INTENSIFYING TRADE PROTECTIONISM: IMPLICATIONS FOR INDIA

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EXECUTIVE SUMMARY

The well-established, rules-based world trading system under the WTO has been remarkably successful in enabling today's unprecedented international economic integration, with lower tariffs as one of its key pillars. However, in the recent past, a radical shift in the trade policies of major economies seems to threaten the entire rules-based trade regime formed over decades of deliberation.

One of the most important trade policy measures is the ongoing trade war between the USA and China. In a highly-integrated and globalized trade set up, such protectionist policy by two large trading economies have far-reaching consequences for economies across the world. Major countries involved in the recent upsurge in protectionist policies are also the major trading partners of India, and therefore, such policies also make Indian exporters vulnerable to the effects of the protectionist measures. In light of these developments, the study analyses the effect of growing protectionism on India, both positive and negative, and highlights the strategies to benefit from the changes or counter the challenges brought about by the trade-restrictive measures.

THE GLOBAL SCENARIO OF TRADE PROTECTIONISM

The year 2008-09 was a watershed year as the financial crisis triggered fears of a potential worldwide protectionist spiral. Since 2009, nearly 14,000 trade-distorting interventions have been implemented globally, adding up to an average of more than 1300 new trade-distorting interventions per year. There has been a notable rise in the number of new trade distorting interventions introduced over the past 2 years, registering an annual average growth rate of 17.6 percent between 2016-2018, reaching a peak of 1688 new trade-restrictive measures in the year 2018. This post-financial crisis uptick in protectionism and intensifying anti-trade and anti-globalization sentiments, coupled with a persistent slowdown in trade flows have led to a steady decline in trade openness over the recent years.

Globally, the USA has been at the forefront of trade protectionist measures over the past decade, and has imposed the highest number of trade-distorting interventions during 2009-2018, followed by Russia, India, Canada, and China, with import tariffs being the most predominantly used trade policy instruments since 2009. Sectors most commonly impacted by protectionist measures include iron and steel, machinery and mechanical appliances, electrical machinery and equipment, and organic chemicals, although, in 2018, barriers that affect agriculture and allied sector have also gained prominence.

The G20 economies, which account for nearly three-fourth of global trade, have been imposing consistently high number of trade restrictions. During the 12-months review period between mid-October 2017 to mid-October 2018, G20 economies had introduced an average of 11 new trade-restrictive measures every month, the estimated trade coverage of which amounted to nearly US$ 588 billion. During mid-October 2018 to mid-May 2019, although fewer measures were introduced by the G20 economies, at an average of approximately 5 measures per month, the scale of these measures has been much higher in value, with an aggregate trade coverage of nearly US$ 340 billion.

Trade distorting measures against India have

also been moderately rising, witnessing a rapid upsurge post 2012. However, since 2016, the number of new interventions against India has been declining. As has been the case globally, import tariffs are the most used trade distorting intervention against India. Anti-dumping duties have also been a major trade distorting intervention against India. The USA has imposed highest number of tariff related measures against India, followed by Argentina, Turkey, South Africa, Russia and Brazil. These protectionist measures against India primarily impacted sectors such as metals and their products, motor vehicles and their parts, organic chemicals, pharmaceuticals, machinery, among others.

THE US-CHINA TRADE WAR

The multilateral trading system has been challenged by a series of trade conflicts since the beginning of 2018, set in motion by the USA's decision to raise import tariffs against some of its trading partners, especially China. The series of tariff escalations between the USA and China led to distortions in the global supply chains and had ripple effects on the global economy, thereby dampening the revival in global growth and causing greater uncertainty about the future of global growth.

The overall effect of trade war on global trade is unambiguous. Global trade has substantially weakened in 2018 and in the early 2019, amidst decelerating investment growth and rising trade policy uncertainty. As per recent data, the trade policy uncertainty, as measured by World Trade Uncertainty Index, has been rising sharply, having been stable for nearly 20 years. In fact, World Trade Uncertainty Index has jumped nearly 8-folds in the first quarter of 2019, as compared to the first quarter of 2018. IMF estimates indicate that the increase in trade uncertainty observed in the first quarter of 2019 could be enough to reduce global growth by up to 0.75 percentage point in 2019.

Rising trade tensions have led to a downturn in trade volumes, with global merchandise trade volume registering negative growth rates during the first two months of the 2019. At the same time, new export orders, measured by Purchasing Managers' Index, also witnessed a similar trend, steadily declining from January 2018 onwards.

Trade in Asia, which comprises certain key, closely integrated, global manufacturing centres, was particularly affected since the start of 2018. Weakness in global trade has weighed down heavily on the production of capital goods, including electronic components such as semiconductors, which are deeply embedded in the global production networks, and are in fact the most targeted products in the trade war.

Export growth in the tariff-affected markets of the USA and China has itself witnessed acute deceleration owing to the tariff hike. However, in relative term, China's imports from the USA have declined more precipitously than the USA's imports from China, while China's imports from other countries have been rising at the same time. China is consciously aiming at switching to other import sources, as evident in the massive tariff reductions on its imports from the rest of the world.

On the whole, China's tariff impositions on the USA has mostly affected agricultural products (including soybean meal and pork), chemicals, medical equipment, and energy equipment, which are abundantly available in other markets at nearly uniform pricing levels. In contrast, the USA imposed tariffs mostly on machinery, transport equipment, and other industrial parts, which are goods that tend to be deeply immersed in global value chains. Thus, the displacement of the USA's goods in China would be relatively more favourable for third countries

due to the higher substitutability of these products. On the other hand, the displacement of Chinese goods in the USA would benefit only a few major exporters. But the tariffs by the USA would affect global trade more sharply as it would impact those countries with greater global value chains participation.

Overall, the country-wise implications for the rest of the world are bound to be very case specific, as the impact of tariffs on international patterns of trade will depend mainly on the extent of substitutability of tariff-affected products in the markets of China and the USA with those originating from other countries.

IMPLICATIONS FOR INDIA

India's exports, which are highly susceptible to changes in global slowdown, are also vulnerable to the rising trade protectionism. In order to tide over these disruptions, as also benefit from the trade diversion by notching up a higher share in the tariff-affected markets of the USA and China, India needs a robust export strategy. While tariffs imposed by the USA and China creates opportunities mainly in sectors such as machinery, mechanical appliances, and electrical equipment, India's competitive advantage and exportable surplus in these areas is fairly low. In fact, India runs a trade deficit in these product categories. Therefore, India is relatively disadvantaged as compared to its Asian peers in capitalizing on trade gaps in these key sectors in particular, and the capacities in these sectors need to be substantially beefed up.

An essential first step for India would be to identify sectors which can be targeted for increasing exports to the tariff-affected markets of the USA and China. As the gains from trade displacement needs to be identified and realized in the short to medium term, only those products must be considered where India already has a comparative advantage in exports.

An analysis of India's globally competitive export commodities indicates that, in the short to medium-term, India could easily tap nearly US$ 29.1 billion worth of the tariff-displaced market in the USA, and about US$ 2.9 billion worth of the tariff-displaced market in China. A total of 33 products have been identified for the USA market, and 12 products for the Chinese market. These are products where India's exports are competitive, and the country is already an important supplier to the US and China, with the potential for further expansion in its market share.

The products with maximum potential for exports to the USA comprise made-up textiles, apparels, home textiles (including handicrafts), jewellery, marine preparations, and engineering goods such as transmission shafts and gears for machinery, parts of internal combustion engines, and parts of electric motors and generators. In some of the home textile products, India and China together account for more than half of the total imports by the USA, and tariffs on China's imports can open up a large market for India. The recent round of tariff announcement also provides an increased opportunity for Indian gems and jewellery exporters, as it targets China's exports of rough and polished diamonds, rough and polished synthetic gemstones, as well as jewellery articles of precious or semi-precious stones coming into the USA.

In the Chinese market, the largest opportunities exist in the segments of cotton, organic chemicals, light oils and preparations of petroleum, polypropylene polymers, and engineering goods such as internal combustion piston engines and its parts, gears for machinery, and parts of air or vacuum pumps. Other than these identified products, there also exist opportunities for Indian exporters in the pharmaceutical sector of China, especially on account of the easing of import norms in the sector by the Chinese authorities during 2018-19.

The trade war is also set to create opportunities for value chain integration as it has led to a realignment of the global value chains due to changes in the supply chain dynamics. Rising economic uncertainty driven by trade policy is likely to make way for shift in manufacturing bases away from China, into relatively stable economies with sound policy environment. Strengthening India's manufacturing base, in this regard, along with improving ease of doing business will be a key imperative for attracting foreign investors and engendering global value chains.

On the flipside, there are also increasing challenges for India, as the USA has been increasingly undertaking trade actions against India over the recent years, including tariff barriers, anti-dumping duties, and other non-tariff barriers. In March 2018, India was among the countries that were hit by tariffs under Section 232 of the Trade Expansion Act of 1962. Citing national security concerns, the USA had imposed duties of 25 percent on steel products and 10 percent on aluminium products. This was followed by the removal of GSP benefits for India in June 2019. Additionally, on account of intellectual property rights related concerns, India is currently placed on the Priority Watch List for the USTR Special 301 report. This is foreboding, as inclusion in the Priority Watch List was also a precursor to the USA's imposition of the record-high tariffs on China. In response to a host of trade actions, India ultimately retaliated in June 2019 by raising tariffs on the USA's agro products such as fruits and nuts, including walnuts and almonds from California, and apples from Washington.

Though the impact of the tariff increase and India's GSP withdrawal may not be significantly large, any move against India under Section 301 could have potentially higher impact on India's export to the USA. Therefore, India also needs to prepare for future uncertainties and in the longer run, focus on accelerating its export competitiveness and diversification for enhancing its market presence.

WAY FORWARD

Rising vulnerabilities in the face of growing protectionism, makes it a core concern for policy makers. There is a need for strategies which can prepare the country for the vulnerabilities arising from the trade wars, as also for tapping the emerging opportunities on account of trade diversions.

Strengthening Mega Trade Agreements

Recent research provides evidence that trade agreements can be particularly valuable as an insurance mechanism during downturns, when protectionism tends to increase. There is also growing evidence on the positive effects of major trade agreements on exports through decline in uncertainty. Clearly, from the point of view of India, mega regional trade blocs such as the Regional Comprehensive Economic Partnership (RCEP) will play an important role in safeguarding its exporters in an increasingly protectionist set up, as also for reducing policy uncertainty. There have been several rounds of detailed negotiations to conclude the RCEP. However, thus far, only 7 out of the 18 final chapters of the RCEP agreement have been concluded.

The size of the market created by RCEP, the potential opportunities to participate in regional production networks, elimination of multiple trade agreements, and trade liberalisation with respect to services exports of India are some of the key advantages of RCEP from the Indian perspective. However, a primary concern for India with respect to RCEP is that duty free trade with China could lead to the flooding of cheap imports from China. Further, as India runs trade deficits with 11 out of the 15 other

RCEP negotiating economies, it is seeking stricter terms and conditions in its negotiations. Addressing these concerns and effective implementation of the RCEP will be crucial in the current era of heightened global trade tensions. There is a need for early resolution on RCEP, with a comprehensive coverage benefitting all parties under consideration.

Incentivising Exports of Identified Products to Tariff-Affected Markets

One of the ways to step up exports to the tariff-affected markets would be by incentivizing the exports in the sectors with higher potential. Products which are affected from trade protectionism and where India's exports have a comparative advantage, should be the focus areas. This includes sectors such as machinery, textiles, chemicals, automotive, metals, and petroleum products. Each of these sectors may face several different challenges emanating from infrastructure, logistics, high cost of debt, import duties, lack of tax benefits, etc. In order to promote exports from these sectors, it is important to alleviate the specific challenges in these sectors and encourage capacity building, while ensuring across-the-board engagement in areas such as quality infrastructure, efficient business environment and other fiscal or financial incentives. The government could also consider prioritizing these sectors under its existing export promotion schemes.

Export Capacity Creation

The headwinds from the ongoing trade conflicts have left India at a relatively disadvantageous position at a time when other countries are capitalising on the opportunities arising from mutating supply chain patterns, mainly due to India's lack of export capacity in the tariff-affected products. Focusing on export-oriented manufacturing in areas such as machinery, textiles, chemicals, automotive, metals etc., in line with global import demand, by bringing in greater foreign investments, improving industrial set-up and R&D incentives, would be a key imperative for India. Additionally, effective marketing strategies, brand building for specific products, and quality improvements to meet global market standards would also be essential for India to facilitate export growth. Further, a focussed approach by prioritisation of promising high technology industries, augmenting flow of credit, fiscal and financial incentives would also be essential to further bolster export growth.

Enhancing Global Value Chain (GVC) Participation

India is the 19th largest merchandise exporter in the world, yet has relatively lower GVCs linkages than several other developing economies. India's total GVC participation stood at 34 percent of its total gross exports, which is much below the GVC participation of 41.4 percent for developing countries as a whole. India's backward linkages in GVC have particularly been higher than its forward linkages, especially from 2008 onwards. India's forward participation in GVC, which stood at 14.9 percent of total gross exports, remains much below that of the developing economies, which stood at 20 percent. While rising backward linkages in GVC are certainly beneficial for domestic industries in terms of integration into GVCs, greater forward linkages are essential for increasing export competitiveness and strengthening of domestic ancillary industries.

India, thus, needs to focus on upgrading in GVCs. Initiatives such as 'Make in India', greater openness for FDI inflows and enhanced trade facilitation by improvement in the quality of trade related infrastructure including trade logistics, intellectual property protection, and standards, should remain the core motif of India's strategy for trade integration. Further, India has one of the more stringent tariff regimes among major world economies, with

many of India's bound tariff rates being among the highest in the world. To facilitate forward and backward linkages in GVC as also to bargain for trade liberalisation, lowering of India's own import tariffs will be important.

Collaborate for Reinvigorating the WTO Dispute Settlement Mechanism

Majority of the global trade in goods is currently conducted under the WTO's rules. Particularly, tariffs are levied within the WTO-agreed bounds. However, currently, the WTO dispute settlement mechanism is in a near-crisis situation. On the one hand, the WTO members have been unsuccessful to negotiate updates to the rulebook. On the other hand, the appellate body is soon likely to not have enough members to review dispute cases, which would thereby put the WTO dispute settlement system to a halt. The failure to resolve this crisis runs a great risk of pushing the world trading system away from the free and liberal system that exists today, leading the big players to act in unilateral interest. In such an environment, several developing economies may lose interest in negotiating new rules on trade.

To ensure the proper functioning of the dispute settlement system, WTO members need to collaborate to agree on new procedures calling on the appellate body to submit issues of legal uncertainty arising on appeal to respective WTO committees for further discussion and negotiation among WTO members. India has been at the forefront of such initiatives for collaborating with WTO member nations to strengthen multilateral trade ties and end the deadlock in the appellate body for dispute settlement. India has been hosting informal meetings and mini-ministerial meetings with WTO members to call for more open, transparent and inclusive processes. In order to prevent the ongoing impasse from paralyzing the dispute settlement system, it is essential that India collaborates with like-minded WTO member nations in such initiatives and urges to expedite the process of appointment of new members to the Appellate Body.

CONCLUSION

Reversing globalisation puts at risk the real economic gains that have come about through closer trade and investment linkages. Growing trade tensions could increase prices, raise unemployment and affect global growth. Retreating into protectionism also risks unravelling the financial interdependencies that enable and encourage trade and investment links. These real and financial risks could amplify each other, creating a perfect storm and exacting an even higher price. The Indian economy also faces risks in the face of these protectionist trends. However, there also exists opportunities to benefit from the trade diversion in the tariff-affected markets. Incentivizing exports from the identified products through policy interventions will, thus, be crucial, as other countries also vie for the market created in tariff-affected products. Besides, India must also focus on strengthening its relations with key trade partners through mega trade agreements, enhanced GVC participation, and also collaborate for reinvigorating the WTO dispute settlement mechanism.

CHAPTER

BACKGROUND

After five decades of negotiations that resulted in the creation of the World Trade Organization (WTO) in 1995, low tariffs in advanced economies became one of the pillars of the international trading system, facilitating trade, prompting subsequent liberalization in emerging markets, and underpinning the development of global supply chains. The established world trading system, based on the rules of the WTO, has been remarkably successful at promoting trade policy cooperation. Over the years, it has produced and secured extensive trade liberalisation, thereby facilitating today's unprecedented international economic integration.

During this process, it navigated even major challenges such as the recessionary period following the 2008 financial crisis, and therefore appeared well equipped to prevent countries from reverting to large-scale protectionist policies. While there was, and still is, room for further tariff reductions in certain sectors of advanced economies, average tariffs had reached such low levels that the negotiating agendas of advanced economies eventually evolved to address non-tariff barriers ranging from regulatory cooperation to digital trade. However, in the recent past, a radical shift in the trade policies of major economies seems to threaten the entire rules-based trade regime formed over decades of deliberation.

Across the world, in both advanced and emerging economies, majority of the public views trade in a positive light. Economists have time and again emphasised the benefits of enhancing trade openness, which allows countries to specialize according to their comparative advantage, enhances competition, and enables knowledge and technology to flow across borders, boosting the productivity and income of all countries. Lower trade barriers and efficiency gains from the globalization of production have also significantly contributed to declines in the relative price of capital goods, thereby driving strong real investment and narrowing income gaps for emerging market and developing economies. However, results of a recent global survey by the Pew Research Centre reflects the heightened and growing scepticism about the benefits of trade with respect to jobs, wages, or prices. According to the survey, the scepticism is particularly pronounced in advanced economies, wherein more than half of the respondents believe that trade does not positively impact jobs[1]. It is unsurprising therefore that trade protectionism is gaining fervour across the world, and governments are increasingly focusing on inward-looking, protectionist policies, leading to an unprecedented era of trade protectionism.

Trade protectionism, by definition, means the limiting of trade between countries by implementing tariffs on imported goods, restrictions, quotas and other regulations imposed by the governments. The typical methods of protectionism are in the form of tariffs on imports. Tariffs are the taxes imposed on imported goods - generally as a percentage of total cost of the imported goods, inclusive of

[1] Global Attitude Survey Spring 2018, Pew Research Centre https://www.pewresearch.org/global/2018/09/26/americans-like-many-in-other-advanced-economies-not-convinced-of-trades-benefits/

freight and insurance - which results in higher prices of the imported goods. Apart from tariffs, trade protectionism could also be in the form of non-tariff barriers, such as quotas, standards, sanitary and phytosanitary measures, minimum import price limits, embargoes, anti-dumping practices, and other charges on imports.

There have been a host of revisionist trade protectionist measures over the past two years, including the withdrawal of the USA from the Trans-Pacific Partnership, the imposition of special tariffs on steel and aluminium imports by the USA and the consequent retaliatory tariffs by some of its partner countries, the replacement of the North American Free Trade Agreement with the USA–Mexico–Canada Agreement (USMCA), the announcement to consider special tariffs on auto imports into the USA, under its section 232 investigation, and even the USA's threat to exit the WTO. But one of the most important trade policy measures, with far-reaching impact on the world at large, is the ongoing trade war between the USA and China.

RATIONALE BEHIND THE GROWING PROTECTIONIST APPROACH

While protectionist trade policies can take numerous forms, these are all intended to improve the position of the domestic producers vis-à-vis the foreign producers. Primarily, such policies are instated to safeguard the interests of local producers, businesses, and workforce of the import-competing sector from foreign players. The recent upsurge in protectionist pressures could be attributed to large and persistent trade deficits, particularly in the advanced economies. The large and rising bilateral trade deficits in the advanced economies has come under scrutiny due to serious concerns that trade imbalances lead to disruptions in the domestic economy and negatively impact some groups of workers and communities. Some policymakers are apprehensive that these imbalances are the result of asymmetric obstacles to trade (such as tariffs), and may have distortive effects on labour, productivity, output, and employment. In this context, it is contested that protectionist policies would reduce the asymmetries in trade by discouraging unfair trade practices, and would encourage fair ground for competition of the imported goods and services with the ones produced or generated domestically. This, in turn, is expected to decrease the trade deficit and enable job creation. While these protectionist policies ostensibly bode well for domestic producers, the anti-globalization wave on account of these policies threaten the revival in global GDP and exports growth.

KEY ECONOMIC CONSEQUENCES OF TARIFF PROTECTIONISM

A recent study by the IMF[2] shows that targeting a specific bilateral trade imbalance using tariffs initially leads to considerable trade diversion effects. Such attempts to neutralize bilateral trade deficits through tariffs or other trade distorting measures spills over to the country's trade relations with other partners. The measures lead to counterbalancing changes in the trade balances with other partners, eventually leading to little or no impact on the country's aggregate trade balance. Therefore, changes in bilateral trade balances are unlikely to translate into sustained changes in the overall trade balance of countries imposing tariffs and trade distorting measures.

Further, when tariff changes are more discriminatory and less generalized across countries, there is significant rearrangement of trade flows, and trade diversion emerges as a window of opportunity for third countries that could potentially benefit from these bilateral measures. While such third countries may benefit from trade diversion initially, a trade war resulting from such discriminatory and retaliatory tariffs would also trigger increased

[2] "The Drivers of Bilateral Trade and The Spillovers from Tariffs", IMF World Economic Outlook, April 2019

uncertainty, generate negative confidence, and lead to tightening of global financial conditions. These negative effects would affect most countries which are well integrated in global trade and investment networks, thereby leading to adverse effects on even those that benefit from trade diversion. In addition to being ineffective in addressing external imbalances, tariffs are also costly for economic activity, affecting not only countries that are directly involved, but also those that are indirectly linked through global value chains. The significant decrease in tariffs and other trade costs (such as transportation costs) since the mid-1990s has remained in tandem with the growing participation of countries in the global value chains, thereby facilitating unprecedented trade specialization and productivity improvements. However, recent increases in tariffs negatively affect productivity, employment and output, and the costs from tariff increases would snowball on account of the significant interconnectedness of global production and trade.

A significant increase in tariffs would have ripple effects through global value chains, amplifying the detrimental impact on output and trade. In fact, IMF research[3] indicates that the negative impact of a generalized 1 percentage point increase in tariffs on real value added by all countries would be larger today than it would have been in 1995, particularly for countries that are highly integrated in manufacturing supply chains. This is because closer integration into global value chains has increased the sensitivity of the upstream and downstream tariffs to nominal tariff changes, amplifying their overall effect. Especially in context of countries such as Germany and Korea and, to a slightly lesser extent, China and Japan, whose manufacturing sectors are both big and particularly integrated into global value chains, the effects of tariff hikes on GDP are likely to be larger.

