

An ability to capitalize on supply-chain shifts will determine whether we emerge stronger in the new global economic order

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The recent wave of tariff announcements by the Trump administration in the US marks a significant shift in global trade dynamics. With 10 percentage points (pp) of additional tariffs on Chinese imports already implemented, and a flurry of additional announcements (25pp additional tariffs on Mexico and Canada, plus additional tariffs on steel and aluminium), there is a lot on the US policy plate. Further, there is the possibility of even more drastic measures like “reciprocal tariffs” (with the possible inclusion of foreign value added taxes) and duties on US imports of critical minerals, apart from universal tariffs on all imports.

We are realizing that all this was not just campaign rhetoric. Unlike during Donald Trump's previous presidency, when tariffs on Mexico and Canada were threats that never materialized, this time they may soon become reality. Aspects like the tenure of these tariffs and gaps between threats and their actual implementation will determine the behavioural responses of economic agents and ultimately their economic impact.

Two key patterns have emerged. First, energy considerations remain paramount, evidenced by the exclusion of Canadian oil and energy products from Trump's executive orders. Second, inflation concerns may have moderated the US approach towards China, where baseline expectations of much higher additional tariffs, with potential increases of up to 60pp on certain industrial products, have been tempered, though yet another 10pp hike may be in the offing. This relative restraint likely stems from Trump's campaign narrative that was critical of the previous leadership for letting inflation spiral out of control.

For the US, there are both direct and indirect consequences of Trump firing on all cylinders. The immediate effect may include higher prices, reduced consumption and slower growth in the US. However, the indirect impact through increased trade-policy uncertainty—which has been hitting historic highs—could significantly deter investment and further hamper growth, especially in times of global value chains (GVCs).

Note that these tariffs do not exist in isolation. Substantial corporate-tax cuts and broad deregulation, both of which are on Trump's agenda, could potentially stimulate US economic growth, though these benefits may take longer to materialize compared to the more immediate negative effects of tariffs on consumption and investment.

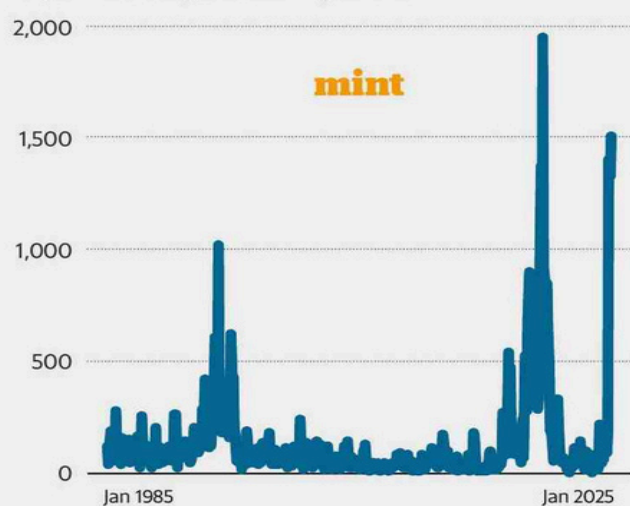
For countries directly targeted by US measures, like China, the effects are not straightforward. Chinese exports to the US will face headwinds. But China's retaliatory tariffs on US imports will also reduce its imports from America. The net result on China's trade balance and economic growth may not be as severe as initially anticipated, especially if China pre-emptively deploys macroeconomic



Trump has the world on edge

Spikes in policy uncertainty, especially over the future of international trade, could deter investment and hamper economic growth.

US, Trade Policy Uncertainty Index



Source: "Measuring Economic Policy Uncertainty" by Scott Baker, Nicholas Bloom and Steven J. Davis at www.PolicyUncertainty.com.

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tools—including fiscal, monetary, and foreign exchange policies—to counterbalance the negative impact. In times of GVCs and global fragmentation of production, there may be rebound effects for US exports too.

Let's look at the rest of the world, including India. The implications are multifaceted. As US tariffs deter the entry of Chinese goods, China will likely redirect these shipments to other markets, potentially dumping them elsewhere. This may reduce India's relative competitiveness in global markets. If China resorts to currency devaluation as a growth stimulus strategy—like it did in the 1990s—it could further displace demand for export products from its competitors like India.

The situation raises concerns about international legal frameworks as well. With speculation about a potential US withdrawal from the World Trade Organization, the future of the multilateral rules-based trading system hangs in the balance.

However, there could be a silver lining to these dark clouds. Increased supply of Chinese goods to non-US markets might reduce global prices, which may mean lower inflation in the rest of the world.

For India, specifically, these developments present both challenges and opportunities. The space vacated by countries directly targeted by US tariffs could be captured by Indian exports. Despite being a labour-abundant country, India has increasingly shifted toward capital-intensive production and exports. We now have a chance to aggressively expand labour-intensive production, particularly in sectors like textiles.

A four-pronged strategy could help us capitalize on this opportunity: expedite free trade agreements, reform labour regulations, strengthen raw material ecosystems and create large special economic zones with comprehensive infrastructure. Additionally, both domestic and international trade costs in India would need to be brought down significantly.

India's integration with GVCs will be crucial. As Chinese labour costs rise and China moves up the value chain, following the 'flying geese' model of economic development, India must identify where its comparative advantage lies, whether in upstream or downstream activities.

Take the example of iPhone assembly. While China earns about \$8.46 per unit (like what India could earn), China assembles 230-250 million units annually, compared to India's 30-40 million. Scale makes all the difference in value addition to the economy.

Fortunately, India may escape US attention, as it represents only 2-3% of total US exports and imports. Also, for geopolitical reasons, India could serve as a neutral force amid renewed US-China trade tensions. A mini trade war between the US and India in 2019 affected about \$7 billion of Indian exports—a manageable 6% of India's overall exports to the US.

India's recent budget moves to rationalize customs duties, eliminating some rates above 20% and reducing those above 70%, while maintaining effective protection through a careful recalibration of basic customs duties and cess levies, appear designed to send positive signals to trade partners while protecting domestic industries.

Like 1991, could the latest economic shock trigger tough reforms? Behind our challenge lies what we can describe as a 'Trump opportunity.' As global trade tensions evolve, India's strategic response and ability to capitalize on supply-chain shifts will determine whether it emerges stronger in the new global economic order.

These are the author's personal views.