

Will U.S. Tariff Barriers Against China Become America's Maginot Line?

By Drew Bernstein

It was 800 miles long, stretching from the Swiss Alps to the English Channel, and was a marvel of forts, retractable turrets, underground railways, massive guns, and anti-tank and anti-personnel defenses. It incorporated all the "lessons learned" from the previous war and was considered impregnable. And in the end, it proved utterly useless.

The Maginot Line was France's attempt to win what was expected to be a long, hard-fought conflict against a rising power with a superior population and industrial production capabilities. But when war finally came, it was irrelevant to the German's new, mobilized blitzkrieg tactics.

In May, the Biden Administration imposed a new round of tariffs on \$18 billion of goods from China. This includes 25% on steel and batteries, 50% on semiconductors and solar cells, and 100% on electric vehicles (EVs). The administration justified these new tariffs as responding to China "flooding global markets with artificially low-priced exports" using "unfair trade practices," such as forced technology transfers.

In reality, the government is ratcheting trade barriers in recognition that American companies are woefully uncompetitive in sectors like solar, battery technology and EVs. In the past, China used policies such as mandatory joint ventures and state subsidies to build these sectors. But today, China is at the leading edge of technological advances. It benefits from economies of scale and integrated supply chains that are difficult for foreign competitors to match.

When used surgically, tariffs can be part of an effective strategy to nurture domestic industries essential to national security or other non-economic goals. However, once tariffs become a permanent part of the economic landscape, they undermine the competitiveness of domestic producers and force consumers to overpay for lower-quality products. Sooner or later, the tariff walls will come tumbling down.

China dominates the solar energy supply chain, accounting for 85% of solar cell production and 97% of wafers. The Biden Administration has provided generous subsidies for solar manufacturers willing to establish production in the United States and a tax credit of 7 cents per watt for solar modules manufactured domestically. Taken together, government incentives can cover as much as 50% of the cost of solar gear used by utilities, according to Enphase Energy (NASDAQ: ENPH).

However, this has not been sufficient to sustain U.S. based solar manufacturers, as the global price of solar panels fell by 50% in 2023. In response to lobbying efforts by companies such as First Solar (NASDAQ: FSLR) and Hanwha's Qcells, the administration hiked the tariffs on Chinese solar products from 25% to 50 percent. It removed the solar tariff exemption for Southeast

Asian countries, including Malaysia, Cambodia, Thailand and Vietnam, which accounted for 84% of solar imports in 2023.

These levels of punitive tariffs risk several unintended consequences. First, the pace of new utility-scale solar installations could slow dramatically as developers are forced to either pay higher prices or use less efficient technology from outside Southeast Asia and China. This will cost American jobs and slow the transition to sustainable energy.

Second, it may actually slow the development of the domestic solar industry. According to a report by Clean Energy Associates, solar module production in the United States is expected to grow from 31 gigawatts (GW) in 2024 to about 60 GW by 2026. However, the capacity for more capital- and technology-intensive solar cells is expected to increase more slowly, from just 1 GW in 2024 to 11 GW in 2027. In short, U.S. manufacturers could be rendered uncompetitive by paying a 50% premium for their most critical component that isn't produced in any quantity domestically.

Finally, excessively high, long-duration tariffs reduce producers' incentives to strive for innovation and efficiency. Despite having lower labor costs, Chinese solar manufacturers have implemented more extensive automation in their manufacturing processes and are pushing the limits of solar technology. As a technology laggard in this sector, the United States should incentivize Chinese producers to set up domestic manufacturing to encourage technology transfer and competitiveness rather than locking them out of the market.

The alternative is to continually ratchet up the tariff protections offered to domestic producers while reducing the pace of new solar capacity installation, guaranteeing that America will not be globally competitive in this industry.

Juicing Up American EVs

No administration can afford to fumble the auto industry. Not only does it account for over one million American manufacturing jobs, but it also sustains an industrial base that is essential to conducting armed conflict. A nation without an auto industry cannot claim to be a global industrial power.

Therefore, it is extremely concerning that America lags behind China in the once-in-a-century transition from internal combustion to electric mobility. Despite a rebound in sales in the second quarter, EVs currently make up only 8% of new car sales in America, compared with 50% in China. China currently controls over 80% of the production of lithium-ion batteries, the critical power source for electric vehicles and a wide range of military applications.

Tesla (NASDAQ: TSLA), which essentially controlled the EV industry for many years, has seen its market share and sales slip in the past two quarters due to a series of unforced errors and a stale product lineup. The American auto majors Ford (NYSE: F) and GM (NYSE: GM) have yet to produce an all-electric model capable of shipping in volume. The other American EV start-ups,

including Rivian (NASDAQ:RIVN) and Lucid (NASDAQ: LCID), continue to struggle to show that they can generate significant enough scale to be able to earn a positive gross margin on their high-end offerings.

At this point, the EVs arriving in American showrooms are about two years behind the technical specifications offered at auto shows in Shanghai and Beijing, with battery range, charging time, and electronic features far less advanced than Chinese consumers are seeing. Even more importantly, most EVs remain at a premium price to their internal combustion equivalents. Thus far, not a single American auto manufacturer has introduced a quality EV that can break the \$20,000 price mark—much less match the \$9,700 price tag of BYD's Seagull EV.

The most critical barrier to the widespread adoption of EVs is to drive the price meaningfully below that of an IC automobile. Given that Americans spend an estimated 14% of their lifetime expenditures on automobiles, second only to housing, few things could more dramatically reverse inflation than driving EVs down the cost curve. A long-term 100% tariff barrier provides little incentive to American manufacturers to accomplish this.

Just as significantly, sheltering domestic producers will ensure that China gobbles up the fast-growing markets in the Global South. Already, Chinese EV manufacturers have captured 74% of the market in Southeast Asia and seen sales to Brazil leap six-fold and to the UAEiShares MSCI UAE Capped ETF 0.0% nearly double this year.

Doubling Down On Tariffs

The Biden Administration has aggressively used tariffs in strategically crucial sectors under the “small yard, high fence” approach. A second Trump term in office could extend this approach to cover the entire economy, promising an across-the-board 10% tariff on all imported goods and 60% tariffs on every import from China.

According to the Peterson Institute, if implemented, this approach would be equivalent to a massive tax increase on American consumers, equivalent to \$1,700 per household. Most economists also agree that it would send inflation soaring.

The other downside to building a Maginot Line of high, permanent tariffs is that it erodes the competitiveness of industries where America currently enjoys a solid competitive advantage, including technology, aviation, agriculture, and energy. Friendly nations in the developed world will likely erect their countervailing duties. At the same time, the growing economies of the Global South will be tempted to join alternative trade regimes sponsored by China and its allies.

America has a decades-long history of using tariffs to shore up politically sensitive industries where we no longer had a comparative advantage, including textiles, shoes, steel, tires, motorcycles, and apparel. Today, these industries are a shadow of their former selves, and none is a meaningful source of employment.

When used selectively, with clear, predictable time limits, tariffs can provide breathing room for nascent or struggling domestic industries to find their feet. But when they become a permanent, rigid part of the landscape, they ultimately accelerate a nation's decline and hasten the hour in which its defenses are breached.