American Chemistry Council
Statement for the Record
House Committee on Ways and Means

Impact of the U.S.-China Trade Dispute on the Business of Chemistry in the United States

March 11, 2020

The U.S. chemical industry is a $553 billion dollar enterprise, supporting more than 25 percent of U.S. gross domestic product (GDP), and providing over 542,000 skilled, good-paying American jobs, with production in nearly every state. Thirty percent of these jobs are export dependent. And because over 96 percent of manufactured goods are touched by chemistry, the chemicals industry is truly the foundation of American manufacturing.

For the first time in decades, the United States enjoys a competitive advantage in chemicals and plastic production, made possible by affordable domestic natural gas, the industry's primary feedstock. Since 2010, chemical manufacturers in the United States have announced approximately $204 billion of investment in new chemicals and plastics production capacity. More than 60 percent of that capacity stems from foreign direct investment. In 2016 and 2017, the chemical industry accounted for nearly half of all construction spending in U.S. manufacturing. Much of this capacity is intended for export, reflecting investors' understanding that the United States is competitively advantaged in serving the global marketplace.

Due to the shale gas revolution, the United States has gone from one of the most expensive places to produce chemicals, to one of the world's lowest cost producers. American chemical manufacturers today produce 15 percent of the world's chemicals. They are one of the top exporting industries in the United States, accounting for 10 percent of all U.S. exports, which amounted to $136 billion in 2019. The U.S. trade surplus in industrial chemicals was $35 billion in 2019. Given the competitive advantage created by the American shale gas revolution, that surplus is estimated to grow to $61 billion by 2024.

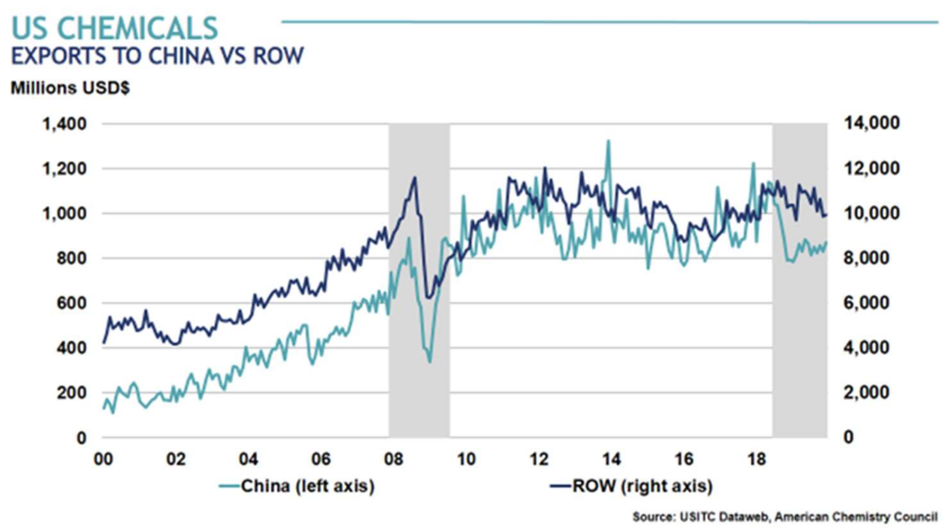
U.S. Chemical Manufacturers Support Addressing China's Unfair Trade Practices

ACC supports the Administration's efforts to address unfair trade practices in China, including inadequate protections of intellectual property (IP) and forced technology transfer practices, which have hurt our industry. The principles of free and fair trade should apply to all members of the World Trade Organization (WTO), including China. While we welcome the Phase 1 deal between the United States and China as a necessary step forward, we also believe that the United States will succeed in addressing unfair trade practices in China in the long run principally through leveraging the multilateral, collective willpower of countries that share our concerns.

