Tariffs On China Mean Higher Prices For US Consumers

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Overview

Not long after I started studying economics in graduate school in 1975, I concluded that government-imposed tariffs on imported goods are almost always a bad idea. Ditto for trade wars. In general, the government has no business influencing the prices US manufacturers and others pay for the goods they import from abroad.

As we all know, however, China has been a really bad actor when it comes to trade. China is notorious for stealing intellectual property and coercing companies that want to do business there to share their proprietary technology with Chinese entities.

This is especially true for US companies doing (or attempting to do) business in China. President Trump routinely complains that China has been ***"ripping us off"*** for years. As a result, the president decided earlier this year to punish China by placing tariffs on Chinese goods that are exported to America.

As of yesterday, the US has imposed a 10% tariff on $250 billion worth of goods and services China sells to Americans each year. And Mr. Trump is threatening to more than double the tariffs if China retaliates. If so, that would mean we have tariffs on more than $500 billion in exports to the US.

There is broad agreement that *something* needs to be done to penalize China for this bad behavior. The question is, are tariffs the best way to go – because tariffs almost always result in higher prices paid by consumers, in this case American consumers.

The good news is that China's currency has weakened this year, making Chinese goods cheaper to purchase, so US consumers have not experienced significantly higher prices – so far. But Mr. Trump plans to increase the tariffs from 10% to 25% on January 1st, which will almost certainly lead to higher prices for Americans.

There is a heated debate over how best to punish China for its bad behavior on trade. President Trump and his senior trade adviser favor tariffs on China, apparently the more the better. Others fear that when the tariffs go up to 25%, it will result in an all-out trade war with China. That's what we'll talk about today.

Trump's Tariffs on China – A Look at the Numbers

The US has a huge trade deficit with China; in August alone imports from China were a whopping record **$44.4 billion,** whereas we exported only $**13.3 billion** to China**.** For 2017, the US imported a record **$505.5 billion** from China, while China imported only **$129.9 billion** from the US.

As I have argued **recently**, the trade deficit with China should not really matter. The fact that American consumers choose to buy goods and services made in China – and ***save some money*** – is not a bad thing. Yet President Trump believes China is ripping us off. If he and his trade advisers are wrong, we could be in an all-out trade war with China next year. Remember I said ***could***. I hope I'm wrong.

Now let's take a look at the tariffs Trump has imposed so far, how much more he's threatening and how China has reacted. In June, Trump imposed tariffs on **$34 billion** worth of steel and aluminum imports from China. In August, he added another **$16 billion** of goods subject to tariffs. Last week, he announced tariffs on another **$200 billion** of additional imports from China that reportedly took effect yesterday. That's a total of **$250 billion** in Chinese goods subject to the tariffs.

The current US tariffs are at 10% but Trump has said they will escalate to 25% starting January 1. At 10%, this is not a severe blow for China since its currency has declined by almost that much this year. Yet at 25%, that's a real blow!

So far, China has responded with offsetting tariffs on **$50 billion** of US goods. It remains to be seen how China will react to yesterday's tariffs on $200 billion of goods hit with new tariffs. Trump warned last week that if China retaliates against our latest $200 billion worth of goods hit with more tariffs, he will impose tariffs on another **$267 billion** of Chinese products.

The thing to keep in mind is the fact that China imported only about $130 billion from the US last year. Since China already has tariffs on $50 billion of our goods, that means they only have about **$80 billion** of additional imports they can impose tariffs on – *if* they choose to go that route and risk even more tariffs from Trump. So, we are very close to an all-out trade war with China.

President Trump Has a Strategy – But Will It Work?

If China retaliates against the additional $200 billion in goods subject to US tariffs that went into effect yesterday, and if Trump responds with the extra $267 billion in goods subject to tariffs, that will mean we have tariffs on **100%** of our annual imports from China. And remember, those tariffs are slated to increase from 10% to 25% on January 1st.

That is the heart of Trump's tariff strategy. At that point, he believes China will have to give-in and make meaningful reforms. That's a very risky strategy! It has been reported that several members of Trump's Cabinet disagree with his tariff strategy and believe it's too risky. Some have even resigned because of it.

It is well-known that Trump's Director of Trade and Industrial Policy, **Peter Navarro**, has the president's ear on how to deal with China. Navarro, who for years has been a liberal Democrat, is well-known for his advocacy of tariffs and opposition to trade deals.

