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# Comments on Proposed Tariffs on Imports in the Section 301 Investigation of China

*June 17, 2019*



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Joseph Barloon  
General Counsel  
Office of the United States Trade Representative  
600 17<sup>th</sup> Street, NW  
Washington, DC 20508

**Re: Request for Comments Concerning Proposed Modification of Action Pursuant to Section 301: China's Acts, Policies, and Practices Related to Technology Transfer, Intellectual Property, and Innovation, 84 Fed. Reg. 22564, pp. 22564 to 22639 (May 17, 2019)**

Dear Mr. Barloon:

The Entertainment Software Association (ESA) welcomes the opportunity to provide comments in response to the request for industry input by the Office of the U.S. Trade Representative (USTR) on the Administration's intent to impose an additional *ad valorem* duty of up to 25% on certain Chinese imports, including video game consoles, controllers and other hardware accessories. ESA is the U.S. trade association for companies that publish interactive entertainment software for video game consoles, handheld devices, personal computers, and the internet.<sup>1</sup> Our members not only create some of the world's most engaging interactive experiences for consumers, but also develop novel technologies that are at the cutting edge, such as virtual, augmented and mixed reality hardware and software as well as the latest consoles and handheld video game devices.

USTR's notice seeks comment on the following questions regarding the proposed action: (1) whether specific tariff subheadings proposed for increased duties should be retained or removed; (2) the level of the duty increase; (3) whether imposing increased duties on a particular product would obtain the elimination of China's acts at issue in the Section 301 investigation; and (4) whether the imposition of additional duties on a particular product would cause disproportionate economic harm to U.S. businesses and consumers. Because video game consoles and controllers are essential to the ecosystem of video gameplay in the United States, the proposed duties will have a significant impact on the access to video games and video game consoles, controllers and accessories – and, in turn, on American consumers and American jobs.

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<sup>1</sup> A list of ESA members is available at <http://www.theesa.com/about-esa/members/>.

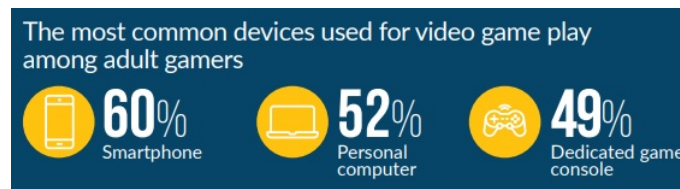
## About the Industry

The U.S. video game industry has been growing steadily as consumers have been presented with an array of choices on how to play and interact with their favorite games. In 2018, the industry generated \$43.4 billion in total revenue, with consumers spending \$35.8 billion on software, downloadable content and subscriptions,<sup>2</sup> up from \$29.1 billion in 2017.<sup>3</sup> Also in 2018, consumers spent a total of \$5.1 billion on video game consoles and \$2.4 billion on accessories and virtual reality hardware, including headsets,<sup>4</sup> up from \$4.7 billion and \$2.2 billion in 2017, respectively.<sup>5</sup>



Video game companies added more than \$11.7 billion in value to U.S. GDP in 2017 and directly employed more than 65,000 workers nationwide who earned an average compensation of \$97,000 per year. Indirectly, the industry employs more than 220,000 workers.<sup>6</sup> In 2017, there were 2,711 video game companies across the country in all 50 states. Ninety-nine per cent of U.S. video game companies qualify as small businesses with 94 % domestically founded.<sup>7</sup>

Video games play an integral role in the lives of Americans, whether young or old. For example, 65% of adults in the United States (approximately 164 million) play video games using smartphones (60%), personal computers (52%) and dedicated video game consoles (49%).<sup>8</sup>



<sup>2</sup>Entertainment Software Association, 2019 ESSENTIAL FACTS ABOUT THE COMPUTER AND VIDEO GAME INDUSTRY, p. 20 available at [file:///H:/About%20ESA/About%20the%20Industry/ESA\\_Essential\\_facts\\_2019\\_final.pdf](file:///H:/About%20ESA/About%20the%20Industry/ESA_Essential_facts_2019_final.pdf).

