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INSIGHT

U.S. Trade Friction with China Intensifies

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Commercial relations between the United States and China are experiencing an increasing level of tension and uncertainty. In August 2017, the Trump Administration launched a Section 301 investigation of Chinese policies relating to technology transfer, intellectual property, and innovation policies deemed harmful to U.S. economic interests. In March 2018, the Administration announced it would take specified action against China in response to such policies, including increased tariffs. The Administration subsequently raised tariffs on three tranches of import products from China, (with estimated combined worth of $250 billion). China imposed retaliatory tariff increase on three tranches of imported products from the United States (with estimated combined worth of $110 billion).

On February 14, 2019, President Trump tweeted that trade negotiations with China were in "advanced stages" and suggested that an agreement could soon be reached. However, on May 5, he tweeted that trade negotiations were going "too slowly" and that China was attempting to "renegotiate" previous trade commitments. As a result, on May 10, he ordered that tariffs on a third tranche of Chinese goods be raised from 10% to 25% (made fully effective on June 15) and that the process for increasing tariffs by 25% on nearly all remaining U.S. imports from China (estimated value at $300 billion) be started. On May 13, China announced it would increase its tariffs on many of the U.S. products listed in its third tranche (effective June 1). China blamed the United States for the breakdown in talks, claiming it had "persisted with exorbitant demands" and demanded concessions touching on "China's sovereign affairs."

Tariff Increases and Trade

Both sides are experiencing trade impacts of the tariff hikes. While U.S. merchandise imports from China in 2018 rose by 6.7% (to $540 billion), over the previous year (data not shown), they fell by 13.9% during the first quarter of 2019 year-over-year, while imports covered by U.S. tariff hikes dropped by 29.9% (see **Figure 1**). Similarly, while Chinese imports from the United States increased by 2.4% (to $154 billion) in 2018 (data not shown), they fell by 29.3% during the first quarter of 2019. Imports of U.S. products covered under China's retaliatory tariff measures fell 36.6% (year-over-year). (See **Figure 2**.) This has

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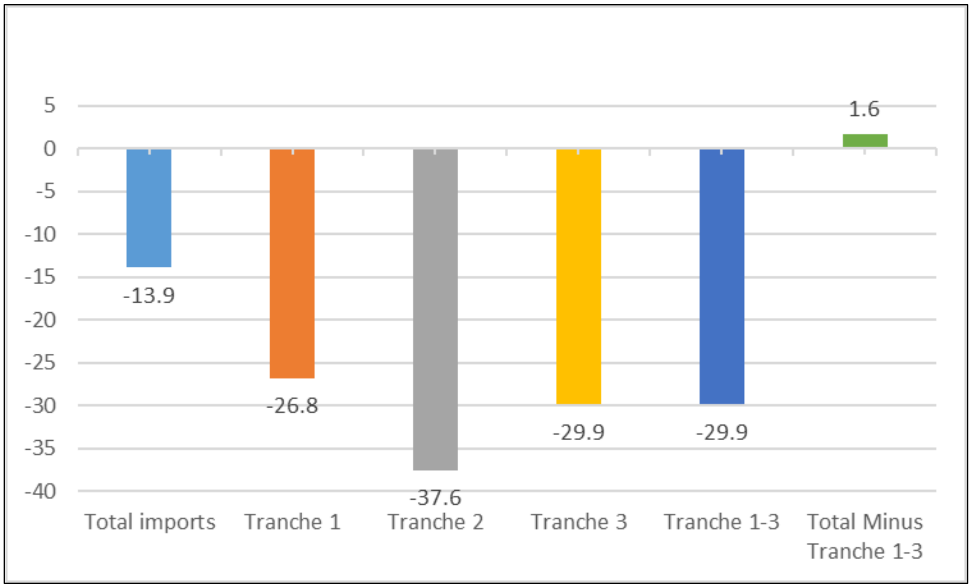
raised concerns that China is increasingly turning to non-U.S. suppliers who are not subject to the higher tariffs.

