



# Trade War

## Why in News

According to the World Bank's [Global Economic Prospect](#), the global economy has slowed to its lowest pace in three years because international trade and investment have been weaker than expected. International trade has been severely affected by the trade war between the US and China.

- On July 6, 2018, the United States administration slapped a tariff of 25% on \$50 billion worth of imports from China. China responded immediately with retaliatory tariffs on a similar scale. On April 2, China announced tariffs on US goods worth \$3 billion on some 130 American products like fruits, nuts, wine and steel pipes, as well as pork and recycled aluminium.

## What and Why of Trade War

- [Trade war](#) is a **subset of Trade Protectionism**.
- It is a conflict between two or more nations regarding trade tariff imposition on each other's goods.
- A trade war is usually initiated when a nation imposes tariffs or quotas on imports and foreign countries retaliate with similar forms of trade protectionism. As it escalates, a trade war reduces international trade.
- A trade war starts when a nation attempts to protect a domestic industry and create jobs. In the short run, it may work. But in the long run, a trade war costs jobs and depresses economic growth (by suppressing demand for goods as they become expensive) for all countries involved.
- It also triggers inflation when tariffs increase the prices of imports.

## Four Methods of Trade Protectionism

1. One way is to enact **tariffs** that tax imports. That immediately raises the price of the imported goods. They become less competitive when compared to local goods. This method works best for countries with a lot of **imports**, such as the United States.
2. A second way of protecting trade is when the government **subsidizes** local industries. This makes the products cheaper even when shipped overseas. Subsidies work even better than tariffs. This method works best for countries that rely mainly on **exports**.
3. A third method is to **impose quotas** on imported goods. This method is more effective than the first two. No matter how low a foreign country sets the price through subsidies, it cannot ship more goods.
4. Fourth type of trade protectionism is subtle. It is a deliberate attempt by a country to **lower its currency value**. This would make its exports cheaper and more competitive. This method can result in retaliation and start a **currency war**.

## What the "Smoot Hawley Act" Can Teach Protectionists Today

- It was designed to protect U.S. farmers from cheap agricultural imports coming from Europe (which was increasing farming output) after the destruction in World War I.
- The resultant competitive **trade war** restricted global trade.
- It also raised food prices for Americans who were already suffering from the **Great Depression**. Other countries retaliated with their own tariffs.
- It forced global **trade down** by 65 percent, worsened the **Depression**, and contributed to the

start of **World War II**.

## Advantages

- Imposing tariffs **protects the economy from foreign competitors**. This provides the new companies time to develop their own competitive advantages.
- Protectionism also **temporarily creates jobs** for domestic workers.
- The protection of tariffs, quotas, or subsidies allows domestic companies to **hire locally**.
- However, these benefits end once other countries retaliate by erecting their own protectionist measures.

## Disadvantages

- In the long term, trade protectionism **weakens the industry**. Without competition, companies within the industry have **no need to innovate**.
- Eventually, the domestic product declines in quality and becomes more expensive than what foreign competitors produce.
- Increasing protectionism can further **slow down economic growth** (weak consumer demand owing to inflation). It would cause more layoffs, not fewer.
- If the country closes its borders, other countries will do the same. This could cause **layoffs among the workers who owe their jobs to exports**.
- Trade war in the long term would **hamper global economy due to reduced trade volumes** among nations. The IMF noted that the US-China trade tension was one factor that contributed to a “significantly weakened global expansion” in 2018, as it cut its global growth forecast for 2019.
- The trade tensions could result in an **increasingly fragmented global trading framework**, weakening the rules-based system that has underpinned global growth, particularly in Asia, over the past several decades.

## Complicated Nature of Traded Goods

- There are many complexities in the goods that are traded between the two or more countries.
  - For example, A “Chinese” product comprises elements from other countries.
  - The logo on the iPhone notes, “Designed in California, assembled in China”. The iPhone costs Apple \$220. It is assembled in China for \$6.50, but the rest of the cost is for its sophisticated components made in Germany, South Korea, Japan and the US. In other words, any “trade war” between the US and China will have consequences for many other smaller countries — there will be **collateral damage**.
- According to The Economist, 30% of the value of goods that China exports to the US is added elsewhere — Taiwan, Malaysia, Singapore and so on. If the situation worsens, “countries entwined in Chinese supply chains will suffer”.

## Criticism of the US Action

- On January 22, 2018, US imposed tariffs and quotas on imported Chinese solar panels and washing machines. China is a world leader in solar equipment manufacturing. **The [World Trade Organization](#) ruled that the United States acted unfairly in levying the tariff.**
- The head of the U.S. Chamber of Commerce said Trump's trade war could cost 2.6 million U.S. jobs.
- Eight countries have filed formal complaints with the World Trade Organization. Many of these countries, like Canada, India, and the European Union, are allies. The countries have argued that the US cannot justify the tariffs on the basis of national security.

## [Opportunity for India](#)

- India has an increasingly widening trade gap with China. Ongoing trade war may be an opportunity for India to reduce it significantly.
  - India **can export the surplus agricultural products** such as soybean to China after decrease in the export from USA.
- **India can become China's software industry partner**, as it looks to replace the US hegemony of technology companies. India needs some strong pegs to pitch to China, and India's software industry is capable of graduating to a higher level.
- Growing trade tensions between China and the US could **enhance the flow of Chinese investment towards India**.
- India can **explore opportunities to export the demands of goods by the US** after restricted entry of Chinese goods in the US economy. Of the \$300 billion in Chinese exports that are subject to US tariffs, only about 6% will be picked up by firms in the US, according to [a report released by the UN Conference on Trade and Development \(UNCTAD\)](#). Here, India can be benefited along with other nations.
- India may be able to **increase its exports in textile, garments and gems and jewellery** to US if Chinese exports to the US slow down.

## Threats

- America has a trade deficit with every nation of the G7 grouping and that deficit has been increasing each year. With India, the US has a trade deficit of \$21.3 billion, which on the contrary is a trade surplus (FOREX earning) for India, which is at risk due to the ongoing trade war.
- US wants duty reduction from India in Harley Davidson bikes, stents, knee implants and medical devices and dairy and poultry products among others. India has already reduced duty on high powered bikes to 50% from 75%. However, further pressure for duty reduction can affect the domestic production.
- India should remain cautious of China's intention of dumping its overproduction of steel and aluminium due to restrictions imposed by the US.
- The rising price of oil threatens to widen India's current account deficit, impacting India's macroeconomic stability.
- India's already struggling currency may further decline in value due to the ongoing trade war.

## Way Forward

- Even though it is a lengthy and time consuming process, the settlement of disputes through international conventions and rules is the need of the hour.
- WTO dispute settlement resolution mechanism should be approached instead of unilateral decisions. The benefit of the WTO process is that it prevents the damaging consequences of trade protectionism. Nations can resolve their disputes through WTO instead of raising tariffs.
- India can derive maximum benefits of the opportunities created by the ongoing trade war between the US and China. However, it should remain careful and prepare for the challenges arising out of the trade war.