Berkeley Center for Law and Business
University of California, Berkeley
School of Law
Boalt Hall #7200
Berkeley, CA 94720-7220

Silicon Valley Startups: Caught in the Crossfire of the U.S.-China Trade War

By Anand Purohit, J.D. Candidate 2021 | October 1st, 2018

President Trump has announced new tariffs on Chinese imports, further escalating the ongoing trade war between the United States and China. On September 17th, the administration released a sprawling list of Chinese products, ranging from food items to industrial machinery. In total, the slew of goods (everything from tuna to fertilizer to cranberries to steam turbines) amounts to roughly $200 billion worth of Chinese products. Each item will be subject to a 10% tariff. Importantly, the extensive list includes circuit boards, semiconductors, cell tower radios, and internet modems. A 10% tax on these items will have devastating effects throughout Silicon Valley. The Valley's smaller tech startups will be among the first to feel the adverse impacts.

In recent years, fledgling American innovators have managed to carve out their space in the Silicon Valley market largely thanks to cheap Chinese manufacturing. By outsourcing their operations to China, these startups are able to produce goods in much larger quantities, thereby benefitting from economies of scale. Utilizing China's cheap labor and lax regulations, smaller startups have managed to avail themselves of the advantages that come with mass-production. With these new tariffs, however, small-tech is struggling.

Under the new import restrictions, young businesses will be faced with a 10% tax when they try to import their Chinese-made products back to the Silicon Valley. There are only two ways for companies to deal with this problem: 1) absorb the extra cost by cutting into their profit margins or 2) pass the cost along to consumers, in the form of higher prices. The former option is unavailable to small startups; with thinner margins, many of these nascent companies simply don't have the 'wiggle-room' to take on additional costs. And pursuing the latter option would likely mean being priced out of the market. Thus, startups who rely on outsourcing will struggle to remain afloat. If small businesses truly are the backbone of the American economy, the weight of these tariffs will likely crack some vertebrae.

The tech industry's larger companies do not face the same existential threat. With massive margins, they are better able to absorb extra costs. Moreover, they are better equipped to reorganize their supply chains. Already, Micron has discussed shifting its production out of China, moving its factories to other low-wage countries within its global supply chain. For smaller companies with limited funds, uprooting an entire production facility is not so simple.

Further, large industry titans can exercise lobbying power, thereby insulating themselves against the tariffs. For example, thanks to Apple's successful lobbying efforts, the administration exempted the Apple Watch and Apple AirPods from the import tax. Of course, smaller startups lack the political influence to have their imports exempted. Thus, while big tech is protected by transferrable supply chains and lobbying, small businesses remain vulnerable.

Although the tariffs may not send Google and Apple plummeting into collapse, the impact on small businesses cannot be ignored. A recent empirical analysis shows that startups account for nearly all net job growth in the U.S. economy. Indeed, that data reveals that, for the past four decades, startups have been responsible for virtually all net job creation. Moreover, beyond their indispensable contributions to employment, startups are also essential to innovation. Research indicates that larger companies tend to invest in 'incremental technologies' (i.e. improvements upon existing technologies); this is because improving an existing device—for example, upgrading the camera on a Samsung Galaxy or equipping an iPhone with a thumbprint scanner—involves less risk and a more predictable return. Meanwhile, smaller startups are more amenable to high-risk, high-reward ventures and therefore direct their R&D towards developing groundbreaking innovations.

For these reasons, startup growth is absolutely crucial to economic progress. Currently, Silicon Valley leads the world in startup growth. Between 2012 and 2017, the Valley produced 57 'unicorn' startups (i.e. startups that grew to be worth $1 billion). Over that same time period, China produced only 46. Simply put, the Bay Area alone cultivates more successful startups than the entire nation of China. The Valley's explosive startup growth is one of the few areas in which we outpace China by leaps and bounds. If these new tariffs undermine the growth of Valley startups, it will threaten a key pillar of our economic dominance, thus undercutting the very objective Trump seeks to achieve.

Deeply concerned by the tariffs' impacts on our economy, some have called for legal action against the Trump administration. President Trump has been levying these tariffs pursuant to 19 U.S.C. § 2411. In a recent statement, the Consumer Technology Association (CTA) argued that President Trump and the United States Trade Representative have not conformed to the stringent requirements of the law. Specifically, the CTA alleges that President Trump has failed to meet certain statutory deadlines and, moreover, is acting outside the scope the authority conferred upon him by 19 U.S.C. § 2411.

If the CTA is correct in its assessment of the tariffs' legality, we may see parties requesting injunctive relief very soon. Given what we know about President Trump's personality, it seems unlikely that Trump will voluntarily be the first to cave in this escalating game of economic retaliation. As such, absent some legal intervention, tensions and tariffs will continue to rise. Injunctive relief may be the only thing that prevents President Trump from crippling his own economy.

If the matter is brought before the courts, it will exemplify an often under-discussed role of the law: achieving substantive policy outcomes through litigation. Just as litigation forced the administration to restructure its travel ban, so too can litigation pressure Trump into reshaping his trade policy. From *Trump v. Hawaii* (addressing the travel ban) to *New York v. Trump* (addressing the rescission of DACA), the sculpting of public policy through private litigation appears to be a defining feature of this administration. The tariffs on Chinese imports represent yet another opportunity for lawyers to reshape President Trump's policy through the courts.