<sup>3</sup> Entertainment Software Association, SALES, DEMOGRAPHIC AND USAGE DATA: 2018 ESSENTIAL FACTS ABOUT THE COMPUTER AND VIDEO GAME INDUSTRY, p. 10 available at [http://www.theesa.com/wp-content/uploads/2018/05/EF2018\\_FINAL.pdf](http://www.theesa.com/wp-content/uploads/2018/05/EF2018_FINAL.pdf).

<sup>4</sup> Entertainment Software Association, 2019 ESSENTIAL FACTS at p. 20.

<sup>5</sup> Entertainment Software Association, 2018 ESSENTIAL FACTS at p. 10.

<sup>6</sup> Stephen E. Siwek, Video Games in the 21<sup>st</sup> Century: The 2017 Report, p. 2 available at [http://www.theesa.com/wp-content/uploads/2017/02/ESA\\_EconomicImpactReport\\_Design\\_V3.pdf](http://www.theesa.com/wp-content/uploads/2017/02/ESA_EconomicImpactReport_Design_V3.pdf).

<sup>7</sup> Entertainment Software Association, “Impact of the Video Game Industry: State by State” available at <https://www.areweinyourstate.org>.

<sup>8</sup> Entertainment Software Association, 2019 ESSENTIAL FACTS at p. 6.



Seventy-five percent of U.S. households have at least one gamer in their household,<sup>9</sup> while 70% of U.S. households have a child who plays video games<sup>10</sup> with 57% of parents playing games with their child at least weekly.<sup>11</sup>



Millions of Americans not only play video games for stress relief (78%), but also for mental stimulation (79%)<sup>12</sup> and for education.<sup>13</sup> The average age of the most frequent game purchasers for consoles is 33.<sup>14</sup> Sixty-nine per cent of male millennials (18-34) most often play on their game consoles, with the majority preferring to play with friends.<sup>15</sup>

### **Video Game Consoles and Controllers Should be Removed from the Proposed List**

We respectfully urge USTR to remove video game consoles, controllers and accessories from the proposed list of products potentially subject to tariffs. Given the importance of video game consoles to the industry and to consumers, the impact of tariffs of up to 25% would be deleterious to consumers, companies, jobs, and investments in innovation. Consoles, controllers and other hardware accessories are essential to video gameplay and other interactive entertainment experiences. The ubiquity and affordability of legitimate video game consoles and accessories drive the uptake of new technology by consumers, which then funds research and development (R&D) into new technologies. The National Science Foundation has noted that innovation fueled by R&D is key to U.S. economic competitiveness and that scientific and technological advances have led to the creation of new jobs – often in new industries – and can lead to an improved standard of living.<sup>16</sup>

<sup>9</sup> Entertainment Software Association, 2019 ESSENTIAL FACTS at p. 13. Forty percent are ages 18 to 35, 21% are 50 years and older and 18% are ages 36 to 49.

<sup>10</sup> *Id.* at p. 12.

<sup>11</sup> *Id.* at p. 11.

<sup>12</sup> *Id.* at p. 6.

<sup>13</sup> *Id.* at p. 11. Seventy-four percent of parents think video games are educational.

<sup>14</sup> *Id.* at p. 13.

<sup>15</sup> *Id.* at p. 15.

<sup>16</sup> National Science Board, *Research and Development: Essential Foundation for U.S. Competitiveness in a Global Economy: A Companion to Science and Engineering Indicators 2008*, Jan. 2008 available at <https://wayback.archive-it.org/5902/20150627220358/http://www.nsf.gov/statistics/nsb0803/start.htm>.

