COLLECTIVE INTELLIGENCE

US Tariffs on China:

What to Expect Next

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Earlier this week, US President Joe Biden directed the office of the US Trade Representative (USTR) to increase tariffs on $18 billion worth of Chinese imports after the agency extensively reviewed existing tariffs under Section 301 of the Trade Act of 1974.

The new tariffs target key growth industries and national security sectors. The White House has said the measures result from "China's unfair trade practices concerning technology, transfer, intellectual property, and innovation." The announcement came after US Treasury Secretary Janet Yellen and US Secretary of State Antony Blinken expressed concerns about Chinese overcapacity during their recent visits to China.

These new tariffs further demonstrate the major shift in US trade policy in recent years, with far-reaching consequences for global business. Moreover, they come during an election in which both candidates have fully embraced protectionism (albeit with important differences). In the post-war era, US trade policy was focused primarily on opening markets, with US presidents generally pushing back against the more localized interests of Congress. That era is over.

In 2018, then-President Donald Trump imposed tariffs on $300 billion worth of Chinese goods and his actions were broadly condemned by many at the time as poor economic policy. President Joe Biden has now opted to keep all those tariffs in place and add additional tariffs. The move is broadly supported across the political spectrum (with public support). The major point of political opposition is that the tariffs don't go far enough.

Some additional points for business to consider:

- US trade policy is now fully established as a national security tool and not just an economic one. That makes anticipating potential tariff actions more difficult and increases the probability that additional tariffs will be put in place.

- These new measures reinforce the Biden economic policy of combining subsidies with protection, with associated unintended macro risks.

- The action highlights that the green agenda and energy transition is secondary to protectionist politics.

These are big shifts for US economic and national security policy, with major implications for businesses to consider.

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Looking ahead

China's expected response

China will likely take retaliatory action, albeit calibrated not to alarm US and other Western investors or to create further challenges for the domestic economy. Ministry of Foreign Affairs spokesperson Wang Wenbin told reporters ahead of the expected announcement that "China opposes the unilateral imposition of tariffs which violate World Trade Organization (WTO) rules and will take all necessary actions to protect its legitimate rights." The tariffs are receiving widespread media and broader attention in China. China's strong rhetorical response will continue, but the economic constraints against more forceful action at this stage are significant.

One option for Beijing would be to launch a WTO complaint, although this would be lengthy. The WTO's dispute resolution mechanism is frozen due to the US's failure to appoint judges to the appellate body. Alternatively, China could take reciprocal trade and tariff action against the United States.

US automakers may be particularly vulnerable. In past spats with South Korea and Japan, carmakers from the two countries suffered. In Germany, carmakers are concerned about potential retaliation if the European Union applies tariffs against Chinese electric vehicles (EVs) this year, and they are lobbying against the move.

In the past, China's trade policy responses targeted companies or industrial sectors with ample alternative supply. For instance, in hitting out against Australia over its call for an international inquiry into the origins of COVID, China banned imports of Australian coal, switching quickly to suppliers from Indonesia and elsewhere, but did not target iron ore, where Australia is the low-cost – and high-quality – producer. Regarding autos, China has vast surpluses, and consumers could be persuaded to forgo US brands without much damage to the Chinese economy (although the Chinese joint venture partners of those brands would take a hit, too.)

Alternatively, China could target consumer products with additional tariffs and other restrictive trade actions, as it has done on many occasions. For example, in response to the European Union's ongoing anti-subsidy investigation into Chinese EVs, Beijing has threatened an anti-dumping probe into brandy. This key French export supports some 70,000 workers in the country. French President Emmanuel Macron is so concerned about a potential loss of sales in China that he lobbied China's leader, Xi Jinping, during his recent state visit to France, even gifting him several bottles of cognac.

US luxury goods companies should be prepared, too. Their products are similarly high value but relatively easy for Chinese consumers to do without, given abundant choice. In its 2017 spat with South Korea over installing a US anti-missile system, China targeted South Korean cosmetics, TV dramas and K-pop bands (Korean semiconductors escaped unscathed).

China has a long track record of targeting agricultural produce for retaliation, partly because the agricultural lobby in many countries is so strong. Bulk commodities, including grains and oilseeds, account for around two-thirds of US exports to China by value.

Moreover, China's toolkit is broader than tariffs. In many cases, China frames its trade actions as administrative procedures, such as health and safety checks and tax audits. Foreign businesses are vulnerable to consumer boycotts, sometimes fanned by social media. Indeed, businesses operating in China should be vigilant for less visible challenges – especially those in critical sectors. They should prepare for delays in review processes, approvals, and other things. This will pose a challenge for businesses operating on critical timelines.

Still, given the stakes, China will likely calibrate any retaliation against US companies with extra care. During escalating geopolitical tensions, China may be reluctant to expand a trade war with the world's largest economy. Besides, a tit-for-tat trade dispute would hurt China disproportionately: China runs colossal trade surpluses, and its exports as a share of GDP are higher than in the United States.

Set against those considerations is China's uncompromising response so far to complaints about Chinese industrial overcapacity that plagues many of the items on the Biden tariff list, especially EVs. Janet Yellen highlighted the issue on her latest visit to China. But China is unapologetic. During his recent visit to Europe, Xi Jinping insisted that "the so-called 'problem of China's overcapacity' does not exist, either from the perspective of comparative advantage or in light of global demand."