It is Navarro who has pushed Trump to wage an escalating trade war that pits the US against not only economic adversaries like China but also allies like Canada and the European Union. *TIME* magazine recently stated that Navarro ***"is the most powerful person in Washington on the most volatile issue of Trump's presidency. It is Navarro who helps translate Trump's beliefs into action, supplying him with policy direction, affirmation and arguments to help his case."***

In conclusion, many of us have been puzzled by President Trump's trade policies and his obsession with China, especially in comparison with most of his other policies which have been largely conservative in nature. Many of us have wondered if he just doesn't fully understand trade and the colossal failures trade wars have delivered.

In any event, Mr. Trump seems intent on punishing China to the point of placing tariffs on 100% of Chinese goods and services imported by the US – if they don't change their ways. While this qualifies as a strategy, it doesn't mean it's a good one. It will eventually mean higher prices for US consumers and will hurt the economy. Plus, it will almost certainly be bad news for US companies operating in China. And it could cause an all-out trade war next year.

Mr. Trump needs to stop listening to Peter Navarro and pay more attention to his free-market advisers like Larry Kudlow and others.

China's Economy Weakens, Stock Market & Currency Plunge

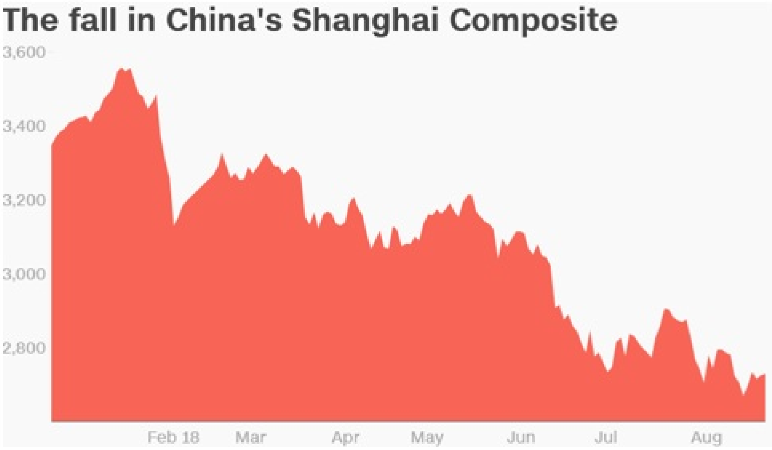
Most of you reading this are aware that China's red-hot economy has started to slow down this year, its stock market fell into bear market territory this summer and its currency is weakening. A trade war with the US will only make matters worse.

China is one of the world's fastest growing major economies – it expanded **6.9%** in 2017, according to government figures. But it has started to lose steam this year, and signs of further weakness are multiplying. As of August, growth had been downgraded to **6.5%** (annual rate), and it's expected to slow even further.

Official data for the summer showed a slowdown in investment, factory production and retail sales. There are also fears that China's highly-leveraged property market is at risk for a painful devaluation just ahead. If true, that would be very serious.

Forecasters also expect China's economy to weaken further due to domestic headwinds caused by slower credit growth – as the government tries to manage its out-of-control debt. And that's not all the problems they face.

China's stock market has been pummeled by investors concerned about the health of the country's economy and the impact of the trade war with the US. Its main stock index, the Shanghai Composite, fell over 20% and was down nearly **25%** in August from its peak in January.



The country's currency, the yuan, has shed almost **10%** versus the US dollar since April. Even though a weaker yuan makes Chinese exports cheaper, helping offset the impact of US tariffs, analysts suggest that Beijing is more concerned with propping up the currency to avoid a steep plunge that could spook investors.

China's Out-of-Control Public & Private Debt

China's slowdown comes as Beijing is trying to tackle the country's heavy debt burden, a legacy of its huge stimulus programs in the wake of the global financial crisis. The biggest worries surround the alarmingly high levels of debt held by companies, especially China's bloated state-owned enterprises.

President Xi Jinping and other top officials have called for China's financial system to cut down on riskier lending, a campaign often referred to as ***"deleveraging."*** Authorities have tried to crack down on China's vast "shadow" banking sector in which murky forms of lending are kept off banks' official balance sheets.

Analysts worry, correctly, that a slowdown in lending will weigh on the economy. Add up the problems noted above, and throw in the trade war with the US, and China's outlook is not very good. I'll stay on it.

All the best,
Gary D. Halbert