ESA members, known for driving technological innovation, are designing and creating video game consoles that consumers can take anywhere for uninterrupted gameplay,<sup>17</sup> adaptive controllers for disabled gamers including wounded veterans,<sup>18</sup> wireless controllers that adapt to a player’s hand size for personalized control and ergonomics,<sup>19</sup> consoles that one can use to watch live television, play DVDs and virtual reality games, listen to music, and chat with friends.<sup>20</sup> Research and development extends to interfaces, such as touch screen panels and sensors, wireless communications, as well as networks and cybersecurity, such as, for example, the introduction of two-factor authentication.<sup>21</sup> Future consoles still in development possess new possible capabilities, such as faster CPUs and GPUs, “ray tracing,”<sup>22</sup> 8K television support, and 3D audio immersion<sup>23</sup> that goes beyond the limit of conventional surround sound systems.<sup>24</sup> A console made solely for digital downloads with no mechanism for traditional discs is now on the market, the result of years of research.<sup>25</sup> Tariffs could potentially rupture this cycle of continuous innovation by reducing the incentive for investment in next-generation technologies.

At issue are products with the following harmonized tariff schedule (HTS) numbers:

HTS Sub-heading	Product Description
9504.50.00	video game consoles and machines
8544.42.20	Insulated electric conductors nesoi, used for telecommunications, for a voltage not exceeding 1,000 V, fitted with connectors <sup>26</sup>
8518.30.20	Headphones, earphones and combined microphone/speaker sets, other than telephone handsets <sup>27</sup>
8517.62.00	Machines for the reception, conversion and transmission or regeneration

<sup>17</sup> The Nintendo Switch was the highest-selling console in 2018 at 34.7 million units sold. See Kevin Webb, “The Nintendo Switch conquered the PlayStation 4, the Xbox One, and most of the rest of the video game industry in 2018,” BUSINESS INSIDER, Jan. 27, 2019 available at <https://www.businessinsider.com/nintendo-switch-best-selling-console-2018-2019-1/>.

<sup>18</sup> Deborah Bach, “How the Xbox Adaptive Controller is helping VA Medical Centers support veterans,” Apr. 30, 2019 available at <https://news.microsoft.com/features/how-the-xbox-adaptive-controller-is-helping-va-medical-centers-support-veterans/>.

<sup>19</sup> Microsoft’s Xbox Elite Wireless Controller, billed as the world’s most advanced. See <https://www.xbox.com/en-US/xbox-one/accessories/controllers/elite-wireless-controller>.

<sup>20</sup> Sony PlayStation 4 and PlayStation VR. See <https://www.playstation.com/en-us/>.

<sup>21</sup> Nintendo, “Annual Report 2018 for the fiscal year ended March 31, 2018,” p. 13 available at <https://www.nintendo.co.jp/ir/pdf/2018/annual1803e.pdf>.

<sup>22</sup> Gerald Lynch, Emma Boyle, Vic Hood, “PS5: all the games, specs, news, and rumors for Sony’s PlayStation 5,” TECHRADAR, May 28, 2019, available at <https://www.techradar.com/news/gaming/consoles/ps5-release-date-news-and-features-1213409>. Ray tracing is “an advanced lighting technique that can bring next-level immersion to gaming visuals. It’s a Hollywood technique that’s used in big-budget CGI spectacles, putting into context the level of visual fidelity you can expect.”

<sup>23</sup> Sony Interactive Entertainment, “Game & Network Services Segment,” available at [https://www.sony.net/SonyInfo/IR/library/presen/irday/pdf/2019/GNS\\_E.pdf](https://www.sony.net/SonyInfo/IR/library/presen/irday/pdf/2019/GNS_E.pdf).

<sup>24</sup> Steve May, “Best Dolby Atmos speakers: Your guide to getting amazing object-based audio,” TECHRADAR, Mar. 26, 2019, available at <https://www.techradar.com/best/best-dolby-atmos-speaker-guide>.

