

# U.S.-China trade war escalates with new round of Section 301 tariffs and currency manipulation designation

13 August 2019

Following on the heels of U.S. trade negotiators' return from China, on 1 August, President Trump abruptly announced via Twitter an "additional Tariff of 10 percent on the remaining 300 Billion Dollars of goods and products coming from China" starting "on September 1." After China hit back by allowing the yuan to depreciate below a key threshold, proclaiming its intent to impose "necessary counter-measures," and halting purchases of U.S. farm products, the Treasury Department on 5 August designated China a "currency manipulator" under Section 3004(b) of the Omnibus Trade and Competitiveness Act of 1988, further heightening U.S.-China trade tensions. Markets, which had been anticipating a period of calm following resumption of U.S.-China trade negotiations after President Trump's meeting with Chinese President Xi Jinping at the G-20 Leaders Summit in Osaka, Japan, responded with a drop of 767 points in the Dow Jones Industrial Average and a sharp drop in Treasury yields.

## **List 4 tariffs threaten to target everyday consumer goods**

President Trump's tweet referred to the List 4 Section 301 tariffs, which were detailed in the USTR's [Federal Register notice of 17 May, 2019](#), requesting public comments and giving notice of the Section 301 Committee's public hearing on a preliminary list covering US\$300 billion of Chinese products. The preliminary list covered many imported consumer goods, including toys, electronics, laptops, cell phones, televisions, apparel, kitchen utensils, home textiles, and outdoor equipment, as well as an array of chemicals, metals, and food products, amounting to approximately US\$300 billion. For the last week, USTR and the inter-agency Section 301 Committee have been formulating a final list of products that will be subject to retaliatory duties under Section 301 of the [Trade Act of 1974](#). The final list was issued in a *Federal Register* notice on 13 August, which identifies the final list of products subject to higher U.S. tariffs and what products were removed from the list following the public comment period earlier this year. While most of the tariffs will go into effect at [12:01 am EDT on 1 September](#), USTR removed certain products from the list based on health, safety, national security and other factors. In addition, it postponed the effective date for certain high-profile consumer product, including cell phones, laptop computers, video game consoles, certain toys, computer monitors, and certain items of footwear and clothing, until [15 December](#) in an apparent effort to avoid disrupting the holiday shopping season. Finally, in a surprising development [USTR stated](#) that it intends to conduct an exclusion process for products subject to the additional 10 percent tariff. Previously, USTR's

position was that it would not provide such a process unless and until the tariffs were increased to 25 percent.

### **Treasury Department brands China a “currency manipulator”**

Following the Presidential tweet criticizing China currency actions, the Treasury Department designated China a “currency manipulator” under Section 3004 of the Omnibus Trade and Competitiveness Act of 1988 ([22 U.S.C. §5304](#)) for its recent devaluation of the yuan as part of the ongoing trade war. In its [press release](#), the Treasury Department pointed to China’s recent devaluation, noting that “[t]he context of these actions and the implausibility of China’s market stability rationale confirm that the purpose of China’s currency devaluation is to gain an unfair competitive advantage in international trade.” Previously, the Treasury Department had refrained from this designation, although it did note in its May 2019 [Report to Congress on the Macroeconomic and Foreign Exchange Policies of Major Trading Partners of the United States](#) that China has a “long history of facilitating an undervalued currency through protracted, large-scale intervention in the foreign exchange market.” While China has engaged in currency interventions in the past, since 2008 it has primarily intervened in order to boost the value of the yuan or manage it within a target range based on an informal understanding negotiated by the Treasury Department in the George W. Bush Administration.

While largely symbolic, designation as a currency manipulator under Section 3004 triggers bilateral negotiations between the United States and China and requires the United States to consult with the International Monetary Fund to try to eliminate unfair advantages afforded to China by virtue of its ongoing currency policies. The Treasury Department has not labeled any country as a “currency manipulator” since the designation was applied to China in 1994.

