Trump escalates trade war with China following first round of tariffs

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As President Donald Trump ratchets up trade war rhetoric against China this week, trade experts worried that China, which has the world's second-largest economy, will unleash a Pandora's Box of punitive tactics against American companies.

After Trump threatened another $200 billion in tariffs in response to China's pledge to match an initial $50 billion in trade sanctions, the Chinese Ministry of Commerce promised quantitative and qualitative retaliatory measures in its response on Tuesday.

Some economists remained unfazed by the escalating tensions, pointing out that while the United States imports more than $500 billion worth of goods from China, the value of our exports is only around $130 billion. This imbalance means that China will run out of ammunition in tit-for-tat tariff responses well before the United States, giving it less leverage.

"It's true that the base on which they can put on additional tariffs is much narrow than the U.S.," said Ludovic Subran, global head of macroeconomic research at Allianz and chief economist at Euler Hermes.

But Subran and other international trade experts warn not to count China out too quickly.

"The first thing to observe here is that China is not a country of laws, it's an authoritarian dictatorship," said Jacob Kirkegaard, a senior fellow at the Peterson Institute for International Economics, who warned that American businesses could take the punishment for Trump's antagonism. "So from that opening point, China is potentially able to play much, much dirtier than the United States."

"He will essentially force the Chinese government to retaliate in other ways — and those other ways can be much more costly to American firms," he said. "That belief is premised on a fundamentally erroneous assumption about how the modern economy works … and a lack of concern with how engaged American businesses are involved already in China."

American manufacturers like automakers have made considerable investments into manufacturing facilities in China, and the financial and professional services sectors have a large and profitable presence there. These and other multinationals operating in China are vulnerable to a wide array of actions the government could take against them.

For example, Chinese officials could slow the customs process for U.S. products entering the country, launch investigations into or spring inspections onto factories, hotels or other businesses — all activities for which a veneer of plausible deniability would make proving a punitive motive difficult. The Chinese government could restrict access to its market by stopping American business investment or, if the situation worsened, mandate that they divest entirely, said Mark Zandi, chief economist at Moody's Analytics.

For manufacturers in particular, this prospect could be a big hit to the bottom line. "That would be very disruptive, it would be more costly and it would be a mess," Zandi said.

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Financial companies, along with legal, consulting, and other professional service providers could also find themselves facing more hurdles, Sabran said. "They could start to show their teeth a little bit and make it more difficult to do business," he said. "They could basically put additional regulatory constraints on these businesses," he said, such as requiring China-based executives to be fluent Chinese speakers, requiring data centers to be located in China or — perhaps most onerous — placing capital controls on repatriating profits.

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China's control over a state-run media could also be weaponized, turning China's millennial middle class against American consumer brands. "Economic patriotism is very high," Subran said. A campaign against highly visible products like GM cars, Starbucks coffee, Apple iPhones or even Boeing jets could damage these companies' profitability in China.

Other retaliatory measures at China's disposal could expand the current confrontation beyond trade and into currency markets.

"The other qualitative thing they could do [would be to] devalue the currency — that would be even more extreme — to offset the impact of the tariffs on their products," Zandi said, adding that evidence suggests China has been keeping the yuan from falling in value recently. A reversal could roil currency markets.

China could also sell off — or stop buying — U.S. government debt, a dire prospect given that the United States already faces rising costs to service its growing debt. Experts think this is less likely in that the tactic would be a double-edged sword: It would hurt the U.S. economy but would also seriously depreciate the value of the huge cache of Treasuries already held by China.

But the more unpredictable the dispute becomes, the greater the risks to all parties involved.

“The odds that there’s a misstep here are rising. Even if he does take it back, he’s doing damage,” Zandi said of President Trump. “Business relationships are about trust, and he’s blowing this apart.”