<u>The U.S.-China Trade Dispute Has Decreased U.S. Exports of Chemicals and Plastics to China (and the Rest of the World)</u>

The U.S. chemicals industry is one of this country's leading exporting industries, and an important trading partner to China. China also supplies the United States with a number of chemicals which are not available anywhere else and which are critical inputs to U.S. manufacturing. As a result, the U.S.-China trade dispute and the associated volleys of tariffs on both sides have yielded unintended consequences on U.S. chemical manufacturers. ACC communicated our concerns about the detrimental impacts of U.S. tariffs and China's retaliatory tariffs through nine sets of public comments since April 2018 (see <u>Annex A</u>). In a number of our comments, we communicated our serious concern that steep tariffs met by retaliation would depress demand for chemicals, plastics, and downstream manufactured products.

As we forecasted, the trade dispute has negatively impacted the ability of U.S. chemical manufacturers to export to customers in China. U.S. exports to China – our third largest export market after Canada and Mexico – have contracted by 13 percent or $1.4 billion since 2017, before the U.S. began to impose Section 301 tariffs. By December 2019, monthly chemicals exports to China were down by 23% compared to June 2018 (the month before additional tariffs were first implemented). Increased trade costs and tensions has disrupted integrated manufacturing supply chains between partners in the U.S. and China and has also caused spillover effects contributing to a global trade slowdown. The global slowdown, in turn, his manifested in reduced demand for U.S. manufactured goods.



As global growth has weakened, U.S.-based production has suffered from displaced exports going into other reginal markets (i.e., Latin America and Europe) resulting in oversupply and margin depreciation. Chinese and foreign competitors are supplanting U.S. access to the large and growing China chemicals market. U.S. chemical manufacturers are becoming less competitive at home, as the U.S. tariffs have increased the cost and decreased the availability of key inputs into chemical manufacturing. U.S. exports to China have been reliable supply for sourcing significant domestic production that supports the substantial Chinese consumer market.

Future growth for our industry depends on a strong trading relationship with China, the ability to support the world's second largest consumer market, and a trade policy that creates certainty and predictability for investors – not a looming threat of more or higher tariffs. As this Committee is well aware, restoring certainty has become an even more urgent need due to the supply chain disruptions caused by the global spread of COVID-19. These disruptions, on top of the tariff burden already placed on U.S. chemicals manufacturers, have made it difficult for ACC members to import the chemicals they need to manufacture other chemicals in the United States.

We urge the United States and China to bring an end to the trade war through a Phase 2 agreement that eliminates the tariffs on both sides as soon as possible. Failure to do so will risk creating further imbalances in global chemical trade and investment. A prolonged trade war – whereby higher tariffs on all imports from China and exports to China become a fixture, not an exception – will not achieve a more balanced trading relationship between the U.S. and China. It will not advance the interests of the U.S. economy. And it will not help U.S. manufacturers and consumers. Many recent studies demonstrate that the tariffs have produced pain for the U.S. economy, businesses, and consumers – with no relief in sight. (See Annex B for a list of recent tariff impact studies).

Phase 1 solidifies steep tariffs on the majority of U.S. chemicals trade with China

Prior to the implementation of the List 2 and 3 tariffs, ACC also provided a list of anecdotes from our member companies, which outlined their estimations in 2018 of how the tariffs would impact their companies. Since the implementation of the tariffs, a number of ACC members have cited tariffs and trade policy uncertainty as the most significant factors weighing on their bottom lines and potential for growth.

It is therefore unfortunate that the Phase 1 deal locks in a new status quo of additional tariffs in U.S.-China trade. In the short run, it may reduce uncertainty, but in the mid- to long-run, there is no guarantee that China will implement the deal and it is unlikely that it could meet its purchasing commitments. The Administration could decide to snap tariffs back to address China's lack of implementation. Thus, for U.S. chemical manufacturers, uncertainty in the U.S.-China trade relationship remains along the following lines:

a. Additional tariffs on Lists 1-3 remain in place at 25 percent on $15 billion in imports and on List 4a at 7.5 percent on $5.1 billion in imports of chemicals and plastics.
b. Additional tariffs on Lists 1-3 could still increase by 5 percent (suspended indefinitely, cite FR notice).
c. Additional tariffs on List 4a could snapback to 15 percent if China does not meet its commitments.
d. Additional tariffs on List 4b could be applied if China does not implement the agreement, impacting another $5.1 billion in imports of chemicals and plastics.
e. China's retaliatory tariffs at 20 and 25 percent are still in place on almost $11 billion in U.S. exports of chemicals and plastics, but decreased from 10 to 5 percent and 5 to 2.5 percent only on $100 million in U.S. exports of chemicals and plastics.

