RESEARCH REVIEW JOURNALS
Volume-04
Issue-02
February-2019
ISSN: 2455-3085 (Online)
RESEARCH REVIEW International Journal of Multidisciplinary
www.rrjournals.com[UGC Listed Journal]

Impact of US China Trade War over Indian Economy

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ARTICLE DETAILS

Article History
Published Online: 20February 2019

Keywords
Trade War, Trade Practices, Exchange Rate, Indian Economy, Domestic Traders

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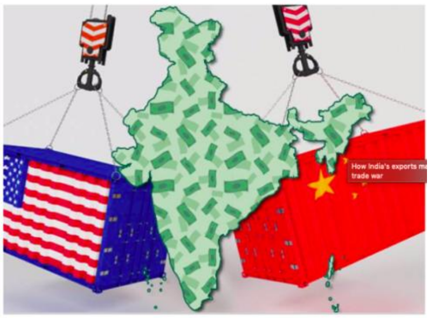
ABSTRACT

This research paper seeks to evaluate the spillover benefits and threats of the US-China trade war on India. The hypotheses that, can India take trade advantage and substitute US goods in China and vice versa is tested by data from various scholarly articles and carefully aligned with the present and probable policies prevailing in India. This paper gives insight on the multidimensional trade practices that India indulges in. It considers the factors like the exchange rate of Rupee and its military conditions too in order to have a holistic approach on the scenario. This research paper brings out that the fate of Indian economy is closely related to how individual domestic traders react to the economic pulses and the confidence of investors in substituting India as their investments' safe haven. Thus the paper revolves around the question "To what extent will the US-China Trade war benefit Indian economy?".

1. Introduction

As thematically displayed in the book: "The World is Flat", world economies have been in a cycle of protectionist and globalized free trade methods. Globalization post the world wars had benefited the world tremendously, but now US President Donald Trump has triggered protectionist measures in the form of tariffs which is resulting in retaliations from countries across the globe, leading the world economy towards protectionism yet again. While Trump sees this as an opportunity for US steel industries to flourish and the domestic US industries to prosper, it leads to a global misallocation of resources and the series of retaliatory policies question the very soul of WTO[1].

India is one of the fastest developing economies in the world with an impressive growth rate of 7.5%. Indian exchange rates compared to US dollars also hit the record lowest lately. The demonetization and hike in GSTs were only short term barriers in the rapid advancement of Indian economy, which have been readily dealt with by the help of extensive trade strategies.[2] Considering India's past with WTO, until the launch of the Doha Development Agenda (DDA) in November 2001, work at the Council for Trade in Goods (CTG) had focused mainly on customs and border-crossing procedures. The Regional Comprehensive Economic Partnership (RCEP) brought together the 10 countries of the Association of Southeast Asian Nations (Asean), Japan and South Korea, Australia and New Zealand, and China and India, thus promoting intensive trade amongst the countries. India's extensive free trade strategies via these organizations have been the backbone of its growth. One can foresee the adverse dents on Indian economic growth owing to the trade war in the world's biggest economies. India, along with China have seen US tariffs as a threat because tempted by the benefits to individual economies, the steel exporter-countries might move towards a protectionist society raising the overall steel prices. India imports a major part of its steel requirements and thus preaches free-trade in order to safeguard it's interests. Free Trade might not have benefitted India directly, but studying a paradigm of events, it can be concluded that openness in trade builds a competitive industrial sector. Exports and growth in general follows a prospering industrial sector and thus, free trade is the key behind India's high development rates in spite of no direct indicators.



[1] *WTO is an organization that promotes free trade and is against protectionist measures of any kind. It holds the view that any protectionist measure solely makes short-term benefits ruining long-term economic growth. It upholds its vision by supporting concepts of comparative advantages between two trading companies.*
[2] *us-china-trade-war-impact-india*

Despite the threats for India in this trade war, there are promising opportunities that India can seize, however, with its share of reservations. There is a need for research on the role and impact of protectionist measures in Indian economy as a result of the trade war, and how it might prove to be helpful for India. Taking this forward, the research question is "To what extent will the US-China Trade war benefit Indian economy?"

2. Research Hypothesis

The protectionist measures can promote the growth of Indian economy, and the trade war between China and US will benefit India.

3. Research Methodology

This research will extensively look into the present scenario of Indian economy and assess the potential advantages of trade war between the US and China for India. The Exchange rates, state of the Stock Exchange market and the present policy states will be looked into deeply and the hypothesis will be tested and evaluated with a range of data from across the literature reviewed.

