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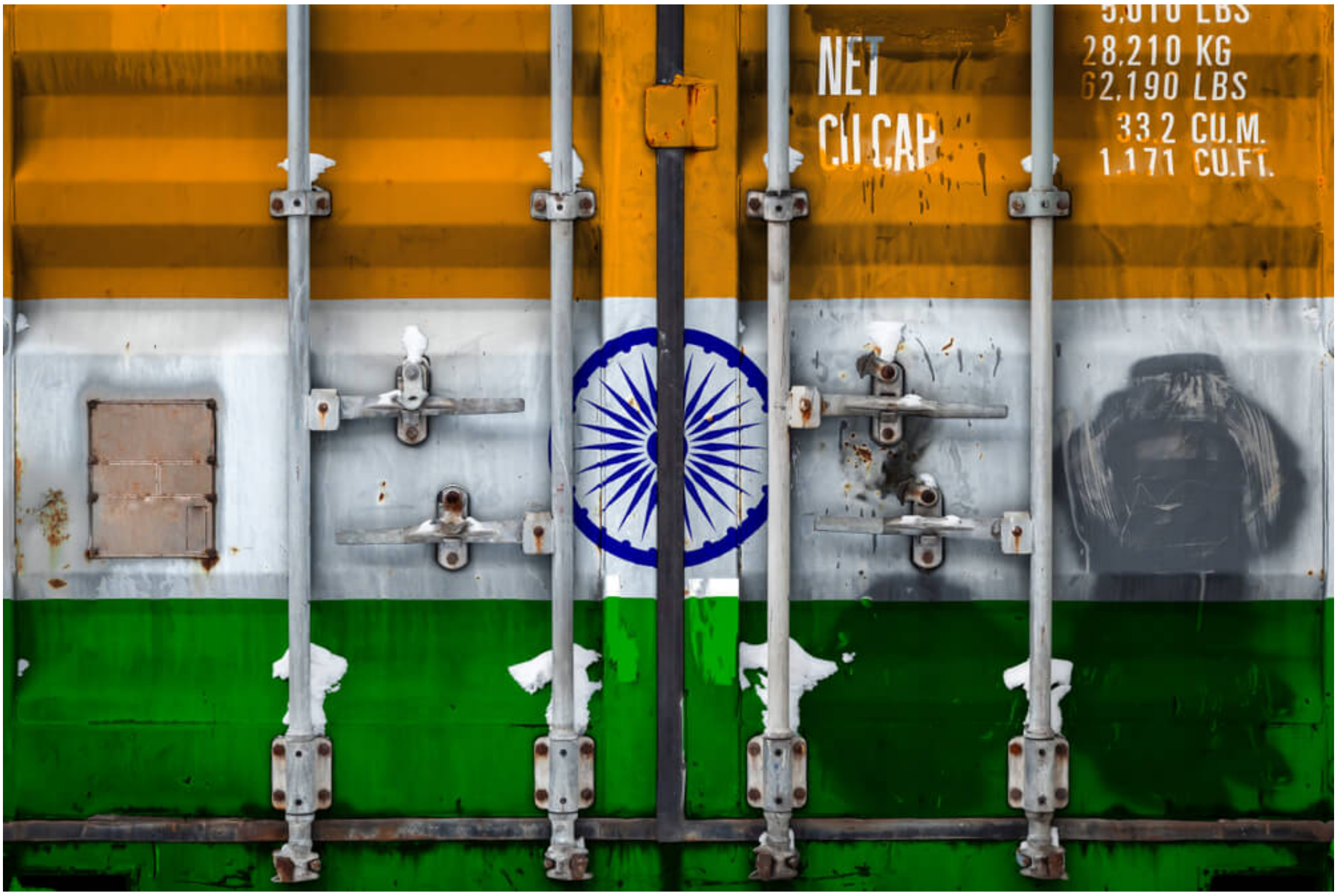
By: Kaushik Basu

India needs to avoid falling into Trump's tariff trap



Economic relations between India and the United States have been thrown into disarray after US President Donald Trump announced a sweeping 50% tariff on nearly all Indian imports, with the exception of iPhones and certain pharmaceutical products.

