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Will India be a winner or loser when Trump unleashes trade war?

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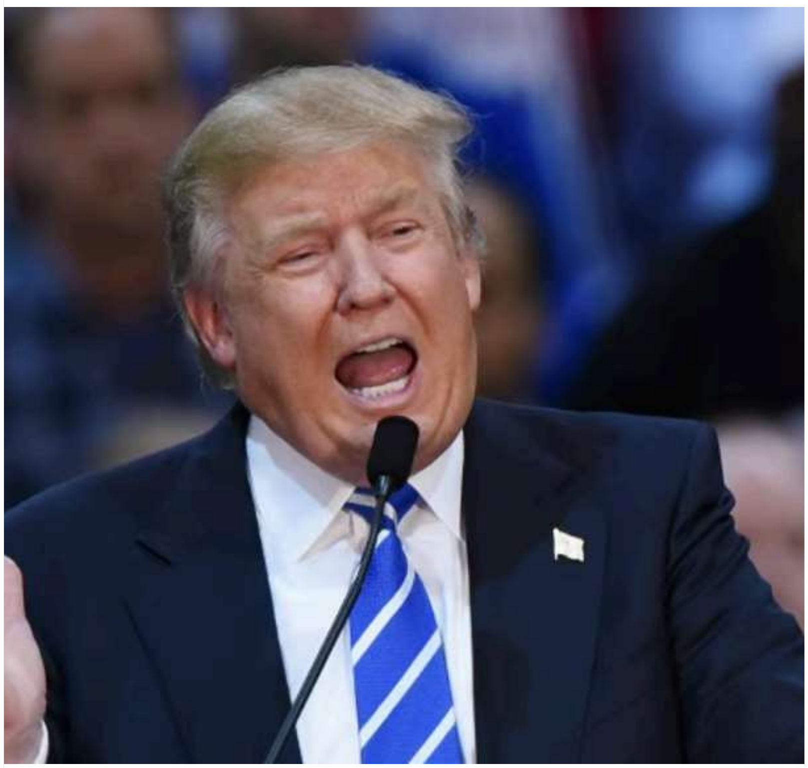

Trump. FILE Photo | AFP

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As US President-elect Donald Trump reaches for his tariff hike sword, countries may soon be engaged in an unavoidable trade war.

As with all trade wars, it'll be easy to begin, but hard to stop the far-reaching consequences of a full-blown global economic battle, where countries slam additional taxes on each other's exports.

And contrary to Trump's assertion that 'trade wars are good and easy to win,' they may yield winners or losers, just as luck can run both ways.

Tariff hikes aren't new to the world's largest economy and while episodes of sector-specific or country-specific import duty hikes were seen every now and then, the US largely refrained from imposing across the board tariff hikes. But that's set to change, and after a period of relative calm, tariff wars -- the very concept that can bust an economy's blood vessel -- are staging a comeback.

If Trump's first term wheeled out duty increases on select destinations, he seems keen on digging deeper and wider and has announced a flat 10%-20% duty increase on all imports and a special 60% hike on Chinese goods during his campaign. If the proposal materialises, the impact, some believe, could be greater than anything seen since the start of the Cold War.

It's not that the US isn't aware of trade war fallouts. In 1922, it enacted the Fordney-McCumber Act, which saw the most punitive protectionist tariffs passed in the country's history, raising the average import tax to about 40%. Later, in response to the stock market crash of 1929, and as protectionism gained strength, it introduced the Smoot-Hawley Tariff Act in 1930, which raised the average tariff by about 20%. Global trade was already reeling under the Great Depression, and despite a petition from over 1,000 economists urging the government to veto the legislation, it was passed.

The Act raised import duties to protect American businesses and farmers, but ended up with retaliatory tariffs from foreign governments, eventually leading to a decline in global trade over the four years when the legislation was in effect. Finally, in 1934, it was ripped to shreds and the US bowed down to sign the Reciprocal Trade Agreements Act, reducing tariffs and promoting trade liberalisation and cooperation with foreign governments.

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One need not even look that far to determine who actually benefits from trade wars. In 2018, Trump imposed a series of tariffs on everything from steel and aluminum to solar panels and washing machines. Though China was his primary target, these duties impacted goods from the EU, Canada, and Mexico, which retaliated, imposing stiff duties on American agricultural goods and other products.

These hikes were simply passed on to the American consumer via price increases, which is the exact opposite of what trade wars are intended to accomplish. According to a 2020 Brookings study, the US-China trade war had significantly hurt the American economy without solving the underlying economic concerns that trade wars were meant to resolve.

Until recently, countries embraced the doctrine of free trade as it offered plenty of choice to consumers, while reducing the cost of goods. But as countries were whomped with a wave of protectionist policies, tariff increases are seen as the ideal way to protect domestic businesses, generate employment and overcome a trade deficit.

Higher tariffs make goods expensive, affecting consumers. Importantly, it adjusts the nominal exchange rate in such a way that a given value of imports can be financed with a lower value of exports. Trade economists call this effect the terms-of-trade externality. However, this only holds if a country can raise tariffs without its trading partner retaliating. Retaliatory tariffs neutralise the terms-of-trade effect, resulting only in higher import prices for both countries, according to economists Wolfgang Lechthaler and Mariya Mileva.

Raising import tariffs not only make imports expensive, but also result in an economic restructuring, as it reduces the incentives to specialise. Lastly, trade wars can be damaging to both consumers and businesses, exacerbate bilateral relations and have detrimental effects on the trading relationship between two countries.

As for India, the incoming US administration under Trump may choose to intensify trade frictions and if the proposed 10%-20% tariff hikes are indeed imposed, it'll adversely affect us, potentially altering the balance of trade, which remains in India's favour with a surplus of $35.3 billion in FY24.

Trump often argued against India's tariffs, pointing to the 100% duty on Harley-Davidson motorcycles, which was consequently reduced. Terming India as the 'Tariff King' and 'an abuser' of import tariffs, he called for equitable trade practices and so there are genuine fears that Indian exporters may face high customs duties for goods like automobiles, textiles and pharmaceuticals if the new US administration pursues the 'America First' strategy. It may not only affect sectors where India maintained high tariffs to protect domestic industries such as agriculture and manufacturing, but also sectors like pharmaceuticals, where it is the world's leading generic drug producer, that could be hit with new regulatory hurdles besides tariffs. Likewise, other industries like steel and aluminium too may suffer if Trump reinstates tariffs on these metals, as he did during his previous term.

That said, if Trump pushes for decoupling from China, it could benefit India in the medium-term, potentially drawing more foreign investments into the country. India will have a unique opportunity to position itself as a reliable alternative for overseas companies looking to diversify supply chains away from China, particularly in areas with critical and emerging technologies.

A September report by Nomura suggested that despite probable strains on trade and immigration, India could benefit from Trump's policies that drive supply chain reconfigurations away from China. "India is largely a domestic demand-driven economy, so the negative growth spill-over from weaker US growth should be limited. On the contrary, lower commodity prices owing to the hit to China's growth and lower oil prices, due to a greater push towards fossil fuels, could be a macro tailwind for India," it noted.

While trade with the US needs clarity, elsewhere it's flourishing. For instance, notwithstanding the border disputes, China has emerged as

India's largest trading partner with $118.4 billion, overtaking the US, whose trade stood at $118.3 billion. Likewise, India's trade with Russia saw a 5-fold increase in the past five years. Bilateral trade between the two countries stood at $60 billion currently and the government wants it to reach $100 billion by 2030.

Donald trumps Kamala, but man to watch out for is Elon Musk

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