4. Findings

As it has been observed by SandipSen[3], the trade war was instigated when President Trump took the office with China warning US for retaliation against any trade action and subsequently increasing the quality standards for US soy imported to China, thus affecting US producers tremendously. This was followed with the steel and aluminum tariffs by US and again a series of tariffs by China on agricultural products, then the technical tariffs by US and so on. While the US blamed China for indulging in 'dirty floating' to depreciate its currency artificially and violating copyright laws, China questioned US products' quality leading to an inevitable trade war and tying the hands of WTO, as it allowed countries to impose tariffs for the above mentioned reasons. The trade between US and China is summarized in the following figures:

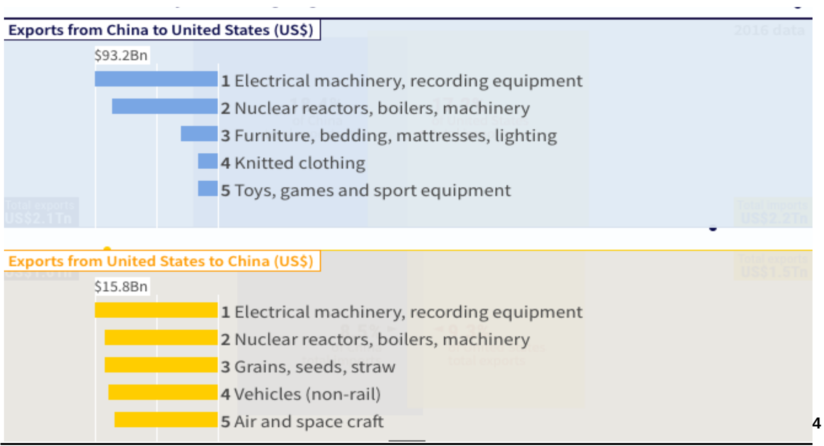


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Figure 1: Exports from China to United States

This figure clearly points out the trade deficit for US and thus, the tariffs might help US to improve its trade deficit. However, US is one of the largest consumers of Chinese products and thus can lead to a huge setback for Chinese economy. China imports products worth $15.8 billion from US and tariffs on these products can lead to an excess demand in Chinese products which India can substitute and take advantage.

Figure 2: Trade Deficit in US

Source: Comtrade.un.org

[3] *Sen, Sandip. "Can India Benefit from the US-China Trade War?" ORF, www.orfonline.org/expert-speak/can-india-benefit-from-the-us-china-trade-war/.*

[4] https://www.businesstoday.in/current/economy-politics/how-indian-exports-may-benefit-from-us-china-trade-war/story/281711.html

China has been consistently substituting its US product consumption. For example, it has substituted US Soy with Brazilian and other Latin American Soy. It has also switched to the European Airbus instead of the American Boeing jets for its aviation industry. The US has imposed tariffs on almost all countries except its NAFTA counterparts. On the contrary, heavy Chinese tariffs solely target US. Thus, while India might not have much scope to expand its export markets to US, but it can substitute US products in China, owing to the substantial demand and make the most out of this trade war.

As brought up by the commerce department of India[5], If Indian exports can successfully capture the US' share of the trade pie, the massive bilateral trade gap with China will also come down.

