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SPOTLIGHT

China-U.S. Trade War Intensifies

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The imposition of tariffs has escalated into a full-blown tariff war between the United States and China. Both economies will be seriously affected, although it is likely to be more severe for China. Both sides probably will seek the EU's support. In its decision-making, the Union should take into account both its own economic interests (e.g., the threat to EU industry from China, aggressive U.S. tariff policy) and security issues, most importantly Chinese economic support for Russia in its aggression against Ukraine.

What measures have the parties taken?

On 2 April, the U.S. imposed import tariffs on all trading partners, including a 34% duty on Chinese goods to take effect on 9 April. China responded with a 34% tariff on U.S. products and restrictions on exports of selected rare-earth elements. In response, the U.S. raised its additional tariff on goods from China by 50 percentage points to 104% total (including those imposed earlier), which took effect on 9 April. On the same day China announced it was raising the tariffs against the U.S. by another 50 percentage points, to 84%.

This is yet another stage in the escalating U.S.-China tensions, which now amount to a full-scale trade war. Earlier, on 1 February, the U.S. imposed additional duties of 10% on Chinese goods, which came into effect on 4 February. China responded with a 15% tariff on coal and LNG and 10% on oil, agricultural equipment, and trucks from the U.S. (which came into effect on 10 February) and launched an antitrust investigation of Google. On 4 March, the U.S. raised the additional duty on China to 20%. That same day, China responded with tariffs of 10-15% on a range of U.S. agricultural products, which came into effect on 10 March.

What will be the consequences for the United States?

The main problem for the U.S. economy at the moment is the high uncertainty about the future of trade policy and the impact of the ongoing changes. This is evident in the falling consumer sentiment indicators. It brings about negative investor reactions, translating into unprecedented drops of the modern stock market, only comparable to the financial crisis of 2007-2008 and the COVID-19 pandemic period. In the long term, the sharp increase in the cost of imports will lead to higher inflation, an economic slowdown, a decline in investment, and possibly a recession (the probability of which is now estimated by major investment banks at 50-60%). The introduction of 104% tariffs on Chinese goods will be particularly severe for buyers of industrial products, the low prices of which have limited U.S. inflation for decades. China's restrictions on exports of rare earths, taking into consideration its near-monopoly, will be a problem for the U.S. technology sector. Despite the emerging difficulties and the negative public and business reaction, President Donald Trump stands by his decisions. Given the highly critical attitude to China of his main advisors (notably Peter Navarro, senior counselor to the president for trade and manufacturing), quick opening of negotiations is unlikely, although—as demonstrated by the swift suspension of tariffs on Mexico and Canada in February this year—not impossible.

What will be the consequences for China?

Economically, the situation is very dangerous for China, whose economy is based on exports and where many companies (up to 25%) have been making losses in the recent years. In the face of low domestic consumption, the severing of ties with the largest buyer of Chinese goods will lead to a decline in demand that cannot be resolved in the short term. This could lead to a wave of bankruptcies and deepen the years-long economic crisis, ultimately forcing the Chinese Communist Party to intervene deeply in the economy to prevent the turbulences from translating into social unrest and political issues. These measures will be effective in the short term, but in the long term they will exacerbate China's structural problems, especially the inadequacy of its economic model for the current level of development and excessive political control over the economy. Without finding new sources of demand, the long-term maintenance of economic and therefore political stability in China will be impossible. This will give rise to the risk that the Chinese authorities might base their legitimacy on security issues and nationalism, which could lead to aggressive actions, for example against Taiwan or in the South China Sea.

What will be the consequences of the dispute for the EU and Poland?

The rapid escalation of the U.S.-China dispute indicates that possible retaliation by the EU in response to the 20% tariffs imposed on it is also very likely to lead to an escalation. With the U.S. market virtually closed to goods from China (except for those that cannot be replaced in the short term), a redirection of Chinese exports to other developed markets, primarily the EU, is likely. While this would result in lower inflation, it would be detrimental to European industry, including Polish companies integrated into the production chains of companies from other Member States. However, the imposition of very high tariffs by the U.S. on Chinese goods will result in a relative increase in the competitiveness of EU products (despite also being subject to tariffs), which may help to partially mitigate the effects of U.S. actions on the EU.

The EU will be faced with a political choice—increasing imports from China will support that country in its rivalry with the U.S., a traditional ally of the Union with which it currently finds itself in a dispute over tariffs. Despite high-level EU-China talks, it is not yet possible to estimate what specific solutions will be adopted. In view of the strategic incompatibility of the Chinese and Western economic models, it is advisable to try to resolve the dispute with the U.S. and, if successful, to join the pressure on China to get the country to rebalance its economy and address the issue of overproduction. Any concessions to the Chinese side should be linked to its cessation of economic support for Russian aggression against Ukraine.