April 23, 2025

Tariffs, Deficits, and China—Oh My!

It seems like just a few days ago we were skipping down the Yellow Brick Road singing, *"We're Off to See the Wizard,"* but now we're hearing continuous news and press conferences repeating a different chorus: *"Tariffs, Deficits, and China—Oh My!"* It feels like a lot of noise—sound bites without much perspective. So, I'm going to attempt to make some sense of it.

Tariffs

Tariffs are not a new phenomenon. There's evidence of the first tariffs being charged in Mesopotamia around 3000 BCE. The United States enacted the Tariff Act in 1789, and today, the U.S. International Trade Commission oversees more than 17,000 duties on foreign goods.

It's important to understand who actually pays a tariff. In nearly all cases, it's not the foreign government or exporter—it's the U.S. company importing the goods. For example, if Target purchases shirts from China, they typically take delivery at a Chinese port, manage the shipping, and bring them into a U.S. port. At that point, U.S. Customs assesses and collects the tariff directly from Target. The current state of the April 2, 2025 announcements:

- A 10% baseline tariff now applies to most imported goods from all countries (except Canada and Mexico), effective April 5, 2025.
- Higher tariffs (above 10%) on goods from approximately 60 countries are paused for 90 days, pending further negotiations (pause ends July 4, 2025).
- China is excluded from the 90-day pause—tariffs on Chinese goods have risen to 125%, with some categories facing rates up to 145%.
- Canada and Mexico are exempt from the new tariffs under the USMCA, except for pre-existing tariff categories.
- The U.S. will eliminate the $800 "de minimis" exemption for all Chinese imports on May 2, 2025, impacting e-commerce platforms like Temu and Shein.
- Products currently exempt from the new tariffs include:
    - Semiconductors and consumer electronics (e.g., phones, computers)
    - Essential goods such as pharmaceuticals, energy products, and critical minerals
    - Information materials (books, media) under 50 USC 1702(b)
    - Items already subject to existing Section 232 tariffs (steel, aluminum, autos, etc.)

Deficits

In 2024, the U.S. Gross Domestic Product (GDP)—the combined total of everything we produce—was $29.2 trillion. We primarily consume our own production—about $26 trillion—and export $3.2 trillion to other countries. However, we import $4.12 trillion, resulting in a $918 billion trade deficit. Put simply: the government and people of the United States purchased $2.5 billion more per day than we produced.

These numbers are so astronomical that it might be helpful to view them on a smaller scale. Imagine a large, multi-generational family farm. It began in 1776 with a few hundred acres, worked entirely by the family. In the early years, farm production exceeded the family's needs, allowing the estate to expand—raising livestock, growing crops, mining for minerals, and even producing electricity via a small hydroelectric dam. As the family grew, some members became teachers, plumbers, doctors, lawyers, and financial advisors, selling services and goods to other farms. These other farms specialized in electronics, automobiles, or exotic food and spices, things the family wanted and began to purchase more frequently. In 2024, the family produced $2.92 million worth of goods and services. They consumed $2.6 million themselves and sold $320,000 to neighboring farms. But they also purchased $412,000 from those same neighbors—resulting in a $91,800 deficit for the year. Because the family was respected and productive, they were able to issue IOUs—debt with interest—secured by their land and future production. A $91,800 deficit may not seem alarming in a $2.92 million operation—but year after year, generation after generation, this results in a significant transfer of wealth away from the family, until they're working just to pay the debt service. The farm is a simple and powerful metaphor thinking about the long-term effects of trade deficits.

China

Long before shipping containers filled with electronics, China was exporting silk as early as 2700 BCE. For centuries, its techniques for raising silkworms and weaving fabric were closely guarded, giving rise to the Silk Road—a vast trading network that made China a key player in ancient global commerce. That legacy continues today. China has become the world's second-largest economy and a critical trade partner, supplying a significant portion of the goods used daily by American households. In 2024, China ran a record trade surplus of $992 billion—nearly equal to the U.S. deficit. Of that, $295 billion came from its trade imbalance with the United States.

Yet China operates under a one-party Communist government, not a free-market democracy. While it has adopted many market-based reforms, the state maintains deep control over key industries, with private-sector decisions ultimately answering to the Communist Party. This centralized system has led to several persistent concerns:

- Intellectual Property Theft – including widespread issues with patent infringement and corporate espionage
- Human Rights Violations – particularly in regions like Xinjiang, where forced labor and cultural suppression have been documented
- Environmental Impact – China is the world's largest emitter of carbon dioxide, with severe industrial pollution in some regions
- Limited Transparency – foreign businesses face opaque legal systems and unequal market access
- Suppression of Dissent – even successful entrepreneurs like Jack Ma, founder of Alibaba, have faced repercussions for challenging government norms

Despite these concerns, China continues to be a vital part of the global economy. Unlike Western democracies, which operate on 2-, 4-, or 6-year election cycles, China's leadership thinks in 50- to 100-year timelines. This long-term view allows the country to pursue strategies that prioritize future dominance over short-term outcomes. Decades ago, they established—and have been working toward—two important milestones: 2021, the goal of becoming a "moderately prosperous society"; and 2049, the goal of becoming a fully developed, globally dominant nation—economically, militarily, and technologically. To meet these goals, China is heavily investing in infrastructure, artificial intelligence, semiconductors, green energy, rare earth minerals, and even space technology—often through state-directed coordination that outpaces market-driven systems in scale and speed. This approach isn't necessarily right or wrong. But it is very different—and understanding that difference matters when assessing economic risks and opportunities.

I am certainly no wizard, and I don't pretend to have all the answers—but this is a horse of a different color, and it deserves a little deeper understanding. I hope this sheds light on some of the dynamics at play beyond the nightly news noise.

My Very Best,

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