

Section 3

CHINESE ECONOMY: CAN CONSUMPTION-BOOSTING MEASURES MITIGATE THE IMPACT OF TRUMP TARIFFS?

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Introduction

The forceful implementation of high tariff measures by the Trump administration, inaugurated in January 2025, has sent shockwaves not only through China but across the entire world. On February 4, the administration imposed an additional 10% tariff on all imports from China. In response, the Chinese government levied additional tariffs of up to 15% on imports from the U.S., including coal and liquefied natural gas (LNG). Subsequently, on March 4, the U.S. government raised the additional tariff rate to 20%. Nevertheless, up to that point, the Chinese government's response remained relatively measured.

The situation began to take on the characteristics of a *game of chicken* when, on April 2, the Trump administration shocked the world by announcing the imposition of “reciprocal tariffs,” under which a basic 10% tariff applicable to all countries would be supplemented by additional rates varying by country or region. Although the implementation of these “reciprocal tariffs” was later postponed for 90 days, the tit-for-tat measures between the two countries showed no sign of abating: when China responded to the newly imposed 34% additional tariffs by announcing retaliatory tariffs at the same rate. Eventually, the confrontation culminated in the U.S. imposing tariffs of 145% and China imposing 125% on imports from each other.

On May 11, U.S. Treasury Secretary Bessent and U.S. Trade Representative (Ambassador) Greer held the first ministerial-level meeting of the second Trump administration with Vice Premier He Lifeng in Switzerland. The two sides announced that they had agreed to reduce the additional tariffs imposed on each other by 115%, of which 24% would be suspended provisionally for 90 days, during which time further negotiations would continue toward a more comprehensive agreement.

In the U.S., stock prices had already plummeted following the effective embargo on Chinese products, raising concerns that the situation would worsen due to growing shortages of various industrial goods and the resulting corporate bankruptcies. On the Chinese side as well, as shown in [Figure 1-3-1](#), both the Consumer Price Index (CPI) and Producer Price Index (PPI) have continued to exhibit deflationary trends, and there were fears that the sharp decline

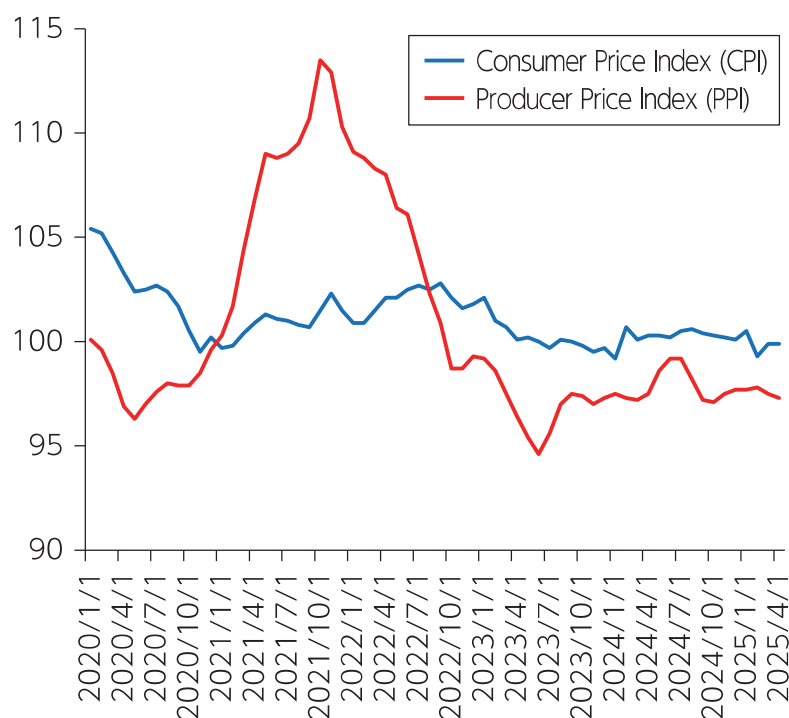


Figure 1-3-1

Price Index Trends (Year-on-Year Comparison)

Source: CEIC

in exports caused by high tariffs could further deepen the domestic recession. These developments are believed to have prompted both sides to de-escalate their confrontation relatively early¹⁾.

