Tariffs and Inflation for the US, Disruption for Indian Supply Chains

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U.S. President Donald Trump has initiated a global trade war — politely called “reciprocal tariffs.”

Tariffs are taxes that countries levy on imported goods which make them more expensive and unaffordable with the intent of encouraging domestic manufacturing. At the same time, the global economy prospers if some goods are imported from other countries where they are cheaper to produce, and satisfy domestic consumers. In return, the importing country can produce goods or technologies that serve the exporter countries. This becomes a cycle of trade flows and value chains based on comparative or even absolute advantage.

Trump, who won a second term on the slogan “Make America Great Again” (MAGA), has two underlying assumptions behind his economic un-planning.

One, that he can literally kickstart American manufacturing by putting high tariffs on basic goods imported from all countries into the United States. Two, he will use the instrument of reciprocal tariffs; i.e., any country that puts tariffs on U.S. goods will be subject to tariffs in return, whether those goods imported by the U.S. are important for the U.S. consumer or not.

This, he believes, will force countries that import U.S. goods to lower the taxes on them, so they are more affordable in the host country.

By levying tariffs Trump is punishing the U.S. consumer for past U.S. economic policies where manufacturing was outsourced to countries with cheap labor and easily available raw materials and then imported by the United States.

Very often U.S. companies themselves outsourced such manufacturing and made financial gains. Trump is also punishing other countries especially from the Global South like India, Vietnam, Indonesia, China and many more, where cheap labor allows them to make goods at much cheaper rates than the United States.

This has benefited the U.S. consumer for years.

India, along with other countries, is also a target, as Trump has imposed a 27 percent tariff on Indian exports into the United States.

The U.S. is a major destination for Indian exports comprising about 18 percent of India's outbound trade. The World Trade Organization, of which the U.S. is still a part, says that imports from developing countries should see fewer tariffs to encourage equitable growth, but Trump does not care for the multilateral rules-based order and he has little interest in the growth of countries like India.

Trump's policy of reciprocal tariffs means that India will have to lower the tariffs it imposes on goods imported from the United States. These tariffs were imposed by India to protect its own nascent industries.

Trump has specifically pointed to these Indian tariffs as being unfair to the United States. By lowering tariffs on U.S. imports under pressure, India could see more American goods in its market, even at the cost of Indian-made goods.

The Indian Government believes that lower tariffs on U.S. electric vehicles (EVs) could be a good thing and seems happy to comply. But will Indian EV manufacturers be happy?

Moreover, will the Indian luxury car buyer who demands Toyota SUVs, BMWs, etc. now switch to Fords and Chevrolets? And will the Indian drinking class switch from the Glens and Scotches to American bourbons?

America's tariff war will be a setback to developing economies like India who may be forced to undo their protective tariff barriers to let in American goods and initiate a change in their consumer patterns. Even if this pleases the U.S., it takes away from the strategic and economic autonomy of India.

Trump's unilateral tariffs with global designs are unlikely to fulfill his mercantilist desires.

International trade economist Professor Sunanda Sen believes that these reciprocal tariffs can bring in global recession, with multiple nations (including the U.S.) in the grip of a contracting spiral of their respective GDPs.

Tariffs are an old 19th Century method of protecting economies. However, post-globalization where value chains have been internationalized, Trump's tariffs will be highly disruptive with unintended consequences that are difficult to predict.

What should countries like India do to avert being drawn into a U.S.-led global recession?

India has been opening its economy to the U.S. and Indian businesses have struggled and managed to develop comfortable supply chains with the US. They will now have to diversify. The government needs to help small and medium enterprises and manufacturing exporters diversify to other countries and markets.

The U.S.' imports constitute about 15 percent of all global markets. This means that other economies receive 85 percent of the global exports. If carefully planned, the U.S. induced tariff crisis can be averted. India has also diversified its key import sectors. India is welcoming defense imports from the U.S. with lucrative profits for U.S. defense industries.

Further, Trump has pushed India to buying more oil and hydrocarbons from the U.S. and India is doing that. India can leverage this for other concessions.

India has been happily appeasing the U.S., but as these punitive tariffs show, the U.S. wants more. The belief that by bandwagoning with the U.S. India could have avoided punitive reciprocal tariffs has turned out to be false. It will not lead to Indian growth or economic stability.

Therefore, India must work at making India great as opposed to bending over backwards for the MAGA program.

The Indian government has set up a control room to monitor the tariff issue. India has enough economists who can show the way so that India does not subordinate its core interests and growth trajectory to U.S. interests.

Economic autonomy is key to strategic autonomy, multipolarity and better development for the Indian people.