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Devina Mehra: Trump’s tariffs will create more problems than they solve

Devina Mehra | 9 April 2025

Every policy measure has to be measured against what it is trying to achieve and how effective it is in reaching those goals. **(REUTERS)**

SUMMARY

The US President insists that his country’s trade partners have been unfair to it, even though America Inc has not complained. Most value addition, businesses reckoned, lay not in manufacturing but in intangibles like intellectual property and brands. Think Apple.

Donald Trump has put paid to the world’s proverbial ‘*Raaton ki neend and din ka chain*’ (night’s sleep and day’s peace) as everyone now tracks index and future quotes from around the world around the clock. His tariffs have created a sensation, but what I wonder about is the problem he is trying to solve.

After all, the US was pretty close to full employment and its labour market has been fairly tight for years. Inflation had begun to float down. So it is inexplicable why he would break something that wasn’t broken.

As Fareed Zakaria set out in a recent video, in 1990 the US economy was the same size as the EU’s. It is now almost 85% larger. In 1990, the US per capita income was way below Japan’s. Today, not only is it far higher, even the per capita income of the poorest state in the US is more than that for the UK or France.

Yes, America has many problems, including a disgraceful healthcare system with frankly terrible outcomes for a country so rich. Inequality is also high, which the Trump campaign capitalized on. But how are these policy measures going to get Americans better lives?

Every policy measure, be it a corporate tax cut or production incentive, has to be measured against what it is trying to achieve and how effective it is in reaching those goals.

If US tariffs take effect as announced, they will have a substantial inflationary impact on the US. Even in the best-case scenario, at least some part of their burden will pass on to its consumers. It will damage consumer confidence, which has already fallen significantly, and may lead to stagflation. The ‘raze everything and rebuild’ approach may not be the smartest. The economy is like a huge tanker with momentum and is very difficult to get back on course once brakes are applied forcefully.

Medium-term inflation expectations in the US were already at 30-year highs, close to 4%, even before the tariffs were announced. Given this, it would be very hard for the US Fed to cut rates rapidly. So much for those who are predicting that this is a grand design to lower the servicing cost of US debt. Plus, the tariffs are predicated on trade deficits, not on others’ tariffs, making it hard for countries to get relief.

Now for the impact on India. As every macroeconomic textbook tells us, trade is about relative advantage and not absolute cost of manufacture or pricing. Hence, while the 26% tariff on imports from India makes Indian goods more expensive in the US, this disadvantage is relative to goods being produced there. The question then becomes how many Indian exports are capable of being substituted by US-made goods?

My guess is not a whole lot and rapid substitution may not be possible, especially as the US currently has very low unemployment and its labour market is being tightened by immigrant round-ups. Plus, the tariff imposed on India is lower than the rates for most of India’s competitors. Against 26% for India, we have 34% for China, 37% for Bangladesh, 46% for Vietnam, etc.

For goods like garments and gems and jewellery, we may have become more, and not less, competitive. However, other countries will also look for workarounds and this may or may not have a significant impact on India.

Moreover, we must remember that it is literally the first throw of the dice and it is difficult to bet on what the eventual picture would be, given the virtually infinite game-theory outcomes possible with so many players in the world.

China has taken an aggressive stance by restricting exports of critical raw materials, using retaliatory tariffs, etc, while the EU may strike back too. India and Japan are taking a more conciliatory approach. Currency depreciation can also be activated as a weapon.

And there will be multiple rounds of this game. Trump has taken a sledge- hammer not just to multilateral institutions, but also to the soft power of the US: trust in institutions and the rule of the law, freedoms intellectual and otherwise, the kind of academic and research structure that attracts the best and brightest. This is what set the US apart not just from Europe, but also Asian countries which had developed very rapidly in terms of wealth but lagged behind on institutions. All of this may get damaged for good.

Along with that, it may permanently damage the US dollar’s position as the world’s default currency for reserves and trade transactions, something I had thought was still decades way.

The real issue to my mind is that 30- year-old interviews of Trump suggest that he has long held a belief that other countries have been unfair to the US, which makes it less likely that he will change his mind in a hurry. Never mind that US corporations had long decided that the maximum value addition was in intangibles like intellectual property and brands. Meanwhile, manufacturing could be done elsewhere. Apple was the poster boy for this.

Interestingly, Elon Musk, the *de facto* presidential deputy, has posted an old video of Milton Friedman explaining how free markets, free trade and global cooperation are needed even to make a pencil. This adds to the irony of an administration that buys Teslas and also wants oil firms to “Drill, baby, drill." We sure live in interesting times!

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