<u>China's purchasing commitments are unrealistic and do not cover the most competitive U.S. exports of chemicals and plastics</u>

As regards China's purchasing commitments, China must increase its U.S. imports this year by a historically unprecedented amount this year and in 2021. If U.S. Department of Commerce data is employed to measure the value of the flow of manufactured goods trade between the U.S. and China, the Chinese would need to import 57% more goods from the U.S. this year compared to what they imported in 2017. This level of expansion is historically unprecedented. Given that tariffs remain in place on both sides, we are skeptical that China could meet these commitments unless it suspends or eliminates its retaliatory tariffs. China's recently cut its retaliatory tariff rates from 10 percent to 5 percent for some products and 5 percent to 2.5 percent for others. However, these cuts impact only a fraction of U.S. exports to China ($100 million per annum). The remainder of China's retaliatory tariffs stay in place at high rates (20 and 25 percent).

We are also concerned that the Phase 1 deal does not include the most competitive U.S. exports made by U.S. chemical manufacturers. The attachment to Annex 6.1 under the Phase 1 deal only covers 672 chemical tariff lines under HTS Chapters 28, 29, 33, 35, and 38. Resins and plastic product exports under HTS Chapter 39 are not listed in the attachment to the Annex. Resins and plastic product exports under HTS Chapter 39 are not listed in the attachment to the Annex. These products still face prohibitively high retaliatory tariffs. Unfortunately, the Phase 1 deal does not commit China to eliminating these tariffs.

In fact, if China wants to meet its purchasing commitments, it will have to take whatever steps are necessary to do so. One option that China may use is its product exclusion process rather than lifting the tariffs. This is an understandable viewpoint since the United States is maintaining its additional tariffs under Section 301 on the products in Lists 1, 2, 3, and 4a. Based on our understanding of China's product exclusion process, it is yielding very narrow exclusions designed to benefit China's companies importing very specific products. We are concerned that China's product exclusion process will not enable China to meet its purchasing commitments.

This stalemate calls into question how U.S. chemical manufacturers can increase exports of the products in the attachment to Annex 6.1 to China with China's retaliatory tariffs still in place. <u>Overall</u>, it is not realistic to expect that China could live up to the purchasing commitments even if it lifted its retaliatory tariffs AND even if the trade dispute never happened and the U.S. and China never applied additional tariffs on their bilateral trade.

<u>The U.S. and China Tariffs Are Impacting U.S. Chemical Manufacturers</u>

In 2018 before the U.S. and China imposed the bulk of their additional tariffs, ACC provided anecdotal evidence on how the tariffs could impact our members.[1] Our members tell us that many of their estimations of impact have happened in reality.

One ACC member company is being hurt by both the U.S. tariffs on imports from China and the retaliatory tariffs imposed by China. This company currently imports Product X to the U.S. from

[1] See FIRSTHAND ACCOUNTS OF THE IMPACT OF CHINA SECTION 301 TARIFFS ON U.S. CHEMICALS MANUFACTURERS: https://www.americanchemistry.com/Policy/Trade/Firsthand-Accounts-of-the-Impact-of-China-Section-301-Tariffs-on-US-Chemicals-Manufacturers.pdf.

one of its production sites in China. The company does not currently have the capacity to manufacture Product X in the U.S., and is seeking to build a market by selling the China-made good here and building a base of customers so as to justify expanding local production. This would mean building a new production line in the U.S. and hiring the employees needed to run it. The import tariffs imposed by the U.S., however, have effectively precluded this from happening by increasing prices to the point the company cannot compete for potential new customers.

Likewise, the company exports Product Y from the U.S. to customers in China because its Chinese facilities do not currently have the capacity to make this Product Y. In anticipation of the eventual Chinese retaliatory tariffs on U.S. goods coming to China, the company lost customers to local competitors. While not as cost-effective as producing here and selling there, the company may now have to invest in additional production capacity in China to ensure it does not lose any more customers.