In such an uncertain environment, how should we assess the future trajectory of the Chinese economy? The author considers that three key factors will be decisive: (1) the industrial and trade policies pursued by the U.S.; (2) the competitiveness of China's manufacturing sector; and (3) the government's policies to stimulate domestic demand. The following sections will discuss each of these points in turn.

1. Domestic Debates in the United States over the Trump Tariffs

Prominent American economists, regardless of their political affiliations, have been almost uniformly critical of the Trump administration's tariff policies. Among the most outspoken critics is former Harvard University professor

1) Subsequently, at the U.S.-China summit held in South Korea on October 30, the provisional reduction of 24% in U.S. tariffs on Chinese goods was extended for one year. Additionally, it was decided that the 20% additional tariff imposed to curb the influx of fentanyl would be reduced to 10%.

Lawrence Summers, who served as Treasury Secretary under the Clinton administration. In an interview with *The New York Times*, Summers sharply criticized the Trump administration's tariff measures introduced since April, describing them as the most radical trade policy announced by the U.S. since World War II, and asserting that their impact on the stock market would be regarded as one of the most frightening developments in decades (Summers, 2025).

Summers referred to a remark made by Commerce Secretary Howard Lutnick, who stated that it would be a "more desirable future" for the U.S. to become the assembly plant for iPhones. He drew an analogy between this economic strategy—one that seeks to foster domestic industries by excluding foreign products—and the policies of Juan Perón's administration in Argentina during the 1940s and 1950s. Summers warned that, if this course continues, the U.S. risks repeating the fate of the Perón regime, which ultimately collapsed under the weight of crony capitalism favoring politically connected firms and the accumulation of massive fiscal deficits.

On the other hand, some American economists have begun to argue that the U.S. should more effectively contain the Chinese economy by combining the deliberate fragmentation of supply chains with an active industrial policy. For example, Noah Smith, a well-known economic journalist, wrote in a blog post published shortly after Mr. Trump's victory in last year's presidential election that the U.S. economic security strategy to counter China should consist of three elements (Smith, 2024).

- (1) Impose import tariffs and other trade barriers on China in order to prevent the decline of domestic industry caused by a sudden surge in Chinese exports.
- (2) Introduce industrial policies aimed at maintaining and expanding domestic manufacturing capacity.
- (3) Establish large-scale common markets in cooperation with countries other than China, thereby enabling manufacturing firms to exploit economies of scale.

The Trump administration's tariff policy, needless to say, aligns with the first of the measures outlined above; its defining feature, however, is the principle of applying uniform tariffs, including to allied countries such as Canada. This approach is entirely incompatible with the third objective. Moreover, in the absence of adequate domestic industrial development measures, imposing import tariffs from abroad does not automatically lead to the rapid establishment of factories producing chips or batteries across the U.S.. In other words, while Trump's tariff policy may protect the operations of domestic firms, it could

actually weaken the relative competitiveness of U.S. industries compared with China, as Smith has pointed out.

2. The “Underlying Strength” of Chinese Manufacturing

Meanwhile, the implementation of U.S. industrial policies under the Biden administration has been closely linked to sanctions on China in advanced technologies that began under the first Trump administration. It is useful to clarify the factual background in this regard. Initially, U.S. sanctions targeted specific companies, such as Huawei Technologies, a leading Chinese telecommunications equipment and device manufacturer. In March 2018, Huawei’s communication devices were barred from U.S. networks on the grounds that they contained unauthorized programs intended for information leakage. In 2019, the company was added to the U.S. Entity List, which prohibits American firms from exporting to designated entities. Further, in 2020, direct product restrictions were introduced, extending the export ban to products manufactured in third countries using U.S. technology or software.

