U.S. China Trade Wars-New Initiatives Of The U.S. And What Industries Are Impacted

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When Is The War and Who Started It?

Although tensions have existed for many years on trade and other issues, most observers would agree that 2018 was a pivotal year in defining the trade war with China. Former President Trump fired the first shot across the bow by imposing tariffs of up to 25% on most exports from China under Section 301 of the Trade Act of 1974-a law designed to protect the U.S. from unfair trade practices. Currently, these Section 301 tariffs fall heavily on U.S. auto parts producers, who rely on Chinese components or raw materials to manufacture their products.

The focus of this Client Alert is on what has happened recently to raise the U.S.-China trade war to a new level that is equal to or exceeds what has happened in 2018. Although fears of China exports and trade practices occur in many industries, the recent alarm has special focus on the automotive industry and its future.

President Biden has prioritized the future growth of the U.S. automotive industry, particularly the environmentally friendly electric vehicles (EV). There has been considerable China-focused activity relating to the automotive industry technological innovation. For example, last month there was issued a "Statement from President Biden addressing national security risks to the U.S. auto industry." The essence of his statement is summarized as follows:

> *"China is determined to dominate the future of the auto market, including by using unfair practices. China's policies could flood our market with its vehicles, posing risks to our national security. I am not going to let this happen on my watch."*

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In addition to this strong general statement of his motives and intentions, President Biden made more specific references to "*taking action on Chinese cars based on the national security*" (emphasis added). And he concludes:

> *"So today, I am announcing unprecedented actions to ensure that cars on U.S. roads from countries of concern like China do not undermine our national security. I have directed the Secretary of Commerce to conduct an investigation into connected vehicles with technology from countries of concern and to take action to respond to these risks."*

The mention of "national security" is the key word, as it links the investigation to Section 232 of The Trade Expansion Act of 1962, often referred to as the "National Security Clause." This law was last used in 2018 by President Trump to impose tariffs on steel (25%) and aluminum (10%) on many countries. It is still in effect. Certain countries were exempted including Canada and Mexico based on the U.S. Mexico Canada Free Trade Agreement ("USMCA") and certain countries were excluded from the beginning for reasons not particularly clear, *e.g.* Argentina and Brazil. Europe is still struggling with these tariffs, which have been turned into tariff rate quotas, allowing certain quantities to enter before the tariff is imposed.

Section 232 is probably the strongest weapon that the U.S. has in its arsenal of trade remedies. It is administered by the Commerce Department and, although there is an evidentiary hearing, it is far from the safeguards in a court case. However, it is possible for importers to win a Section 232 case, if they have good counsel and support in key industries.

For example, President Trump had also started an investigation under Section 232 on a tariff on automobiles, but it was never implemented. At that time most of the automotive industry, including U.S. companies with overseas plants, opposed the tariffs, as did key automotive suppliers in the steel and aluminum industries. At the hearings at the Commerce Department the only real proponent of Section 232 tariffs on autos was the UAW.

<u>Why Is There Alarm Now Over Chinese EVs?</u>

Anti-China sentiments have steadily increased, particularly regarding EVs. The U.S automotive industry has the support of the government and certain new incentives to buy American produced products, including EVs and EV batteries. However, there is broad concern that Chinese advantages in cost and technology and even larger government subsidies will allow it to dominate the U.S. market before the U.S. EV producers can stand on their own. China's BYD brand is displaying a small electric hatchback vehicle called the Seagull that will sell in the U.S. for $10,000. BYD has already exceeded Tesla as the world's largest EV producer and China has passed Japan as the world's largest exporter of automobiles.

<u>How Is Washington Reacting To The Alarm?</u>

It is concerns raised by these low priced EVs that have led Senator Josh Hawley (R-MO) to introduce several bills to the Senate which have re-kindled the fairly low-keyed trade war since President Biden has taken office.

The first is *Protecting American Autoworkers from China Act* of 2024, which would increase the base tariff rate of auto imports from China to 100%, for a total tariff of 127.5% on all imported autos from China (the existing duty on automobiles of 2.5% plus the 25% Section 301 tariff plus the proposed 100% new tariff).

The second bill is the *Ending Normal Trade Relations with China Act*, which would revoke China's normal trade relations status. What this means is China will no longer be eligible for the reduced "Most Favored Nation" ("MFN") tariffs granted to almost all members of the World Trade Organization (WTO) but would be subject to a column two tariff of 10%, four times the normal tariff. Currently, the only countries paying these higher non-MFN rates are Cuba, Russia and North Korea. Note that this action would apply to all exports from China, not just autos. It would quadruple the existing MFN tariff now paid by most auto and auto parts producers to 10%, most of which are also paying the 25% Section 301 tariff.

Many economists believe that the existing tariff has already cost U.S. consumers billions of dollars; the two bills, if both were enacted into, law would raise the tariffs on vehicles from China to 135% and auto parts from China to 35%. Further, this proposed tariff also would apply to Chinese vehicles manufactured in Mexico by applying the punitive tariff not only to vehicles manufactured in China but also to those produced by an entity organized under the laws of or otherwise subject to the jurisdiction of China, without regard to the country in which that entity is located, or produced by an entity over which control is exercised by an entity organized under the laws of or otherwise subject to the jurisdiction of China, without regard to the country in which either such entity is located.

This is very significant since there also has been a movement among Chinese owned companies to produce EVs in Mexico and import them into the U.S. Under the proposed legislation ,products of Chinese auto companies even for vehicles produced in Mexico by Mexican workers would still have to pay the 25% Section 301 duties and the 2.5% (or 10% if MFN is removed) statutory duty which otherwise do not apply to imports from Mexico that meet the rigid requirements of the United States Mexico Canada Free Trade Agreement (USMCA).

<u>Non-Tariff Issues - Tax Incentives Limited To The U.S.</u>

Much attention has been given to the tax and other incentives for EVs provided in the Inflation Reduction Act (IRA). The IRA already limits the incentives to vehicles to those with final assembly in the United States. Beginning in 2025, it will be required that the battery and critical mineral content utilized in the battery be extracted processed or recycled is principally of U.S. origin. The percentage rises from 30% to 80% in 2027. China has recently filed a complaint, in late March, with the World Trade Organization (WTO) alleging that the U.S. is giving discriminatory subsidies to electric vehicles.

<u>How Does This Affect Us Automotive Suppliers?</u>

Economic orthodoxy would predict that increased tariffs would hurt consumers and help domestic producers. But not all agree with that economic orthodoxy. More importantly, every producer is also a consumer (of inputs) and many, perhaps most, domestic parts producers have a significant presence in both domestic and international markets, including in China. Finally, the U.S. does not operate in a vacuum. Chinese or other affected foreign governments are likely to retaliate Thus, there is not a one-size-fits-all answer to whether any of these China-focused proposals will benefit or harm any particular domestic parts producer.

That being the case, we believe the best advice for domestic producers is to first attempt to assess the impact of these proposals (and more that may emerge in this election year) on their businesses. Many suppliers may lack the expertise and resources to fully understand those affects, but trade associations and subject-matter experts, including skilled international trade attorneys, can fill that gap. Once that is understood, it becomes possible to formulate lobbying, political and legal strategies to try to influence policies in the preferred direction.

Lawyers at Butzel have years of experience in trade and the automobile industry. Please contact your Butzel attorney, or the authors of this Client Alert for further information.

Leslie A. Glick
202.454.2839
glick@butzel.com

Sheldon H. Klein
248.258.1414
klein@butzel.com