



## Tit-for-tat tariffs: Political one-upmanship by 'tariff man'

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The evolving tit-for-tat (TFT) tariffs and their implications for US-China trade, ramifications for the world economy, and the potential opportunities that might emerge for the Bangladesh economy needs some examination. The latest rounds of tariffs are not arising from a trade dispute between United States (US) and China. It comes from the presumption of the current US administration that they are being taken advantage of by China and other countries, thanks to the lopsided rules of trade. An economic power like the US should not be running trade deficits with China. Trade deficits are considered bad economics.

To put it in historical context, it is not the first time that a US administration has reacted to trade deficits. Back in 1981, it was Japan's turn to be targeted as it was the country running huge trade surpluses with the US. But Japan was a US ally, not the People's Republic of China. The US-Japan trade war simmered for almost a decade and concluded with an unusual trading arrangement - voluntary export restraints on Japanese auto exports, steel and machines, in addition to 100 per cent tariffs on electronics. It was described as a small-scale trade war, a phase that is long over. This time the setting appears more ominous and

involves political one-upmanship by the US President, a self-styled 'tariff man'.

✘ Tariffs are the principal instrument unleashed in this trade war. Several rounds of TFT tariffs between the two countries are summarised in Table 1. Note that tariffs (negligible by developing country standards) are a minor source of US revenue (under 0.5 per cent)]; its main objective being modest protection of domestic industry. Before the trade spat, the simple average rate of tariffs in the US was 3.5 per cent, while the trade weighted average rate was 1.6 per cent. The vast majority of imports (over 85 per cent) entered the US at tariffs of 0-5 per cent. 39 per cent of agricultural imports into the US were duty-free, while 40 per cent of them faced tariffs of 0.1-5.0 per cent. 54 per cent of non-agricultural imports into the US were duty-free, while 34 per cent of them faced tariffs of 0.1-5.0 per cent. Tariff peaks (15 per cent +) applied to a few products such as clothing, dairy products, sugar, confectionary, beverage and tobacco. These averages are now in the past.

Of the \$505 billion of Chinese imports into the US in 2017, some \$269 billion are already subject to these augmented tariffs. If a resolution in the trade talks is not reached by end-February, practically all Chinese products will be subject to tariffs of 25 per cent or more. Though the main thrust of the tariffs was to restrict Chinese imports into US, its application under the garb of 'national security', 'serious injury to domestic industries', and 'unfair trade practices', were a full-scale trade war to happen, higher tariffs could extend to all imports of the subject products, barring the small list of countries exempted. As expected, imports from China are falling, and prices rising sharply, paid by American consumers. But imports from other countries are not spared either, at least from the first round of tariffs that included critical industrial inputs like steel and aluminium. There is also a looming threat of up to 25 per cent protective tariffs on cars, auto parts, and trucks. Economists estimate that that could have devastating consequences for the German auto industry which would eventually lose 50 per cent of its \$38 billion of auto exports to USA. US consumers are expected to pay as much as \$2750 extra on domestic cars, half of whose inputs come from Mexico, Canada, and Japan. The geopolitical fallout of these measures will have to be seen in the coming days or years.

The rationale for these tariffs, initiated by USA, has been judged by analysts to be in contravention of WTO rules of which the Trump administration is no fan. Not surprisingly, preceding the new tariffs the WTO dispute resolution mechanism – widely regarded as the

most significant contribution of the multilateral trading system, a 'jewel in the crown' of WTO - was rendered ineffective by the US blocking the reappointment of judges to the settlement court. By end 2019, there will be only two out of seven judges left in a court that needs a minimum of three for a decision to be valid. That takes the wind out of the sails of the WTO if it were to question the US tariff actions. In the circumstances, China is left with no choice but to retaliate. Other WTO members who will suffer collateral damage will also have no recourse in the multilateral body. In the circumstances, the multilateral trading system is in serious jeopardy as never before, if a full-scale trade war ensues.

How do the augmented tariffs impact US consumers, producers, and its trade deficit? First, Chinese exporters to US are not paying the tariffs. American consumers, on the other hand, will find themselves paying higher for the Chinese goods - the average expenditure for an American family is expected to increase by \$127 per year due to these tariffs. Prices of various products, especially different types of electronics which are imported from China, have increased in the US. Second, so many of the intermediate and capital goods come under these tariffs that producers will face higher costs of production, becoming even less competitive than before. The American export hardest hit by Chinese retaliatory tariffs has been soybeans (HS Code 1201) - before the tariffs, the US was the largest exporter of soybeans to China (\$12 billion), it slipped to 18th position while the volume of exports fell by 97 per cent compared to the previous year. Finally, as Chinese exports decline, their imports (US exports) will be falling too. That could leave the US-China trade deficit moderately lower while deficits with other countries rise. Overall US trade deficit might not be reduced as long as the fundamental imbalance of excess spending over income, excess investment over savings, persist in the US economy. No doubt this whole affair is an external shock to the Chinese economy which was undergoing the challenge of its own adjustment of redirecting demand from external to domestic sources, resulting in significant slowdown of economic growth.

What is going to be more difficult to decipher are the implications for the complex web of cross-border value chain integration that has evolved over the years as trade and investment openness took hold in the world economy. Consider the Chinese investors building two chemical plants in the state of Louisiana for a cost of \$3.1 billion. Production costs are already up due to tariffs on steel frames to be imported from China and the processed finished products to be exported to China will come under higher tariffs, neither of which was

factored into the financial feasibility of the projects. Both costs and return on investment, in addition to future profitability, face uncertainty until the trade tensions are fully resolved. Such value chain integration in production across the different regions and continents are in serious jeopardy if the current trade tensions break into a full-scale trade war.