The Wire China

OPINION

The High Costs of Tariffs without End

The Biden administration's new measures against Chinese imports risks creating a doom-loop of declining American competitiveness.

BY VICTOR SHIH — MAY 19, 2024

POLITICS SUPPLY CHAIN TRADE

President Joe Biden signs a memorandum on increasing tariffs on China under Section 301 of the Trade Act of 1974, May 14, 2024, in the White House Rose Garden. *Credit: The White House Photo/Carlos Fyfe via Facebook (https://www.facebook.com/photo/?*

fbid=784471597200296&set=a.242934844687310)

Earlier this week, the Biden administration announced dramatically higher tariff rates (https://www.ft.com/content/c8c09e9f-df88-4e19-88a4-539ba97b2cfc) on a range of imports from China, focusing on batteries, strategic minerals, and electric vehicles, but also including steel, personal protective equipment and semiconductors. These tariffs are likely to impose a number of costs on the American public without meaningful medium term benefits; a much better policy mix of additional subsidies, favorable tax policies, and some non-tariff barriers would produce similar results at much lower costs to U.S. consumers and firms. The enactment of these tariffs instead risks pushing important American industries toward a rent-seeking doom-loop of declining competitiveness and greater isolation and protectionism.

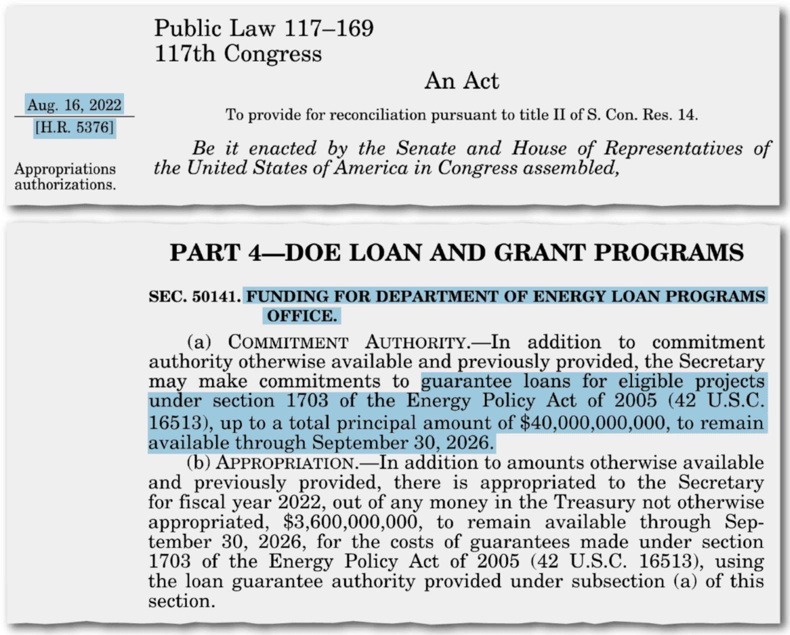
AN OVERVIEW OF THE INCREASES IN TARIFFS ACROSS STRATEGIC SECTORS

Product Category	Old Tariff	New Tariff	Effective Date
Battery parts (non-lithium-ion batteries)	7.5%	25%	2024
Electric vehicles	25%	100%	2024
Facemasks	0 – 7.5%	25%	2024
Lithium-ion electrical vehicle batteries	7.5%	25%	2024
Lithium-ion non-electrical vehicle batteries	7.5%	25%	2026
Medical gloves	7.5%	25%	2026
Natural graphite	0%	25%	2026

Other critical minerals	0%	25%	2024
Permanent magnets	0%	25%	2026
Semiconductors	25%	50%	2025
Ship to shore cranes	0%	25%	2024
Solar cells (whether or not assembled into modules)	25%	50%	2024
Steel and aluminum products	0 – 7.5%	25%	2024
Syringes and needles	0%	50%	2024

Source: USTR (https://ustr.gov/about-us/policy-offices/press-office/press-releases/2024/may/us-trade-representative-katherine-tai-take-further-action-china-tariffs-after-releasing-statutory)

Let's be clear, China's own industrial policies of tariffs, non-tariff barriers, forced technology transfers, and massive subsidies laid the foundation for these countervailing U.S. tariffs. Chinese policies have led to a spectacular build-up of its domestic industrial capacity, especially in the green technology space. Some kind of protectionist response was inevitable from Western politicians facing narrow vote margins.



Public Law 117–169
117th Congress

An Act

Aug. 16, 2022
[H.R. 5376]

To provide for reconciliation pursuant to title II of S. Con. Res. 14.

Appropriations authorizations.

Be it enacted by the Senate and House of Representatives of the United States of America in Congress assembled,

PART 4—DOE LOAN AND GRANT PROGRAMS

SEC. 50141. FUNDING FOR DEPARTMENT OF ENERGY LOAN PROGRAMS OFFICE.

(a) COMMITMENT AUTHORITY.—In addition to commitment authority otherwise available and previously provided, the Secretary may make commitments to guarantee loans for eligible projects under section 1703 of the Energy Policy Act of 2005 (42 U.S.C. 16513), up to a total principal amount of $40,000,000,000, to remain available through September 30, 2026.

(b) APPROPRIATION.—In addition to amounts otherwise available and previously provided, there is appropriated to the Secretary for fiscal year 2022, out of any money in the Treasury not otherwise appropriated, $3,600,000,000, to remain available through September 30, 2026, for the costs of guarantees made under section 1703 of the Energy Policy Act of 2005 (42 U.S.C. 16513), using the loan guarantee authority provided under subsection (a) of this section.

