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Trump's tariff war: End of multilateralism?

TRADE WORRIES. India doesn't seem to have been badly singled by the US tariff hikes

True to his word, US President Donald Trump issued an Executive Order on April 2, titled, 'Regulating Imports with a Reciprocal Tariff to Rectify Trade Practices that Contribute to Large and Persistent Annual United States Goods Trade Deficits'.

Declaring a national emergency and lamenting over the hollowing out of US manufacturing base, in a mercantilist spirit, the Order tracked large and persistent US goods trade deficits in terms of a lack of reciprocity in its bilateral trade relationships. It went on to say:

"This situation is evidenced by disparate tariff rates and non-tariff barriers that make it harder for US manufacturers to sell their products in foreign markets. It is also evidenced by the economic policies of key US trading partners insofar as they suppress domestic wages and consumption, and thereby demand for US exports, while artificially increasing the competitiveness of their goods in global markets. These conditions have given rise to the national emergency that this order is intended to abate and resolve."

Is this the end of multilateralism and its principle of Most Favoured Nation (MFN) and equal treatment of all member countries?

This "reciprocal tariff" is not calculated based on the tariff charged by the partner countries. As the Office of the US Trade Representative (USTR) explains: "Reciprocal tariffs are calculated as the tariff rate necessary to balance bilateral trade deficits between the US and each of our trading partners."

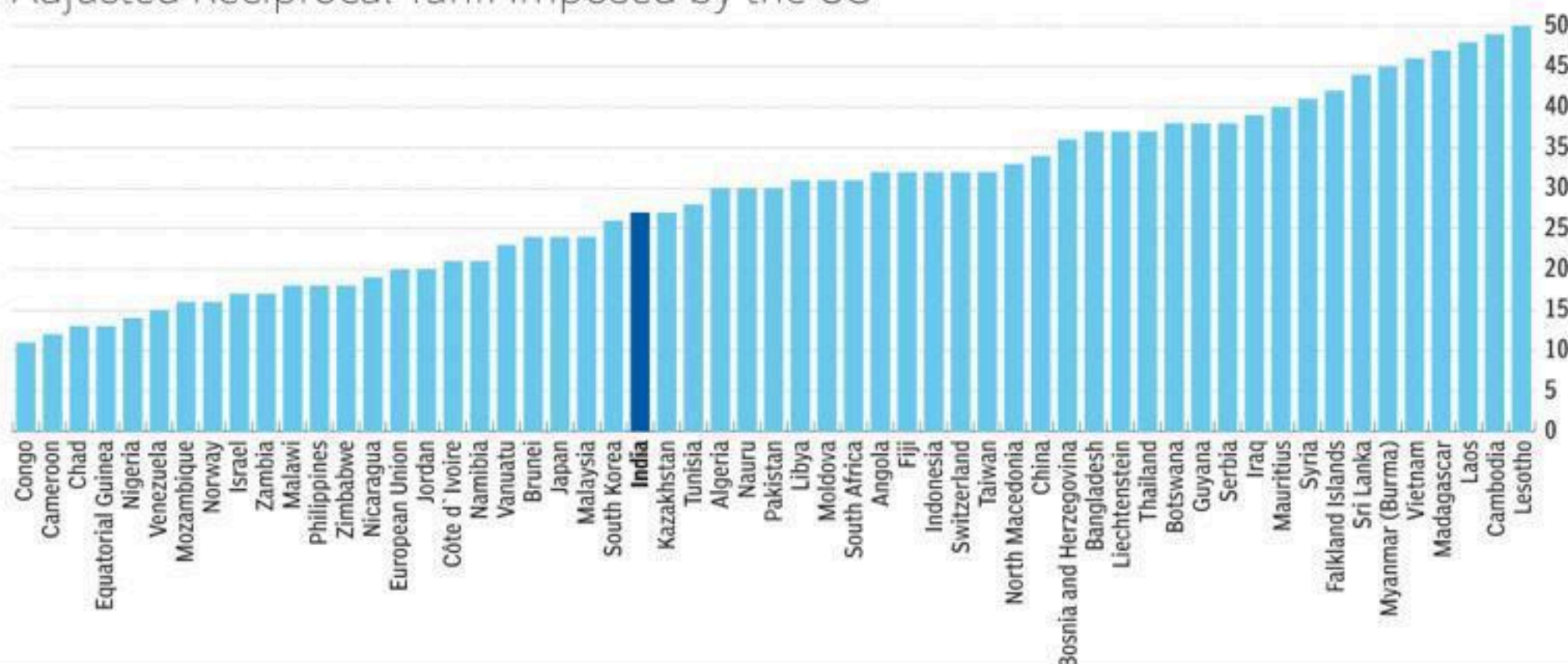
Moreover, an analysis of the adjusted reciprocal tariff imposed reveals a number of interesting patterns (see graph). First, in the top 41-50 per cent range, Asian countries like Sri Lanka, Myanmar, Vietnam, Laos, and Cambodia are present prominently.

