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Mayer Brown Consulting
Trade Alert
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The Stakes in the US-China Trade War

The trade war between the United States and China appears to be escalating. The US imposed an additional 25% tariff on US$34 billion of Chinese goods on July 6, and China retaliated with a similar tariff on US imports worth US$29.6 billion. The US may impose an additional 25% tariff on another US$16 billion of Chinese goods in September and perhaps a third new tariff of 10% on another US$200 billion in trade later this year. China's reaction bears watching.

Both countries have also used other policy instruments in their trade fight. The US, for example, has used the CFIUS[1] process to block Chinese acquisitions of certain US companies on national security concerns, while China has withheld regulatory approval of Chinese companies on global mergers that involve US companies.

There are no signs that either country will back down in the immediate future.

The US and China have been engaged in a war of words over trade since 2017 but followed through with tangible actions in 2018. We map out the timeline of actions taken.

US' ACTIONS

17 DEC 2017

Releases the National Security Strategy document, labelling China as a "strategic competitor" and prioritizing the protection of the US "innovation base" from IP theft by the Chinese in order to preserve the country's long-term competitive advantage.

2 JAN 2018

Committee on Foreign Investment in the United States (CFIUS) blocks MoneyGram's sale to China's Ant Financial on national security concerns.

22 JAN

Imposes global safeguard tariffs on solar panels and washing machines.

15 FEB

The Securities and Exchange Commission blocks the acquisition of the Chicago Stock Exchange by a subsidiary of the Chongqing Casin Enterprise Group.

22 FEB

CFIUS blocks the sale of US semiconductor testing company Xcerra to Hubei Xinyan, which is backed by a Chinese semiconductor investment fund.

22 MAR

Releases a report which finds China is conducting unfair trade practices related to technology transfer, intellectual property and innovation.

1 The Committee on Foreign Investment in the United States (CFIUS) is an inter-agency committee made up of members of the State, Defense, Justice, Commerce, Energy and Homeland Security departments, and led by the Treasury Secretary. It has the authority to intervene and review any pending or completed transactions if members of the committee think a deal could raise national security concerns.

23 MAR

Imposes a 25% tariff on all steel imports and a 10% tariff on aluminium, with exemptions for selected countries; action seen as a policy directed at China, which is the world's largest steelmaker.

Files WTO complaint on China's protection of intellectual property rights.

CHINA'S ACTIONS

2 APR

Imposes a 15% tariff on 120 US products, such as fruits, nuts, wine and steel pipes, and a 25% tariff on 8 other US products including recycled aluminium and pork.

5 APR

Files WTO complaint over the US tariff measures on Chinese goods.

9 APR

Initiates WTO complaint against US tariffs on steel and aluminium products.

16 APR

Bans ZTE Corp. from buying components from US firms for 7 years as a penalty for failing to honor a settlement in regard to prior US sanctions violations.

17 APR

Imposes preliminary anti-dumping duty of 178.6% on US sorghum.

18 MAY

Ends US sorghum tariffs.

11 JUN

Limits visas for Chinese citizens to protect intellectual property, including students majoring in robotics, high-tech manufacturing, aviation (areas identified in "Made in China 2025").

27 JUN

President Trumps supports congressional effort to expand CFIUS powers to review foreign investments in the US for national security threats.

6 JUL

Gives ZTE Corp. limited authorization to resume business.

Imposes an additional 25% tariff on China imports worth US$34 billion, such as machinery, mechanical appliances and electrical equipment, taking aim at the priority sectors identified in "Made in China 2025".

Imposes an additional 25% tariff on US imports worth US$29.6 billion, including soybeans and vehicles.

COMING END JULY

May impose an additional 25% tariff on another US$16 billion worth of goods from China.

Depending on US actions, may retaliate with additional tariffs on another US$16 billion worth of goods from the US, including crude oil, plastics, chemicals and liquefied propane.

COMING 3RD OR 4TH QUARTER 2018

May impose a 10% tariff on another US$200 billion in Chinese exports, such as consumer goods, computer and auto parts.

Depending on US actions, may retaliate.

Will the US trade deficit really shrink?

On the campaign trail, US President Donald Trump had railed against the trade deficit with China and the "theft" of US jobs and intellectual property by China. Imposing tariffs on Chinese goods seeks to reduce the flow of Chinese imports, move manufacturing and jobs back to the US, and force American consumers to buy domestically made products.

Meanwhile, the shift in China's trade patterns in recent years – from processing trade to general trade[2] – shows that China is slowly moving away from importing goods for processing and export, to importing for domestic consumption. Businesses leveraging the growing Chinese market will still need to set up operations in the country.