NEED FOR THE STUDY

The pace of rising protectionist measures during the past two years has been the fastest since 2008 financial crisis. Clearly, trade ties that bind countries are now fraying, and countries are increasingly looking at newer avenues for encouraging trade growth. The most prominent and trade-altering tariff hikes have been put in place by two of the major trading economies- the USA and China. This severing of trade policy cooperation between these two largest economies has brought to fore newer concerns for the global economy.

Major countries involved in the recent upsurge in protectionist policies are also the major trading partners of India, and therefore, such policies make Indian exporters vulnerable to the effects of the protectionist measures. This creates a need to study the effects on India, both positive and negative, and the possible measures to benefit from the changes or counter the changes brought about by these measures. While non-tariff barriers are also witnessing a rise and creates challenges for exporters, the primary focus of this study shall remain restricted to tariff protectionism.

[3] "The Drivers of Bilateral Trade and The Spillovers from Tariffs", IMF World Economic Outlook, April 2019

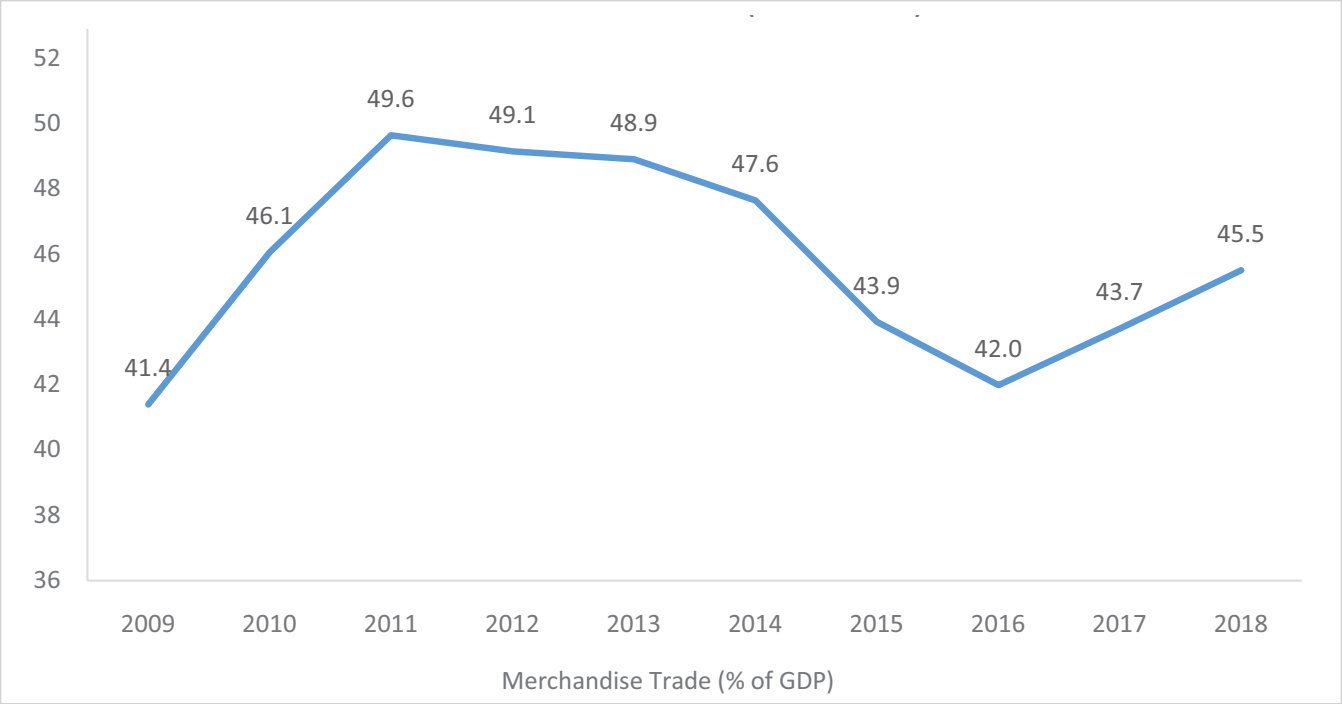
CHAPTER

2

THE GLOBAL SCENARIO OF TRADE PROTECTIONISM

Decades of continued liberalization of trade barriers and fast trade growth have resulted in positive spillovers for growth and development in countries across the globe. However, the post-financial crisis uptick in protectionism and intensifying anti-trade and anti-globalization sentiments, coupled with a persistent slowdown in trade flows have led to a steady decline in trade openness over the recent years (Exhibit 1). This has been one of the key reasons for the growing interests in discussions pertaining to the potential impact of increasing protectionism.

Exhibit 1: Trade Openness over the Decade

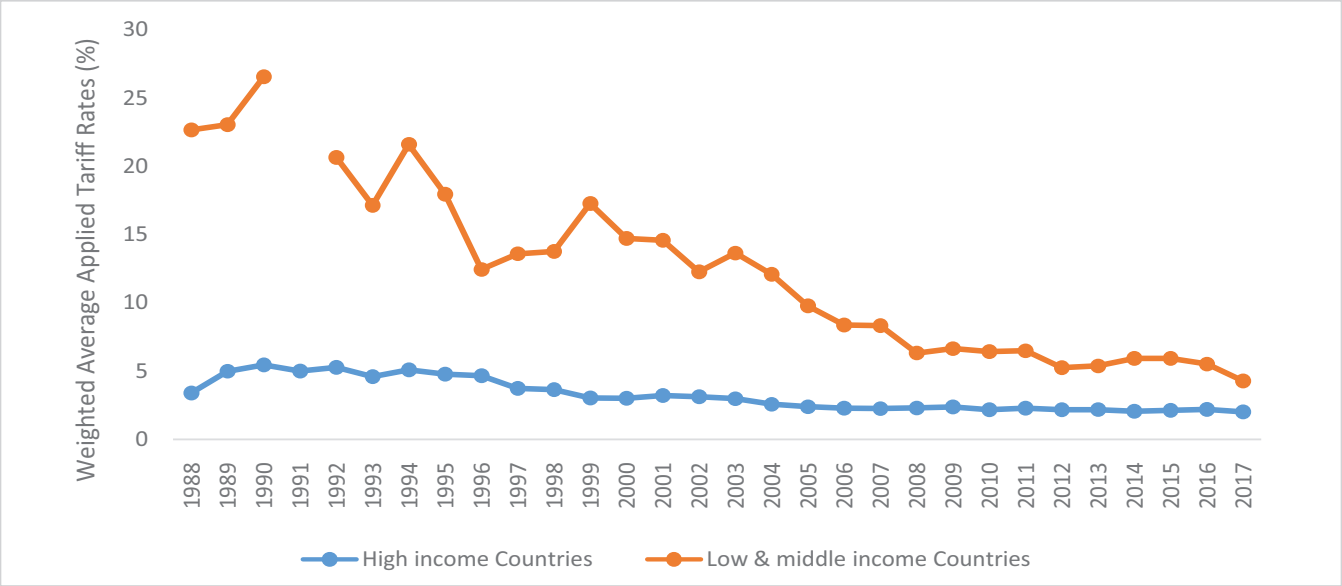


Source: ITC Trademap, WDI, Exim Bank Research

TRENDS IN GLOBAL TRADE PROTECTIONISM

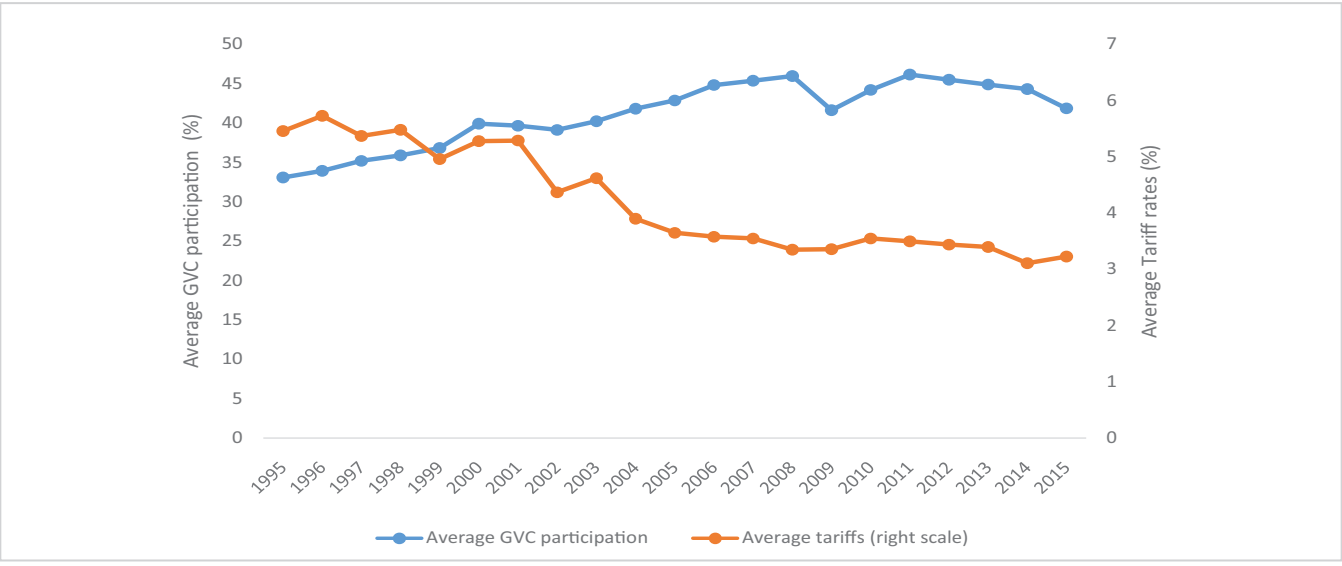
An ever-deepening rules-based system-notably under the GATT and WTO—brought more openness, transparency, and stability to international trade. As a result, tariffs fell sharply between the 1990s to early 2000s, led by the advanced economies, and followed by the emerging market and developing economies as well (Exhibit 2). While tariffs, regulatory differences, and other policy barriers continued to impede trade in goods, the countries made significant progress towards trade liberalization. The reduction in tariffs and transportation and communications costs since the mid-1990s has gone hand in hand with a significant upsurge in complex global value chain participation (Exhibit 3). This is because large and sustained reduction

Exhibit 2: Trends in Applied Tariff Rates (1988-2017)



Note: Gaps in the graph are the result of gaps in available data
Source: WDI, Exim Bank Research

Exhibit 3: Tariffs and Global Value Chain Participation (Value Added-Weighted Average Over Countries and Sectors; Percentage)



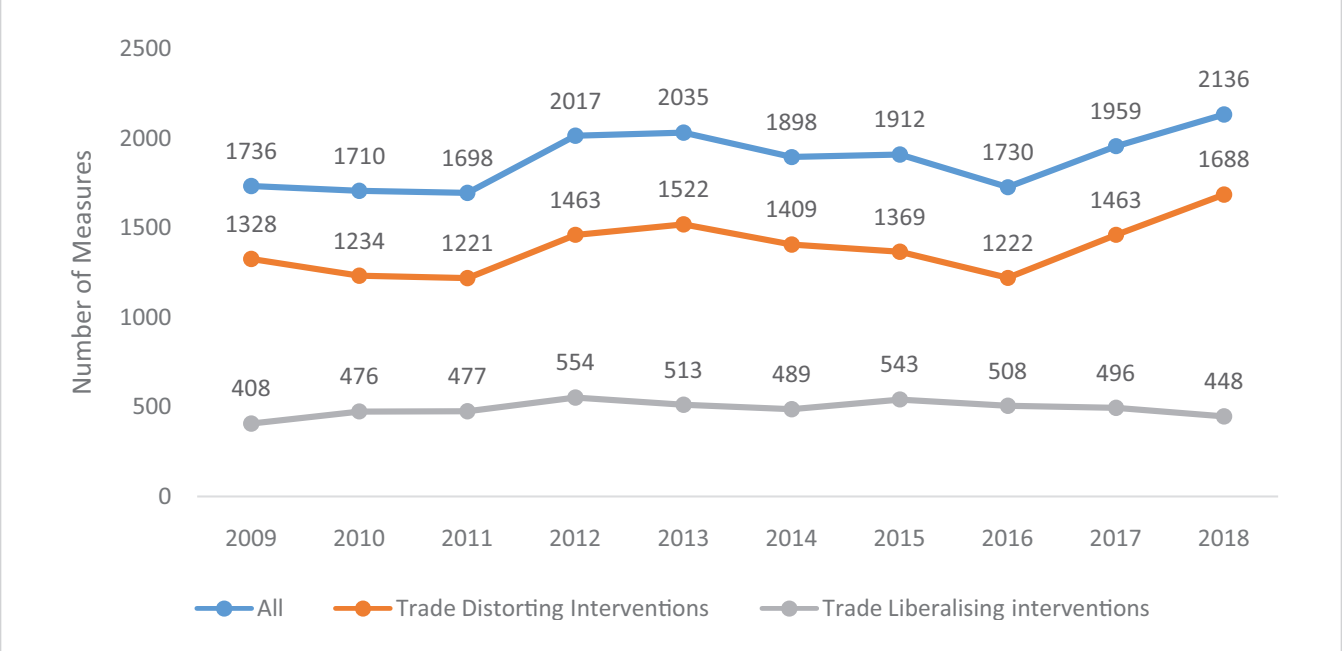
Source: IMF, Exim Bank Research

in tariffs facilitates the international division of labour and enhances specialization, which fosters domestic and international investment and production structures.

The year 2008-09 was a watershed year as the financial crisis triggered fears of a potential worldwide protectionist spiral. Unsurprisingly, this led to a steady and significant increase in the number of protectionist measures, which add up to an average of more than 1300 new trade-distorting interventions per year (Exhibit 4). The year 2018 has been a particularly eventful one with regard to trade interventions. While global trade continued to substantially outpace GDP growth during 2018, the year was mainly characterized by several trade confrontations. While some confrontations have de-escalated through bilateral arrangements, some continue to escalate. Based on a broader definition of protectionist measures, including both tariff and non-tariff measures, the latest data from Global Trade Alert database indicates that there has been a consistent rise in the number of new trade distorting interventions introduced over the past 2 years, registering an annual average growth rate of 17.6 percent between 2016-2018, reaching a peak of 1688 new trade-restrictive measures in the year 2018. Since 2009, nearly 14,000 trade-distorting interventions have been implemented (Exhibit 4).

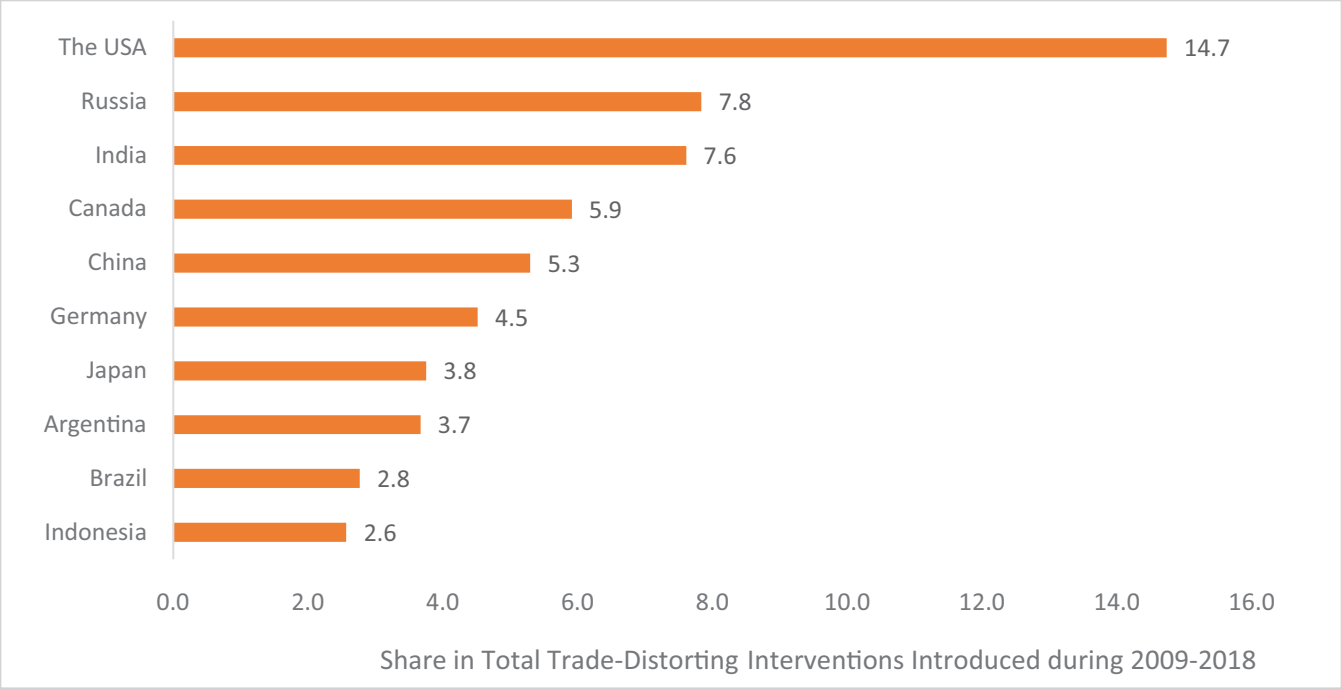
Globally, the USA has imposed the highest number of trade-distorting interventions in the past decade, with a share of 14.7 percent in the total measures introduced during 2009-2018 (Exhibit 5), followed by Russia (7.8 percent share), India (7.6 percent), Canada (5.9 percent), and China (5.3 percent).

Exhibit 4: Trends in Global Trade Interventions (Per Year)



Source: ITC Trademap, WDI, Exim Bank Research

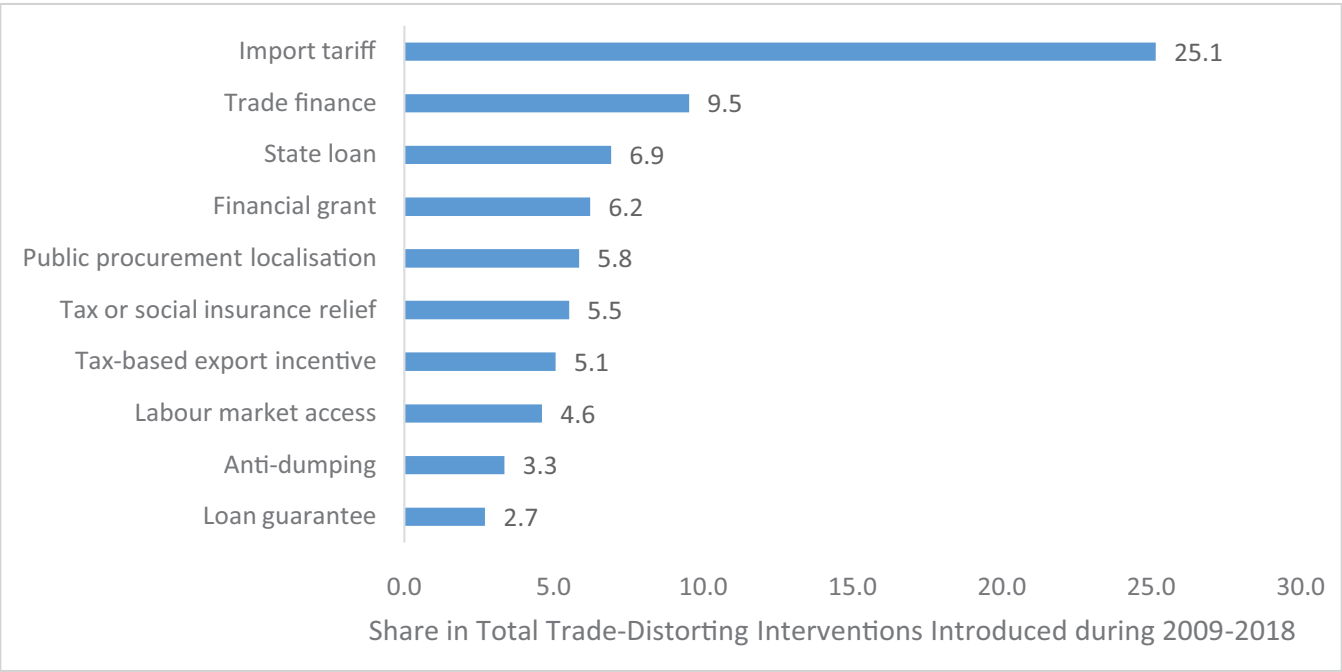
Exhibit 5: Top 10 Countries Imposing Trade-Distorting Interventions (2009-2018)



Source: Global Trade Alert Database, Exim Bank Research

The use of non-tariff barriers has been on the rise, although traditional trade barriers such as import tariffs continue to be the most predominantly used policy instruments. Nearly one-fourth of the total harmful interventions introduced since 2009 are in the form of import tariffs. While measures such as anti-dumping duties also translate into effective increases in applied tariffs, their share in total trade-distorting interventions remain low (Exhibit 6).