The move places India among the five most heavily targeted countries under Trump's tariff regime, alongside Brazil (50%), Syria (41%), Laos (40%), and Myanmar (40%).

The announcement caught Indian policymakers off guard, particularly given Prime Minister Narendra Modi's open support for Trump's re-election campaign.

The White House's harsh statement, framing the move as punishment for India's purchases of Russian oil, has only added to the confusion.

As the Wall Street Journal recently noted, this reasoning does not hold up, since China – the largest buyer of Russian oil – has not been penalized for its purchases.

So, what explains Trump's decision? Paradoxically, India's policy of unquestioningly siding with Trump may have made India easier to take for granted, to the point that even a minor departure from Trump's preferences is treated as unacceptable.

Subservience to Trump

This dynamic is reminiscent of Anton Chekhov's short story "The Ninny," in which an employer withholds the equivalent of nearly a month's salary from his children's governess for arbitrary reasons.

The governess accepts each cut without protest – a passivity that the employer chastises as spineless.

The economist Ariel Rubinstein later drew on Chekhov's story to develop a model illustrating how submission can invite exploitation.

India's current subservience to Trump marks a sharp departure from its longstanding role as a strong, independent country.

As a co-founder of the Non-Aligned Movement, it once championed strategic autonomy, balancing relations with multiple countries while avoiding subordination to any major power, be it the US or the Soviet Union.

It is time for India to draw on that legacy and cultivate economic and diplomatic ties with countries like Mexico, Canada, and China.

This also means strengthening trade and cooperation with other governments concerned about the impact of Trump's tariffs, particularly in Europe and Latin America.

Courage does not necessarily mean responding in kind

It would be a mistake for Modi to retaliate by matching Trump's tariffs, as some prominent Indian commentators have urged. While retaliation would hurt the US, the damage to India would be far greater.

The US is India's largest trading partner, whereas India is only the tenth-largest partner for the US – well behind Mexico, Canada, China, and Germany. The US economy is also far larger and therefore better able to absorb major shocks.

More importantly, courage does not necessarily mean responding in kind. By imposing heavy tariffs on longtime trading partners, the US is making a grave error, isolating itself and inflicting enormous damage on its own economy.

To be sure, tariffs can play an important role in economic policy. A well-known example is the infant-industry argument, which holds that when a promising sector is still in its early stages, temporary tariff protections can give businesses the confidence to invest, allowing the sector to grow, achieve economies of scale, and become competitive.

But once the industry matures, tariffs should be reduced, so that the discipline of open competition can help it perform even better.

The collateral damage

India is a case in point. In 1977, a political dispute led the government to expel IBM, compelling the country to develop its own mini- and micro-computers. Protected by trade barriers, the domestic computing sector expanded quickly.

But it was the economic reforms of 1991-93, which opened up India's markets to international competition, that enabled its IT sector to flourish and Indian corporations like Infosys, Wipro, and Tata Consultancy Services to emerge as global leaders, driving a period of unprecedented economic growth.

Competing with emerging economies like India, Vietnam, and Indonesia would require driving down US workers' wages – a strategy that is neither realistic nor desirable

Interestingly, the infant-industry concept predates modern academic economics and can be traced back to Alexander Hamilton, America's first Treasury Secretary, who successfully advocated for US tariffs to protect and nurture its nascent industries.

Although trade policies shifted after 1860, relatively high tariffs remained in place until 1934, after which they fell sharply, fueling a sustained economic boom.

By contrast, Trump's decision to raise tariff rates to their highest levels in more than 90 years is less an infant-industry policy than a nonagenarian one, shielding a manufacturing sector that long ago outgrew any need for protection.

Moreover, competing with emerging economies like India, Vietnam, and Indonesia would require driving down US workers' wages – a strategy that is neither realistic nor desirable.

The same applies to India: tariffs should not be used to settle political scores. In the long run, the collateral damage will far outweigh any short-term gains.

And, as for Trump's tariff policy, we can only hope that he will recognize the mistake and reverse course before it causes any more damage to the US economy.

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