The Section 301 Product Exclusion Process Needs Significant Improvements

There have been numerous reports[2] about the inconsistency with which the exclusion process has been administered, the opaqueness with which USTR makes decisions on exclusion petitions and the overall sluggishness of the process. We urge Congress to increase its oversight of the exclusion process and demand that USTR administer the process in a fair, transparent and efficient manner to ensure that it provides meaningful relief for those bearing the brunt of these harmful tariffs.

Tariff elimination for chemicals and plastics is the only way forward for U.S. chemical manufacturers

In charting a course forward, we offer three concrete recommendations:

1. The Administration should provide indefinite product exclusions for all chemicals and plastics on Lists 1, 2, 3, and 4a, covering approximately $20 billion in imports. This would prompt China to exclude indefinitely all U.S. chemicals and plastics exports (approximately $11 billion) from the application of its retaliatory tariffs.

2. If that is not possible, the Congress should as soon as possible pass legislation that eliminates that Section 301 tariffs for products in Lists 1, 2, 3, and 4a and are also covered by the Miscellaneous Tariff Bill of 2018 (MTB). The Congress in passing the MTB decided that certain imports, including a wide range of chemicals, were essential for U.S. manufacturing competitiveness. However, approximately 75% of the chemicals and plastics products included in the MTB are also listed on China Section 301 Lists 1 to 3 and face additional tariffs when imported from China. List 4a included another 19 eight-digit HTS codes that are also covered under the MTB. List 4b would have included still an additional 19 eight-digit HTS codes. The Section 301 tariffs across all four lists

[2] *See*, e.g., "Amid opaque tariff process, questions arise as to why some companies receive exemptions," NBC News (February 13, 2020), *available at* https://www.nbcnews.com/business/business-news/amid-opaque-tariff-process-questions-arise-why-some-companies-receive-n1119071.

have obviated or could obviate the benefits of the MTB to U.S. chemical manufacturers relying on those imports to manufacture certain chemistries in the United States. Furthermore, as the Congress deliberates on the next possible set of MTB products, we encourage it to consider negating the Section 301 and Section 232 tariffs on MTB products in the future.

3. ACC advocates for greater progress on eliminating tariffs globally, particularly between the top chemical producing countries (e.g., China, the European Union, Japan, South Korea) and also large emerging markets (e.g., Brazil and India). ACC believes the achievement of this goal will give U.S. chemical manufacturers the predictability and certainty they need to plan, grow, compete, and succeed in the global marketplace. For Phase 2, ACC recommends the United States obtain two binding, enforceable commitments from China as a part of the Phase 2 deal:

   - First, China should harmonize its WTO tariff bindings for chemicals and plastics to U.S. levels under the Chemical Tariff Harmonization Agreement (CTHA).
   - Second, China should work together with the U.S. to bring other markets (e.g., the Brazil, India, and the United Kingdom) into the CTHA, to broaden the scope of participation in that initiative, bind currently unbound tariffs for chemicals and plastics (e.g., for India, Malaysia, and Nigeria), and lower both the bound and applied rates for chemicals and plastics for new participants. In Annex C, we detail the average WTO bound and most-favored-nation (MFN) tariff rates for a range of WTO members, who are not U.S. trade agreement partners.

Conclusion

ACC urges Ways and Means Committee members to request that the Administration to get back to the negotiating table, end the trade war, and lift the China Section 301 additional tariffs, so that China can then lift its retaliatory tariffs on U.S.-made exports of chemicals and plastics. If the Administration continues applying the Section 301 tariffs, we hope that the Ways and Means Committee can provide the requisite oversight of USTR's product exclusion process so that it becomes fairer, more transparent, and efficient, and provides meaningful relief for U.S. chemical manufacturers bearing the brunt of the Section 301 tariffs. Lastly, we urge Ways and Means Committee members to emphasis that U.S. global leadership on eliminating tariffs will create more certainty for the U.S. chemical sector so that it can grow, thrive, and access new markets.