Exhibit 6: Top Trade-Distorting Interventions (2009-2018)

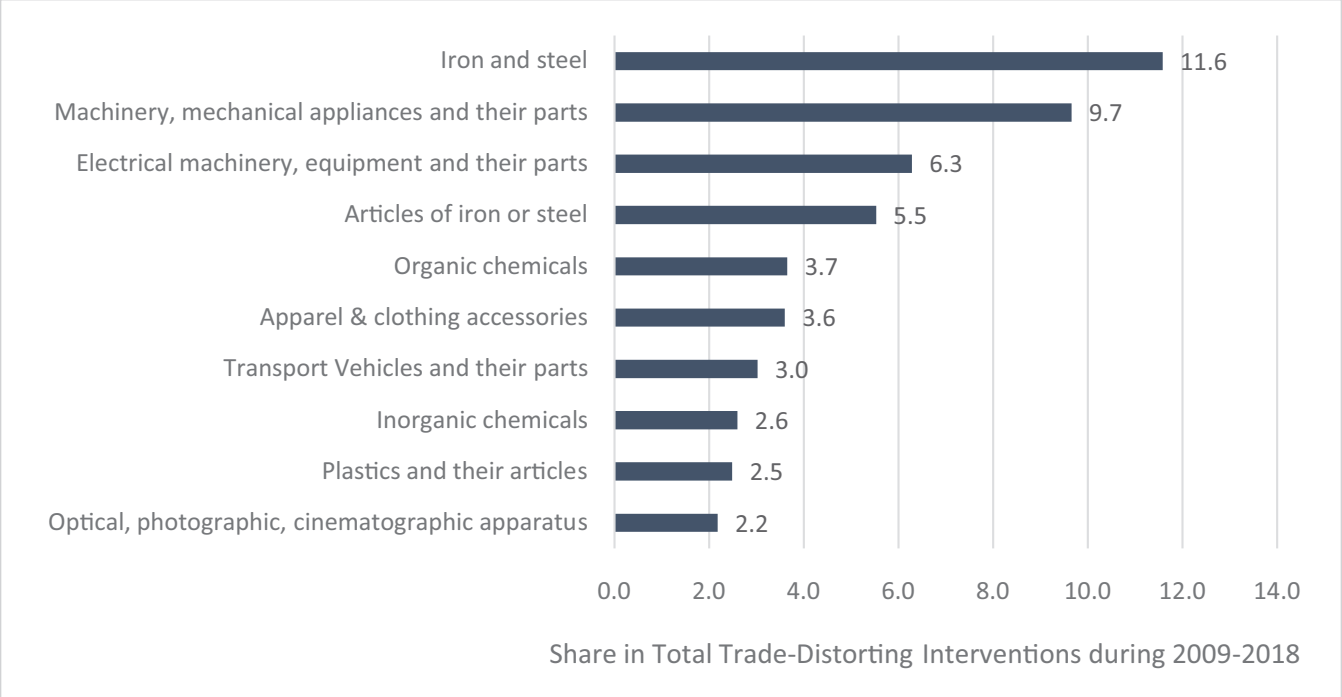


Source: Global Trade Alert Database, Exim Bank Research

Sectors most commonly impacted by protectionist measures include iron and steel, machinery and mechanical appliances, electrical machinery and equipment, and organic chemicals (Exhibit 7). In 2018, barriers that affect agriculture and allied sector have also gained prominence, and are likely to disproportionately affect exports of the poorest countries, which are highly dependent on agricultural production and exports.

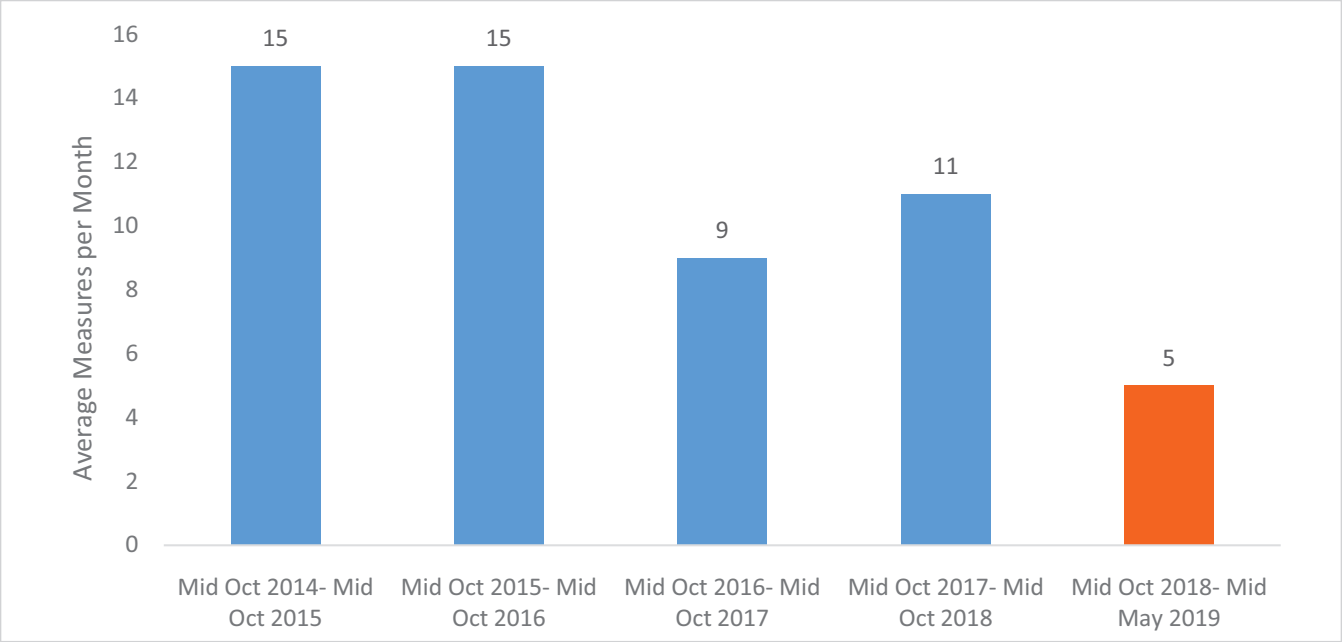
In context of the G20 economies, which together account for 76.98 percent of global trade, trade restrictions have been consistently high. During the review period, from mid-October 2017 to mid-October 2018, G20 economies applied an average of 11 new trade-restrictive measures per month, including tariff increases, import bans and export duties (Exhibit 8). The trade coverage of the import-restrictive measures imposed during this period amounted to an estimated US$ 588 billion, which is more than seven times higher than that recorded in the previous period, and is the largest since it was first calculated in 2012 (Exhibit 9). In the latest review period from mid-October 2018 to mid-May 2019, 38 new trade restrictive measures (an average of approximately 5 measures per month) were introduced by the G20 economies, including tariff increases, import bans and new customs procedures for exports (Exhibit 8). Although fewer measures were introduced during this period as compared to the previous periods, the scale of these measures has been higher in terms of the level of tariffs imposed, with an aggregate trade coverage of nearly US$ 340 billion, which is the second highest figure on record (Exhibit 9). Together, the two review periods—mid-October 2017 to mid-October 2018, and mid-October 2018 to mid-May 2019—represent a spike in the trade coverage of import-restrictive measures. In fact, the period after May 2019 also witnessed an increasing number of trade-restrictive measures by G20 member nations, including major economies such as the USA, China and India.

Exhibit 7: Top 10 Affected Sectors Due to Trade-Distorting Interventions (2009-2018)



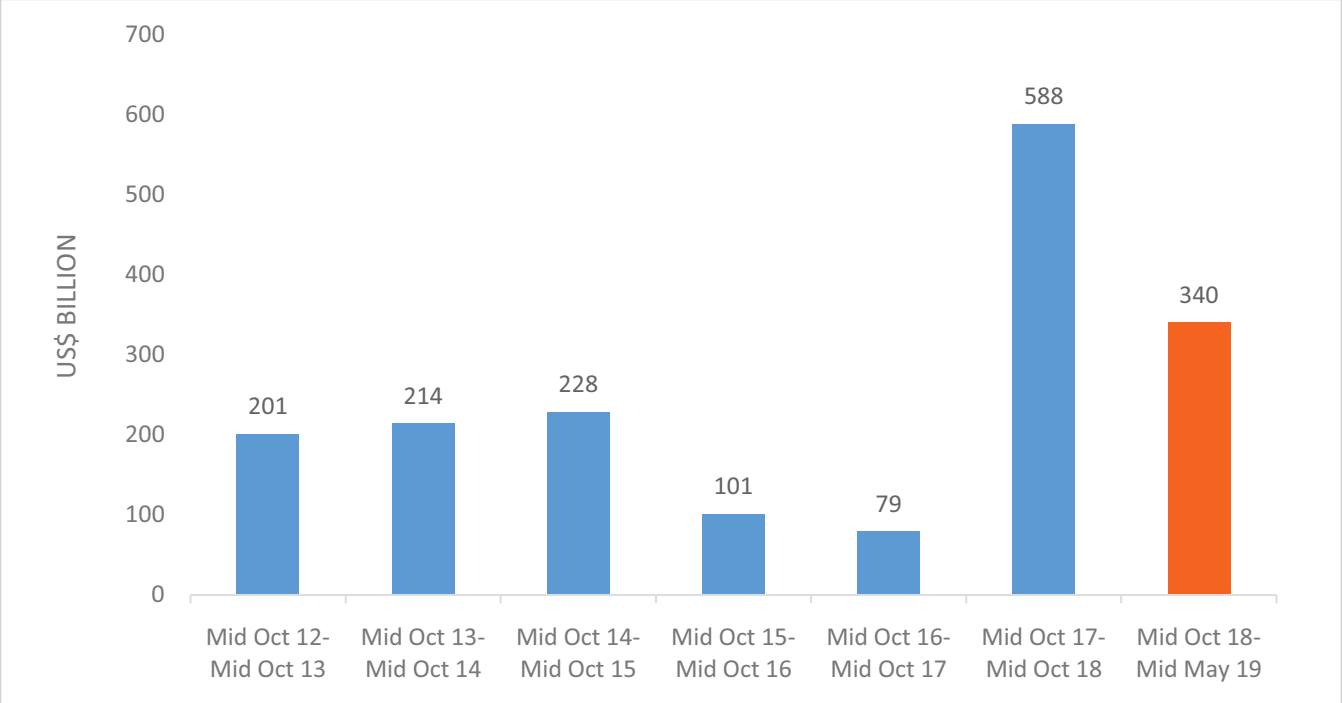
Source: Global Trade Alert Database, Exim Bank Research

Exhibit 8: Number of New Trade-restrictive Measures Introduced by G20 Economies



Source: WTO, Exim Bank Research

Exhibit 9: Trade Coverage of New Import-Restrictive Measures Introduced by G-20 Economies during Review Periods



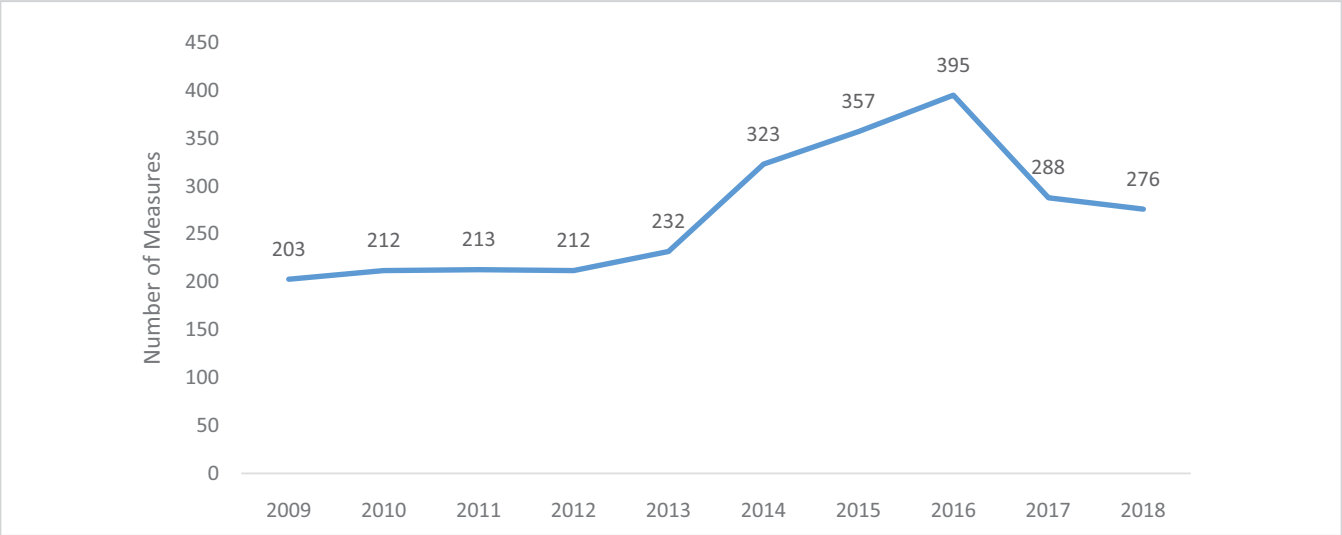
Source: WTO, Exim Bank Research

RISING PROTECTIONISM FACED BY INDIA

After the financial crisis, new trade distorting interventions against India have been moderately rising. Trade distorting interventions against India witnessed a rapid upsurge post 2012, with the number of measures currently in force being the highest at 395 in 2016. However, in the last two years, the number of new interventions has been declining (Exhibit 10).

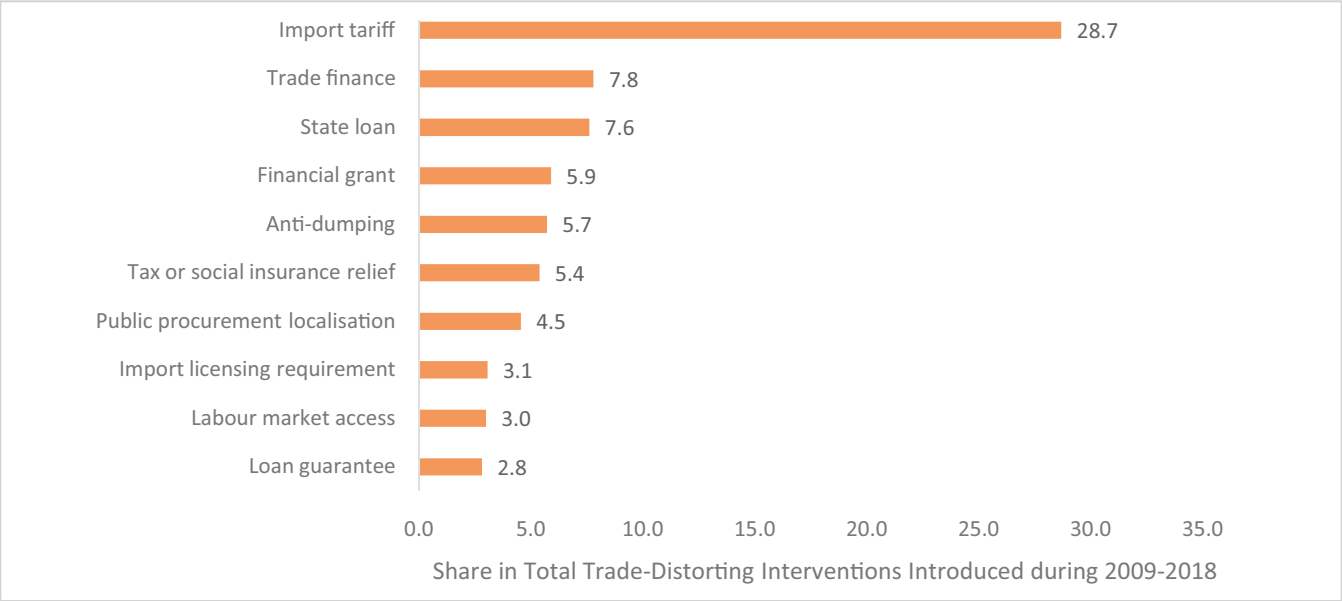
As has been the case globally, import tariffs are the most used trade distorting intervention against India, with a share of nearly 28.7 percent in the total measures faced by India during 2009-2018. Anti-dumping duties faced by India have also been a major trade distorting intervention against India. Anti-dumping measures accounted for a share of nearly 5.7 percent in the total trade distorting measures faced by India (Exhibit 11), which is higher than the share of such measures at the global level (3.3 percent).

Exhibit 10: Trends in Trade-Distorting Interventions Faced by India (Currently in Force)



Source: Global Trade Alert Database, Exim Bank Research

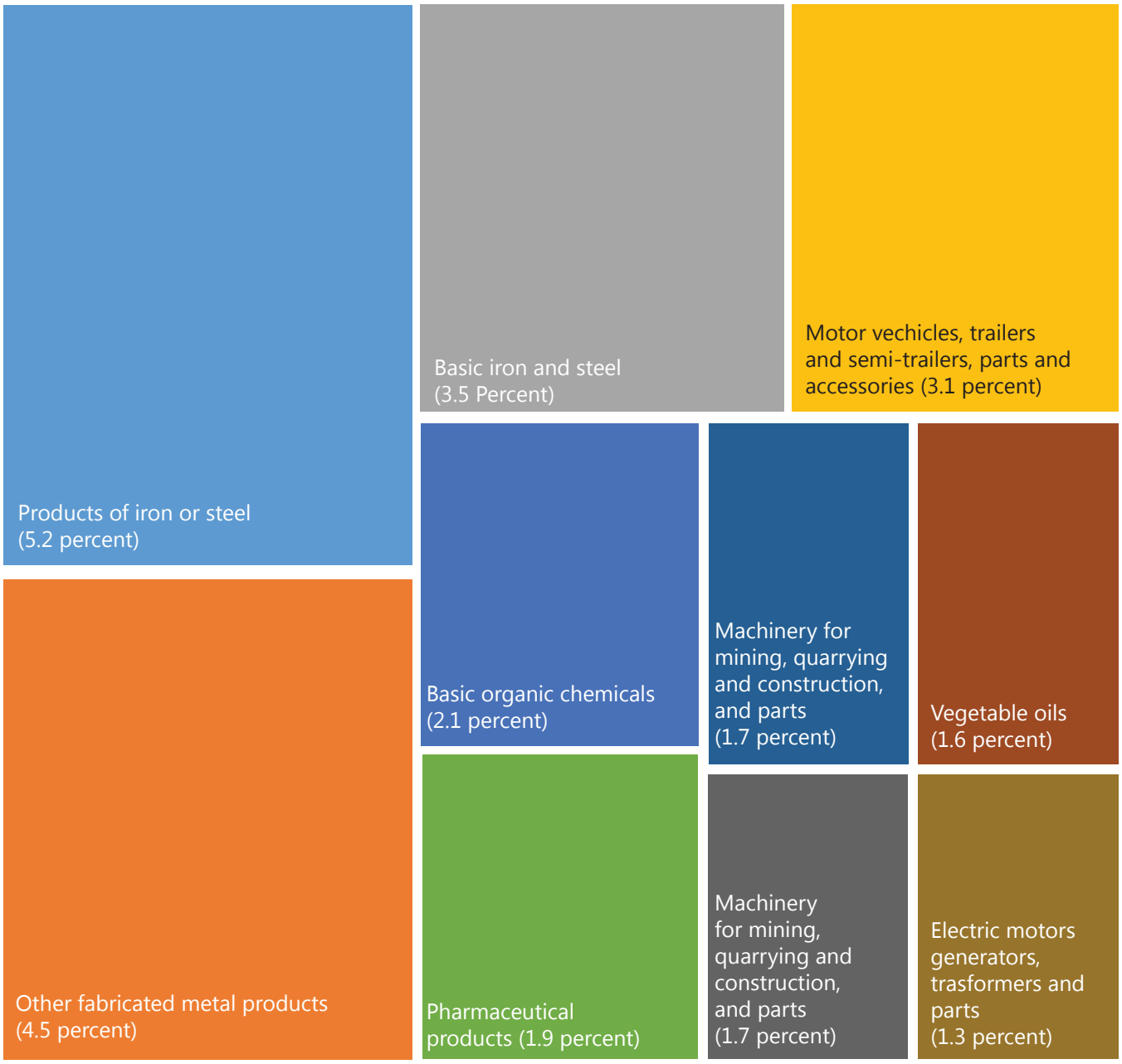
Exhibit 11: Top Trade-Distorting Interventions Faced by India (2009 - 2018)



Source: Global Trade Alert Database, Exim Bank Research

These protectionist measures against India primarily impacted sectors such as metals, including iron and steel and their products, other fabricated metal products; motor vehicles, trailer and their parts and accessories; organic chemicals; pharmaceuticals; machinery used for mining and quarrying; vegetable oils; pumps; and electric motors and generators (Exhibit 12).

Exhibit 12: Top 10 Sectors in India Affected by Trade-Distorting Interventions



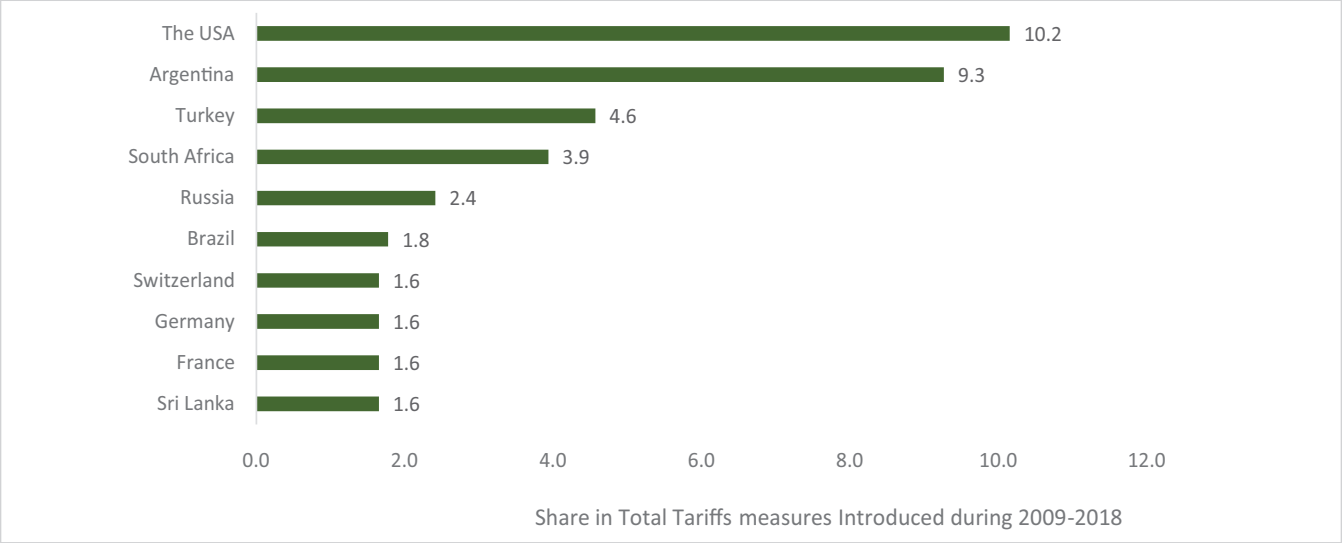
Note: - Values in parenthesis indicate the share in total number of trade-distorting interventions introduced during 2009-2018

Source: Global Trade Alert Database, Exim Bank Research

The USA has imposed highest number of tariff related measures against India, with a share of 10.2 percent in the total tariff measures against India during 2009-2018. Other important countries imposing tariff measures against India include Argentina (share of 9.3 percent), Turkey (4.6 percent), South Africa (3.9 percent), Russia (2.4 percent) and Brazil (1.8 percent) (Exhibit 13). The USA has also imposed the highest number of anti-dumping measures against India during the same period, accounting for nearly 20.4 percent of the total anti-dumping measures faced by India during 2009-2018. Other countries imposing anti-dumping measures against India include Turkey, China, Canada, Brazil, Italy and Argentina (Exhibit 14).

