

Will Trumps Tariffs Work

C.P. Chandrasekhar

There is nothing definitive about policy under US President Donald Trump. With the deadline for accepting his trade demands having passed, a revised set of tariffs has been announced, lower than the originally threatened hikes of up to 49 per cent in some cases. This follows negotiations that have led to “deals” with some countries (such as Vietnam and Indonesia) and stand-offs with others (India and Brazil). But there is still little certainty about where tariffs on individual countries will settle and when.

Although there has been a significant increase in tariff levels for many countries, the final hike in most cases has been 10 to 15 per cent. Of the 194 countries covered in a BBC survey, 98 are subject to a base reciprocal tariff of 10 per cent, 67 up to 15 per cent, and another 10 between 18 and 20 per cent. Only 17 are outside the 10 to 20 per cent range, with rates varying from 25 to 50 per cent. Additional duties in the 10 to 20 per cent range are indeed significant. But what is noteworthy is the large number of countries that fall in the lower additional tariff range.

This similarity in tariff levels across many cases has some implications. Assuming that these are the final rates, producers in each country can choose to pass on the additional tariffs to customers in the form of higher prices, or absorb them, either by cutting costs (already many countries pay low wages), or trimming profit margins, or by combining the two. Competition between producers from countries with different tariff rates would likely lead to adjustments of costs and profits, and price increases.

To the extent that prices in the US rise, depending on how responsive demand for each commodity is to an increase in price, import volumes would be affected. On the other hand, if the tariff increases are not passed on to consumers, there would be no change in the US, but exports of individual countries and global trade would be affected.

Where tariffs imposed are significantly higher than 10-20 per cent (such as in Brazil [50 per cent], India [50 per cent], and Switzerland [39 per cent]), absorbing the tariff increases and holding prices would be extremely difficult. This would result in loss of competitiveness. But the overall impact for the countries concerned would vary depending on how important are their exports to the US relative to their GDP. India and Brazil, threatened with the highest rates of 50 per cent each, account for only 2.7 and 1.3 per cent of US imports. They are also not as dependent on exports to the US as others like Vietnam. So the impact of the Trump tariffs on their trade would possibly depend more on how contagious the US policy of tariff-based protectionism is. If it spreads, the overall volume of global trade would be reduced relative to pre-tariff levels, and sections of the population dependent on exports to the US, either as workers or producers, would take a hit.

The confusion stemming from this lack of certainty is compounded by the lack of clarity on the real objectives behind the Trump tariff hikes. If Trump’s dramatic statement on “Liberation Day” (April 2) is to be believed, the intent is to reduce America’s overall current account deficit, by curtailing the most egregious bilateral deficits. The expected collateral effect is a return of offshored manufacturing to America. The first of these effects is likely to some degree, given the surprising willingness of most countries to arrive at trade deals with the US. Those deals would add the benefit of an increase in US exports to the country concerned to whatever reduction in imports are realised. But given the costs and complexities associated

with moving manufacturing to the US, the collateral objective is unlikely to be realised. Lower imports and higher prices may be the principal result.

This suggests that other objectives are likely to have been the more important drivers of tariff hikes. One such objective is that of mobilising revenues from import duties to finance the tax cuts on corporates and the rich embedded in Trump's "big", "beautiful" Budget Bill. Trump himself is confident that he will rake in substantial sums of money. But whether that expectation is realised will depend on the degree to which imports remain stable after the tariff hikes.

The other objective is Trump's attempt to weaponise tariffs and use hikes for political purposes. Brazil is being punished for initiating legal proceedings against its former President and Trump's ally Jair Bolsonaro. India, for importing oil and defence equipment from US-sanctioned Russia. And yet others for alleged failure to prevent the spread of the Fentanyl trade. Such objectives are not always realised. Brazil and India have not caved in unlike many other countries that have accepted a "deal" with the US. Tariffs on trade are a weak instrument at best when the objectives are political and/or strategic.

However, Trump's optimism that a declining US can use a weak weapon to assert its questionable hegemony is strong. In a recent statement, US Treasury Secretary Scott Bessent bundled all these and other objectives when providing an explanation for the tariffs and claiming success from their implementation. That optimism stretched to suggesting that once objectives are realised the tariff hikes may lose their purpose and even be withdrawn. "Over time, the tariffs should be a melting ice cube," he said. Optimism, however, is no guarantee of success.