<sup>25</sup> Xbox One S All-Digital Edition, a 4K HDR streaming-capable console that does not use discs or physical media of any kind. See Nick Pino, Henry St. Leger, Vic Hood, “Xbox Two: what we want to see out of a new Xbox,” TECHRADAR, May 28, 2019 available at <https://www.techradar.com/news/gaming/consoles/next-xbox-release-date-news-and-rumors-1266462>.

<sup>26</sup> Xbox HDMI cables from List 3.

<sup>27</sup> Xbox stereo headsets.

	of voice, images or other data, including switching and routing apparatus <sup>28</sup>
<b>8526.92.10</b>	Radio remote control apparatus for video game consoles
<b>8543.70.87</b>	Infrared video game controller

If the above products are not removed before USTR draws up its final list, and because inclusion on that list will deeply damage the U.S. video game industry, we respectfully request USTR to institute an exclusion process for List 4 as it did for Lists 1 and 2 and as it plans to do for list 3. If USTR decides to create a formal process for List 4, we ask that it take the following four issues into consideration: (1) A determination to grant a product exclusion should extend to all U.S. importers of the same product from China. Tariff relief granted should also apply retroactively to the date on which the tariff is applied; (2) USTR should consolidate applications for product exclusions for the same product into a single file for review. Also, the issuance of a single determination should resolve all pending related applications; (3) A determination to grant a product exclusion should not be time-limited, but should continue throughout the Section 301 tariff process; and (4) To reduce the burdens on U.S. companies, particularly those that are small- and medium-sized, applicants for product exclusions should be permitted to file a single submission that encompasses multiple ten-digit HTS product lines that fall within one eight-digit HTS product category.



### **Imposing Additional Duties on Video Game Consoles and Controllers Would Cause Harm to Consumers, Industry and Innovation**

As advanced technology products, video game consoles, controllers, other devices and accessories can be expensive. As noted previously, in 2018, Americans spent \$5 billion dollars on consoles and controllers and another \$2 billion on accessories, including for virtual reality products. Consumers are highly interested in immersive and interactive entertainment. However, the majority of consumers are also sensitive to fluctuations in price for video game products. Two-thirds, or 66%, of consumers consider price when deciding to purchase a game.<sup>29</sup> Even the imposition of a 10% tariff rate could place these products out of reach for many consumers – let alone a 25% tariff, which would have an even greater impact, likely causing consumers to purchase fewer consoles, controllers and accessories. This is because console makers will be unable to absorb the tariffs on its consoles. Video game consoles are sold under tight margins in order to reduce the barrier to entry for consumers. Every effort is made to price the console at or slightly above cost to keep video game consoles affordable to enable more consumers to purchase them. Video game retailers, such as GameStop, BestBuy, and Walmart, also work under small profit margins, so it is unlikely that they would be able to absorb the additional costs of the proposed duties. All of this would mean that the additional costs would be passed along to consumers. This scenario would result in a ripple effect of harm for the industry and the jobs it generates and supports.

<sup>28</sup> Sony PlayStation wireless headsets from List 3.

<sup>29</sup> Entertainment Software Association, 2019 ESSENTIAL FACTS *at* p. 21.

Imposing tariffs on video game consoles and controllers could also slow uptake of new technology by consumers, who may be less inclined to purchase the newest consoles due to cost. Sixty-three per cent (63%) of Americans surveyed indicated that the quality of graphics is important when deciding whether to purchase a game.<sup>30</sup> Games that are as life-like and immersive as movies are underpinned by complex, sophisticated, and advanced software and are frequently capable of only being played on the latest consoles. These kinds of advances in technology clearly cater to consumer demand and preferences and result from company investments in R&D. The imposition of tariffs may render the decision to continue R&D on the latest technologies and related services to be much more difficult to sustain for U.S. video game companies.

