period of time to shift production would enable U.S. firms to do detailed BOM/MVA/infrastructure assessments well 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. While we remain firm in our position that these items should be removed from the “List 4” tariffs; if such removal is not possible, at minimum we ask that the implementation timeline be adjusted to allow companies to undertake necessary mitigation measures.

Tariffs on Printed Materials Would Affect Product Quality and Headcount in the U.S.

SIIA has a number of members that produce printed materials, in addition to software based activities. Our members’ printed materials include children’s books, trade books, student textbooks, and marketing materials. For them, the tariffs on printed books (HTS 4901.99.00 and HTS 4901.10.00) not only place a heavy burden on their business model, but on their customers too, many of who are part of an environment where the cost of materials remains top of mind and the number one issue for purchasing decisions (as reflected in the frequency of press and media stories on the high cost of textbooks and materials for students).

2 See Footnote 1 regarding BOM/MVA/infrastructure assessments
As much as 15% of these companies’ print/manufacturing is carried out in China. Some of this production is for items that can only be produced in China such as tactile (i.e. touch & feel) titles and some very specialized and unique print marketing materials (i.e. contains difficult product specs such as intricate die cuts). For these items there are no other known printer options.

Other items, such as board books, have a very limited alternative source of supply. In fact there is only one non-China board book sourcing option which is a single plant located in Mexico. There are no domestic printer options.

One of the biggest domestic print challenges is a lack of capacity to produce hardcover Trade books. There is a lack of North American printer options to produce these types of titles. We have seen serious capacity challenges since July 2018 to produce this type of title leading to unacceptably long product lead times and numerous missed shipment dates.

Paper supply poses another hurdle to shifting production to the U.S. Domestic paper mill capacity for book grade text papers has been drastically reduced in the last three years with much of that being a permanent reduction due to mill closures. Paper mills often need to make choices between running more profitable packaging paper product versus book paper which is further restricting paper supply in the market. Consequently, paper production lead times have increased substantially compared to historical standards creating product availability challenges.

In theory, manufacturing/printing capability/capacity could be brought back to the U.S.; however, given the lack of equivalent domestic facilities, companies would have to open new plants and acquire new equipment which would require significant up-front capital investment.

Even if these up-front costs could be overcome, problems abound with opening new plants. In recent years, the domestic print industry has seen a continuous trend of mergers/acquisitions, and plant closures to right size capacity needs. Domestic printers are currently struggling to attract and retain workers to fully staff existing print and binding operations, which is negatively impacting their capacity. Thus, were plants to be opened for the production capabilities needed by SIIA members, it is questionable whether they could be properly staffed. As it is, existing domestic production capability/capacity is very challenged to keep up with current domestic production demand. The volume of titles and quantities ordered in China across the US publishing community is enormous. Under the current domestic printer capacity limitations, it is not even remotely conceivable that a substantial portion of print materials produced in China could be moved and absorbed by domestic producers.

Since many of their customers are educational institutions with long-term contracts and tightly restricted purchasing budgets, publishers are constrained in their ability to pass along price increases. This means that were the tariffs to take effect as proposed, reductions would need to happen elsewhere in the business, most likely resulting in sacrifices to breadth and quality of products, as well as reduction in headcount in locations across U.S.

**China’s Trading Practices Need to Change and this Can be Achieved Together with Allies**
Again, SIIA very much appreciates the Administration’s clear interest in changing the ground-rules for the U.S.-Chinese economic relationship. In this context, it is critical to determine what success would look like in negotiating with China and how to achieve that result.

Specifically, with respect to digital trade, China is one of the most restrictive markets. For example: U.S. firms ought to be able to provide cloud computing services in China, but Chinese policies block U.S. companies from doing so. It is also unacceptable that (1) Chinese consumers cannot access 11 out of 25 of the world’s most important consumer websites; (2) voice-over-Internet Protocol services are restricted for no obvious reason; (3) internet domain resources such as domain name registration procedures are subject to opaque rules that make it difficult for U.S. firms to provide services to businesses and consumers; (4) there are restrictions on online video and entertainment software that should be removed; intrusive encryption rules should be excised; (5) there are no valid reasons why Internet-enabled payment services cannot be offered; (6) intellectual property rights, in general, need to be enforced and respected; and (7) data localization requirements should be removed.

Admittedly, achieving these policy outcomes will not be easy. Our experience with respect to China’s proposed “secure and controllable” cybersecurity rules tells us that success is possible in addressing unfair Chinese trading practices if the U.S., EU, Japan, South Korea, and other like-minded governments work together. Such diplomatic coordination, coupled with international private sector coordination, produced results in 2016 with respect to proposed “secure and controllable” cybersecurity requirements in the banking sector. SIIA urges the U.S. government to intensify cooperation with allies to address Chinese commercial practices.

In closing I want to reiterate that SIIA supports the Trump Administration’s emphasis on changing the paradigm for U.S.-Chinese economic relations. China does not provide a level playing field for our member companies and this discrepancy warrants attention. However, SIIA opposes the use of tariffs as a means of changing other countries’ practices because they are ineffective in achieving that aim and impose heavy costs on U.S. businesses, and hurt American consumers. As my testimony explained, the proposed tariffs on mobile phones, connected devices, laptop and tablet computers, and printed books would cause egregious harm to American consumers and damage American competitiveness in the global market.

Once again, SIIA appreciates this opportunity to testify.

Respectfully submitted,

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