The American Chemistry Council (ACC) represents a diverse set of companies engaged in the business of chemistry. An innovative, $553 billion enterprise, we work to solve some of the biggest challenges facing our nation and our world. Our mission is to deliver value to our members through advocacy, using best-in-class member engagement, political advocacy, communications and scientific research. We are committed to fostering progress in our economy, environment and society. The business of chemistry drives innovations that enable a more sustainable future; provides 542,000 skilled good paying jobs—plus over six million related jobs—that support families and communities; and enhances safety through our diverse set of products and investments in R&D.

Annex A

ACC Written Comments on Section 301 Tariffs

Since April 2018, ACC provided nine sets of written comments that additional tariffs would negatively impact U.S. chemical manufacturers:

a. 12 April 2018: ACC Statement for the Record, House Committee on Ways and Means: https://www.americanchemistry.com/Policy/Trade/Effects-of-Tariff-Increases-on-the-US-Economy-and-Jobs.pdf
b. 11 May 2018: ACC Public Comments on the proposed List 1: https://www.americanchemistry.com/Policy/Trade/ACC-Public-Comment-on-China-Section-301-Proposed-Tariff-Action.pdf
c. 23 July 2018: ACC Public Comments on the proposed List 2: https://www.americanchemistry.com/Policy/Trade/ACC-Section-301-Public-Comments-USTR-List-3.pdf
d. 6 September 2018: ACC Public Comments on the proposed List 3: https://www.americanchemistry.com/Policy/Trade/ACC-Section-301-Public-Comments-USTR-List-3.pdf
e. 7 June 2019: ACC Public Comments on the proposed product exclusion process for List 3: https://www.americanchemistry.com/Policy/Trade/ACC-Public-Comment-on-Section-301-List-3-Exlcusion-Process.pdf
f. 17 July 2019: ACC Public Comments on Proposed List 4: https://www.americanchemistry.com/ACC-Section-301-Public-Comment-USTR-List-4-June2019.pdf
g. 3 July 2019: ACC rebuttal comments on Proposed List 4: https://www.americanchemistry.com/Trade/ACC-Section-301-Rebuttal-Comments-USTR-List-3-July-2019.pdf
    i. These comments focused on specific instances of policy dissonance:
        1. The Administration in 2018 decided to take 114 HTS lines off of proposed List 3, but then added them to proposed List 4. Only 3 of those products were taken off of final List 4 A or 4B.
        2. On the one hand, the President signed into law on September 13, 2018 the Miscellaneous Tariff Bill, which suspended or reduced U.S. customs duties on imported products deemed to be essential for U.S. manufacturing – including 392 chemical and plastics products.
        3. Additional tariffs imposed under Section 301 undercut the relief promised by MTB. Following enactment of the MTB, many products that had been formally recognized as essential to U.S. industrial competitiveness were then covered by the ensuing U.S. Section 301 trade actions. For example, approximately 75% of the chemicals and plastics products included in the MTB are also listed on U.S. Lists 1 to 3 and face additional tariffs when imported from China. List 4a included another 19 eight-digit HTS codes that are also covered under the MTB. List 4b would have included still an additional 19 eight-digit HTS codes. For U.S. chemical and plastics importers, the additional tariffs imposed under Section 301 negate the benefits of the MTB suspensions and reductions.

h. 18 September 2019: ACC public comments on China's compliance with its WTO commitments: https://www.americanchemistry.com/policy/policy-position/ACC-Public-Comment-on-China-WTO-Commitments.pdf

i. 20 September 2019: ACC public comments on proposed 5 percent tariff increase: https://www.americanchemistry.com/Policy/Trade/ACC-Public-Comments-on-5-Percent-Tariff-Increase-on-China-Lists-1-3.pdf

Annex B

Recent Studies on Economic Impact of Tariffs

1. January 2020, National Bureau of Economic Research: Who's Paying for the US Tariffs? A Longer-Term Perspective; Mary Amiti, Stephen J. Redding, David E. Weinstein

2. January 2020, National Bureau of Economic Research: Rising Import Tariffs, Falling Export Growth: When Modern Supply Chains Meet Old-Style Protectionism; Kyle Handley, Fariha Kamal, Ryan Monarch

3. January 2020, Congressional Budget Office: The Budget and Economic Outlook 2020 to 2030 (see pg. 33: "In CBO's estimation, the trade barriers put in place by the United States and its trading partners between January 2018 and January 2020 would reduce real GDP over the projection period. The effects of those barriers on trade flows, prices, and output are projected to peak during the first half of 2020 and then begin to subside. Tariffs are expected to reduce the level of real GDP by roughly 0.5 percent and raise consumer prices by 0.5 percent in 2020. As a result, tariffs are also projected to reduce average real household income by $1,277 (in 2019 dollars) in 2020.")