Figure 1. U.S. Imports from China of Products Affected by U.S. Section 301 Tariff Hikes

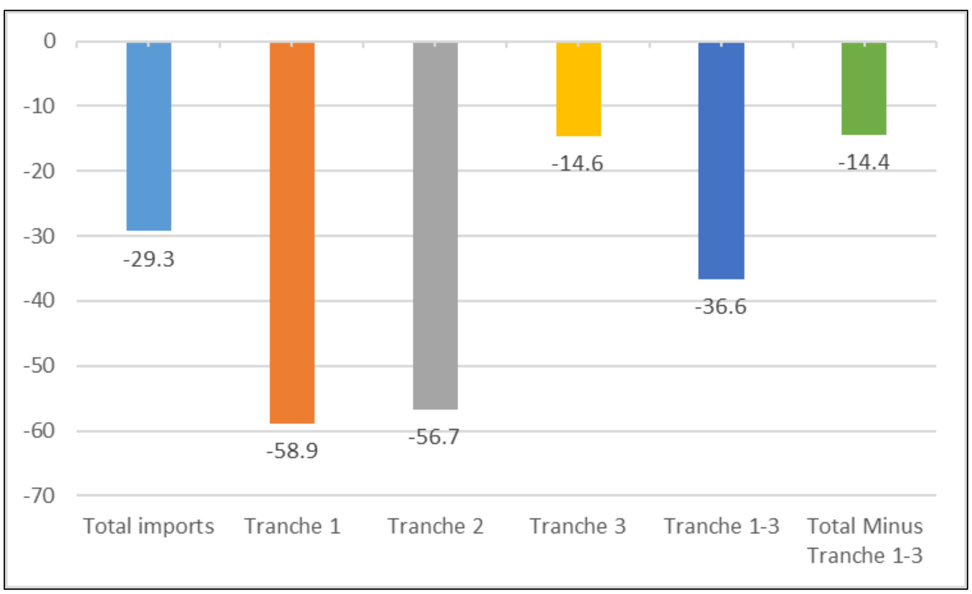
(January-March 2019 Year-on-Year (% Change))



Source: USITC Dataweb.

Figure 2. Chinese Imports of U.S. Products Affected by Retaliatory Chinese Tariff Hikes

(January-March 2019 Year-on-Year (% Change))



Source: USITC Dataweb.

Additional Economic Measures

In addition to tariff increases, the United States and China have implemented other measures (or have threatened to take certain actions) that could lead to additional restrictions on bilateral commercial ties and greater uncertainty in the bilateral economic relationship

- **Information and Communications Technology (ICT)**. China is the largest foreign supplier of ICT equipment to the United States. In 2018, U.S. ICT imports from China totaled $157 billion, or 60% of total U.S. ICT imports. Citing a "national emergency," President Trump, on May 15, 2019, issued Executive Order 13873 on Securing the Information and Communications Technology and Services Supply Chain. The order stated the Administration's view that U.S. purchases of ICT goods and services from "foreign adversaries" posed a national security risk to the United States and authorized the Federal government to ban certain ICT transactions deemed to pose an "undue risk." As of June 18, the President has not yet designated any entities pursuant to this order.
- **Restrictions on Commercial Ties to Huawei**. Chinese firm Huawei is the world's largest telecommunications equipment producer. On May 15, 2019, the U.S. Department of Commerce announced that Huawei "is engaged in activities that are contrary to U.S. national security or foreign policy interest." As a result, Commerce said it would add Huawei and 68 of its non-U.S. affiliates to the Department's Bureau of Industry and Security Entity List, which would require an export license for the sale or transfer of U.S. technology to such entities. On May 20, the Trump Administration delayed the measure by 90 days. China responded by announcing on May 31 that it would create an "unreliable entity list" of foreign firms and individuals that seriously damage Chinese enterprises by failing to comply with market rules, deviating from contracts, and imposing restrictions on Chinese firms for noncommercial purposes. China implied that punitive measures could be imposed against such entities.
- **Potential Chinese Curtailment of Rare Earths Exports**. China is the world's largest producer and exporter of a number of critical materials, including rare earths, a group of 17 elements (metals) whose unique properties make them critical in a variety of advanced technologies (including some used by the U.S. military). In 2018, nearly three-quarters of U.S. rare earth material imports by value came from China. On May 17, 2019, the USTR published a notice in the Federal Register with a proposed fourth tranche of products imported from China that could be subject to 25% ad valorem tariffs. The notice specified that rare earth materials (and certain other products) would be excluded from the list. On the same day, Chinese President Xi Jinping toured a firm in China's Jiangxi province that produces rare earth magnets. Some viewed this as a veiled warning to the United States that China could restrict future rare earth exports to the United States if the current trade conflict intensified further.

Some economists have raised concerns that the current U.S.-China trade conflict (if not resolved soon) could eventually hit nearly all bilateral trade with increased tariff hikes, lead to additional types and rounds of commercial retaliatory measures, and possibly result in "economic decoupling."