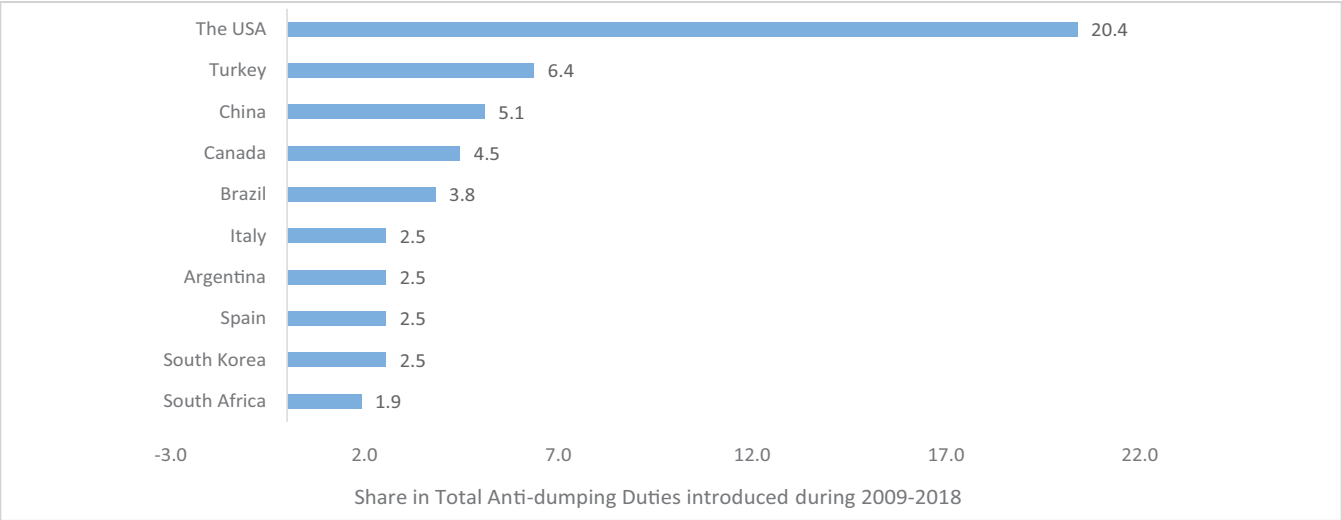
The USA's policy actions against India are not unique, as its recent policy announcements have had a broad-based target on some of its major partner countries. There is an increasing scepticism that the USA's recent tariff escalations could deepen the problems in trade relationships with its key partners, especially with China, particularly in context of the ongoing trade war.

Exhibit 13: Top Countries Imposing Import Tariffs on India (2009-2018)



Source: Global Trade Alert Database, Exim Bank Research

Exhibit 14: Top Countries Imposing Anti-Dumping Duties on India (2009-2018)



Source: Global Trade Alert Database, Exim Bank Research

CHAPTER

THE US-CHINA TRADE WAR

BACKGROUND

Since the onset of 2018, the multilateral trading system has been challenged by a series of trade conflicts set in motion by the USA's decision to raise import tariffs against some of its trading partners, especially China. The trade war between the USA and China has been distorting the global supply chains and has had ripple effects on the global economy, dampening the revival in global growth and causing greater uncertainty about the future of global growth. The early salvos of the trade conflict initiated in January 2018, when the USA imposed 20 percent tariffs on imports of large residential washing machines and 30 percent on solar panels from all countries. The tariffs were a result of the findings of the USA International Trade Commission that imports of solar panels and washing machines have caused injury to the USA domestic solar panel and washing machine industries, and subsequently recommended the imposition of "global safeguard" restrictions, under Section 201 of the Trade Act of 1974. These were the first industry petitions under the law since 2001. This was followed by the imposition of 25 percent tariffs on imports of steel and 10 percent tariffs on imports of aluminium by the USA against all countries in March 2018, citing national security threats under Section 232 of the US Trade Expansion Act of 1962, whose investigations were initiated in April 2017.

Together, these two rounds of tariffs affected nearly US$ 58.3 billion worth of goods traded with the USA. The economies that were hit by the steel and aluminium tariffs, such as Canada, the EU, Mexico, Russia, Turkey, and in developing Asia— India and China, retaliated with their own tariffs, which in turn affected nearly US$ 35.8 billion of the USA's exports to these countries[4]. The conflict escalated and became more bilateral in nature in the second and third quarters of 2018, when the USA imposed, in two tranches, 25 percent tariffs on a wide range of imports from China worth a total of US$ 50 billion: US$ 34 billion worth of Chinese goods in July 2018 and another US$ 16 billion worth of Chinese goods in August 2018. Most of the products affected in these two rounds of bilateral tariffs were capital and intermediate goods that were promoted under China's "Made in China 2025" plan, which is a strategic plan aimed at steering the country away from being the world's factory to one producing greater value added products and services for the global market. The major sectors impacted by higher tariffs included metals, chemicals, electrical equipment, machinery, non-metallic minerals, rubber, plastics, textile, leather, and transport equipment.

In response to the tariff escalations by the USA, China immediately retaliated with tariffs on an equal amount of imports from the USA, in two tranches, of US$ 34 billion and US$

[4] "The Impact of Trade Conflict On Developing Asia", ADB, December 2018

16 billion worth of US goods. This covered mostly agricultural goods, chemicals, medical equipment, energy equipment, food and beverages, leather, paper, wood, transport equipment and textiles, among others.

Further, in September 2018, the USA announced an additional tariff of 10 percent on US$ 200 billion worth of Chinese imports, and also announced that starting January 1, 2019, the level of the additional tariffs would be increased to 25 percent. China retaliated with tariffs ranging from 5 percent–10 percent on US$ 60 billion worth of imports from the USA, effective on the same day. In spite of bilateral trade negotiations, the two sides failed to reach a favourable consensus, and consequently, another round of tariff escalations followed. During May 2019, the USA announced increase in tariff on US$ 200 billion of imports from China from 10 percent to 25 percent. The USA also proposed a new set of increase in tariffs on a list of US$ 300 billion of US imports from China, targeting most of the remainder of China's exports to the US, covering consumer goods such as toys, footwear, clothing, and electronics. In retaliation, China announced a revised list of US$ 60 billion worth of US goods, including additional tariff of 25 percent against 2,493 goods including liquefied natural gas, soy oil, peanut oil, petrochemicals, frozen vegetables and cosmetics, and of 20 percent on 1,078 products, further escalating the trade war.

The relatively smaller values of goods covered by China's tariff retaliations in the latest round of May 2019 is because China's imports from the USA were only about US$ 154.4 billion in goods in 2017, with almost 90 percent already subject to tariffs as of September 2018. On the other hand, the USA imported nearly US$ 525.8 billion worth of goods from China during 2017, thereby reflecting a higher tariff coverage. Realizing the need for restoring normalcy, the two countries engaged in a series of trade negotiations. At the G-20 summit in June 2019, the leaders of the two countries agreed on China purchasing large quantities of agricultural produce from The USA, as a move to subside the trade tensions. However, in August 2019, citing that China has not been following through with those purchases, the USA announced additional 10 percent tariffs on the remaining US$ 300 billion worth of goods, as proposed in May 2019, to come into effect from September 1, 2019.

The average US tariff on Chinese goods has significantly increased in the recent period, rising from 3.1 percent in 2017 to 12.4 percent in end-2018. The latest round of tariffs is likely to raise up the average US tariff on China to 21.4 percent by end-2019, from 18.3 percent in May 2019[5]. Following this, China has halted its imports of agricultural products from the USA and has allowed its currency, the Yuan, to devalue, making its exports cheaper.

[5] "Trump's Latest Trade War Escalation Will Push Average Tariffs on China Above 20 Percent", Peterson Institute of International Economics, August 2019

Exhibit 15: Timeline of the USA's Trade Actions Affecting China

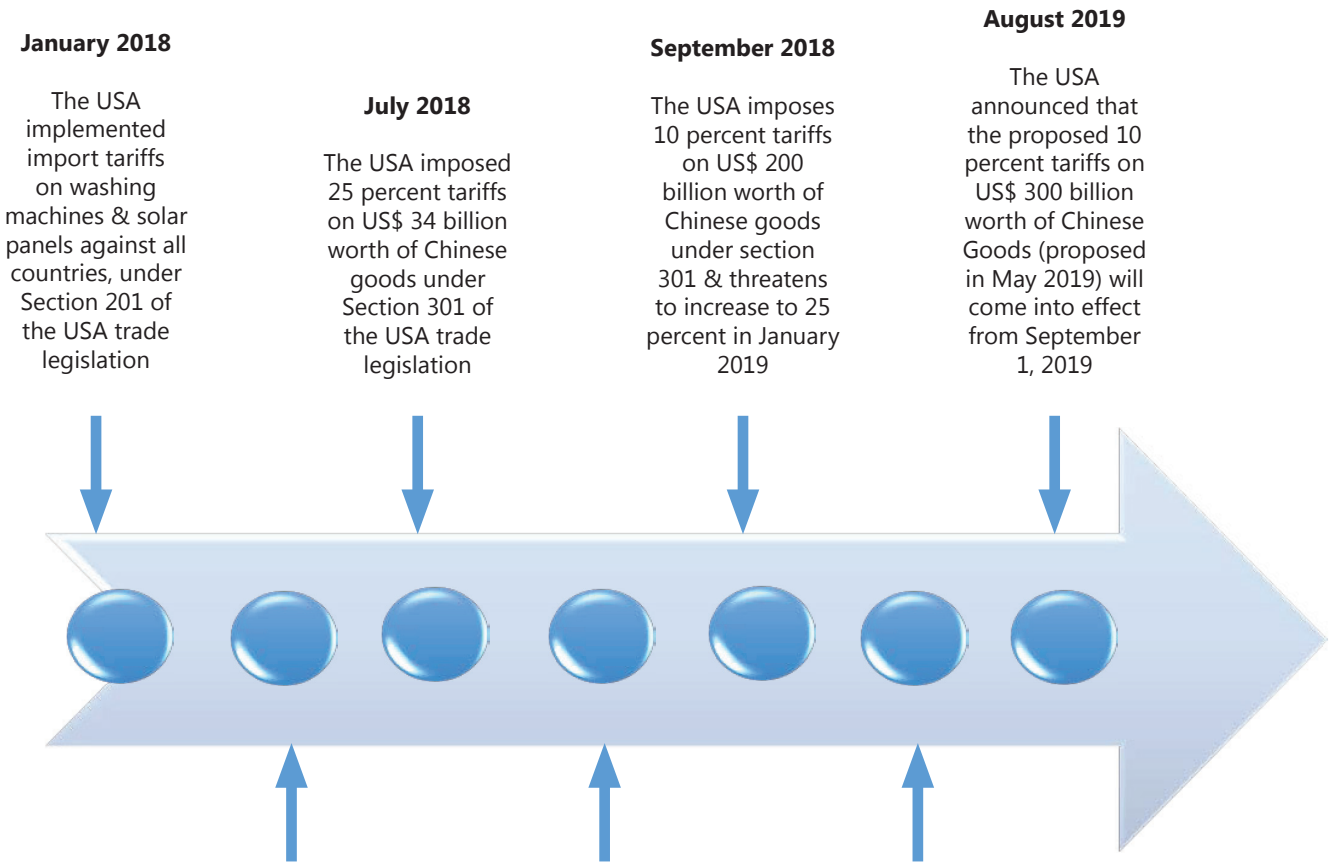
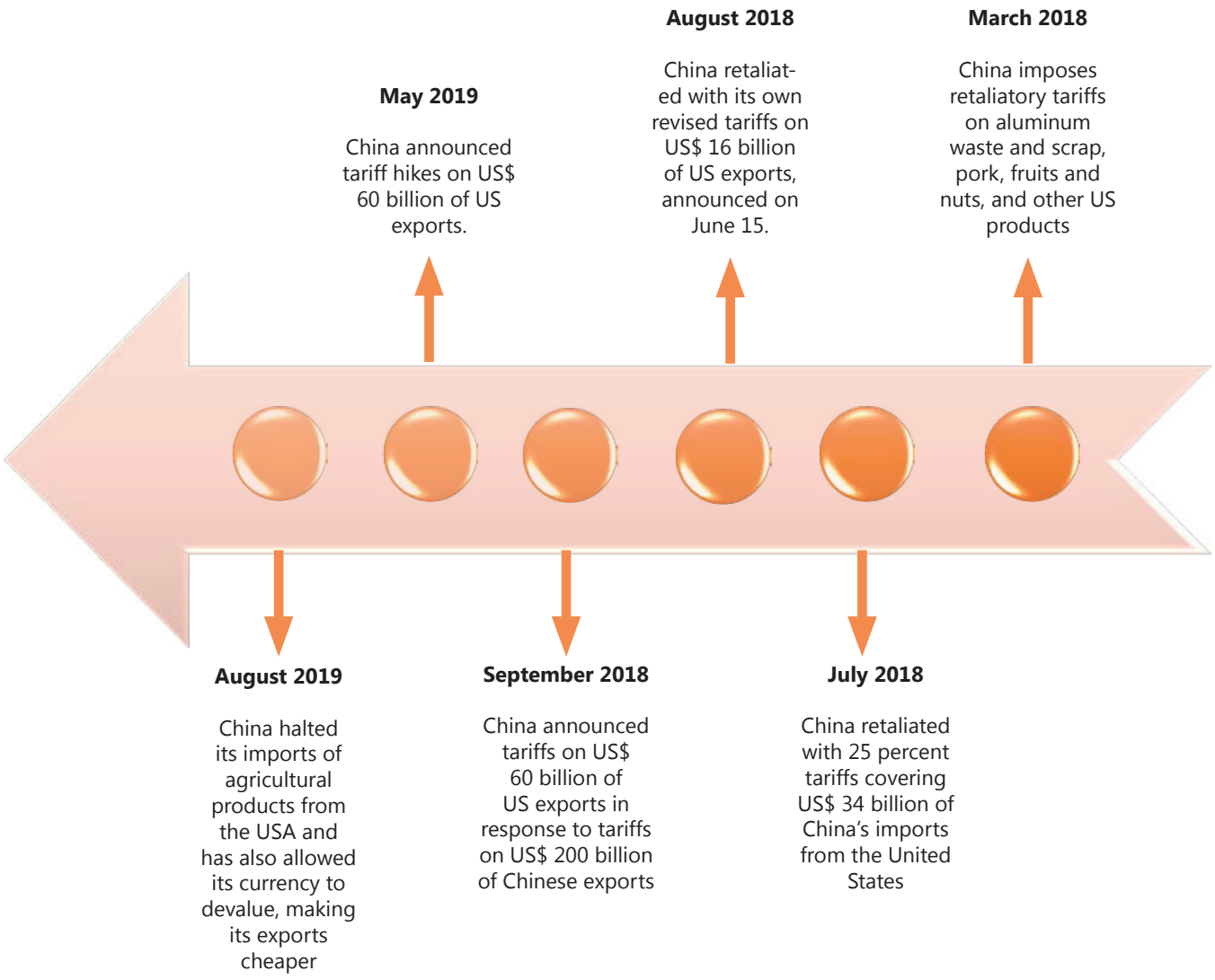


Exhibit 16: Timeline of China's Retaliations to the USA's Actions

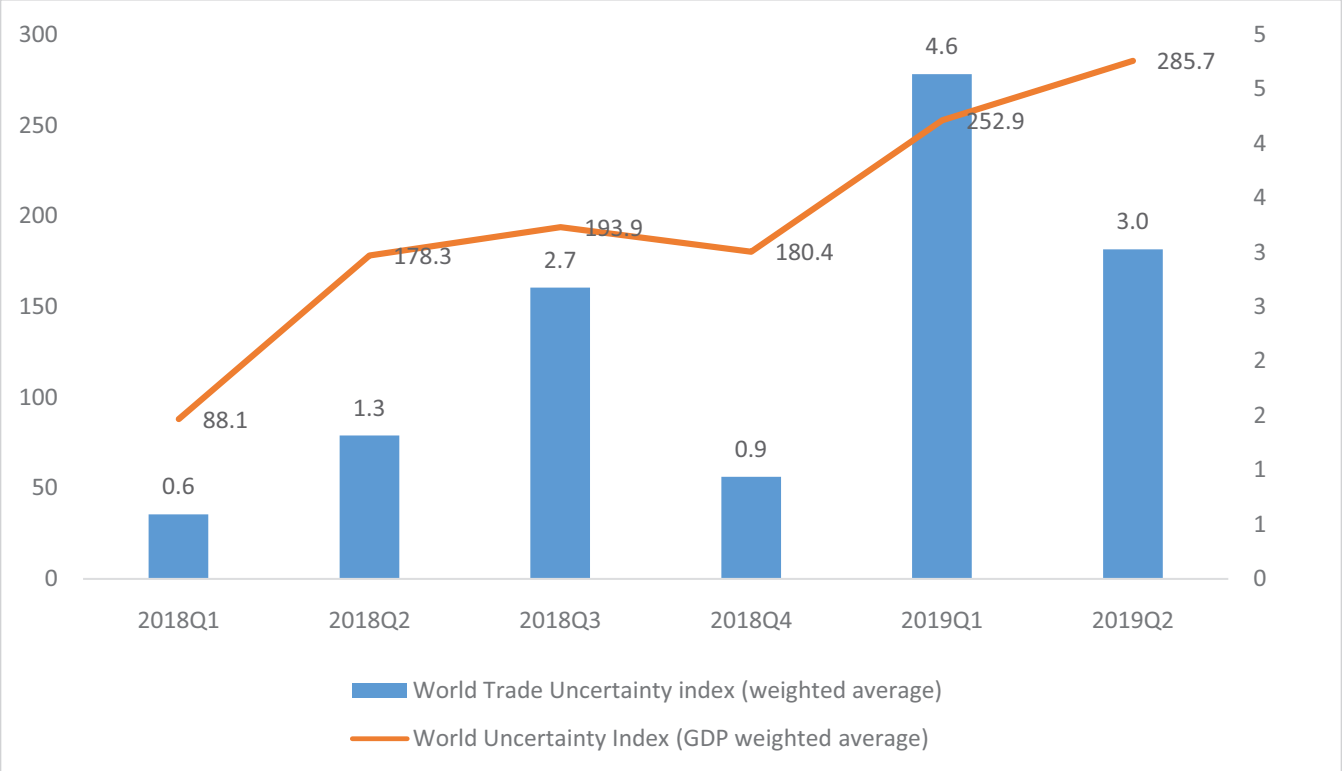


IMPACT ON GLOBAL TRADE AND PRODUCTION

While the impact of the escalations in tariffs will invariably be felt on both the USA and China, the contagion effect is expected to affect various facets of global trade. Trade conflicts among major economies unavoidably cause spillovers and ripple effects on other economies, and are therefore, worrisome, especially given the size of the two economies and their positioning as two of the important centres for global production chains, with high linkages in key high-technology sectors.

The effect on global trade is unambiguous. After substantially recovering in 2017 following two consecutive years of subdued growth, global trade has substantially weakened in 2018 and in the early 2019, amidst decelerating investment growth and raising trade policy uncertainty. Recent data shows that global uncertainty, as measured by World Uncertainty Index, has been increasing since the onset of the trade war between the USA and China, with a sharp hike particularly in the third quarter of 2018, coinciding with the series of retaliatory tariff increases by the USA and China. The level of uncertainty then declined in the fourth quarter of 2018 as the USA and China announced a deal to halt the escalation of tariffs at the G-20 meeting in December in Buenos Aires. It significantly spiked again in the first quarter of 2019, following a substantial expansion of American tariffs on imports from China (Exhibit 17).

Exhibit 17: Trends in World Uncertainty and World Trade Uncertainty Indices Since Trade War

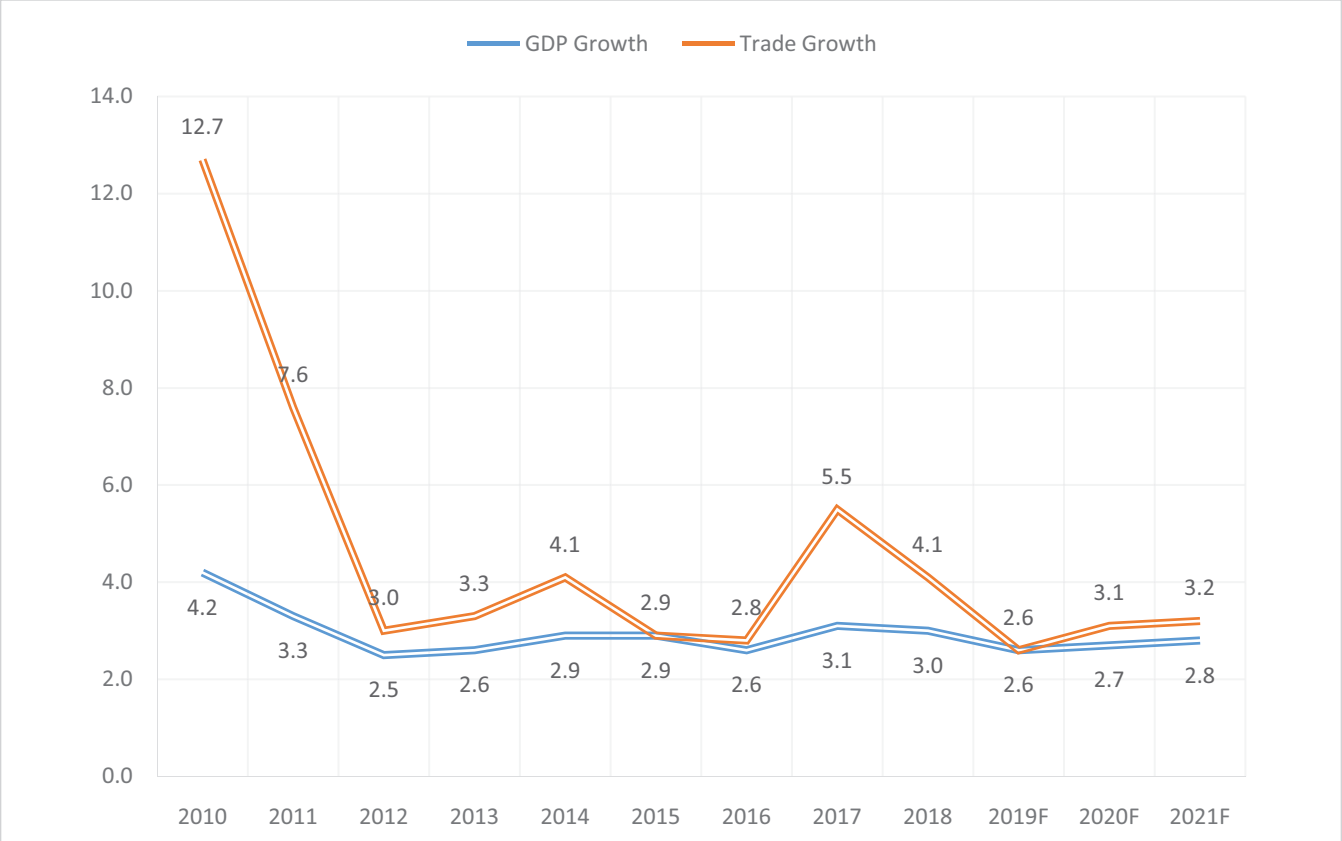


Source: World Uncertainty Index, Economic Policy Uncertainty

Consequently, the trade policy uncertainty, as measured by World Trade Uncertainty Index, has also been rising sharply, after 20 years of stability. In fact, World Trade Uncertainty Index has jumped nearly 8-folds in the first quarter of 2019, as compared to the first quarter of 2018. Recent research by the IMF[6] also finds that increases in uncertainty foreshadow significant output declines. Based on IMF estimates, the increase in trade uncertainty observed in the first quarter of 2019 could be enough to reduce global growth by up to 0.75 percentage point in 2019.