4. December 2019, Federal Reserve Board: Disentangling the Effects of the 2018-2019 Tariffs on a Globally Connected U.S. Manufacturing Sector; Aaron Flaaen and Justin Pierce

5. October 2019, Revised December 2019, National Bureau of Economic Research: The Consumption Response to Trade Shocks: Evidence from the US-China Trade War; Michael E. Waugh

6. October 2019, National Bureau of Economic Research: Tariff Passthrough at the Border and at the Store: Evidence from US Trade Policy; Alberto Cavallo, Gita Gopinath, Brent Neiman, Jenny Tang

7. March 2019, Revised October 2019, National Bureau of Economic Research: The Return to Protectionism; Pablo D. Fajgelbaum, Pinelopi K. Goldberg, Patrick J. Kennedy, Amit K. Khandelwal

8. March 2019, National Bureau of Economic Research: The Impact of the 2018 Trade War on U.S. Prices and Welfare; Mary Amiti, Stephen J. Redding, David E. Weinstein

9. February 2019, The Trade Partnership, LLC: Estimated Impacts of Tariffs on the U.S. Economy and Workers, Laura Baughman

10. December 2018, National Bureau of Economic Research: Macroeconomic Consequences of Tariffs; Davide Furceri, Swarnali A. Hannan, Jonathan D. Ostry, Andrew K. Rose

Annex C

Average Bound and MFN Rates for Certain WTO Members

Tariff elimination for chemicals must lead to the lowest possible bound rates at the WTO and the avoidance of additional duties on top of applied duties. High chemicals tariffs around the world impact the ability of U.S. chemical manufacturers to access new markets. They also limit opportunities for buyers of chemicals in key economic sectors (e.g. building and construction, automotive, agriculture, consumer goods, information technology, and civil aviation) from buying innovative, competitively-priced U.S.-made chemicals.

The WTO's World Tariff Profiles 2019[3] indicates that a number of U.S. trading partners maintain high average bound and most favored nation (MFN) applied duties for chemicals (see Table 1 below). WTO Members participating in the Chemical Tariff Harmonization Agreement (CTHA) have bound their chemical tariffs at relatively low levels, and thus have low average applied tariff rates. Those WTO Members who are not participating in the CTHA have a large percentage of unbound chemical tariffs, meaning that WTO rules do not prevent them from raising tariff rates for certain products to prohibitively high levels. They also have higher average bound and applied tariff rates for chemicals. By contrast. The United States average bound rate and applied MFN rate for chemicals is 2.8 percent; 100 percent of its chemical tariffs are bound. U.S. global leadership will be essential to broad, deep, and durable tariff elimination for U.S.-made chemicals.

Table 1: Average WTO Bound Rates and MFN Applied Rates on Chemicals for Certain U.S. Trading Partners Without Free Trade Agreements (CTHA participants in green)

Country	Average WTO Bound Rate	Average MFN Applied Rate	Percentage of Unbound Chemical Tariffs
Argentina	21.4	8.2	0
Brazil	21.1	8.1	0
China	6.7	6.7	0
European Union	4.5	4.6	0
India	39.6	10.1	11.1
Indonesia	37.9	5.3	4
Japan	2.3	2.1	0
Malaysia	11.5	2.5	24.8
New Zealand	4.3	0.7	0
Nigeria	74.6	Not reported	98.5
Pakistan	57.4	7.9	0.1
Philippines	19.7	3.6	25.5
Russian Federation	5.2	4.6	0
Saudi Arabia	5.4	4.9	0
South Africa	12.4	2.1	0.4
Switzerland	1.0	0.9	0
Chinese Taipei	2.8	2.9	0
Thailand	29.9	2.6	38.8

[3] https://www.wto.org/english/res_e/booksp_e/tariff_profiles19_e.pdf