As U.S. sanctions persisted and intensified, China responded by strengthening its domestic supply chains. In particular, with semiconductors emerging as the focal point of export restrictions, the Chinese government promoted domestic production through a combination of measures, including the establishment of large government-backed investment funds, subsidies, and preferential tax policies. In response, the U.S. further tightened its regulations. The *CHIPS and Science Act* of August 2022 prohibited companies receiving subsidies from constructing new factories in China capable of producing advanced semiconductors below 28 nanometers for a period of ten years. Moreover, in October 2022, the Biden administration introduced comprehensive semiconductor export controls targeting China, including restrictions on semiconductor manufacturing equipment. At the request of the U.S., the Netherlands also imposed export controls, resulting in ASML, a leading manufacturer of semiconductor equipment, being prohibited from exporting its most advanced EUV (extreme ultraviolet) lithography machines to China.

However, this did not necessarily deal a devastating blow to China’s semiconductor industry, nor to industries such as electronics that rely on semiconductors as core components. In fact, in 2023, Huawei launched a new smartphone incorporating domestically produced advanced semiconductors equivalent to 7 nanometers, sending shockwaves across the world.

Another often overlooked aspect of the semiconductor issue is that the majority of global demand is for technologically mature, non-advanced semiconductors.

While the comprehensive U.S. semiconductor export controls introduced in October 2022 targeted advanced semiconductors of 14/16 nanometers or below, their market share by volume is said to be only a few percent. In fact, the presence of Chinese firms has been expanding rapidly in the non-advanced semiconductor sector.

At first glance, the primary societal benefit of improvements in semiconductor performance might appear to be enhanced computing power in computers and smartphones. However, this is not the whole story. Equally important is the process by which performance improvements are realized through the integration of microcomputers into everyday products, such as household appliances and automobiles. The success of DeepSeek in 2025, which captured global attention, should be understood in this context. Even if China lags behind the U.S. in the development of advanced semiconductors, the company has demonstrated that, as long as it can achieve mass production of non-advanced semiconductors at a certain level domestically, it is fully possible of competing on an equal footing with U.S. firms in fields of industrial technology that are likely to become increasingly important, such as AI.

Such *tenacity* in China's industrial sector is also an important factor to consider when assessing the future trajectory of the Chinese economy. In fact, while the European Union imposed high tariffs of up to 45.3% on Chinese-made electric vehicles (EVs), it at the same time began to acknowledge their competitiveness and to encourage the construction of Chinese manufacturing plants within the EU. For instance, the UK *Financial Times* reported remarks by a senior EU official that the EU is planning to require Chinese EV-related firms operating within the EU to transfer technology to local companies in exchange for subsidies (Hancock et al., 2024). According to this report, the EU is expected to introduce new rules stipulating that firms receiving subsidies for the development of vehicle batteries must establish manufacturing plants and share key technologies within the EU.

This, in turn, reflects the remarkable strength of Chinese EV battery manufacturers. According to Lizzi Lee of the Asia Society Policy Institute, Chinese firms already dominate the entire ecosystem of EV battery production, leaving European EV manufacturers with little choice but to rely on them. If these Chinese companies were to establish production within the EU and transfer technology to local firms, such a framework could, in fact, contribute to strengthening the EU's own industrial base (Lee, 2024).

The author believes that the success of China's industrial policy toward emerging industries such as EVs lies in its ability to create a large market scale, that is, to generate sufficient demand for domestic industry products both at

home and abroad. As the market for final goods such as EVs has expanded and the number of manufacturers increased, the number of suppliers providing intermediate goods—such as batteries, metals, and electronic components—has also grown. This expansion of intermediate suppliers has led to a more sophisticated division of labor and intensified competition, which in turn has driven down production costs, enhancing productivity. Consequently, prices of final goods have decreased across the entire industry. Specifically, the expansion of the domestic EV market through policies such as the provision of infrastructure, tax exemptions for consumers, and purchase subsidies have triggered a virtuous cycle, which has enabled continued cost reductions even after government support was withdrawn (Kajitani and Takaguchi, 2025).