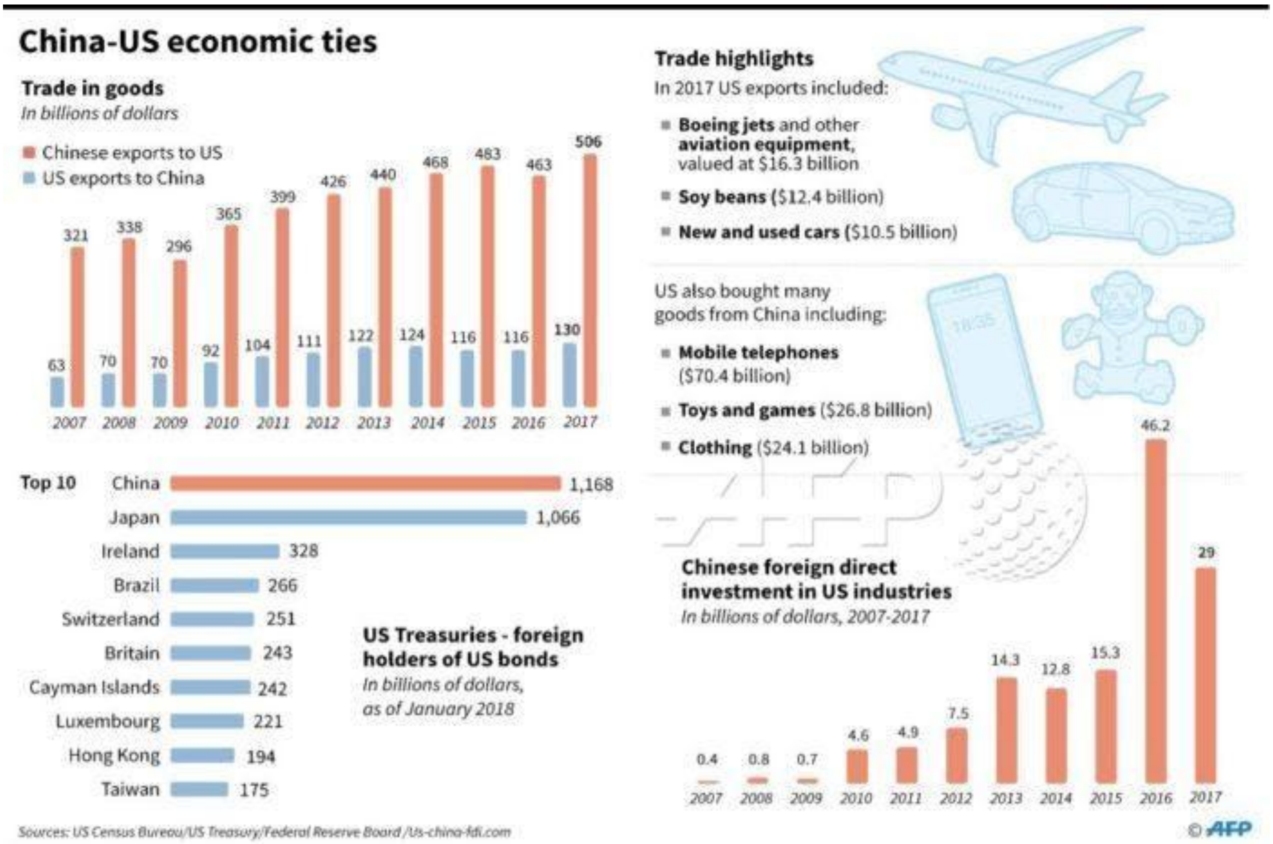

Figure 3: China-US Economies Ties

Source: US Census Bureau/US Treasury/Federal Reserve Board/US-China-idi.com

In the last fiscal, India's exports to China stood at Rs 86,015 crore, while Chinese imports totaled Rs 4.91 lakh crore. In other words, the trade deficit was well over Rs 4 lakh crore. The products where US exports to China overlap with Indian exports are the ones that can benefit India immensely. For instance, fresh grapes, cotton linters, flue-cured tobacco, lubricants and chemicals such as benzene, are a few lines where the value of US exports to China are pegged at above $10 million. India, too, exports these items to China.

Moreover, the most favoured nation (MFN) rate is applicable for members of the World Trade Organization, thus China has imposed tariffs of 15-25% on the goods coming from the US, while other countries are subject to only 5-10% duty. Furthermore, India has been granted additional 6-35% duty concessions on the MFN under the Asia Pacific Trade Agreement, which makes Indian exports all the more competitive at present. India also exports several products to the rest of the world except China, such as oranges, almonds, walnuts, durum wheat, corn and grain sorghum. Significantly, the US exports of these products to China are in excess of $10 million.

The following points are important to consider in order to assess the impact of Trade-war on Indian economy.

1. The **value of the rupee** has recently dropped to an all-time low, settling at 70.02 against US dollar as recorded on 26th December, 2018. This steep drop has coincided with Donald Trump's threat of imposing a fresh round of tariffs on exports worth $200 billion. The trade deficit of India with US was recorded to be 22.8 billion dollars in 2017. The weakening of US dollar as a result of this further round of tariffs will aggravate this deficit further, causing a chain reaction of sorts.

[5] "How India's Exports May Benefit from US-China Trade War." *Business Today*, Business Today, 28 Aug. 2018, www.businesstoday.in/current/economy-politics/how-indian-exports-may-benefit-from-us-china-trade-war/story/281711.html.

2. The key indices in the Indian **share market** were seen to drop due to the declining confidence in investors owing to the hiking trade war in the world economies. During this period, the BSE Sensex saw regular plunges in points. NSE Nifty's performance too was along the same lines as it also saw significant drops. As of now, the Sensex is trading at about 35,649.94 (as on 26th December 2018), which is still below the average.
3. Former US President Barack Obama described the US-India relationship as 'one of the most defining partnership of the 21st century'[6]. India can seek to substitute Chinese market in US, but China has acquired huge economies of scale, making its production highly efficient and competing with Chinese supply chain can be a challenge for India. India cannot grab a share of the ICT exports from China as it lacks proper supply chain, especially in semiconductors. Logistics cost, to move the manufactured goods from the factory to the destination, is also an area of concern for India as China excels there. As the United States of America imposed duties on steel and aluminum, India now has to pay approximately $241 million worth of tax to the US. India, on the other hand, as a countermeasure has proposed imposing duties on 30 different types of goods. This will ensure that the US has to pay about $238 million as duties to India. However, this will make life more difficult for the end consumers as everything that falls under the tariff scanner is expected to become more expensive.