Console manufacturers are not the only types of companies that would be affected by tariffs. Game publishers, developers, retailers, other vendors and service providers would also be affected by a potential decline in the sale of game consoles. U.S. companies that publish games to be played on consoles, particularly those small- and medium-sized companies, would also be negatively impacted by tariffs on video game products. The size and diversity of the video game ecosystem, as a whole, would materially suffer. The decrease in investment would make it more difficult for those publishers writing for multiple console platforms to break into or stay in the business. As a result, consumers would be harmed by a reduction in the variety of third-party games. The prospect of poor sales and poor uptake of new technologies, including virtual and augmented reality,<sup>31</sup> would deter the ability to recoup investments in R&D and would likely put at risk American jobs.

## **Imposing Tariffs on Video Game Consoles and Controllers Would Not Likely Change China's Practices**

The U.S. video game industry has experienced its share of challenges in China, both with regard to the protection and effective enforcement of intellectual property rights and full access to the Chinese market.<sup>32</sup> For example, along with other types of foreign content generally published online, such as movies and books, sales of U.S. video games are barred from the Chinese market unless video game publishers partner with a Chinese entity. U.S. games are also subject to content review by the Chinese government, a practice which effectively reduces market access. To that end, we acknowledge the need for U.S. government efforts to secure a free and fair Chinese market for U.S. companies.

However, imposing tariffs will only harm American consumers and American industry by making the United States a less competitive and less attractive market for the latest video games. In addition, video game consoles, other gaming devices, controllers, and accessories are consumer goods not related to the industry sectors at the center of China's "Made in 2025"

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<sup>30</sup> Entertainment Software Association, 2019 ESSENTIAL FACTS at p. 21.

<sup>31</sup> Virtual and augmented reality products, components and accessories are subject to 25 % tariffs beginning May 10, 2019, inflicting further harm on the U.S. video game industry. *Please see* HTS 8471.80.10, 8471.60.10 and 4202.19.00.

<sup>32</sup> The Chinese video games market is one of the world's largest with 619 million players expected to spend over \$37 billion in 2018. Newzoo, "2018 Insights into China's Games Market" available at <https://newzoo.com/insights/infographics/china-games-market-2018/>.

policy. The outcome would only threaten U.S. industry's dominant position in emerging technology for interactive and immersive entertainment and cause disproportionate economic harm in the process. Nor is shifting production and manufacturing from China a feasible undertaking in the short term. Video game consoles are not general-purpose computers, but rather highly customizable machines that require custom chips and casings and numerous specifically designed and complex components that cannot be made in a generic factory. Setting up a factory to manufacture a video game console would require extensive re-tooling of factories and retraining of workers.

Instead, we urge USTR to focus on bilateral, plurilateral and multilateral cooperation to force a meaningful change in China's trade and industrial policy practices. The Administration is already working through other avenues to address China's discriminatory and trade-distortive practices. For example, USTR holds periodic trilateral meetings with the trade ministers from the European Union and Japan on shared trade objectives. USTR is also working with its counterparts at the World Trade Organization to institute reforms that may have a positive impact on China's trade practices and would hold China to account. In the area of intellectual property, we applaud working-level, government-to-government talks on patent office cooperation including through the IP5, TM5 and ID5, that spur reforms to China's intellectual property system. We also urge a resumption of bilateral exchanges to discuss certain trade irritants like protection of trade secrets and enforcement of their theft such as the U.S.-China Joint Commission on Commerce and Trade (JCCT) or its successor.

## **Conclusion**

Imposing tariffs on Chinese imports of consumer goods, like video game consoles and controllers, will only serve to hurt ordinary Americans, who will bear the brunt of price increases. The proposed tariffs will also negatively affect U.S. industry and its investment in innovative technologies. Console manufacturers, video game publishers, and developers would suffer loss of revenue, which would ultimately lead to job losses here at home and a possible contraction of the industry. We strongly urge USTR to remove the following identified tariff codes: 9504.50.00, 8518.30.20, 8526.92.10 and 8543.70.87 from the final list or in the alternative, create a formal exclusion process.

Thank you for your consideration of this important matter. We are available to answer any additional questions you may have.

Respectfully submitted,



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