

# ISAS Brief

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## United States-China Trade War: Tremors for India and South Asia

*While the latest United States (US) trade actions are targetted specifically at China, they have wider implications. The effects of the tariffs would reverberate across Asian manufacturing supply chains and would also be felt by Indian and South Asian firms. Furthermore, the 'Made in China' tariffs might not result in the relocation of more final-product assembling to India, as the country too remains on the US radar for possible trade actions.*

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The trade restrictive actions announced by the United States (US) on 8 March 2018 in the form of higher tariffs on steel and aluminium imports into the US have been followed up by more actions, specifically against China. Most American security partners and allies have been temporarily exempted from the steel tariffs. While these tariffs were imposed under Section 232 of the US Trade Act of 1974, citing national security considerations, more tariffs, targetted specifically at imports from China, were announced on 4 April 2018. These were justified under Section 301 of the US Trade Act. China has, expectedly, retaliated by

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announcing tariffs on several US imports into China, though the date of the coming into force of these tariffs is still not clear.

While the rest of the world is holding on to the hope that the US and China would negotiate and bring to an end the trade war that seriously threatens global trade prospects and the rules-based trade framework of the World Trade Organization (WTO),<sup>2</sup> no concrete progress is noted till now. Fears, therefore, remain on the adverse impact of these trade actions. The adverse impact would also extend to exporters and producers from India and the rest of South Asia.

## **Integration ensures Implications**

Indian and South Asian firms have been integrated into several regional production networks and global supply chains. Some of the prominent supply chains include apparels, automobiles, processed food, electronics, and information and communication technology items. Widespread tariff escalation by the US under Section 301, while specifically meant for products made in China, will, nonetheless, affect Asian firms, including Indian firms that are part of supply chains contributing to final products assembled and shipped out of China to the US.

As the ‘Made in China’ products experience higher prices in the US market, profit margins will decrease for lead firms managing these supply chains. The decline will trickle down the chains and reduce the profit margins of all suppliers of raw materials, and makers of parts and components. The impact will be greater for firms and countries that have greater ‘forward’ linkages with regional product chains that end up with the final products being assembled in China.

Indian and South Asian firms can hardly avoid this impact, given the scale of US tariff actions. These actions are now the combined effects of tariff hikes announced at two different stages over the last few weeks. The first of these was on 8 March 2018. Two Presidential

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<sup>2</sup> Amitendu Palit, “US tariffs hit WTO hard”, *Financial Express*, 22 March 2018 <http://www.financialexpress.com/opinion/us-tariffs-hit-wto-hard/1106892/>. Accessed on 11 April 2018.

Proclamations issued on the day mentioned the intent of the US to raise tariffs on steel and aluminium imports by 25 and 10 per cent respectively.<sup>3</sup> These announcements targetted imports in general and were not country-specific. Less than a month later, on 4 April 2018, the US announced its intention to raise tariffs by 25 per cent on around 1,300 imports, *specifically from China*.<sup>4</sup> These tariffs are expected to come into force within 30 days, unless the US and China negotiate and avoid their implementation. However, assuming they come into force, the effect of the ‘trade war’ on firms – from a supply chain perspective – will be much greater, given the combined effect of the two announcements.

### **Machinery Producers will to be hit**

The China-specific announcement of 4 April 2018 includes several items belonging to HS Codes 29 (organic chemicals), 30 (pharmaceuticals), 40 (rubber and rubber products), 72 (iron and steel products), 73 (alloy and stainless steel), 76 (aluminium products), 84 (machinery and mechanical appliances, including parts), 85 (electrical machinery), 86 (railway and locomotives, including parts and fixtures), 87 (motor vehicles and parts), 88 (aircraft and parts), 89 (ships, boats), 90 (optical and photographic items and parts), 93 (arms & ammunition and parts) and 94 (furniture and fitting).

Most items on the list belong to HS Codes 84, 85 and 90. These comprise almost the entire range of machineries and machine products used for different industrial and households, including their parts, components and fixtures. Coupled with the tariffs on items from HS Codes 72, 73 and 76 – raw, semi-finished and finished iron, steel and aluminium products – the effect of the tariffs would extend to all segments of the machinery manufacturing supply chains. Firms from Northeast Asia, Southeast Asia and South Asia are variously integrated into different stages of these supply chains.

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<sup>3</sup> “Presidential Proclamation on Adjusting Imports of Steel into the United States” Proclamations, Economy & Jobs, 8 March 2018. <https://www.whitehouse.gov/presidential-actions/presidential-proclamation-adjusting-imports-steel-united-states/> and “Presidential Proclamation on Adjusting Imports of Aluminum into the United States”, Economy & Jobs, 8 March 2018. <https://www.whitehouse.gov/presidential-actions/presidential-proclamation-adjusting-imports-aluminum-united-states/>. Accessed on 10 April 2018.

<sup>4</sup> Notice of Determination and Request for Public Comment Concerning Proposed Determination of Action Pursuant to Section 301: China’s Acts, Policies, and Practices Related to Technology Transfer, Intellectual Property, and Innovation’; Office of the USTR, Docket no USTR-2018-0005 <https://ustr.gov/sites/default/files/files/Press/Releases/301FRN.pdf>. Accessed on 11 April 2018.

## Relocation Prospects and India

The perpetuation of the tariffs in the long-run might result in some reconfiguration among regional supply chains. The obvious attempt on the part of lead firms could be to contemplate shifting to locations other than China to avoid US tariffs on the final products. Such decisions are never easy from a business perspective. The integration of the firms from different countries in the global and regional value chains depend on various factors. These include location-specific cost considerations, particularly the availability of raw materials and skilled labour, and the ‘rules of origin’ to determine the ‘origin’ of a product into which it would be labelled for shipping to its final destination. These factors are dynamic and change rapidly with changes in local and global circumstances.

It might be tempting to jump to conclusions that machinery and appliance assemblers from Taiwan, Japan, Korea and mainland China would consider shifting to South Asian locations like India, Sri Lanka and Bangladesh to avoid the ‘Made in China’ tariffs. Much would depend on whether the tariffs persist and, if they do, whether they are enlarged through Section 301 to cover more items than what the 4 April 2018 announcement contains. It would also depend on how the US treats its trade relations with the major South Asian economies like India.

India might well be facing tariff action through ‘reciprocal tax’ as it not only runs a trade surplus with the US, but has also been mentioned by the US President, Donald Trump, specifically as a country that imposes high tariffs on US imports and needs to be ‘reciprocated’ accordingly.<sup>5</sup> If the recent US actions initiated against India at the WTO on its export-subsidy programmes are an indication, then further trade action against India cannot be ruled out. That would hardly leave India in a position to benefit from relocation considerations of supply chain managers.

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<sup>5</sup> “Donald Trump threatens India, China with reciprocal tax”, Asit Ranjan Mishra, *LiveMint*, 13 March 2018. <http://www.livemint.com/Politics/AIwPg2i8zTpgDpgV33rvnO/Donald-Trump-threatens-to-impose-reciprocal-tax-on-India-Ch.html>. Accessed on 10 April 2018.