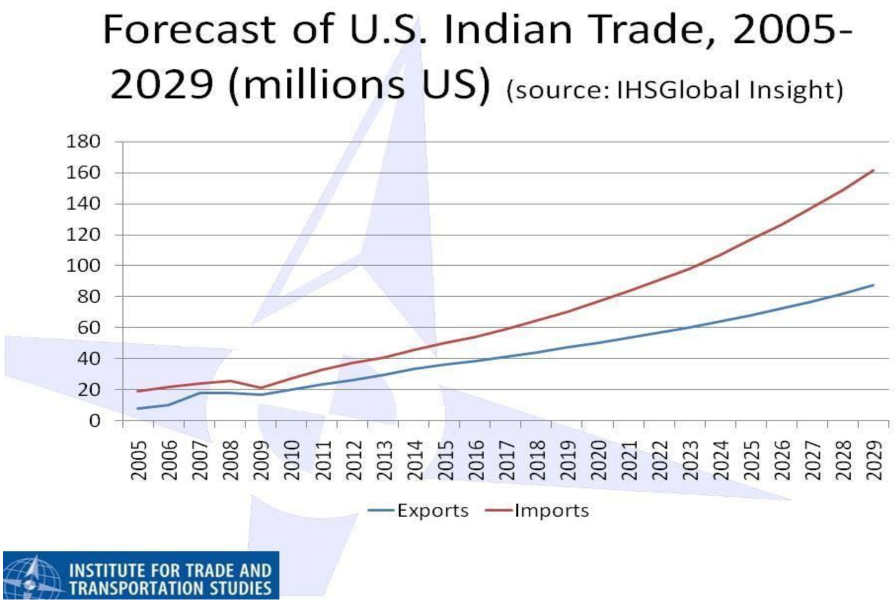

Figure 4: Forecast of US Indian Trade
Source: Institute for Trade and Transportation Studies

5. Policy Implications

1. Yuan devaluation because of US China trade war benefits India as it has net imports of approx. USD 52 billion from China. The decreasing import cost, with a potential increase in exports can reduce India's massive trade deficit with China.
2. India has been building roads, improving port infrastructure/connectivity to the hinterland through Sagarmala and Bharatmalaprogrammes. It is also trying to enhance coastal shipping and boost transportation through inland waterways. In developed markets, companies outsource 70 per cent of their logistics operations that can be outsourced to lower costs. In India it is just 35 per cent. Even though India's steep climb in the recent 'ease of doing business' ranking is noteworthy, it still has a long way to go in reforming labour laws and the land-acquisition process which are essential for lowering costs further.
3. The slowdown of Chinese Economy will have adverse impacts on oil prices as being a predominantly secondary sector economy; it is one of the major oil consumers in the world. Any hike in oil prices might lead to increasing cost of production for India, thus India should consider switching to alternate energy sources.
4. China is likely to curtail very long gestation infrastructural projects, to boost domestic consumption and near term benefits. This might imply a slowdown in CPEC and hence greater pressure on Pak finances that may further lead to curtailing cross border terrorism. India needs to brace up for this kind of situation.
5. With Chinese growth under cloud, and persistent doubts on the health of Chinese banks- once the initial rush of global capital reallocation subsides, India is likely to remain an investment destination of choice, thus the government can support policies to promote flourishing corporations and provide subsidies to promote production in India at lower costs. The government must direct its 'Make in India' initiative on these sectors with suitable incentives.
6. This research can be taken forward by assessing the identify Indian products which can replace Chinese ones and dovetailing trade policy appropriately. India must also keep in mind the fact that it has several competitions to grapple with, like Thailand and Bangladesh, who with their low cost labour can outcompete India in the product space being left by

[6] *Madhavan. "Can India Capitalise on US-China Trade War?" @Businessline, The Hindu BusinessLine, 8 Nov. 2018, www.thehindubusinessline.com/opinion/can-india-capitalise-on-us-china-trade-war/article25446070.ece.*

China. It is interesting to note that China is increasing opting for high skilled products and adapting AI and robotics in a big way, to outcompete USA. India needs to put in place a credible medium term strategy, how to combine its exportable items with low and high skills. That would ensure higher GVA for India and increasing share of the global pie.

6. Way Forward

Under present uncertain circumstances, Indian CEOs have a significant role to play in keeping the business environment stable. Their strategic plans could prove to be crucial, and hence, there is a need for different plans suitable to different economic environments. Today, the world is witnessing an unprecedented trend of synchronous growth, a growth that is dynamic in nature. Hence, there is a necessity for preparedness for all types of eventualities, as on the other end of the spectrum, if the trade war does not materialize, there is the possibility of tremendous growth in the Indian and world economy. India can grab the opportunity to replace Chinese products while countries continue protectionist measures; however free trade governs Indian growth. Assessing the feasibility of Indian products to replace Chinese ones and aligning the political shift in India with the growth objectives can take this research forward.

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