Second, countries like South Africa, Indonesia, Switzerland, Taiwan, China, Bangladesh, Thailand, or Mauritius come under the 31-40 per cent bracket. Third, India appears in the 21-30 per cent bracket, along with countries like Japan, Malaysia, South Korea, or Pakistan. Finally, countries/group of countries like Nigeria, Venezuela, Norway, Israel, the Philippines, European Union come under the least — 10-20 per cent range.

Mexico and Canada have not been mentioned in this list, but they face a 25 per cent tariff due to their alleged role in the fentanyl and migration problems faced by the US.

A 34 per cent tariff has been announced for China in this list, which will be on top of the 20 per cent tariff already announced by the Trump administration, thus taking the tariff on

Adjusted Reciprocal Tariff imposed by the US



Source: White House Press Release

Chinese imports to the US at 54 per cent. A base 10 per cent tariff is imposed for all other countries.

IMPACT ON INDIA

From the April 2 announcement, it appears that India has not necessarily got the rough end of the stick. Out of the 16 countries which received a tariff hike between 11-20 per cent, nine are from Africa, and two are developing countries from South America. Norway, the EU and Israel are other countries in this bucket.

However, these are high-wage countries/territories, and India possibly does not directly compete with them in the US market. Only the Philippines is a developing country from Asia which has received a favourable treatment.

In the 21-30 per cent tariff bracket, India is placed with countries like Japan, Malaysia, and South Korea. These countries have between 1-3 per cent tariff advantage over India. Therefore, India's relative position in the US market vis-à-vis its other competitors does not seem to be affected very significantly.

Moreover, some goods are exempted from these reciprocal tariffs. These include copper, pharmaceuticals, semiconductors, and lumber articles. This is important for India as pharmaceuticals are a top export item from India to the US.

There will be major supply shocks as companies will try to re-optimize their supply chains

Tariffs are imposed to protect domestic industry and Trump too aims to promote US domestic manufacturing by making imports costlier.

Therefore, even if India is not worse off vis-à-vis other exporters to the US, Indian exports to the US may face higher competition from the domestic manufacturers. But the US being a very high wage country, it will not be easy for the US domestic manufacturers to be price competitive for low value-added manufacturing.

DOLLAR APPRECIATION

Moreover, the US dollar has appreciated significantly over the past year, offsetting some of the advantages of higher tariffs for the US domestic manufacturers. But overall, these tariffs will increase prices of Indian exports in the US. This is where the second objective of the Trump-tariff comes in. By erecting a high tariff wall, the US policymakers are nudging the exporters from other countries to set up manufacturing in the US and thereby use foreign direct investment (FDI) to "jump the tariff wall".

It remains to be seen how India responds to this reciprocal tariff by the US at a policy level. The USTR's annual report flags three areas of concern for India.

First, India has very high applied tariff rates on a wide range of products, including agricultural and manufactured goods. Secondly, there is a significant gap between India's bound and applied tariff rates for many products, which gives India the flexibility to increase tariff rates on these goods. Finally, the Indian government has taken advantage of this

flexibility and unilaterally increased tariff rates from 2014 to the present.

The Indian government is reportedly negotiating a free trade agreement with the US. But it should be careful here as these reciprocal tariffs may be used as bait to bring countries to strike a deal with the US.

India should be wary of this trap and should be cautious about protecting their domestic interests like livelihood security and food security while designing its tariff policies. This is particularly true for agricultural products where heavy subsidization by the US allows US producers to export at artificially low prices.

However, in view of India's heavy dependence on the US for its goods and services exports, India faces constraints. Close to 20 per cent of India's total exports (merchandise plus services) go to the US. Secondly, the US has imposed a "discounted reciprocal tariff" on India implying that the tariffs can go up if India fails to act. Overall, the US' radical policy shift will have widespread global ramifications. It may also attract diverse responses from countries ranging from cooperation to conflict.

A full-fledged trade war cannot be ruled out. There will be major supply shocks as companies will try to re-optimize their supply chains and it will impact global investment flows. Its broader impact will go far beyond trade policies and spill over into inflation, monetary and exchange rate policies as well.