Growing uncertainity has impinged on trade growth which has declined from 5.5 percent in 2017 to 4.4 percent in 2018, and is forecast to fall further to 2.6 percent in 2019. Meanwhile, GDP growth, which recovered in 2017, has also witnessed a broad-based deceleration in 2018 and moderated to 3.0 percent, and is forecast to moderate further to 2.6 percent in 2019 (Exhibit 18). While trade growth continued to outpace GDP growth, the tariff escalation and policy uncertainty have significantly dampened the outlook for global growth over the medium term.

Exhibit 18: Global Trade Growth vis-à-vis GDP Growth



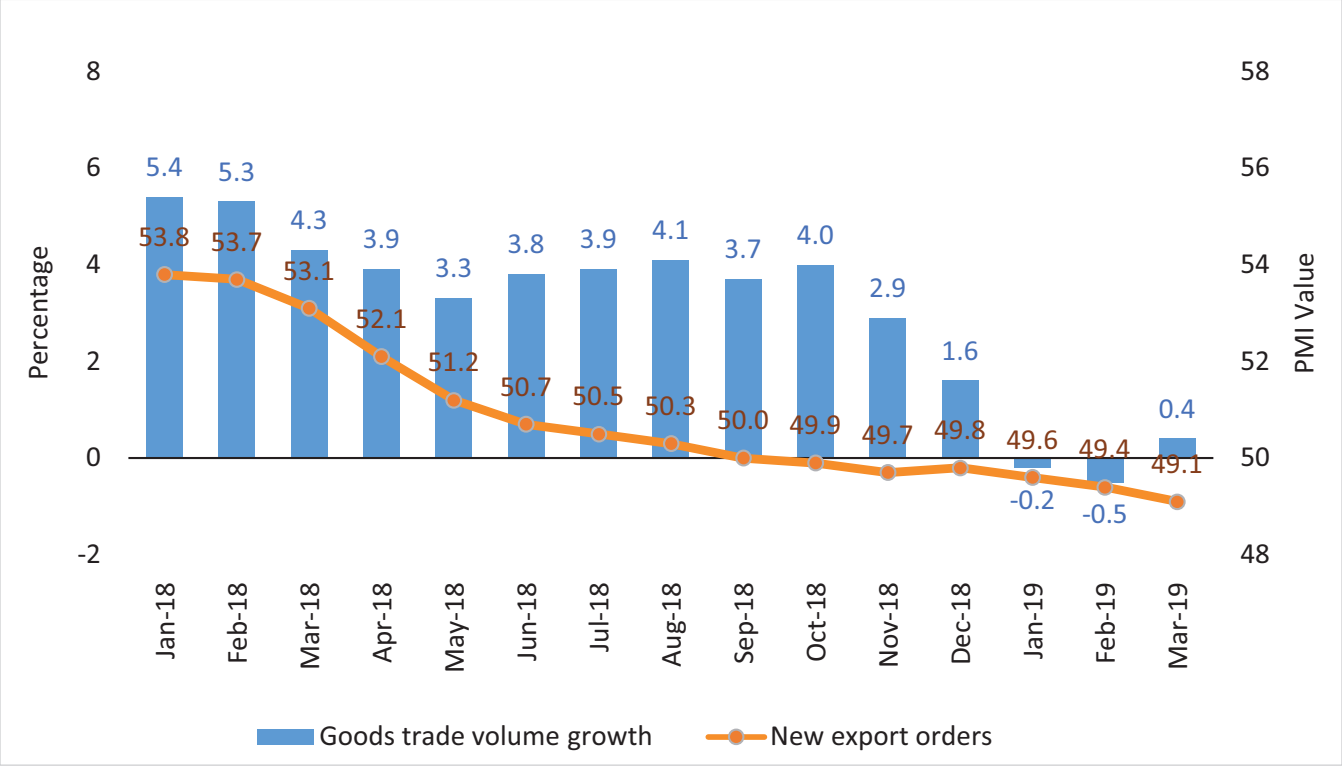
Source: World Bank GEP data June 2019

[6] "New Index Tracks Trade Uncertainty Across the Globe", IMF, September 2019

Monthly data for merchandise trade volume indicates that merchandise trade growth has consistently decelerated since the beginning of the tariff measures by the USA in January 2018, with only intermittent periods of growth spurts. Analysis indicates that there has been steep fall in global merchandise trade volume growth from 5.4 percent in January 2018 to 1.6 percent in December 2018. Rising trade tensions in the first quarter of 2019 have further led to a downturn in trade volumes, with global merchandise trade volume registering negative growth rates during the first two months of the year (Exhibit 19). At the same time, new export orders, measured by Purchasing Managers' Index (PMI), also witnessed a similar trend, steadily declining from January 2018 onwards. The current levels of new export orders have fallen down to the levels comparable to those prevailing at the start of 2016, when concerns about the global economy were elevated, indicative of a broad-based deceleration in industrial activities since the trade war.

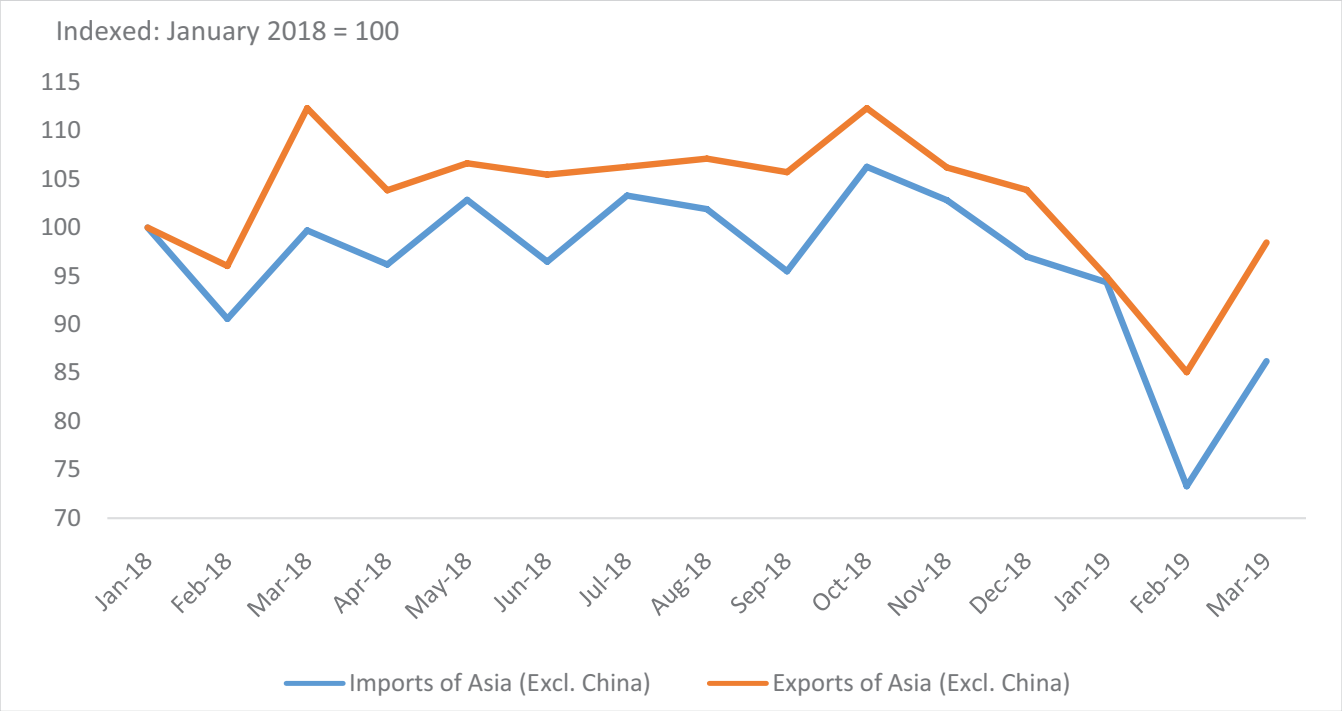
Trade in Asia, which comprises certain key, closely integrated, global manufacturing centres, was particularly affected since the start of 2018. Both exports and imports of Asia (excluding China) have witnessed a significant fall, particularly since November 2018, although in the recent months, there are some signs of stabilization (Exhibit 20).

Exhibit 19: Global Merchandise Trade Volume Growth and New Export Orders



Note: New export orders are measured by the Purchasing Managers' Index (PMI). PMI readings above 50 indicate expansion in economic activity, while readings below 50 indicatecontraction.
Source: World Bank GEP data June 2019

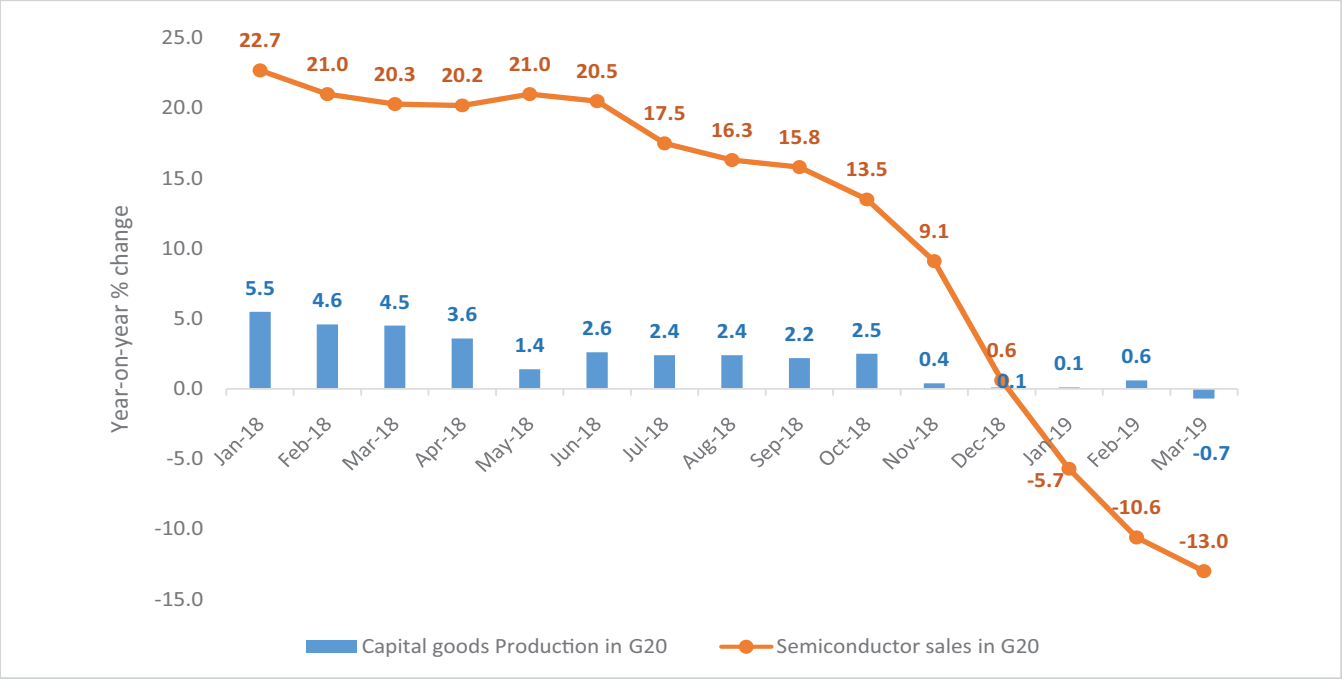
Exhibit 20: Movements in Asia's Trade Flows Since the Trade War



Source: ITC Trademap, Exim Bank Research

Weakness in global trade weighed down heavily on the production of capital goods, including electronic components such as semiconductors. These are products which are deeply embedded in the global production networks, and are in fact the most targeted products in the trade conflict between the USA and China. Recent data for capital goods production in the G20 countries suggests that since January 2018, the production has witnessed a significant downfall, registering a negative growth of 0.7 percent in the month of March 2019, as against a 4.5 percent y-o-y growth in March 2018. At the same time, semiconductor sales witnessed an even steeper fall during the same period, registering a negative growth rate of 13 percent in March 2019, as compared to a 20.3 percent y-o-y growth in March 2018 (Exhibit 21).

Exhibit 21: Trends in Capital Goods Production and Semiconductor Sales in the G20 Countries



Source: World Bank GEP data June 2019

TRENDS IN TRADE AND ECONOMIC OUTPUT IN THE USA AND CHINA

Trends in Economic Activity

While GDP growth in the USA remains solid, export growth has slowed consistently post September 2018, driven particularly by a deceleration in exports of goods to the European Union and the East Asia and Pacific region. The rising costs of a variety of goods due to the recent tariff increases have also had some modest effects on real incomes in the USA.

Going forward, recent tariff increases and associated retaliatory actions are expected to weigh on the economic activity. However, growth is being supported by more accommodative monetary policy than previously assumed and by sustained increases in productivity growth and labour force participation. According to recent data by the World Bank[7], the USA's GDP growth is expected to become sluggish in 2019, to reach 2.5 percent, and further decelerate to 1.7 percent in 2020, as the effects of recent fiscal stimulus are expected to diminish. A continuation of the positive structural trends could result in higher medium and long-term growth than currently predicted. In contrast, further increases in trade restrictions or policy uncertainty could hinder economic activity in the USA. Weakening trade flows in light of the trade tensions with the USA are also contributing towards subdued growth in manufacturing output in China. Accordingly, China's GDP growth is expected to decelerate from 6.6 percent in 2018, to 6.2 percent in 2019, and further decelerate to 6.1 percent in 2020.

Trends in Trade

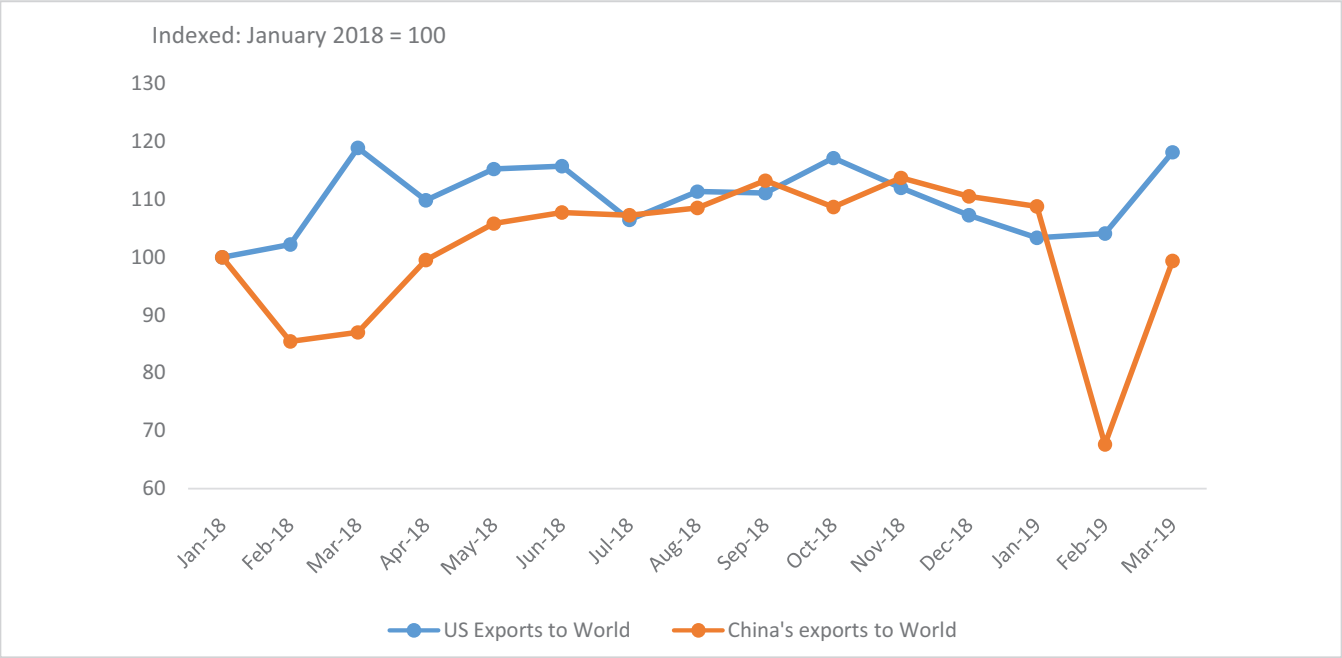
Export growth in the USA has particularly slowed

[7] Global Economic Prospects, World Bank, June 2019

since October 2018, driven by falling export to China as well as an especially acute deceleration in exports to the EU and the East Asia and Pacific region owing to the tariff hike. On similar line, China's exports have also been weakening since November 2018, weighed down by softness in manufacturing output, trade tensions with the USA, and lacklustre global growth (Exhibit 22).

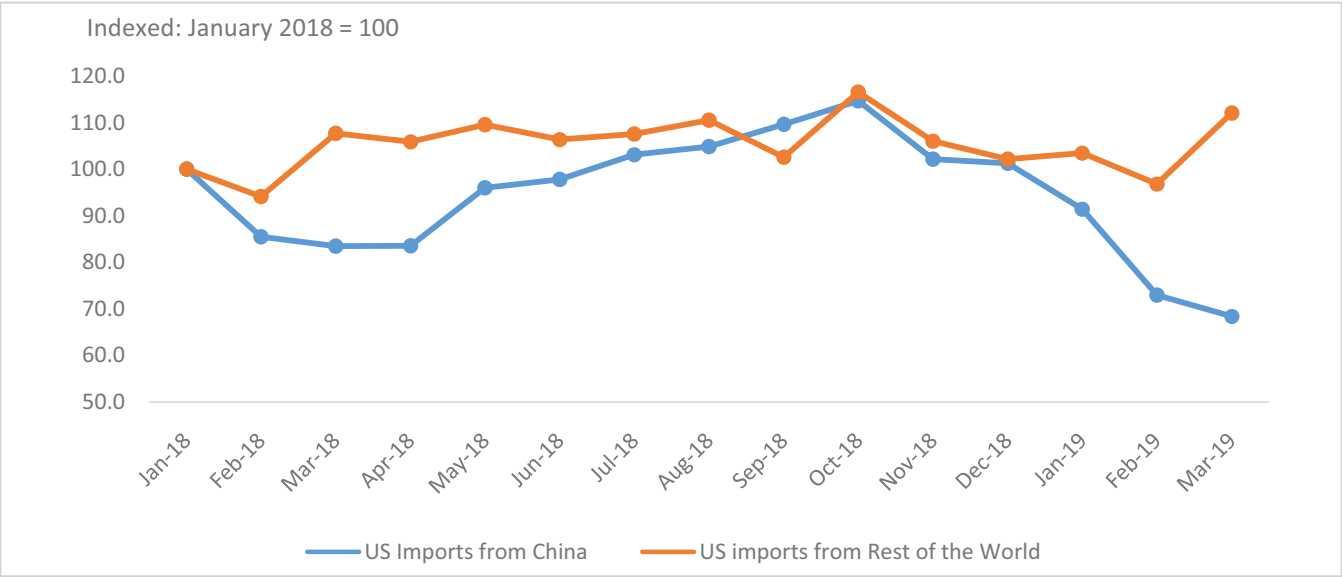
In early 2018, following the initial tariff impositions, the USA's imports from China witnessed a gradual decline, followed by a rapid upsurge in the following months. However, post-October 2018, shortly after the tariffs on US$ 200 billion worth of Chinese goods came into effect, there has been a steady decline in the USA's import from China (Exhibit 23).