3. Expansion of Final Demand as the Key Factor

At the same time, the greatest source of concern for the future of the Chinese economy lies in the persistently sluggish domestic demand. In this regard, attention should be paid to the outcomes of a series of highly proactive and wide-ranging economic measures that began at the end of September 2024. The first to take the lead was monetary policy. On September 24, the People's Bank of China lowered the reserve requirement ratio, the seven-day reverse repo rate—which is the short-term interest rate applied when the central bank supplies funds to commercial banks—and the medium-term lending facility (MLF) rate—which is a medium- to long-term interest rate. In addition, it announced policies aimed at supporting housing demand and strengthening the capital base of major state-owned banks. At the same time, the Chinese government also demonstrated its willingness to respond to calls for aggressive fiscal expansion. For example, at a press conference on October 12, Finance Minister Lan Fo'an explicitly stated that local governments would issue additional special government bonds to inject capital into major state-owned banks and purchase unsold housing as part of stimulus measures.

However, it remains uncertain at this stage how effective this series of stimulus measures will prove to be. The first cause for concern lies in the lack of clarity regarding the purpose and scale of the forthcoming fiscal spending. On November 8, 2024, Finance Minister Lan Fo'an announced an additional fiscal policy under which 10 trillion yuan would be allocated over the next five years to address local government debt problems. However, this measure essentially involves swapping the implicit debts of local governments—accumulated through local government financing vehicles (LGFVs)—for official local government bonds and thus is unlikely to have any direct demand-boosting effect. The

Ministry of Finance merely stated that it would continue to consider narrower, more direct stimulus measures, such as capital injections into state-owned banks using fiscal funds, the purchase of unsold housing with special local bonds, and cash transfers to low-income households.

At the National People's Congress held in March 2025, the Chinese government finally made clear its policy of pursuing economic recovery through the expansion of domestic demand. The Report on the Work of the Government adopted at the session explicitly identified "expanding domestic demand by stimulating consumption" as the top priority among the government's key tasks for fiscal year 2025. It was also decided that 300 billion yuan per year from the newly issued ultra-long-term special government bonds would be allocated to continue and expand the subsidy program for replacing home appliances, which had been implemented since the summer of 2024.

On March 16, 2025, the General Office of the Communist Party of China and the General Office of the State Council released a plan on special initiatives to boost consumption. The plan presented a comprehensive policy package aimed at expanding consumer demand through measures such as enhancing consumer purchasing power by increasing income and reducing financial burdens, stimulating demand through the upgrading of consumer goods, and boosting consumption sentiment. What is particularly noteworthy about this special action plan is that it includes measures to strengthen the protection of workers' rights to take paid leave and to curb excessive overtime work. The intention is to stimulate consumption demand by enhancing workers' willingness to spend through improved labor rights protection. This represents a commendable shift that addresses aspects previously overlooked under supply-side-oriented policies. In response to these stimulus measures, total retail sales of consumer goods recorded a solid year-on-year increase of 4.6 percent in the first quarter of 2025.

Furthermore, the People's Bank of China also announced additional stimulus measures on May 7—prior to the negotiations with the U.S. over tariff reductions mentioned above. These included a 0.1 percent cut in the seven-day interbank lending rate, a 0.5 percent reduction in the reserve requirement ratio, a 0.25 percent cut in the mortgage loan rate funded by the housing provident fund, and the front-loading of the issuance of ultra-long-term special government bonds and local government infrastructure bonds.

Whether these stimulus measures will bring about a genuine recovery in long-stagnant domestic consumption remains highly uncertain.

What is noteworthy, however, is that active policy proposals have been emerging even from outside the government, particularly through policy forums and economic media.

For instance, the March 10 issue of *Caixin Weekly* featured a special report titled “*China Plans Fiscal Overhaul to Fix Local Government Finance Crisis*,” which cited remarks by former Finance Minister Lou Jiwei, a well-known reformist technocrat. Lou pointed out that one of the key factors behind the delayed recovery from the recession lies in the distorted fiscal relationship between the central and local governments. The underlying idea is that the current situation, in which local governments are burdened with excessive formal and informal debt, induces them to act in a procyclical, contractionary manner during economic downturns, thereby slowing the pace of recovery.