Further US policy action

Businesses should prepare for President Biden and former President Donald Trump to continue taking tough-on-China stances on economic issues ahead of the November election. Biden touted his measures as better for US workers, while Trump claimed that Biden followed his lead and argued that tariffs are needed on more products. An escalation of tit-for-tat measures can significantly damage the US-China bilateral relationship and warrants careful monitoring.

Given the broadly bipartisan skepticism toward China, the tariff measures were largely welcomed in Congress, although Republicans criticized elements of the announcement. The response reinforces the tough-on-China economic and national security approach that many members of Congress have taken. Indeed, Congress is likely to continue its actions to restrict the activities of some Chinese companies in the United States on national security grounds:

- The US recently enacted legislation mandating TikTok's China-based owner, ByteDance Ltd., divest its stake in the app within a year or face a ban in the United States. This action underscores broader concerns about Chinese influence and the possibility of the Chinese government accessing American user data or manipulating content to advance its interests.

- On May 15, the House Committee on Oversight and Accountability favorably reported out the BIOSECURE Act, a significant development in the ongoing efforts to address national security risks associated with Chinese firms in health care. Spearheaded by Mike Gallagher, the former chair of the House Select Committee on Strategic Competition with the Chinese Communist Party, and current Ranking Member Raja Krishnamoorthi (D-IL), the act prohibits federal agencies from contracting with biotech companies in "foreign adversary" nations, with a specific focus on Chinese firms. The legislation still faces several procedural hurdles, but may be incorporated into the annual "must-pass" defense spending bill that Congress will consider beginning this summer.

Recommendations for business

China will likely take retaliatory action, perhaps structured to avoid creating further challenges for the domestic economy. However, aggressive, direct action from China against the United States carries significant risk. For these reasons, we expect the response to remain relatively proportional and for the fragile stability that has characterized the US-China relationship since the November 2023 Woodside Summit to remain intact. While that does not preclude retaliatory responses from China or further US economic action, it does suggest that the guardrails around the relationship broadly remain in place, with continued bilateral economic exchanges and military-to-military dialogue.

This escalation in bilateral trade relations will nonetheless test the relative stability in place since the Woodside Summit. These new tariffs are the most aggressive action either side has put on the other since November, testing the strength and durability of the mutual desire to avoid letting the relationship deteriorate further.

In this environment, businesses must take proactive but nuanced responses to manage risks around US-China strategic competition, as outlined below.

Issues and Recommended Actions	
Taking Stock	Businesses must conduct a thorough analysis of all stakeholders- investors, retailers, suppliers, distributors and consumers in both the United States and China. This involves mapping out all direct and indirect connections to assess how each stakeholder might be impacted by geopolitical shifts. Understanding these relationships is critical as companies evaluate their current and future business planning to mitigate the risk of operations being caught in the crossfire of deteriorating relations.
Risk Planning	Develop a nuanced communication strategy that reflects an understanding of political, regulatory and geopolitical landscapes. This should involve not only identifying current risks but also predicting potential future challenges. Scenario planning or other forms of risk assessment are crucial to ensure that contingency plans are in place for potential fluctuations in the bilateral relationship. Communication should be flexible and adaptable, with prepared responses for various scenarios that could affect operations.
Supply Chain Stability and Assessment	Communicate the stability and resilience of your supply chain to stakeholders, highlighting efforts to mitigate risks through diversification of supply sources and investment in technological independence, especially in critical areas like semiconductors and AI. This ongoing narrative should also include a critical evaluation of dependency on the Chinese market and supply chains, particularly where US export restrictions could pose a risk. Such communications reassure stakeholders and position the company as forward-thinking against geopolitical pressures.
Monitoring Political Developments in Real-Time	Tracking political developments directly relevant to a company's business is an increasingly important dynamic. Timing matters. The ability to make swift adjustments to tactical strategy depends on the reliable interpretation of emerging political developments, whether in Washington, Brussels, Beijing or Delhi. Gaining a reliable understanding of political developments is essential.
Cybersecurity Communication	Regularly communicate cybersecurity efforts and achievements to all stakeholders. Detail the measures taken to safeguard data, the continuous improvements to defensive capabilities and compliance with the latest federal and state legislation. Clear communication about cybersecurity preparedness is essential to build trust and demonstrate due diligence.

Proactive Public and Government Relations	Engage in proactive communication campaigns to inform and shape public opinion. This includes regular briefings, updates and engagements with policy influencers, along with participation in public forums to help shape the regulatory environment and enhance the company's public profile.
Navigating Decoupling with Strategic Communication	As economic decoupling may intensify, communicate a strategic narrative that emphasizes the company's commitment to both markets. Highlight how the business contributes to economic prosperity in both the United States and China, positioning the company as a bridge between the two superpowers rather than a participant in their rivalry.
Opportunity-Driven Messaging	In an environment characterized by tension and competition, communicate a vision for seizing emerging opportunities. Focus on how the business is well-positioned to leverage innovations in technology and new market dynamics. Emphasize the company's role in driving future developments in fields like digital transformation, AI governance and green technology, aligning with global power shifts in data and tech.

For more information on the passage of this recent piece of legislation and the broader US-China relationship, please contact Brunswick Group's ***China Hub**, **Geopolitical Practice** or **US Public Affairs, Policy, & Regulatory Practice**.*