Exhibit 22: Movement in the USA's Exports vis-à-vis China's Exports



Source: ITC Trademap, Exim Bank Research

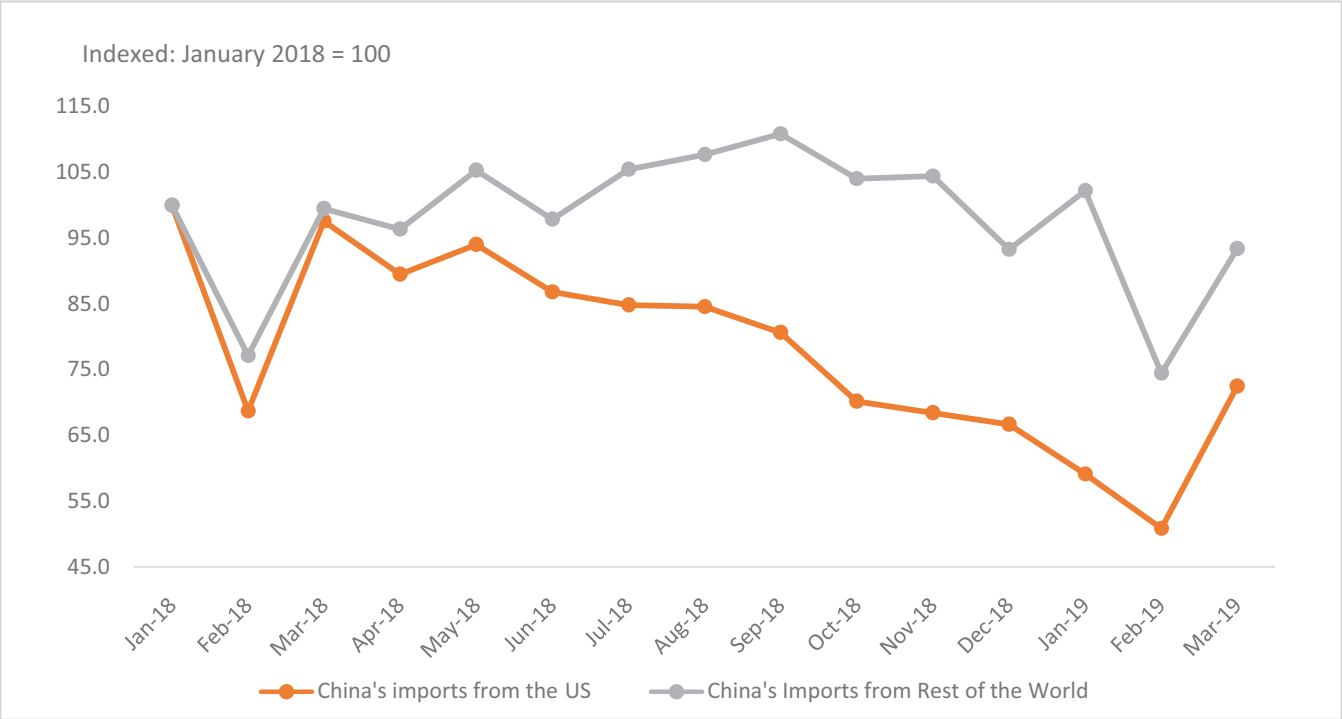
Exhibit 23: Movements in the USA's Imports from China vis-à-vis Rest of the World



Source: ITC Trademap, Exim Bank Research

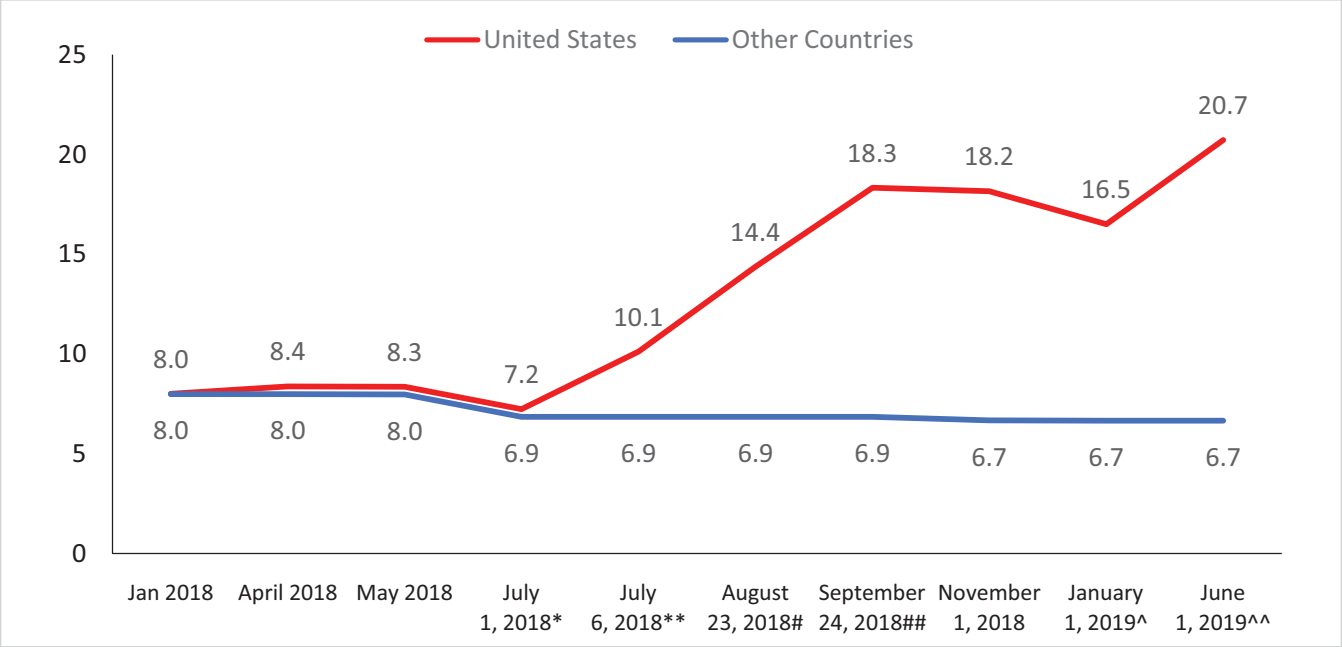
As China's economic growth has slowed due to the trade war, its imports from both the USA and the rest of the world have also fallen, especially since September 2018, owing to slowing domestic demand, the retaliatory tariffs, and severing of value chain linkages (Exhibit 24). However, in relative term, China's imports from the USA have declined more precipitously than the USA's imports from China, while China's imports from other countries have been rising at the same time. China is consciously aiming at switching to other import sources, as evident in the massive tariff reductions on its imports from the rest of the world. While China's average tariffs on its imports from the USA have increased to 20.7 percent in June 2019, average tariffs on imports from other competing countries has significantly declined to 6.7 percent (Exhibit 25). This is in sharp contrast to early 2018, when firms in both the USA and the rest of the world faced similar levels of duties in the Chinese market, facing an average tariff of 8.0 percent.

Exhibit 24: Movements in China's Imports from the USA vis-à-vis Rest of the World



Source: ITC Trademap, Exim Bank Research

Exhibit 25: China's Average Tariffs on the USA vis-à-vis other Countries



Source: Peterson Institute of International Economics, ITC Macmap

Notes: *MFN cut on consumer goods, autos, and ITA products
**Retaliation to US Section 301 tariffs (US$ 34 billion)
#Retaliation to US Section 301 tariffs (US$ 16 billion)
##Retaliation to US Section 301 tariffs (US$ 60 billion)
^Suspension of retaliation against US auto and parts (Section 301) Temporary MFN rates for 2019
^^Tariff increase on some US products (US$ 60 billion)

OUTLOOK

The recent increase in tariffs by the USA announced in August 2019 (as proposed in May 2019) represents a substantial re-escalation in trade tensions and is likely to aggravate the existing challenges to global trade and production. Continued threats of further trade measures, both bilateral and global, add to the policy uncertainty. On the global front, the USA's administration has submitted for consideration a 25 percent tariff on US imports of autos and auto parts from all trading partners, which could affect US$ 350 billion worth of goods. In addition to this, the European Commission indicated that retaliatory tariffs by other countries would reach up to US$ 294 billion worth of US exports. Beyond economic losses for the affected exporters, these new tariffs are contributing to heightened policy uncertainty, which is expected to dent global confidence and investment, particularly impacting smaller open-market economies that largely depend on the external economic environment shaped by the policies of the major economies.

On the whole, China's tariff impositions on the USA has mostly affected agricultural products (including soybean meal and pork), chemicals, medical equipment, and energy equipment, which are abundantly available in other markets at nearly uniform pricing levels. In contrast, the USA imposed tariffs mostly on machinery, transport equipment, and other industrial parts, which are goods that tend to be deeply immersed in global value chains. Thus, the displacement of the USA's goods in China would be relatively more favourable for third countries due to the higher substitutability of these products. On the other hand, the displacement

of Chinese goods in the USA would benefit only a few major exporters, and the tariffs by the USA would affect global trade more sharply as it would impact those countries with greater global value chains participation.

A substantial share of the USA-China trade could be captured by other countries whose firms are close competitors of the Chinese and the USA companies. According to recent findings by the UNCTAD[8], overall European Union's exports to both the USA and China are likely to increase the most due to trade diversion effects, followed by Japan, Mexico and Canada. Substantial gains are also expected for the countries of Australia, Brazil, India, Philippines, Pakistan and Vietnam.

Overall, the country-wise implications for the rest of the world are bound to be very case specific, as the impact of tariffs on international patterns of trade will depend mainly on the extent of substitutability of tariff-affected products in the markets of China and the USA with those originating from other countries. Thus, from the perspective of trade diversion, several contending suppliers in the rest of the world are expected to become relatively more competitive, and the resultant benefits can be large, especially in some sectors. Some products, however, may not be easily substitutable because of lack of foreign competitors or because of improvement in price competitiveness of domestic suppliers, on the back of rise in cost of imports.

[8] "Key Statistics and Trends in Trade Policy 2018: Trade Tensions, Implications for Developing Countries", UNCTAD, February 2019

CHAPTER

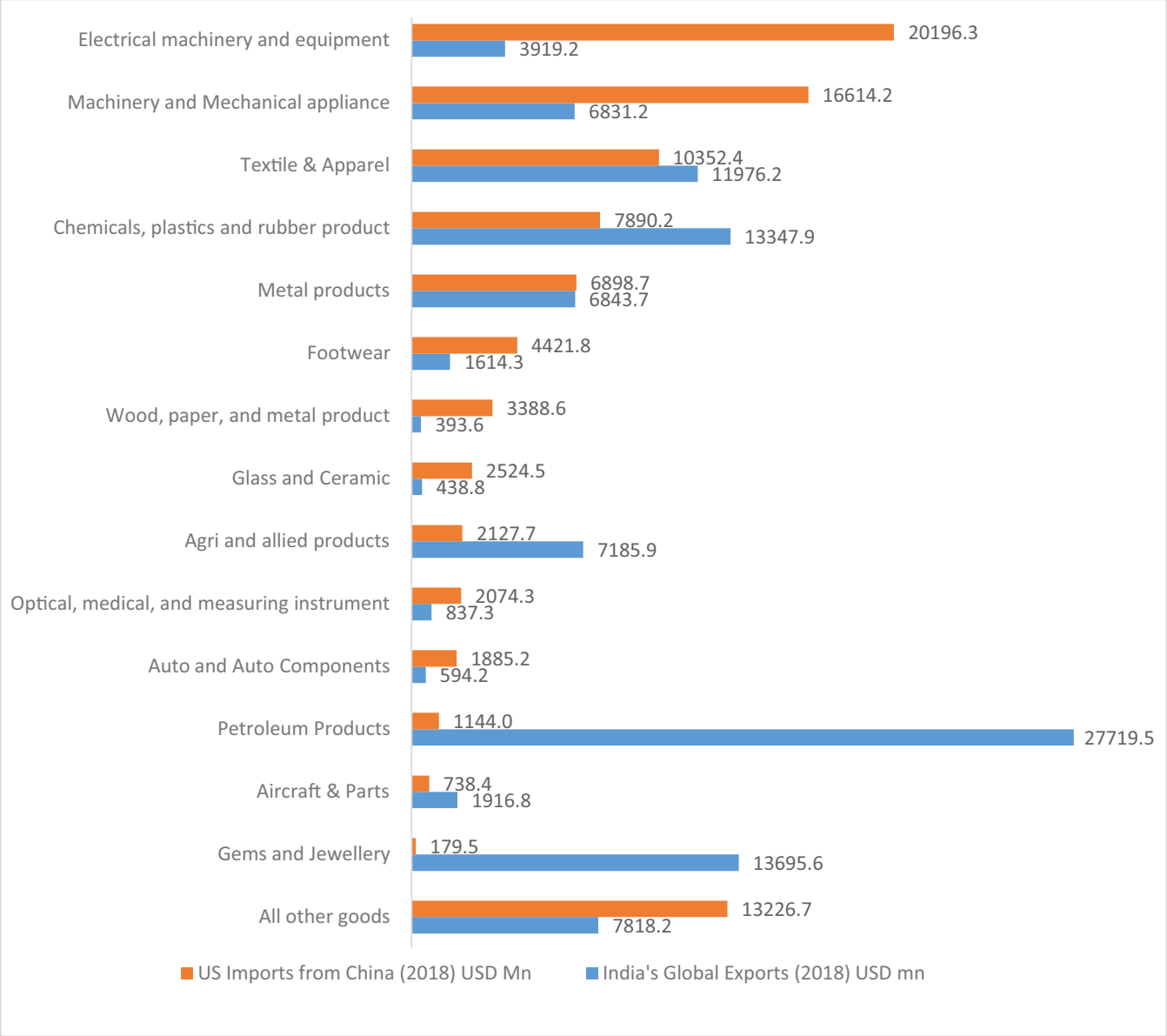
IMPLICATIONS FOR INDIA

India's exports, which are highly responsive to changes in global slowdown, are also susceptible to the growing trade protectionism. India needs a robust export strategy to tide over these disruptions, as also benefit from the trade diversion by notching up a higher share in the tariff-affected markets of the USA and China. This Chapter analyses India's global export competitiveness in the tariff-affected products and attempts to identify emerging opportunities for exporters.

INDIA'S EXPORTS OF TARIFF-AFFECTED GOODS

The tariffs imposed by the USA and China creates the opportunities mainly in sectors such as machinery, mechanical appliances, and electrical equipment. However, India's competitive advantage and exportable surplus in these areas is fairly low. In fact, India runs a trade deficit in these product categories. An analysis of India's exports of the tariff-affected commodities (at HS-8 digit level) indicates that India's global exports of some of the major tariff-affected products in value terms, are far below the imports of the affected markets. For instance, the top tariff-affected products in the USA market were mostly in the sectors of electrical machinery and equipment sector, and machinery and mechanical appliances, whose imports by the USA from China stood at US$ 20.2 billion and US$ 16.6 billion, respectively. In 2018, India's global exports of these tariff-affected products (in electrical machinery and equipment sector, and machinery and mechanical appliances) stood at a mere US$ 3.9 billion and US$ 6.8 billion, respectively (Exhibit 26). Clearly, there is need for substantial capacity creation for exporters to benefit from trade displacement in these sectors. Similarly, the top tariff-affected products in the Chinese market were mostly in the sectors of agriculture and allied activities, auto and auto components, and machinery and mechanical appliances, whose imports by China from the USA stood at US$ 14 billion, US$ 11.8 billion and US$ 10 billion, respectively. However, India's global exports of tariff-affected products within these sectors stood at US$ 12.7 billion, US$ 337 million and US$ 6.6 billion respectively, clearly indicating a wide gap in India's capacity to cater to these markets (Exhibit 27). Therefore, India is relatively disadvantaged as compared to its Asian peers in capitalizing on trade gaps in these key sectors in particular, and the capacities in these sectors need to be substantially beefed up. The subsequent section looks at the areas where India already has comparative advantage in exports, which can be targeted for increasing exports to the markets of the USA and China.

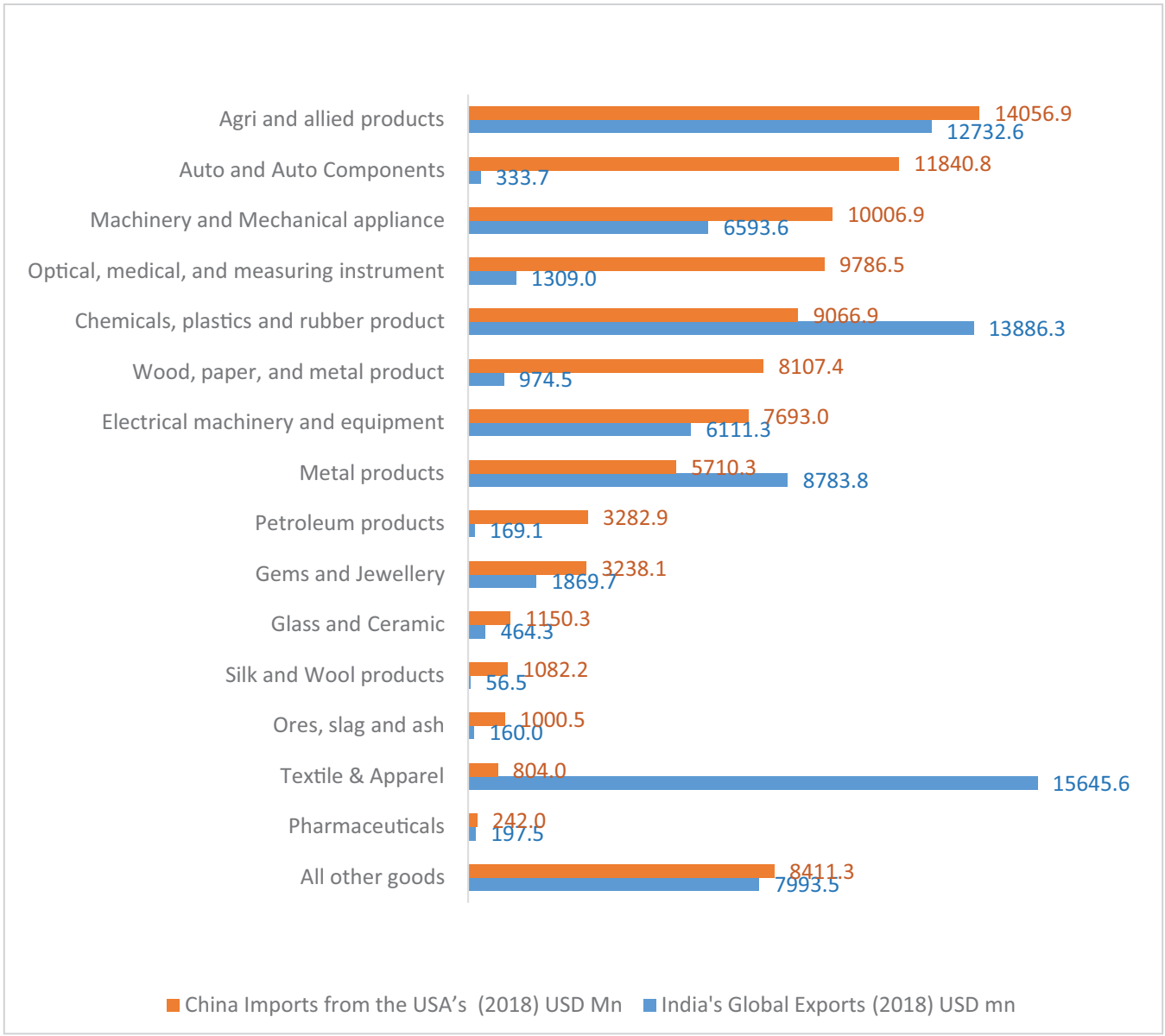
Exhibit 26: Sector-wise India's Global Export of Tariff Affected Goods vis-à-vis the USA's Imports of these goods from China



Note: Total of 10,636 tariff-affected products at HS-8 digit level were considered for this analysis. Of these, 579 products were in electrical machinery; 793 products in machinery and mechanical appliances; 1528 in textiles and apparel; 1458 in chemicals, plastics and rubber products; 919 products in metals; 140 in footwear; 548 in wood, paper products; 246 in glass and ceramic; 2236 in agricultural and allied products; 268 in optical, medical and measuring instruments; 158 in automotive and auto components; 47 in petroleum products; 14 in aircrafts and parts; and 99 in gems and jewellery.

Source: ITC Trademap, Exim Bank Research

Exhibit 27: Sector-wise India's Global Export of Tariff Affected Goods vis-à-vis China's Imports of these goods from the USA



Note: Total of 5,921 tariff-affected products at HS-8 digit level were considered for this analysis. Of these, 739 products were in agriculture and allied products; 204 products in automotive and auto components; 734 in machinery and mechanical appliances; 214 in optical, medical and measuring instruments; 840 in chemicals, plastic and rubber products; 265 in wood, paper products; 461 in electrical machinery; 654 in metal products; 37 in petroleum products; 704 in textiles; 12 in pharmaceuticals; and 64 in gems and jewellery.

Source: ITC Trademap, Exim Bank Research

METHODOLOGY

An essential first step in identification of products would be an objective assessment of the competitiveness of products exported by India. As the gains from trade displacement needs to be identified and realized in the short to medium term, only those products are considered where India already has a comparative advantage in exports.

In order to identify India's export commodities

that are globally competitive, the concept of Revealed Comparative Advantage (RCA) is used. RCA indices are used to identify categories of exports in which an economy has a comparative advantage by comparing country's trade scenario with the world trade scenario. The basic underlying assumption of this concept is that trade profiles reflect the inter-country differences in terms of relative costs, as well as non-price aspects. As per Balassa's measure (1965), RCA index for a country i, commodity j is given as-

$$RCA_{ij} = \frac{(X_{ji}/X_i)}{(X_{wj}/X_w)}$$

Where,
X_{ji}: exports of commodity j from country i
$X_{i:}$ total exports from country i
X_{wj}: total exports of commodity j from the world
X_w: total exports from the world

The RCA index so obtained ranges from 0 to infinity, with 1 as the break-even point. That is, an RCA value of less than 1 means that the product has no export comparative advantage, while a value above 1 means that the product has a comparative advantage.

The normalized revealed comparative advantage (NRCA) index has been demonstrated capable of revealing the extent of comparative advantage more precisely and consistently than other alternative RCA indices in the literature, and is hence, used in the analysis to determine the export competitive products of India.

NRCA can be defined as

$$NRCA_{ij} = \frac{RCA_{ij} - 1}{RCA_{ij} + 1}$$

India has a comparative advantage in products where the NRCA value is greater than 0, while it is at a disadvantage for products with NRCA value of less than 0. Based on assessment of the export competitiveness and the relative market share of India in the imports of China and the USA, two categories of products have been identified:

- **Displacement Products:** These are the products where India's exports are competitive and presently the tariff-affected supplier (i.e., China or the USA) has a larger share than India in the tariff-imposing country (i.e., in the USA or China respectively). Tariff-induced trade diversion in such a scenario can help India emerge as a more important supplier of these products to the markets of the USA and China.

- **Enhancement Products:** These are the products where India's exports are competitive, and India is already a more important supplier than the tariff-affected country. In such a scenario, India can further consolidate its market position.

