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Global Trade War: The Apology of Protectionism

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This editorial is based on the article "[Seven likely outcomes of the US-China trade war](#)" which appeared in "Livemint" on 16th May, 2019. The article talks about implications of the global trade war.

With the collapse of trade talks, the US might soon charge a steep 25% import duty on almost all products from China, though a 25% tariff on the \$325 billion of mostly consumer goods. It is yet to be imposed though.

The escalated tensions will affect more than just the trade with US which imports goods worth around \$540 billion from China.

There are some likely outcomes of this phenomenon.

Likely impact of the trade war on USA and the World

- **On Manufacturing**
 - **Labor charges are very high in USA, as such manufacturing will not return to USA.**
 - Though the USA leads in technology, but due to its earlier policy of outsourcing since 1975, China now leads in most high-tech industries.
- **On US based firms**

Big US firms will now become vulnerable as many of these firms sell more items in China than at home.
- **On Global value chain**

Global value chains (GVCs) will get restructured.

 - Less demand from the US would mean China buying fewer components and sub-assembly units from Japan, South Korea, Vietnam and Thailand.
 - **This will shrink trade and weaken the GVC model. India, with sizeable domestic consumption, may gain from this shift with appropriate incentives.**
- **Labour-intensive production could shift out of China**

The 25% tariff imposed by the US and rising wages in China will make the latter less competitive in manufacturing sectors.

- A substantial part of production may shift to countries like Vietnam, Cambodia, Thailand, Bangladesh or India.
- Most of the investment in these new plants may come from China.
- **Impact on other countries and multilateral institutions**
 - Due to threats of tariff, many countries are signing bilateral FTAs with USA.
 - If USA insists on 'no china deal policy', this could be the end of multilateralism.
 - **The US has withdrawn trade benefits for India under its Generalized System of Preferences; imposed tariffs on steel and aluminium and filed several cases against India at the World Trade Organization (WTO).**
 - As of now, India has not retaliated, but in the long run it can pose a serious challenge for India.
 - Moreover, USA is pushing for plurilateral deals on matters like e-commerce which are of interest to a few large US firms and this will weaken WTO to a significant extent.

- **Increasing resentment against USA**

Position of the Dollar as world reserve currency can face a serious challenge.

For example, as of right now, the Society for Worldwide Interbank Financial Telecommunication (SWIFT) is facing a serious challenge from EU and others in the form of **INSTEX — or "Instrument in Support of Trade Exchanges" — by France, Germany, and the UK which will allow non-dollar trade with Iran** and is being described as facilitating humanitarian goods-related transactions only, including food, medicine and medical equipment.

Reason for the trade war

- **Trade Deficit**

USA is suffering the world's largest trade deficit since 1975 with deficit in goods and services amounting to \$566 billion in 2017.

The deficit with China alone amounted to 63%.

- **Political Reasons**

Trade war is just the economic aspect of this battle of hegemony between USA and China. There are finer, more subtle aspects of geopolitics and one-upmanship going on between the various world powers.

- **Intellectual Property Rights (IPR)**

China, through its unfair technology transfer regime has acquired illegally vast troves of trade secrets.

US Companies are often forced to partner with Chinese companies for establishing businesses in China and these Chinese partners after learning the technology emerge as competitors to the same US firms, resulting in huge financial losses for USA.

- **Made in China 2025**

Made in China 2025 was an official policy statement of China in which it aimed to transform itself into an advanced manufacturing powerhouse.

This was coupled with protectionist policies of China which were targeted on the US through the ongoing trade war.

- **Steel Sector**

Due to demand-supply constraints, China is not able to consume its own steel; consequently it is dumping it in the international market.

Imposing 25% tariff by US on Chinese steel is an attempt to protect the domestic steel industry of US.

Lessons from history: how effective will be tariffs be in the realization of USA's goals?

- For supporting the farmers who were impacted by the Dust Bowls, in June 1930, Smoot-Hawley raised the already high U.S. tariffs on foreign agricultural imports. It is known as the **Smoot-Hawley Tariff War**.
- **Rather than helping, it raised food prices for Americans who were already suffering from the Great Depression.**
 - It also compelled other countries to retaliate with their own tariffs. That forced global trade down by 65%.

Is a Smoot-Hawley effect possible this time?

- **Exports today comprise 13 percent of U.S. GDP.**
- The United States exports a lot of oil, commercial aircraft, food and automobiles. These are industries which will suffer a great deal from this trade war recreating the Smoot-Hawley effect.

Opportunities for India

- **Exports**

As per the Commerce Ministry, India can pump up its exports on at least 61 products.

Most of these products correspond to Agriculture (Soya, Grapes, Tobacco), Industrial products (Boilers) etc.

- **Trade Deficit**

This trade war can help bring down India's trade deficit with China which has been a bone of contention between the two countries.

Due to the volatility in US, India's exports to China have been increasing.

The bilateral trade in 2017 rose by 18.63 per cent year-on-year to reach \$84.44 billion.

- **Investment**

With both US and China embroiled in a trade war and EU joining them too, India becomes the sole major emerging market economy which has skilled cheap labour, required infrastructure and positive demographic dividend for attracting the investment which is fleeing these markets due to lack of market-stability.

- **Tourism**

Trade war hurts tourism - Chinese air traffic to the US has been down by 42 per cent.

As per the Commerce Ministry, the trade war can help in attracting this share of tourists from China to India.

- **Closeness with China**

China is attempting to woo India towards its side by giving concessions on tariffs by Asia Pacific Trade Agreement (APTA).

Way Forward

For India, to take advantage of this Global Trade War, the following steps are needed:

- **Inputs and Intermediate goods**

The trade between nations is nowadays dominated by inputs or intermediate goods through supply chains that are spread across the international borders. India has been unable to become active participant in these supply chains.

The recent surge in FDI in Indonesia, Vietnam and the Philippines points towards shift from China by American companies. India can benefit from this segment by providing the input or intermediate goods.

- **Large Investment Projects**

India can attract large investment projects by having a comprehensive overlook at import tariffs, investment policy, ease of doing business and moving to a GST that encourages exports by zero rating them.

- **Skill development**

China of today is no longer dependent solely on cheap labour for attracting business but more on the skilled component of its labour force which is not easily replaceable.

India therefore needs to work on its skill development, if it seeks to attract the investments that are fleeing or thinking to flee China.

Drishti Input

“Multilateral and plurilateral institutions have outlived their utility, now is the time for bilateral institutions.” Discuss this statement in the context of the global trade war.