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Business

# New U.S.-China tariffs raise fears of an economic Cold War

By David J. Lynch and
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China said Tuesday it would retaliate for President Trump's latest tariff salvo, risking further U.S. trade actions that could result in what some analysts are calling an economic Cold War.

By next week, the United States and China appear likely to be on the brink of slapping tariffs on their entire goods trade, which exceeds $635 billion annually.

Chinese officials in Beijing said they would meet the 10 percent tariffs that Trump announced Monday on nearly $200 billion in imports with similar measures on $60 billion in U.S. products. If that occurs, Trump has said he will "immediately" begin the process of applying tariffs to all Chinese items entering the United States.

The showdown comes as Chinese officials were preparing to travel to Washington for new talks aimed at resolving the months-old trade dispute. Negotiations earlier this year failed to make much progress and it remains unclear whether Chinese officials will resume bargaining in the wake of the president's latest escalation.

As hopes dim for an early end to the conflict, the likelihood grows that the two countries are moving toward some sort of commercial divorce. Some analysts anticipate an economic partition reminiscent of the globe-splitting divide between the United States and the Soviet Union following World War II.

"We're probably talking about a world with two centers: a China-centered economic domain . . . and another centered on the United States," said Aaron Friedberg, a professor of politics and international affairs at Princeton University, who handled China policy as an aide to Vice President Richard B. Cheney in the George W. Bush administration. "It's heading toward a bifurcated global economy."

Such a fundamental reshaping of the U.S.-China commercial relationship after nearly four decades of growing interdependence would ripple through the global economy, shaking financial markets, reordering business supply chains and perhaps even raising the danger of military conflict, analysts said.

The two countries' annual goods trade, which has almost doubled since 2006, is roughly equal to the output of Argentina, which is widely considered to have the world's 21st-largest economy.

For now, a genuine breakdown in the U.S.-China relationship, affecting roughly 40 percent of the global economy, remains a long-term possibility. The immediate prospect is for the trade dispute to percolate for the remainder of this year, gradually ratcheting up the economic pain in both countries.

Trump says the tariffs are needed to compel China to abandon a host of unfair trade practices, including making American companies surrender their trade secrets in return for access to the Chinese market and subsidizing state firms in advanced-technology industries.

"The purpose of the tariffs is to modify China's behavior," Commerce Secretary Wilbur Ross said on CNBC. "The real purpose is not to end up with tariffs. The real purpose is to end up with a level playing field so that American firms can compete properly."

The newest tariffs will hit consumer goods such as appliances and auto parts, but Ross insisted the impact would be so slight that "nobody's going to actually notice it at the end of the day."

That's unlikely to be true in every case. The 25 percent tariffs that Trump imposed on imported washing machines in January quickly translated into sticker shock for shoppers. Over the past year, retail prices rose 13.6 percent, according to the Bureau of Labor Statistics.

In the short run, the president's newest tariffs will be weaker than his earlier trade actions, as a strong dollar allows Americans to overlook any modest price increase on Chinese goods.

The president announced Monday that he will hit up to $200 billion in Chinese goods — itemized on a 194-page list — with a 10 percent tariff starting Sept. 24. That's a smaller tax than the 25 percent levy he applied to $50 billion of imports from China in July, as well as the foreign steel and aluminum shipments that he began taxing in March.

Changes in the value of the U.S. dollar and China's currency over the course of this year are certain to sap some of the new tariffs' power. Since early February, the dollar has gained more than 6 percent against the Chinese yuan, a move that could erode more than half of the new tariffs' impact.

"This shows you how complex it is to narrow the trade deficit," said Torsten Slok, chief international economist for Deutsche Bank Securities. "Tariffs are a small part of the picture. There are many other moving parts and the rising dollar is offsetting some of the effects."

The drop in China's currency likewise will exaggerate the effect of China's retaliatory tariffs, making goods imported from the United States even more expensive for Chinese customers.

"American exporters now face a double whammy in terms of their competitiveness in the Chinese markets due to China's retaliatory tariffs and the strengthening of the dollar," said economist Eswar Prasad of Cornell University, who formerly was the head of the International Monetary Fund's China division.

Under Trump's plan, the tariff pain on the $200 billion batch of Chinese goods will grow on Jan. 1, 2019, rising to 25 percent from the original 10 percent. If there remains little sign of diplomatic progress by that point, more companies may switch their orders from Chinese suppliers to factories in countries such as Vietnam or India, executives said.

"We have not yet seen any significant shift in the customer supply chains. However, if the situation continues for any amount of time, we do expect customers to diversify their supply chains and perhaps some of the trade patterns might change," Rajesh Subramaniam, executive vice president of FedEx, told investors last week.

As the president pursues his uncompromising approach to China, business leaders are growing increasingly frustrated. The U.S. Chamber of Commerce, National Association of Manufacturers and the National Retail Federation were among those blasting the administration's use of tariffs as costly and counterproductive.

"We are disappointed that the administration seems to continue to misunderstand the complexities and reality of global trade," said Ed Black, president of the Computer & Communications Industry Association. "There are many legitimate trade concerns U.S. companies have in the global marketplace, but tariffs are unwieldy and often counterproductive to address those problems."

China's Foreign Ministry said it will respond to Trump's latest round of tariffs with duties on more than 5,200 types of American imports, including industrial parts, chemicals and medical instruments.

Trump has promised to respond to Chinese retaliation with further tariffs on the remainder of Chinese imports — which he has variously characterized as $267 billion or $257 billion worth of products.

Goldman Sachs published a research note Tuesday saying that announcement could come within “the next couple of weeks” with imposition sometime early next year.

“If he does that, we’re just headed inevitably for an economic Cold War with China,” said economist Gary Hufbauer of the Peterson Institute for International Economics. “Down this path, we will see a limitation of all economic contact.”

The administration also has taken steps to discourage Chinese investment in the United States. Congress this year passed legislation, with the backing of the White House, to scrutinize more closely a wider array of potential Chinese acquisitions of American technology companies.

“People are very focused on tariffs. But that’s just one element,” said Michael Hirson, director for Asia at the Eurasia Group. “The non-tariff measures are equally important and may be a longer lasting legacy.”

Some administration hard-liners would be content to see the trade and investment restrictions lead to a decoupling of the U.S. and Chinese economies, Hirson said.

That could be costly, according to Caroline Freund, director of macro trade and investment at the World Bank.

If 25 percent tariffs were applied to all U.S.-China trade, and investors withdrew, the U.S. economy would be 1.6 percent — or $320 billion — smaller than under normal trading circumstances while China would lose 3.5 percent of its gross domestic product, according to a presentation Freund gave Monday at the Peterson Institute.

At the White House on Tuesday, Trump said that while he might make a deal with Chinese President Xi Jinping “at some point,” his focus for now remains on tariffs.

“We are always open to talking. But we have to do something,” the president said. “We have a tremendous trade imbalance with China, tremendous trade deficit. And the way I look at it: Last year, we lost over $500 billion to China. We can’t do that. I don’t want to do that. And that’s been going on for many years. Other presidents should have taken care of this situation, and they didn’t. But I’m going to.”

*Paquette reported from Beijing. Luna Lin and Yang Liu in Beijing contributed to this report.*

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