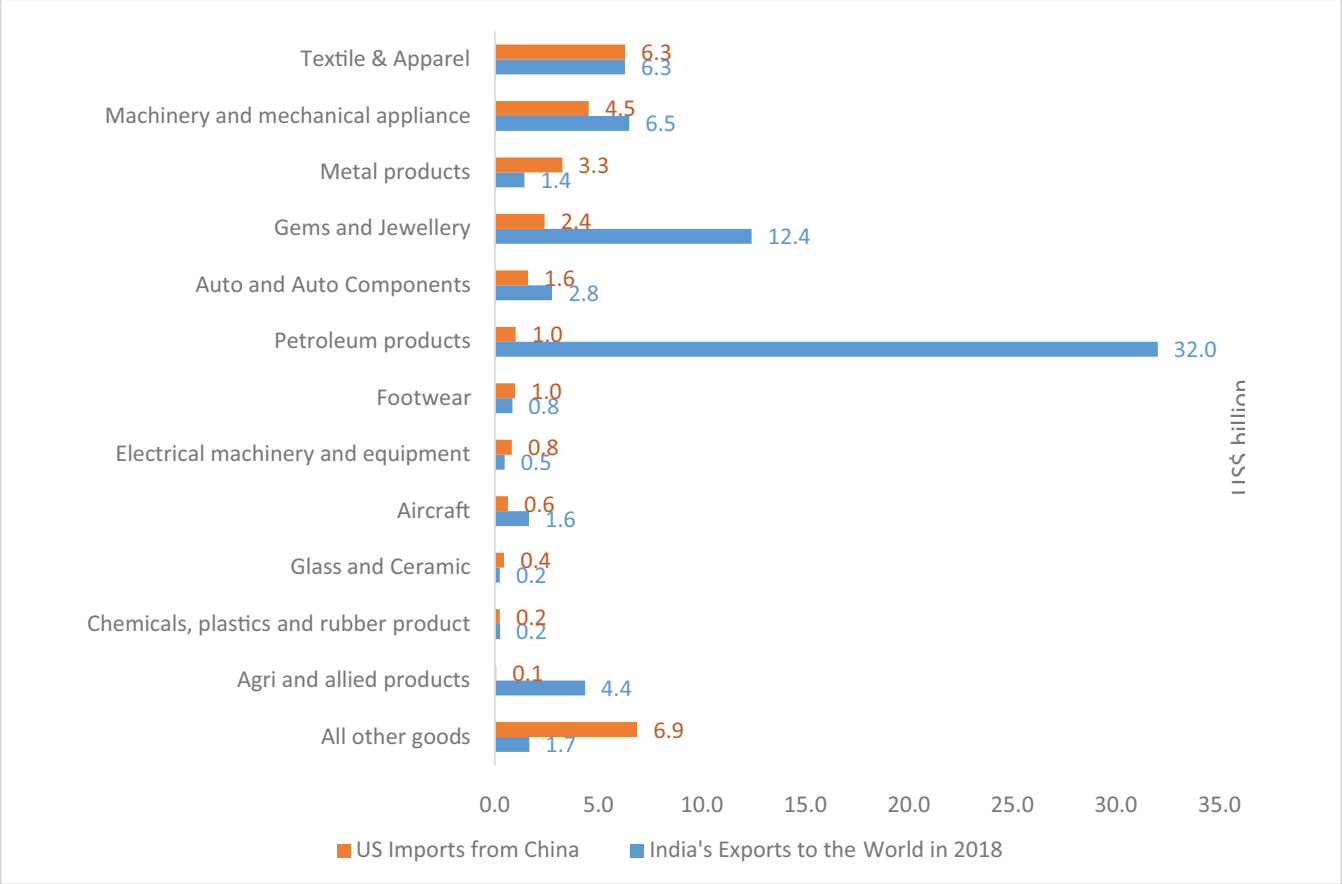
IDENTIFIED PRODUCTS

Analysis based on the aforementioned approach indicates that India has the potential to tap nearly US$ 29.1 billion worth of market in the USA, and about US$ 2.9 billion worth of market in China in the short to medium term. A total of 33 products (at HS-6 digit level) have been identified for the USA market (Annexure 1), and 12 products for the Chinese market (Annexure 2). Of the 33 identified products, 29 products in the USA market are displacement products, which include gems and jewellery, made-up textiles, apparels, home textiles including handicrafts, handbags, footwear, and engineering goods such as transmission shafts and gears for machinery, parts of internal combustion engines, parts of electric motors and generators, parts of valves and similar articles for pipes, boiler shells, tanks, etc. In some of the home textile

products, India and China together account for more than half of the total imports by the USA, and tariffs on China can open up a large market for India. Meanwhile, 4 products are identified as enhancement products in the USA market, which include marine preparations, articles of terry fabrics of cotton, articles of silver jewellery, and turbojets (Exhibit 28). The recent round of tariff announcement also provides an increased opportunity for Indian gems and jewellery exporters, as it targets China's exports of rough and polished diamonds, rough and polished synthetic gemstones, as well as jewellery articles of precious or semi-precious stones coming into the USA. Currently, the USA's imports of loose polished diamonds from China are less than 1 percent, but that of jewellery is nearly 15 percent. With the latest set of 10 percent additional tariffs from September 2019, the USA market for jewellery may be further opened for Indian exporters. Further, China's gold jewellery export to the USA will also no longer remain viable with the tariff impositions, thus, giving the Indian exporters an opportunity to fill that gap.

In the Chinese market, largest opportunities exist in the segments of cotton; organic chemicals; light oils and preparations of petroleum; polypropylene polymers; and engineering goods such as internal combustion piston engines and its parts, gears for machinery, and parts of air or vacuum pumps (Exhibit 29).

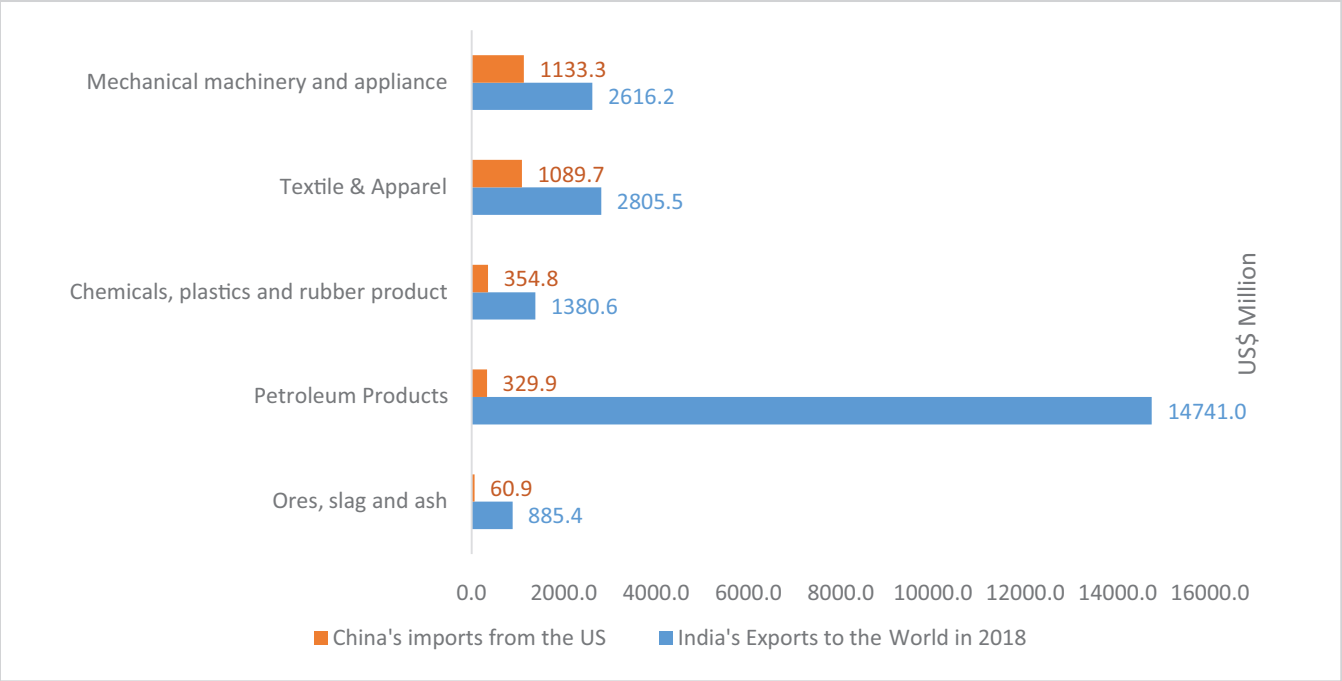
Exhibit 28: Sector-wise Value of Opportunities in Tariff-affected Products in the USA Market



Note: US Imports from China is indicative of the potential opportunity for Indian exporters.

Source: ITC Trademap, ITC Macmap, USTR, MOFCOM of PR China, Exim Bank Research

Exhibit 29: Sector-wise Value of Opportunities in Tariff-affected Products in the Chinese Market



Note: US Imports from China is indicative of the potential opportunity for Indian exporters.

Source: ITC Trademap, ITC Macmap, USTR, MOFCOM of PR China, Exim Bank Research

Other than these identified products, there also exist opportunities for Indian exporters in the pharmaceutical sector of China, especially on account of tariff liberalization and easing of norms in the sector by the Chinese authorities in the recent period. China has cut tariffs on several key pharmaceutical products, including cancer drugs where Indian exports have considerable price competitiveness. China has also revised its drug law, and drugs that are legal in foreign countries but not approved in China will no longer be classified as fake medicines. This is applicable for generic drugs from India as well. Regulatory reforms have also significantly reduced the amount of time taken for drug approval in China. The improving climate has boosted India's exports of pharmaceutical products to China, with exports registering a 70 percent y-o-y growth during 2018. In spite of the growth, India's market share in the pharmaceutical imports of China remains a mere 0.1 percent in 2018, presenting significant room for growth. Indian exporters face host of non-tariff measures in the Chinese market, which restrict the exports in spite of the significant opportunities. With India seeking greater market access for various goods such as agricultural products, animal feeds, oil seeds, milk and milk products, and pharmaceuticals, in light of their potential in the Chinese market, there is significant scope for India to increase its exports.

REALIGNMENT OF THE GLOBAL VALUE CHAINS- IMPACT ON INDIA

India has been the only major Asian economy whose share in global merchandise exports has grown since the start of the trade war in 2018. India's share in global exports has increased to 1.71 percent in the first quarter of 2019 from 1.58 percent in the fourth quarter of 2017,

while the share of every other major exporting economy fell during the same period. Part of the reason behind this is India's fewer linkages in the global value chains. However, going forward, propelling exports to a higher growth trajectory will necessarily entail greater integration in the global value chains.

The trade war is set to create opportunities for value chain integration as it has led to a realignment of the global value chains due to changes in the supply chain dynamics, particularly away from China. While India's fewer linkages in the global value chains have been partly beneficial for retaining India's share in global exports, the realignment in GVCs caused by the trade war has created an opportunity for countries like India to enhance their supply chain integration.

For instance, the USA's tariffs on China have pushed the automotive supply chains to shift their sourcing for the global market away from China, opening up the space for countries like India. A significant trend that could turn around the automotive supply chains is the greater focus on electric vehicles (EV) in developed and developing countries alike. According to recent estimates, the share of EVs in new car sales in America is likely to increase from 2 percent in 2018 to more than 20 percent in 2030. While this could reduce trade in auto-parts dramatically, as EVs have fewer moving parts than conventional cars, it also opens up opportunities for EV manufacturers in countries like India, where increasing impetus is being given to greater production and adoption of EVs.

Another example is that of the ongoing realignment of the electronics value chain. While nearly half of the world's manufacturing capacity for electronics is based in China due to its strengths in terms of scale, diversity and sophistication of products, the rising labour cost had already led some electronics firms to consider moving out a few years ago. Most notably, Samsung has built a huge smartphone-manufacturing complex in Vietnam during the past 4 years, in an attempt to counter the rising labour cost in China. On similar lines, in 2018, Samsung inaugurated its largest mobile factory in India, and also launched its 'Make for the World' initiative, whereby it aims to export mobile handsets produced in India, to overseas markets.

Rising economic uncertainty driven by trade policy is likely to make way for more such shift in manufacturing bases away from China, into relatively stable economies with sound policy environment. Strengthening India's manufacturing base, in this regard, along with improving ease of doing business will be a key imperative for attracting foreign investors and engendering global value chains. Programmes such as 'Make in India' will therefore remain a high priority for the development of the country's manufacturing base.

INTENSIFYING TRADE FRICTIONS BETWEEN INDIA AND THE USA

Over the recent years, particularly since 2016, the US administration has been increasingly undertaking trade actions against India, including tariff barriers, anti-dumping duties, and other non-tariff barriers. However, the most notable recent actions have been the hike in tariffs on Indian steel and aluminium, followed by the removal of GSP benefits for India.

In March 2018, India was among the countries that were hit by Section 232 national security tariffs of 25 percent on steel products and 10 percent on aluminium products. These products together accounted for about 2.3 percent

of India's exports to the USA in 2017. While India's steel exports to the USA were already facing headwinds prior to 2018 due to a series of antidumping duties, these additional tariffs further compounded the challenges, triggering the exports to fall by 46 percent in the following 12 months since the tariff imposition[9]. Although India had announced its course of retaliation to the tariffs in 2018, no action was taken against the USA until June 2019.

The second trade action against India by the USA was its review and the consequent removal of India's eligibility under the US Generalized System of Preferences (GSP) in June 2019, citing issues related to lack of market access for the USA's exporters in India. As a developing country, India had been a beneficiary of the US GSP programme since mid-1970s. In 2018, US$ 6.3 billion worth of India's exports to the US were covered under the GSP, accounting for nearly 11.5 percent of India's total exports to the US.

Nevertheless, the impact of tariff increases across sectors due to GSP removal are expected to be relatively lesser when compared to that of the hike in steel and aluminium tariffs. This is because the tariff facing Indian exporters for the products covered under GSP will increase only to a relatively lesser extent. For instance, gems and jewellery exports will now face an average US tariff of 5.9 percent from 4.7 percent earlier, while chemicals will now face an increased average tariff of 4.1 percent from 3.3 percent earlier, and plastics and rubber exports will face an average tariff of 3.8 percent from 2.1 percent earlier. These tariff hikes against India are not as large as those imposed on China, but could influence India's price competitiveness in the USA market[10].

In response to the host of trade actions, India ultimately retaliated in June 2019 by raising tariffs on the USA's agro products such as fruits and nuts, including walnuts and almonds from California, and apples from Washington. Other products affected by India's retaliation include chickpeas, lentils, steel, and chemicals, jointly covering nearly US$ 1.4 billion of the USA's exports to India in 2018, which accounted for a share of 4.1 percent in the exports from the USA to India.

Further, India is currently placed on the Priority Watch List for the USTR Special 301 report, over its intellectual property rights related concerns- the law which triggered the USA's imposition of the record-high tariffs on China. Though the impact of the tariff increase subsequent to India's GSP withdrawal may not be significantly large, any move against India under Section 301 could have potentially higher impact on India's export to the USA. Therefore, India also needs to prepare for future uncertainties, especially in light of the Special 301 Report, and in the longer run, focus on accelerating its export competitiveness and diversification for enhancing its market presence.

[9] "Trump's Mini-Trade War with India", Chad P. Bown, June 2019

[10] Peterson Institute of International Economics, "Trump's Mini-Trade War with India", July 8, 2019

CHAPTER

CONCLUSION AND WAY FORWARD

Reversing globalisation and retreating into protectionism threatens to reverse the gains of several decades of liberal trade. The deadweight losses caused by protectionism strengthen the case for liberal trade- higher tariffs tend to lower the real output and productivity, while also causing distortions in the closely-integrated global value chains. Retreating into protectionism by raising tariffs and revoking trade agreements are, thus, not likely to fix inequality or trade imbalances of the countries resorting to them. While higher trade barriers could shield some domestic industries from import competition, the resulting wage hikes would be more than offset by the damaging effects of reduced export opportunities due to loss of competitiveness and the increased cost of imported inputs for manufacturing firms. These vulnerabilities make protectionism a core concern for policy makers.

Trade tensions also tend to weaken currencies and may escalate into currency wars with ancillary effects on the real economy, as imposing tariffs on imports tends to weaken the target country's currency. Such depreciation could be interpreted as a currency manipulation, further triggering protectionist measures. If such currency wars break out, financial markets may be deeply affected, which may even put foreign investors off-limits or lead to deliberate cut back on foreign investment by politicising capital flows.

These uncertainties would have implications for India as well. In India, most phases of strong economic growth have coincided with a higher exports growth. Clearly, the ongoing trade conflict and the increasing protectionist policies has implications not only for India's exports growth but also for its economic prospects. However, the trade war also presents opportunities to widen the country's exports footprint, particularly under categories affected by the bilateral tariffs of the USA and China. Apart from exports opportunities, diversion in investment flows is another opportunity for India to benefit from, particularly in manufacturing sectors, mainly due to the realignment of global supply chains. Thus, there is need for strategies which can prepare the country for both the vulnerabilities arising from the trade wars, and for tapping the emerging opportunities on account of trade diversions.

STRENGTHENING MEGA TRADE AGREEMENTS

As the concern over collateral damage from the trade dispute continues, several economies continue to advocate for stronger trade ties, which can help cushion the adverse impact of trade protectionism. Trade liberalization and improved intra-regional integration are crucial to combat protectionist environment, as these could, not only help offset the negative terms of trade effects of increased protectionism on developing countries such as India, but also present new opportunities. Recent research provides evidence that trade agreements can be particularly valuable as an insurance mechanism during downturns, when protectionism tends to

increase[11]. There is also growing evidence on the effects of major agreements on exports through decline in uncertainty. Trade relationships between countries engaged in credible trade agreements are more durable and resilient, engendering stable production and supply networks across countries.

From the point of view of India, mega regional trade blocs such as the Regional Comprehensive Economic Partnership (RCEP) will play an important role in safeguarding its exporters in an increasingly protectionist set up, as also for reducing policy uncertainty. RCEP is a proposed free trade agreement among 16 countries, viz., India, ASEAN (including Brunei, Cambodia, Indonesia, Lao PDR, Malaysia, Myanmar, Philippines, Singapore, Thailand, Vietnam), Australia, China, Japan, New Zealand and South Korea, that jointly account for nearly 45 percent of the world's population, 33 percent of world GDP, and nearly 28 percent of world trade. RCEP negotiations were formally launched in November 2012, at the ASEAN Summit in Cambodia. There have been several rounds of detailed negotiations to conclude the RCEP. The latest round of negotiations for RCEP was held in July 2019, in China, which was 27th in the series of deliberations held between the negotiating countries. However, thus far, only 7 out of the 18 final chapters of the RCEP agreement have been concluded. There is a need for early resolution on RCEP, with a comprehensive coverage benefitting all parties under consideration.

For India, there are several reasons to pursue RCEP. The size of the market, potential opportunities to participate in regional production networks, elimination of multiple trade agreements, and trade liberalisation of the RCEP partners with respect to services exports of India are some of the key advantages from the Indian perspective. The deal would also ramp up India's engagement with its Asian peers and foster the country's "Act East" policy, as well as enhance maritime cooperation in the India-Pacific. However, there are also a few concerns for India over RCEP. Of all the countries in the RCEP, India is the only one not involved in any major bilateral or multilateral negotiations for an FTA with China, except the Asia Pacific Trade Agreement (APTA) which has achieved little in terms of reducing barriers to trade between India and China. A primary concern with respect to RCEP is that duty free trade with China could lead to the flooding of cheap imports from China, which could potentially harm India's domestically manufactured goods including manufacturers of steel and aluminium, copper, pharmaceuticals and textile, which are some of the key contributors to India's economic output and employment.

Further, as India runs trade deficits with 11 out of the 15 other RCEP negotiating economies, it is seeking stricter terms of trade and conditions. India is seeking stricter rules of origin clause to curtail dumping from third country, better market access in services sector, and an extended protection to a number of sensitive areas such as dairy and farm products, which are opposed by several negotiating economies. Another point of contention is India's suggestion for an auto-trigger mechanism as a safeguard measure, under which levies can take effect once imports cross a certain threshold level. Other points include proposed inclusion of the controversial Investor-State Dispute Settlement (ISDS) in the pact by members like Japan and Singapore, which is not favoured by India as its domestic laws will then be challenged by international tribunals.

Addressing these concerns and effective implementation of the RCEP will be crucial in the current era of heightened global trade tensions. Lowering India's trade barriers at a time when the global players seek alternative trade and

[11] "Economic and Policy Uncertainty: Export Dynamics and the Value of Agreements", March 2018, Carballo et al.

investment destinations across the region could nudge the Indian economy to a higher growth trajectory. Striking a balance between domestic interests and investment interests will be crucial in the context of mega trade agreements such as RCEP.

INCENTIVISING EXPORTS OF IDENTIFIED PRODUCTS TO TARIFF-AFFECTED MARKETS

One of the ways to step up exports to the tariff-affected markets is by incentivizing the exports in the sectors with higher potential as identified in the previous chapter. Products which are affected from trade protectionism and where India's exports have a comparative advantage, should be the focus areas. This includes sectors such as machinery, textiles, chemicals, automotive, metals, and petroleum products. Each of these sectors may face several different challenges emanating from infrastructure, logistics, high cost of debt, import duties, lack of tax benefits, etc. In order to promote exports from these sectors, it is important to alleviate the specific challenges in these sectors and encourage capacity building, while ensuring across-the-board engagement in areas such as quality infrastructure, efficient business environment and other fiscal or financial incentives. The government could also consider prioritizing these sectors under its existing export promotion schemes.

EXPORT CAPACITY CREATION

The headwinds from the ongoing trade conflicts have left India at a relatively disadvantageous position at a time when other countries are capitalising on the opportunities arising from mutating supply chain patterns, mainly due to India's lack of export capacity in the tariff-affected products. Currently, India's exports comprise products that have relatively lower share in the global import demand. In the USA market, there are 1,593 tariff-affected products with imports valued at US$ 60.7 billion, in which India does not have a substantial share in global exports[12]. These products belong to the sectors of electrical machinery and equipment, machinery and mechanical appliances, textiles, chemicals, wood, paper and metal products, automotive, among others. Similarly, in Chinese market, there are 3,201 tariff-affected products in sectors such as agricultural products, wood, paper and metal products, chemicals, optical, medical and measuring instruments, among others, with imports valued at US$ 58.1 billion, in which India's share in global exports is not substantial. Focusing on export-oriented manufacturing in these identified areas, in line with global import demand, by bringing in greater foreign investments, improving industrial set-up and R&D incentives, would be a key imperative for India. Additionally, effective marketing strategies, brand building for specific products, and quality improvements to meet global market standards would also be essential for India to facilitate export growth.

Further, a focussed approach by prioritisation of promising high technology industries such as machinery and appliances, electrical equipment, automotive, etc., augmenting flow of credit, fiscal and financial incentives such as higher tax deductions for R&D expenditure, interest equalisation facility for agricultural exports etc., are also essential to bolster export growth.

ENHANCING GLOBAL VALUE CHAIN PARTICIPATION

India is the 19th largest merchandise exporter in the world, yet has relatively lower GVCs linkages than several other developing economies. The GVC participation index 2015 indicates that India's total GVC participation (including forward and backward participation) stood at 34 percent of its total gross exports, which is much

[12] Products where India's share in global exports is less than 1 percent.