Processing trade is driven by low costs and adds very little value in China. Businesses, whose prices are driven up by the US tariffs on China-made goods, will shift production elsewhere where costs are lower and do not attract additional US tariffs.

So, while the US trade deficit with China may reduce in the short term, there may not be significant improvement to the US total trade deficit in the long run.

Will China blink first?

On the surface, US' demand to close the trade deficit may appear innocuous, and China has signalled its openness to negotiate on this issue, including offering to buy more US goods, cut tariffs on some consumer goods and automobiles, and ease foreign investment restrictions in certain sectors.

Chinese President Xi Jinping has acknowledged that intellectual property protection has an important role in enhancing the competitiveness of the Chinese economy, and promises that China will improve laws and regulations, and boost the enforcement of intellectual property rights.

But, China has also signalled its readiness to fight a trade war. At a press conference on July 5, a Ministry of Commerce spokesperson stated that China will not bow to threats and "blackmail", nor will its resolve to defend global free trade and the multilateral system be shaken.

The US appears to be taking a leaf from the 1980s playbook of the US-Japan feud. However, some analysts believe that China is in a better position to deal with the situation.

These critics argue that China is not as export dependent and its growth has shifted to domestic demand. Its markets are also more diversified and it is not reliant on the US for security.

Due to existing capital controls, China has a greater command over the stability of its currency, the Renminbi (RMB). Thus, it does not appear likely that China will accept arrangements similar to the voluntary export restraints (VERs) and the Structural Impediments Initiative (SII) that Japan signed with the US.

Furthermore, the US actions and expressed intentions are seen as specifically targeting "Made in China 2025".[3] There is a growing sentiment among the Chinese public that the US actions are taken to hold back China's economic development and prevent China from moving up the value chain in production and innovation networks. There are even comparisons in China with the "Unequal Treaties" that China was forced to sign during the Qing dynasty in the 1800s. Seen in this light, the Chinese government is unlikely to back down from the US challenge.

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2 In China, there are two key trade modes: general trade mode and processing trade mode. Processing trade refers to the activity of importing all or part of the raw materials, parts and components, accessories, and packaging materials under bond, and re-exporting the finished products after processing or assembly in China. Thus, processing trade normally involves goods destined for markets outside China, while general trade involves goods destined for the Chinese domestic market. In 2017, general trade made up 56% of China's total value of trade.

3 "Made in China 2025" is a strategic blueprint to comprehensively upgrade China's manufacturing sector, to be innovation-driven, emphasize quality over quantity, achieve green development, optimize industry structure, and nurture human talent. The plan provides state subsidies for 10 priority sectors deemed critical to the continued development of China's economy: 1) new advanced information technology; 2) automated machine tools & robotics; 3) aerospace and aeronautical equipment; 4) maritime equipment and high-tech shipping; 5) modern rail transport equipment; 6) new-energy vehicles and equipment; 7) power equipment; 8) agricultural equipment; 9) new materials; and 10) biopharma and advanced medical products.

Sandwiched between the two trade giants, what can businesses do?

The most immediate effect will be on existing contracts. Businesses should ask the following questions:

1. What are the international commercial terms of the contract? Are the goods supposed to be delivered duty unpaid or duty paid? Who is responsible to pay the import duty, including the additional tariffs, on the goods?
2. What happens if a shipment arrives only after new additional tariffs have been imposed, as there may only be a short warning period between the announcement of a new tariff and its implementation? Who will be liable for the additional tariffs? If there is a delay in the shipping time, would the carrier be liable?
3. Are there provisions in the contract allowing for the cancellation of the purchase order?

It may also be time for businesses to take a close look at their existing contracts or prepare for a re-contract, to build in effective safeguards to deal with further actions that the US and China, and potentially other countries, as the trade war continues.

In the longer term, the trade war between the world's first and second largest economies may disrupt global supply chains. Multinational companies with operations intricately distributed throughout the US and China may have to rethink and realign their supply chains.

For businesses exporting to the US, this will accelerate the trend of processing trade operations moving out of China to less costly countries (and which do not currently attract additional US tariffs). Conversely, businesses tapping into the vast Chinese consumer market will need to have non-US sources, whether within China or in other countries.

Will the world revert back to a pre-WTO environment where countries sit behind high tariff walls, and globalization becomes a chapter in trade history?

There is little to suggest that the world at large is abandoning globalization; the world is too inter-connected now. There is a remote possibility that the US may come to see supply chain realignments as circumventing its China tariff action, and thus erect tariff walls against more and more countries, and eventually the world. However the trade war plays out, businesses should start preparing their contingency plans.

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