An excerpt from the Inflation Reduction Act on funding for the Department of Energy Loan Program Office. ***Source: Congress.gov (https://www.congress.gov/bill/117th-congress/house-bill/5376/text)***

Accordingly, the Biden administration has already passed the historical Inflation Reduction Act (https://www.thewirechina.com/2024/04/21/the-chip-comeback-tsmc-arizona-japan-fabs-tsmcs/) (IRA) in 2022, which has provided billions of dollars worth of grants, tax subsidies, and rebates to green energy firms, as well as to firms and government agencies willing to adopt green energy. Although tax payers will ultimately need to foot the IRA bill, it has created strong incentives to invest in green sectors, as well as to adopt green energy, both of which should accelerate the pace of the clean energy transition. Consumer welfare has largely been protected and may even improve from the greater availability of cheaper green energy options. And since China has been carrying out exactly the same policies for decades, such moves can't really be a source of bilateral tension.

Tariffs, though, are another matter entirely. First, tariffs are taxes imposed on American consumers and firms that choose, out of their own preferences and budgetary priorities, to buy from Chinese companies. Taxing them for this decision will lead to welfare losses for these Americans. Firms and individuals would need to pay more for, say, an EV, or forgo that option altogether.

The Chinese EV Price War Goes Global

BY RACHEL CHEUNG

The fierce competition between Chinese automakers has the potential to reshape EV markets around the world — and stoke resistance. (https://www.thewirechina.com/2024/03/24/the-chinese-ev-price-war-goes-global/)

Furthermore, because many of the tariffs focus on crucial components of the green transition, they almost certainly will delay aspects of this process without motivating the development of a competitive green energy sector in the U.S.. To be sure, there is still some competition coming from European, Korean and Japanese EV and battery makers, but they offer more expensive options in a relatively narrow range. Chinese companies offer the fiercest price and, increasingly, quality competition which global green manufacturers have to match to survive in the medium term. BYD — , the largest Chinese EV maker, offers 26 models of battery electric vehicles (BEVs) or hybrid vehicles across a wide price range, whereas KIA, a major Korean automaker, offers nine models of BEVs and hybrids.

To be sure, what happened in Europe, where millions of Chinese cars suddenly appeared on the market, was disruptive and might introduce some security concerns. The U.S. can and should introduce some speed-bumps to slow the entry of Chinese EVs. For example, if there are concerns about the data collected by software inside Chinese EVs, the U.S. could require that software to be developed inside the country, while source code and collected data would also have to be housed domestically. In addition to ensuring security, this would likely delay the entry of Chinese EVs into the U.S. market by months and even a couple of years. In any event, EV adoption in the U.S. has been modest because of the slow development of charging infrastructure. These factors will afford U.S., Korea, and German car companies time to improve quality and/or lower their prices before Chinese EVs enter the American market at scale. With a more definite schedule for the removal of protections, U.S. car companies would also have strong incentives to shape up to withstand competition.

Carefully designed grants, tax subsidies, and non-tariff barriers likely would protect consumer welfare and the long-term competitiveness of U.S. firms much more so than these protectionist cushions of doom.

The sizable literature in economics and political science also points out a major medium term cost of imposing tariffs: unproductive businesses become more interested in lobbying for more protection instead of innovation. Essentially, if businesses see that their profit is derived more from tariff protection, they will devote more resources to lobbying, in order to perpetuate that source of profit, which ultimately crowds out innovation. Over time, the protected industry becomes less and less competitive in the global market. Without clear sunset clauses for the current tariffs, and with a bipartisan consensus on protectionism, this logic may well play out in the U.S. market.

BYD officials, including Stella Li, vice president of BYD Co. and CEO of BYD Americas, at the launch event of BYD's Shark plug-in hybrid electric vehicle (PHEV) pickup truck at Expo Santa Fe Mexico in Mexico City, Mexico, May 14, 2024. ***Credit: @BYDCompany via X (https://x.com/BYDCompany/status/1790882631816540416/photo/2)***

Meanwhile, faced with high American tariffs, Chinese companies will double-down on cost-cutting and innovation in order to gain market share outside of the U.S., or even in the U.S. market itself despite these high tariffs. And of course the Chinese government will also double down on subsidies to Chinese EV, battery, and chip makers. Within a few years, the quality and price gap between Chinese and U.S.-made green energy products may become irreversible, which would completely defeat the purpose of the current tariffs.

Finally, because China is already dominant in a number of supply chains, Chinese companies can easily circumvent the tariffs by setting up final assembly and production using Chinese parts in third-party countries, such as Vietnam and Mexico. In order to counter such tactics, the U.S. would need to violate existing trade agreements such as the USMCA (formerly NAFTA) to impose tariffs on products made in these third-party countries. This would completely undo the liberal international order as we know it and introduce a dark period of multinational protectionism. In fact, most countries do not want this outcome and may well join China's relatively less protectionist trading order. A few countries like Brazil, Hungary, and Serbia have already strongly signaled their intention to do so.

A massive flood of Chinese EVs and green energy products into the U.S. market is not desirable. Yet, short of imposing multiple high tariffs without any clear sunset time-tables, there are many other options to slow the pace of their entry into the American market. Carefully designed grants, tax subsidies, and non-tariff barriers likely would protect consumer welfare and the long-term competitiveness of U.S. firms much more so than these protectionist cushions of doom.

Victor Shih is an associate professor of political economy at UC San Diego and holds the Ho Miu Lam Chair in China and Pacific Relations at the School of Global Policy and Strategy. He is also the director of the 21st Century China Center and the author of *Factions and Finance in China: Elite Conflict and Inflation (https://www.amazon.com/Factions-Finance-China-Conflict-Inflation/dp/0521106478)*. @vshih2 (https://twitter.com/vshih2?ref_src=twsrc%5Egoogle%7Ctwcamp%5Eserp%7Ctwgr%5Eauthor)