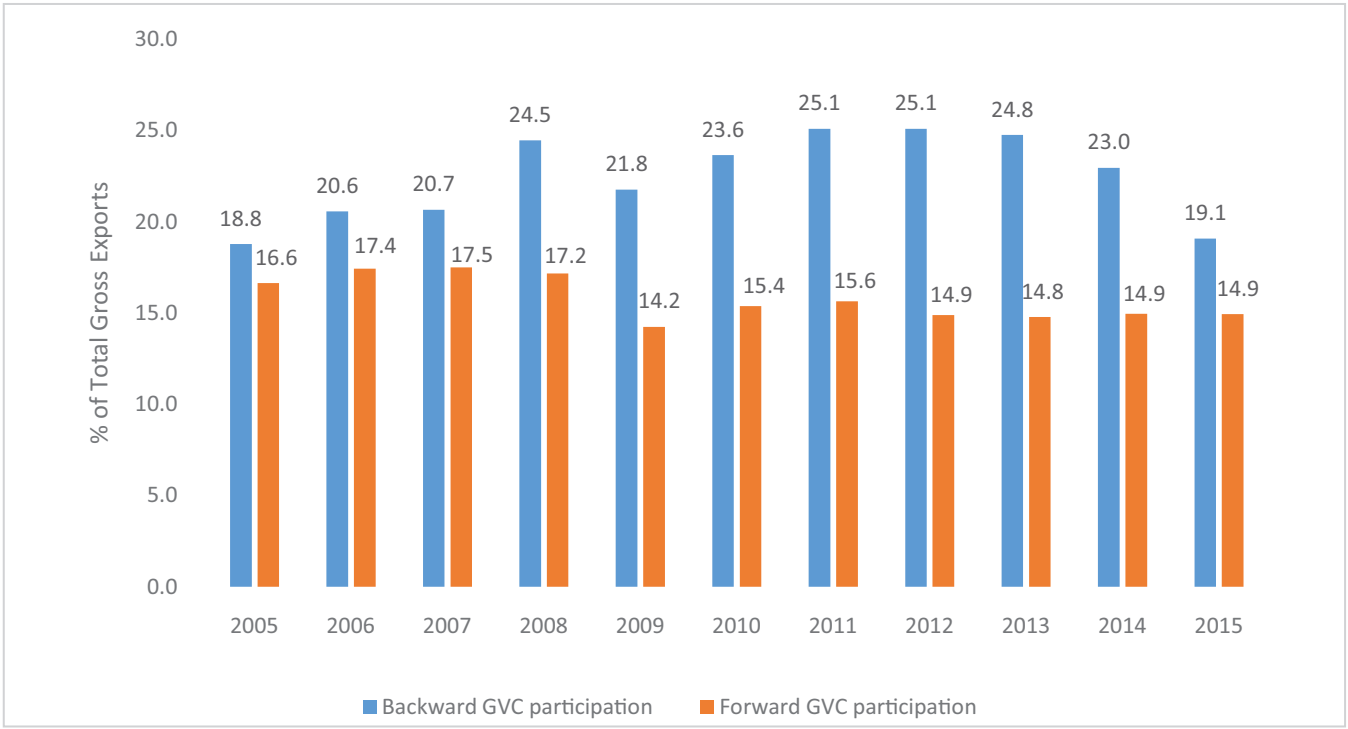
below the GVC participation of 41.4 percent for developing countries as a whole. Particularly, India's forward participation in GVC, which stood at 14.9 percent of total gross exports, remains much below that of the developing economies', which stood at 20 percent.

Following an increase from 18.8 percent in 2005 to 25.1 percent in 2011 and 2012, India's foreign value-added content (FVA) of exports (or backward linkages in GVC) has been steadily declining, marking a 6 percentage point drop, to reach 19.1 percent in 2015 (Exhibit 30). This was likely due to a shift towards local suppliers of intermediate inputs, particularly in the growing services sector, while foreign content in manufacturing exports continued to grow during this period[13].

India's backward linkages in GVC have particularly been higher than its forward linkages (i.e. domestic value-added (DVA) content in foreign exports), especially from 2008 onwards. While rising backward linkages in GVC are certainly beneficial for domestic industries in terms of integration into GVCs and deriving resultant benefits, a country must strive for higher forward linkages, particularly in intermediate goods. Such forward linkages consequently foster export competitiveness, fuels export growth, and leads to strengthening of domestic ancillary industries.

While India's domestic value added in foreign exports of intermediate products has recovered over the recent years, it stands relatively lower than India's peers. As per 2015 data from OECD's TiVA database, India's domestic value added in foreign exports of intermediate products stood at 40.0 percent of its total gross exports, while

Exhibit 30: India's GVC Participation Trends (2005-2015)



Notes:
1. Forward participation in GVCs refers to Domestic value added in foreign exports as a share of gross exports, by foreign exporting country
2. Backward participation in GVCs refers to Foreign value added share of gross exports, by value added origin country

Source: OECD TiVA Database, December 2018

[13] https://www.oecd.org/industry/ind/TIVA-2018-India.pdf

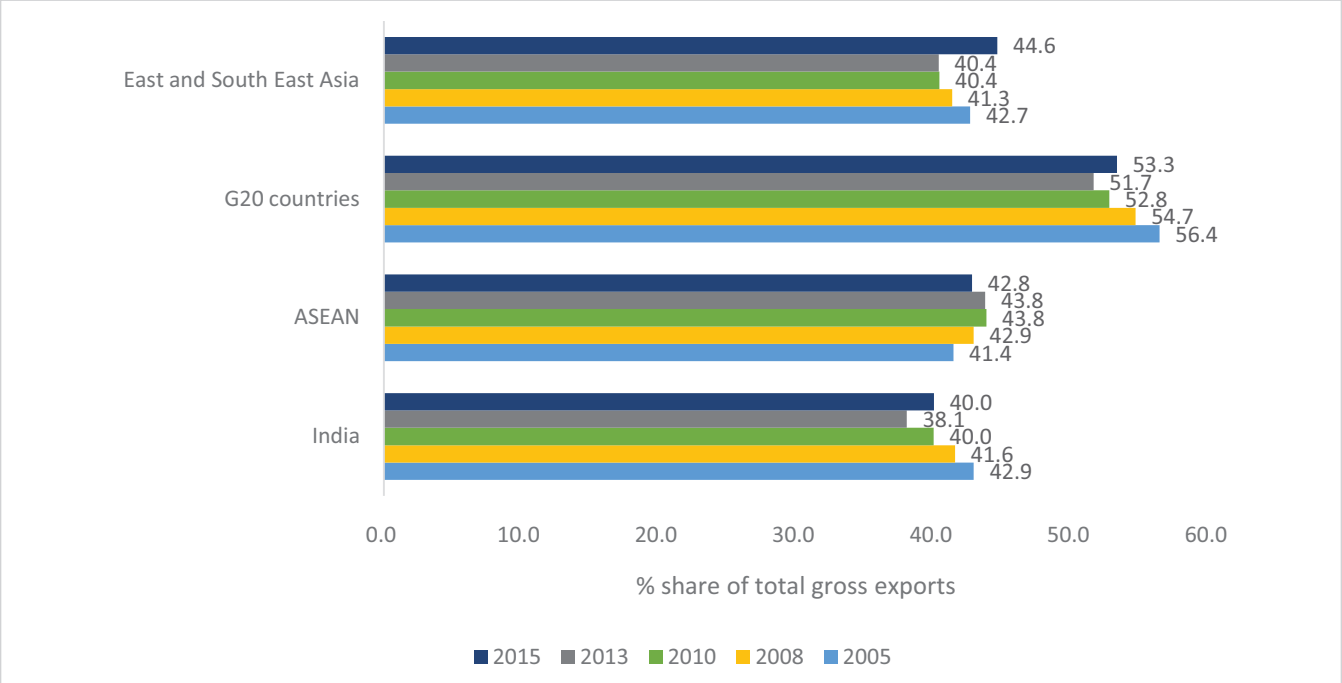
that of ASEAN and G20 countries stood at 42.8 percent and 53.3 percent respectively (Exhibit 31).

Studies shows that net gains from GVCs linkages for Indian textiles and apparel sector as well as machinery sector are particularly greater due to higher forward linkages[14]. India, thus, needs to focus on upgrading in GVCs by forging greater and deeper linkages with existing GVCs, particularly focussing on improving its exports of intermediate goods. Initiatives such as 'Make in India' can be particularly helpful in enhancing India's forward linkages. Greater openness for FDI inflows and enhanced trade facilitation by improvement in the quality of trade related infrastructure including trade logistics, intellectual property protection, and standards, should remain the core motif of India's strategy for trade integration. Further, removal of existing policy distortions such as non-trade barriers would also be essential to reap any benefits arising from the Regional Trade Agreements/ FTAs, and facilitate creation of forward and backward linkages with FTA partners.

Further, India has one of the more stringent tariff regimes among major world economies, with many of India's bound tariff rates being among the highest in the world. For instance, bound tariffs on drug formulations, including life-saving drugs and finished medicines listed on the WHO's list of essential medicines go above 20 percent, while that on agricultural products range from 100 percent to 300 percent.

India's tariffs are also characterized by marked disparities between WTO bound rates and the most favoured nation (MFN) applied rates charged at the border. According to the latest WTO data, India's average bound tariff rate is 50.8 percent in 2018, while its simple MFN average applied tariff is 17.1 percent[15]. India's average WTO-bound tariff for agricultural products is 113.1 percent, while its MFN applied rates stood

Exhibit 31: Domestic Value Added in Foreign Exports of Intermediate Products

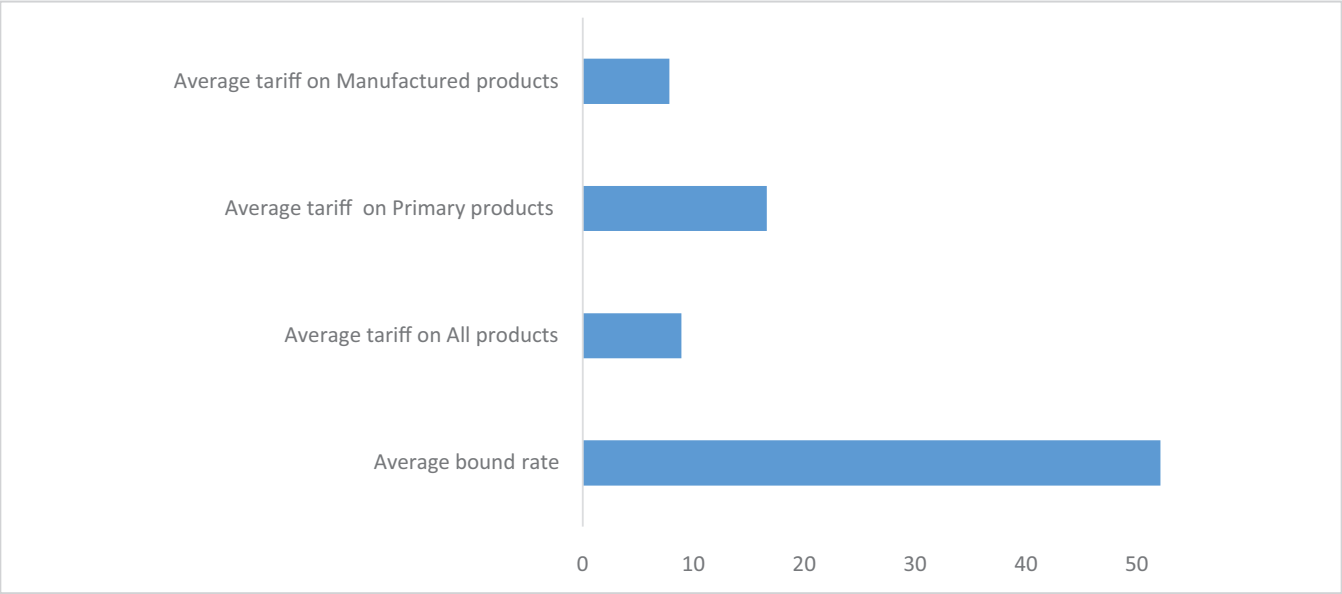


Source: OECD TiVA database

[14] "Domestic Value-added Growth is Vital: Are Indian Industries Gaining by Linking into Value Chains?", Neha Gupta, 2016

[15] https://www.wto.org/english/res_e/statis_e/daily_update_e/tariff_profiles/IN_E.pdf

Exhibit 32: India's Average Tariff Rates (2017, in %)



Source: WDI, Exim Bank Research

at 38.8 percent. The large gap between bound and applied tariff rates allows India to use tariff policy to make frequent adjustments to the level of protection provided to domestic producers, which in turn, creates uncertainty for importers and exporters. Moreover, while India has bound all agricultural tariff lines in the WTO, over 30 percent of India's non-agricultural tariffs remain unbound (i.e., there is no WTO ceiling on the rate).

To facilitate forward and backward linkages in GVC as also to bargain for trade liberalisation, lowering of India's own import tariffs will be important.

COLLABORATE FOR REINVIGORATING THE WTO DISPUTE SETTLEMENT MECHANISM

Most of world trade in goods is currently conducted under the WTO's rules. Particularly, tariffs are levied within the WTO-agreed bounds. The WTO has long been considered an effective institution because of its enforceable dispute resolution processes. Since its inception in 1995, the WTO dispute settlement mechanism has resolved a number of trade disputes of the global trading system. However, currently, the WTO dispute settlement mechanism is in a near-crisis situation.

On the one hand, the WTO members have been unsuccessful to negotiate updates to the rulebook, including rules on dispute settlement itself, resulting in the WTO Appellate Body rendering decisions on ambiguous or incomplete WTO rules. Additionally, in the absence of a resolution to this problem, the appellate body is soon likely to not have enough members to review dispute cases, thereby putting the WTO dispute settlement system to a halt. Should that happen, the WTO would not only lose its system of final appellate review, its panel rulings would also no longer remain binding. The aggrieved countries are likely to then lose their legal rights under WTO rules.

Thus, the failure to resolve this crisis runs a great risk of pushing the world trading system away from the free and liberal system that is today, leading the big players to act in unilateral interest. In such an environment, several developing economies may lose interest in negotiating new rules on trade.

To ensure the proper functioning of the dispute settlement system, WTO members need to

collaborate to agree on new procedures calling on the appellate body to submit issues of legal uncertainty arising on appeal to respective WTO committees for further discussion and negotiation among WTO members. Such "legislative remand" procedures would link the dispute settlement function with the role of the WTO as a forum for permanent negotiations. Some academics describe the current Appellate Body crisis as an emergency that justifies the appointment of Appellate body members by a qualified majority vote and not by consensus. When a consensus cannot be reached among all WTO members, the General Council (comprising all WTO members) can use the latent tool of authoritative interpretations by a three-fourths majority vote to resolve ambiguities in the WTO text. These steps could return the WTO to its essential focus on negotiations[16].

India has been at the forefront of such initiatives for collaborating with WTO member nations to strengthen multilateral trade ties and end the deadlock in the appellate body for dispute settlement. India has been hosting informal meetings and mini-ministerial meetings with WTO members to call for more open, transparent and inclusive processes. The recent ministerial meeting hosted by India was held on May 13-14, 2019, to re-energise and strengthen multilateralism and put in place a more inclusive decision - making process. India had also organised an Informal WTO Ministerial Gathering in March 2018, which emphasised on the need to preserve and enhance the functioning and credibility of the rules-based Multilateral Trading System, and saw participation of more than 50 WTO Members – both developed and developing nations. In order to prevent the ongoing impasse from paralyzing the dispute settlement system, it is essential that India collaborate with like-minded WTO member nations in such initiatives and urge to expedite the process of appointment of new members to the Appellate Body.

CONCLUSION

Reversing globalisation puts at risk the real economic gains that have come about through closer trade and investment links. Growing trade tensions could increase prices, raise unemployment and affect global growth. Retreating into protectionism also risks unravelling the financial interdependencies that enable and encourage trade and investment links. This threatens to unsettle financial markets and put a drag on firms' capital spending, as investors take fright and financial conditions tighten. These real and financial risks could amplify each other, creating a perfect storm and exacting an even higher price.

The Indian economy also faces risks in the face of these protectionist trends. However, there also exists opportunities to benefit from the trade diversion, with the potential to tap nearly US$ 29.1 billion worth of market in the USA and about US$ 2.9 billion worth of market in China in the short to medium term. Incentivizing exports from the identified products through policy interventions will be crucial, as other countries also vie for the market created in tariff-affected products. Apart from this, India should also strengthen its relations with key trade partners through mega trade agreements, enhance its participation in global value chains, lower its own tariff barriers, and also collaborate for reinvigorating the WTO dispute settlement mechanism.

[16] "The Dispute Settlement Crisis in the World Trade Organization: Causes and Cures", Tetyana Payosova, Gary Clyde Hufbauer, and Jeffrey J. Schott, March 2018

ANNEXURE 1: POTENTIAL PRODUCTS FOR INDIA IN THE USA MARKET

(Values in US$ Mn, 2018)

HS Code	HS Description	India's Exports to World	Imports by the USA	India's share in US Imports	China's share in US Imports
Displacement Products					
711319	Articles of jewellery and parts thereof, of precious metal other than silver	11570.3	7080.3	21.9	30.0
630231	Bedlinen of cotton (excluding printed, knitted or crocheted)	285.9	1597.3	12.7	27.3
620640	Women's or girls' blouses, shirts and shirt-blouses of man-made fibres	579.0	1462.5	11.8	15.4
611120	Babies' garments and clothing accessories of cotton, knitted or crocheted (excluding hats)	644.9	1657.9	9.7	38.2
610910	T-shirts, singlets and other vests of cotton, knitted or crocheted	1786.0	4250.0	9.4	21.1
620520	Men's or boys' shirts of cotton (excluding knitted or crocheted, nightshirts, singlets	789.3	2758.1	9.3	19.8
850300	Parts suitable for use solely or principally with electric motors and generators, electric	476.5	2424.6	8.3	33.8
761699	Articles of aluminium, n.e.s.	347.6	1795.7	8.3	46.2
940490	Articles of bedding and similar furnishing, fitted with springs or stuffed or internally filled	441.9	2902.6	7.9	86.1
610990	T-shirts, singlets and other vests of textile materials, knitted or crocheted (excluding cotton)	672.4	1900.6	7.6	47.9
840999	Parts suitable for use solely or principally with compression-ignition internal combustion	817.8	3474.8	7.0	19.3
732690	Articles of iron or steel, n.e.s. (excluding cast articles or articles of iron or steel wire)	762.6	4728.1	6.1	37.8
848340	Gears and gearing for machinery (excluding toothed wheels, chain sprockets and other transmission	431.1	3352.7	6.1	25.0
848310	Transmission shafts, incl. cam shafts and crank shafts, and cranks	336.0	2175.8	5.8	14.5
732393	Table, kitchen or other household articles, and parts thereof, of stainless steel	321.3	1716.8	4.6	37.1
420222	Handbags, whether or not with shoulder straps, incl. those without handles, with outer surface of plastic sheeting of textile materials	286.7	1517.5	4.2	73.4
870899	Parts and accessories, for tractors, motor vehicles for the transport of ten or more persons	2763.1	14925.9	4.1	10.7
841391	Parts of pumps for liquids, n.e.s.	357.2	3473.1	4.0	18.8
420221	Handbags, whether or not with shoulder straps, incl. those without handles, with outer surface of leather, of composition leather or of patent leather	411.1	1961.3	3.9	15.4

848190	Parts of valves and similar articles for pipes, boiler shells, tanks, vats or the like, n.e.s.	418.7	3910.1	3.9	35.7
841490	Parts of : air or vacuum pumps, air or other gas compressors, fans and ventilating or recycling	336.1	2248.9	3.8	21.4
940360	Wooden furniture	515.1	6922.8	3.1	42.7
880330	Parts of aeroplanes or helicopters, n.e.s. (excluding those for gliders)	1637.6	16964.7	3.1	3.7
640391	Footwear with outer soles of rubber, plastics or composition leather, with uppers of leather	840.6	3769.9	3.0	25.6
401699	Articles of vulcanised rubber (excluding hard rubber), n.e.s.	245.0	1648.9	2.5	14.6
840890	Compression-ignition internal combustion piston engine "diesel or semi-diesel engine"	612.5	3208.1	2.2	3.0
271019	Medium oils and preparations, of petroleum or bituminous minerals, not containing biodiesel	32004.6	36751.9	1.9	2.7
630790	Made-up articles of textile materials, incl. dress patterns, n.e.s.	475.2	4324.6	1.7	49.2
701090	Carboys, bottles, flasks, jars, pots, phials and other containers, of glass	241.1	1620.6	1.6	27.4
Enhancement Products					
30617	Frozen shrimps and prawns, even smoked, whether in shell or not	4351.9	4846.3	39.5	1.4
630260	Toilet linen and kitchen linen, of terry towelling or similar terry fabrics of cotton	1054.9	2111.4	31.2	24.1
711311	Articles of jewellery and parts thereof, of silver, whether or not plated or clad with other precious metal	823.9	1694.6	18.8	15.9
841112	Turbojets of a thrust > 25 kN	3174.2	8077.1	10.0	1.0

Source: ITC TradeMap, Exim Bank Research

ANNEXURE 2: POTENTIAL PRODUCTS FOR INDIA IN THE CHINESE MARKET

(Values in US$ Mn, 2018)

HS Code	HS Description	India's Exports to World	Imports by China	Share of India in China's Imports	Share of the USA in China's Imports
Displacement Products					
290121	Ethylene	224.8	3302.4	3.7	4.5
520100	Cotton, neither carded nor combed	2231.7	3165.7	9.3	33.6
840890	Compression-ignition internal combustion piston engine "diesel or semi-diesel engine"	612.5	2458.5	4.9	19.9
848340	Gears and gearing for machinery	431.1	1904.9	1.7	9.0
841490	Parts of : air or vacuum pumps, air or other gas compressors, fans and ventilating or recycling	336.1	1492.0	1.0	11.4
848190	Parts of valves and similar articles for pipes, boiler shells, tanks, vats or the like, n.e.s.	418.7	1383.3	1.4	11.2
840999	Parts suitable for use solely or principally with compression-ignition internal combustion	817.8	1092.6	1.3	13.6
Enhancement Products					
290531	Ethylene glycol "ethanediol"	291.4	9082.4	2.3	1.6
271012	Light oils and preparations, of petroleum or bituminous minerals which >= 90% by volume	14741.0	5834.3	40.7	5.7
390210	Polypropylene, in primary forms	864.4	4191.4	4.4	1.5
520512	Single cotton yarn, of uncombed fibres, containing >= 85% cotton by weight	573.8	2477.4	13.5	1.1
260112	Agglomerated iron ores and concentrates (excluding roasted iron pyrites)	885.4	2336.6	29.2	2.6

Source: ITC TradeMap, Exim Bank Research

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