Jose P Vasquez

April 17th, 2025

US-China tensions could become the biggest trade war in history

*The announced US tariffs and the retaliatory actions taken by China have intensified. If the threats are carried out, they will drive the average implied US tariff to exceed 20 per cent, a level not seen since the 1930s. **Jose P Vasquez** speculates about the causes and possible ways out of the conflict and sees an important mediation role for Europe in diffusing the tensions.*

Since early 2025, the United States government has implemented a series of significant tariff increases. These began with an initial 25 per cent duty on imports of steel, aluminium, automobiles and auto parts. Subsequently, on 2 April 2025 — a date referred to as "Liberation Day" — the administration introduced a universal 10 per cent minimum tariff on all imports, accompanied by "reciprocal" tariffs ranging from 11 per cent to 50 per cent, applied to goods from 57 specific countries. A few days later, the starting date for tariffs was postponed for all countries except for China. In response to increased trade tensions, the tariffs targeting Chinese imports reached 125 per cent.

If the announced tariffs are implemented, these measures would drive the average implied US tariff to exceed 20 per cent, a level not seen since the 1930s. Given the crucial role of international trade in today's global economy and the retaliatory actions taken, particularly by China, this series of tariffs has arguably intensified to become the biggest trade war in history, with the potential for substantial short- and medium-term economic effects in both rich and poor countries.

Stated or potential rationales

The stated rationale provided by the US administration for the initial "reciprocal" tariff formula presented on "Liberation Day" begins with the premise that non-tariff barriers all serve to undermine American exports and explain why the US imports more goods from other countries than it exports to them. These non-tariff barriers include regulatory hurdles faced by American products, environmental reviews, differences in consumption tax rates, compliance hurdles and costs and currency manipulation and undervaluation. The reciprocal tariffs were presented as a tool to address these distortions and restore balanced trade with the targeted nations.

However, this rationale faces criticism from an economic perspective on at least three grounds. First, bilateral trade deficits are not inherently detrimental to a country's economic well-being. These deficits often reflect the principles of comparative advantage, enabling participating countries to benefit from specialisation and trade. For instance, as an LSE employee, I maintain a trade deficit with cafes around campus (I purchase their products, but they do not purchase my academic services in return) while maintaining a trade surplus with LSE (I get paid by LSE and do not buy services from the institution in return). Nonetheless, this arrangement is more than acceptable. LSE, the local cafes and I all benefit from these specialised exchanges. Focusing on bilateral balances neglects the broader advantages derived from multilateral trade patterns.

Second, even when considering the overall trade deficit (the sum of all bilateral balances), this figure is not necessarily an indicator of unfair treatment by trading partners. A country's overall trade balance often reflects underlying domestic macroeconomic factors. For instance, if a nation's total consumption exceeds its total production, it will necessarily import more than it exports. This situation typically corresponds with relatively low domestic savings rates, requiring foreign investment inflows to finance the difference between domestic investments and savings. Attributing the trade deficit solely to foreign trade practices ignores these domestic economic determinants.

Third, even if the goal were to balance trade (an objective already contested above), the current policies focus exclusively on trade in goods, neglecting the substantial trade in services. Overlooking the services sector while aiming for balanced trade solely in goods is, at best, internally inconsistent with the stated policy objective.

Therefore, I believe the US administration likely pursues other non-stated objectives with these protectionist policies. Without explicit statements from the US administration, determining these underlying goals is necessarily speculative. However, from an economic point of view, there could be three non-stated objectives that align with previously stated concerns by the current administration.

1. Bringing manufacturing jobs back

First, there is the potential goal of bringing back manufacturing jobs to the US. Many believe that international trade is a primary reason for the decline in US manufacturing jobs observed over recent decades. The state-of-the-art empirical evidence in economics shows that US regions more exposed to import competition from China have indeed experienced significant relative decreases in manufacturing employment. However, it requires considerable optimism to expect that tariff barriers will restore manufacturing jobs to pre-1990 levels, especially in an era where automation and industrial robots carry out many necessary production tasks.

While acknowledging the distributional consequences whereby some workers and communities may have been adversely affected by trade with China, economic research also finds that this trade has yielded overall benefits for the US. These benefits include access to cheaper consumer goods and intermediate inputs for US producers, enabling firms to specialise in higher value-added activities. Thus, it would not benefit the US to force an increased share of manufacturing employment. Instead, policies aimed at redistributing the gains between the domestic winners and losers from trade are more appropriate than broad trade restrictions.

2. Tariffs as a bargaining tool

A second potential underlying rationale views tariffs as a bargaining tool to exert economic pressure and extract concessions from trading partners. While this approach may yield specific concessions in the short term, it risks inflicting lasting damage on both economic and diplomatic relationships by significantly eroding trust. Such tactics can weaken established alliances and may unintentionally encourage targeted nations to strengthen ties with other global powers, such as China. This potential realignment could shift the geopolitical balance in ways that may ultimately harm long-term US strategic interests, which would more than offset any short-term gain.

3. National security

Third, national security considerations could provide a valid argument for certain trade restrictions. This rationale becomes relevant when a nation perceives excessive dependence on another country, particularly a potential geopolitical rival, for critical inputs such as rare earth elements or other minerals required by strategic industries like defence, renewable energy or high-tech sectors.

There is ongoing discussion regarding the merits of encouraging economic decoupling from China based on these concerns. However, the current application of US tariffs seems somewhat contradictory to this objective, as substantial duties have also been imposed on traditional allies like Canada, the United Kingdom and the European Union. These are the very partners likely needed to establish resilient alternative supply chains if a strategy of decoupling from China were pursued consistently.

Likely economic effects

The first-order impact of tariffs is an increase in the prices of imported goods and supply chain disruptions, which naturally raises concerns about inflationary pressures and the cost of living. However, while potentially harmful, the overall share of international trade in global production is not large enough for these effects alone to precipitate a global crisis. More significant, perhaps, are the second-order effects related to the uncertainty regarding both the future trajectory of US trade policy and the potential reactions of other countries.

The prospect of further major tariff escalations or reductions cannot be dismissed, leading to a situation where future tariff levels remain highly unpredictable. Uncertainty, compounded by increased tensions that could trigger wider economic conflicts such as a currency or financial war, negatively affects consumers' and firms' confidence. A decline in confidence will drag down economic activity during 2025, even if tariffs are eventually lowered to their initial levels.

Looking ahead

My hope for a near end to the trade war primarily rests on two main pillars.

First, internal pressures within the US could play an important role. Substantial declines in the stock market and reduced investor confidence resulting from trade tensions could generate internal political pressure on the US government to consider de-escalating these tensions to restore economic stability.

Second, mediation efforts, potentially involving actors such as the European Union, could be crucial in reducing tensions, particularly between the United States and China.

By leveraging its economic influence, diplomatic channels and commitment to multilateralism, the EU may attempt (and hopefully succeed in) encouraging dialogue to prevent further escalation.

About the author

Jose P Vasquez

Jose P Vasquez is an Assistant Professor at LSE's Department of Management and an associate of the Centre for Economic Performance. (X: @jpvasq)

Posted In: Economics and Finance | LSE Authors | Management

THE LONDON SCHOOL OF ECONOMICS AND POLITICAL SCIENCE