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## US and China Agree to Reduce Tariffs and Expand High-Tech Trade Through the Information Technology Agreement

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The United States and China last week announced a breakthrough bilateral understanding regarding negotiations to expand the scope of the Information Technology Agreement (ITA). This announcement opens the door for formal conclusion of an ITA expansion deal—i.e., ITA-II—at the World Trade Organization (WTO) as early as December, which would zero out tariffs on a number of high-technology items, including next-generation semiconductors, certain medical technologies, GPS devices, videogame consoles, and other items. These newly zeroed tariffs would apply to goods imported from all countries to ITA signatories, in accordance with the WTO's most-favored nation (MFN) rules.

Market participants should closely monitor developments related to the ITA, including the list of information and communications technology (ICT) products to be included in a final ITA-II Agreement and their phase-out periods. After the conclusion of the ITA-II, it will also be critical to monitor any non-tariff barriers (NTBs) that ITA members and others may impose as they eliminate their tariffs; such NTBs are not directly covered by the ITA negotiations but may be covered by broader WTO rules.

### Background

Concluded in 1996, the original ITA is a plurilateral WTO Agreement covering a wide range of high-technology products, such as computers, certain semiconductors (other than multi-component devices (MCOs)), scientific instruments, and other telecommunications equipment. It obligates participating countries to eliminate tariffs on specified ICT products. The 54 ITA parties constitute more than 90 percent of world trade in ICT products, but all WTO states benefit from ITA tariff reductions due to MFN rules.

As a result of the significant changes in the technology landscape since 1996, important gaps have emerged in the coverage of the original ITA. For example, significant technological advances have since occurred in GPS technology, medical devices, and an array of other next-generation software and hardware. Accordingly, since 2012, participating states have been negotiating to expand the list to include more than 200 additional technology products, including communications, data, and

medical devices.

However, negotiations reached an impasse in November 2013, when US and EU negotiators refused to accept China's efforts to reduce the product scope and tariff phase-out periods under the ITA-II. The main sticking points were products for which China still depends on imports, including MCO semiconductors and certain medical devices for imaging, such as magnetic resonance imaging (MRI) machines and computed tomography (CT) scanners. The US and the EU wanted these goods included, whereas China did not lest its domestic producers be harmed. As a result, negotiations among the parties were put on hold.

### **US-China Breakthrough at APEC**

The annual Asia-Pacific Economic Cooperation (APEC) summit provides a forum for leaders of its 21 member states to discuss economic, trade, and related issues. Last week's Summit in Beijing represented, in particular, an important opportunity for US and Chinese leadership to discuss economic issues central to the bilateral relationship, including the ITA.

At the summit, the United States and China announced "an understanding on a bilateral agreement" to expand the scope of the ITA to include more than 200 tariff lines subject to tariff elimination. The covered products include MCOs, MRI machines, CT scanners, GPS devices, prepaid cards to download software and games, printer ink cartridges, static converters and inductors, loudspeakers, software media, solid state drives, video game consoles, video cameras and high-tech ICT testing instruments.<sup>1</sup>

The US and China also reportedly agreed on a common definition of MCOs, which will not be identified under specific tariff lines (no universal tariff code yet exists for MCOs) but rather described qualitatively for inclusion on Attachment B of the ITA. All products meeting the description will be subject to tariff reductions. This agreement was particularly significant in light of China's longstanding efforts to maintain tariffs on MCOs.

### **Next Steps for ITA Negotiations**

The breakthrough announced this week sets the stage for concluding negotiations to expand the ITA, and possibly reaching a deal by the end of the year. If successful, the ITA expansion would be the first major tariff-cutting agreement at the WTO in 17 years.

A key remaining issue for negotiators will be to reach agreement on the phase-out periods for tariffs of covered goods. Under the ITA, products generally fall into staging categories requiring either immediate, three-year, or five-year phase-out periods. China had sought to extend the phase-out periods to up to ten years, but it reportedly dropped this demand as part of the understanding reached last week at APEC. The exact tariff phase-out periods for particular goods will, however, be subject to further negotiation.

As other key ITA participants—including the EU, Japan, Korea and Taiwan—join the negotiations over the next month, the successful agreement on an expanded ITA is by no means assured. However, together with a separate US-India agreement that may allow WTO Trade Facilitation Negotiations to conclude, the US-China ITA deal has resulted in a more optimistic outlook for the December WTO meeting of trade ministers (*i.e.*, the WTO Ministerial) and trade relations in general.

Finally, unlike other pending trade agreements (such as the Trans-Pacific Partnership Agreement), implementation of the ITA-II would be relatively straightforward in the United States, as the Obama Administration can use residual authority from the Uruguay Round without requiring formal Congressional approval. Similarly, we expect relatively swift approval of any final ITA-II deal in China.

## Conclusion

These important developments are encouraging for ICT, medical technology, and other high-technology manufacturers around the world. However, close monitoring of the final details, including the final list of ICT products and their phase-out periods, is warranted. Furthermore, market participants should carefully monitor, over the coming months and beyond, whether ITA members replace zeroed out tariffs with non-tariff protectionist measures, which may have equally harmful effects and may be remediable under other WTO rules.

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<sup>1</sup> US Trade Representative, *Fact Sheet: Supporting Economic Growth at Home and Abroad by Eliminating Trade Barriers on Information Technology Products*, November 11, 2014.

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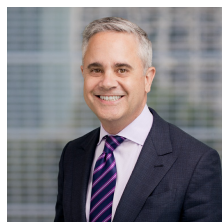
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