While Treasury’s announcement of China’s designation only cited Section 3004, Congress supplemented Treasury’s existing authority by providing enhanced analytical criteria, procedures, and remedial actions in Section 701 of the Trade Facilitation and Enforcement Act of 2015 ([19 U.S.C. §4421](#)). Under Section 701, Treasury must enter into “enhanced bilateral engagement” with a country that has (i) a significant bilateral trade surplus with the United States; (ii) a material current account surplus; and (iii) engaged in persistent one-sided intervention in the foreign exchange market. If after a year the Treasury Secretary finds that the country has failed to correct the undervaluation and surpluses identified under the enhanced criteria, he or she must select from various listed remedies, including denying financing/risk insurance through the Overseas Private Investment Corporation (OPIC); denying the country’s firms access to the U.S. government procurement market; seeking additional IMF surveillance; and taking into account the country’s currency practices in the negotiation of new trade agreements. Most of these remedies would have little impact, since China is ineligible for OPIC financing and U.S. government procurement, can block any IMF surveillance, and is an unlikely candidate for a free trade agreement or bilateral investment treaty. However, if Treasury chooses to follow Section 701, it could further complicate the already complicated U.S.-China trade negotiations by requiring USTR and Treasury to deal with currency issues in any U.S.-China agreement.

One major open question is whether the U.S. Commerce Department will start treating China’s currency practices as a countervailable subsidy in U.S. countervailing duty investigations. Commerce recently published a [Federal Register notice](#) requesting public comments on a proposed rule.

## **Tariff exclusion procedures**

In previous rounds of Section 301 tariffs for Lists 1, 2, and 3, USTR established a process allowing stakeholders (including associations) to request that particular products classified within a tariff subheading subject to the tariffs be excluded. Currently, USTR is accepting “List 3” exclusion requests until 30 September 2019. The window for filing exclusion requests for List 3 opened on 30 June 2019. Over 13,000 requests were filed for Lists 1 and 2, and USTR is anticipating as many as 60,000 requests for List 3. In a mild surprise, [USTR stated](#) that it “intends to conduct an exclusion process for products subject to the additional tariff.” Details on the process have yet to be announced. While the Section 301 duties on List 3 were announced on 21 September 2018, USTR did not announce an exclusion process until after the tariffs were increased from 10 percent to 25 percent on 9 May 2019, despite intense bipartisan Congressional pressure to put a process into effect immediately to assist affected U.S. stakeholders. Given the current backlog of requests for Lists 1 and 2, and the likelihood USTR will be flooded with requests for List 3, it is unclear how it will handle an even bigger influx of exclusion requests for List 4, given its limited personnel and resources.

## **What affected businesses should be doing**

U.S. trade officials say that so far as they know China is still prepared to attend September’s trade talks in Washington, but both sides appear to be digging in for a protracted conflict. While it is hard to see how a lengthy trade war would serve either’s economic or political interests, it may take some time, if ever, for the parties to find their way back to the negotiating table, given the levels of ill-will and mistrust that have built up. Even if the U.S. and China resume serious negotiations in an effort to strike a deal, they face gaps over a daunting series of difficult issues. One risk is that if the situation continues to deteriorate and the U.S. and China continue to trade blows, the logical next step for President Trump is to raise the List 4 tariffs from 10 percent to 25 percent, as occurred with List 3.

Businesses transacting in goods that may be affected by current or future tariffs should stay abreast of the negotiations and on alert for any updates from USTR, the Treasury Department, or White House. Businesses should also carefully review the final List 4 tariffs to determine if and how they may be affected. If goods are in transit, companies should make every effort to get them entered into the U.S. customs territory before 12:01 am EDT on 1 September since otherwise they will be subject to a 10 percent ad valorem tariff if they are on USTR’s final retaliation list.

If the tariffs are causing serious damage, companies could explore shifting production or final assembly to business-friendly third-country markets (e.g. Vietnam, Malaysia, Mexico, etc.). In doing so, companies should ensure that the products would meet U.S. Customs’ “substantial transformation” test, since otherwise they will remain a Chinese product for customs purposes and be subject to Section 301 tariffs. Unfortunately, there is increasing evidence of efforts to circumvent the Section 301 tariffs by shipping “rebranded” or “transhipped” Chinese-origin goods entering the United States through third-country markets in an effort to avoid Section 301 tariffs, and suspicious surges in shipments of goods from Southeast Asia are likely to be subject to heightened scrutiny and potential penalties from U.S. customs.

Finally, companies should consider filing product exclusion requests for Lists 3 and 4. If duty exemptions are granted, they are retroactive to the date duties went into effect (i.e., likely September 1 for List 4). While USTR’s product exclusion process takes time—and is likely to take even longer if it is flooded with 60,000 requests for List 3 and even more for List 4—it appears to be resulting in meaningful review. Three-quarters of the requests filed by Hogan Lovells for Lists 1 and 2 moved to stage 3, which indicated they were approved by the Section 301 Committee and

went to U.S. Customs for a determination as to their “administrability.” Over 60 percent received final approval from U.S. Customs and were granted. For further information or assistance in connection with the exclusion process, please contact any of the lawyers identified below.

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