At the Boao Forum for Asia 2025, held from March 25, Guo Shuqing, former chairman of the China Banking and Insurance Regulatory Commission and known as a reform-minded financial technocrat, emphasized the need for a substantial expansion of the pension system for farmers. He argued that the benefit level should be raised within the next five years to at least the minimum level of pensions received by formal urban employees. The expansion of a pay-as-you-go pension scheme can be regarded as an effective policy tool for stimulating consumption demand across all generations, while at the same time containing asset bubbles. In this sense, Guo’s remarks may be interpreted as an attempt to link the difficult challenge of pension reform with the achievement of expanding domestic demand.

Thus, the fact that reform-oriented politicians and economists—who had until recently remained largely silent—have begun to speak out and engage in active policy debate offers a hopeful sign that China may be shifting its policy orientation. Hopefully, it suggests the possibility of a significant rebalancing of domestic resource allocation, which has long been excessively skewed toward supply-side investment and toward policies aimed at expanding final demand.

4. Navigating Beyond the Illusions of the Chinese Economy

As mentioned earlier, when the U.S. announced its decision to impose tariffs exceeding 100 percent on Chinese imports, mainstream economists who support free trade warned that a cycle of retaliatory measures between the two countries would ultimately work to China’s advantage. For example, Adam Posen, president of the Peterson Institute for International Economics, argued in his *Foreign Affairs* column that in this trade war, the “escalation dominance”—that is, the capacity to escalate a conflict in a way that imposes disproportionate costs on the opponent—rests with China, and concluded that even if the U.S. chooses to confront China at great cost to itself, it is unlikely to prevail. (Posen, 2025)

However, until quite recently, the prevailing view was that as long as China continued its authoritarian regime, its economic growth would eventually come to an end. Indeed, in a column published two years ago, Posen (2023) argued that the increasingly authoritarian rule under the Xi Jinping administration, particularly evident since the COVID-19 pandemic, would be unable to solve the country's current economic stagnation and would instead lead China further down a path of decline through repeated arbitrary interventions and expropriations targeting the private sector. In this way, many mainstream economists who until recently had predicted the downfall of the Chinese economy are now emphasizing the "strength" of China as an authoritarian state in their zeal to criticize the Trump administration's policies.

Branko Milanović, known for works such as *Capitalism, Alone*, mocks what he calls the hypocrisy of these mainstream economists. In his blog, Milanović (2025) sharply criticizes them for lacking the concept of "balance of power," which is considered crucial in the field of international politics. As a result, he argues, economists are capable of doing little more than repeating textbook assertions about how Trump's policies would negatively affect U.S. manufacturing.

According to Milanović, the Trump administration's sanctions against China are premised on the idea that, even if the U.S. suffers some pain itself, it can inflict greater damage on China and thereby achieve a relative advantage. As evidence, he cites an article by Dartmouth professor Stephen Brooks and others published in *Foreign Affairs* in February 2025. Brooks and his co-authors, drawing on findings from the Center for Strategic and International Studies (CSIS), examined the potential consequences of decoupling between the U.S. and its allies on one hand and China on the other, concluding that in almost all scenarios China would suffer far greater losses than the U.S..

However, this view also has several problems. For example, Brooks and his co-authors, citing analyses based on satellite-derived nighttime light data, argue that China's GDP has been overestimated by about 30 percent. It is true that China's real GDP growth rate has often been pointed out to be overstated. Yet one of the main reasons for this overestimation lies in the fact that, in the early years, large portions of the service sector and other areas were not fully captured in official statistics, and their subsequent inclusion has been reflected as additional growth. In other words, there is little basis for the claim that China's current nominal GDP is significantly smaller than the official figures suggest.

In short, both the "China's defeat" scenario confidently advanced by some analysts and the "China's triumph" scenario favored by liberal mainstream economists are built upon illusory images of the Chinese economy. What this

entire debate suggests is that research on the Chinese economy in the English-speaking world is increasingly being conducted to justify the researchers' own political positions. In such a context, the crucial challenge lies in how to build and sustain a more objective and empirical foundation for analyzing China. It can be said that Japan's own China watchers are now facing an unprecedented test of their analytical integrity.

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