From Tariff Shock to Strategic Resilience: Rethinking MSME Competitiveness in India

Abstract

Micro, small, and medium enterprises (MSME)s are a major source of employment in the rural, sub urban and even the urban communities, especially for the developing nations. In India, it complements the large scale industries, and creates a system of equitable distribution.
The Economic survey 2015-2016 suggests that " Due to comparatively low capital costs, and their forward-backward linkages with other sectors, MSMEs will play a crucial role in the success of the Make in India Initiative". They account for one third of GDP, and 45 percent of India's exports.
The global landscape in 2026 is defined by increasing protectionism by aggressive tariff regimes, and a strategic push for regional integration.
MSMEs face uncertainty in the view of US tariff, as it disrupted supply chains.
This article examines the MSME sector, following the February 2026 de escalation of the US tariff from 50 percent to 18 percent reciprocal rate.

Introduction

The tariff reached its peak in the late 2025, when Indian goods faced an effective duties of 50 (round up) percent, which includes a reciprocal tariff of 26 percent, and punitive tariff for buying Russian oil as 25 percent.
Comparative advantage is based on cost efficiency and productivity. Difference between tariffs creates a policy-induced comparative disadvantage for the country facing a higher tariff, thus affecting its competitiveness in the market, even if it has production efficiency.
Later the India trade deal removed the 25 percent punitive tariff, and reduced the final tariff to 18 percent, which is on par with Asian peers (15 to 19 percent).
Although 18 percent is still much higher than the previous 2024 era, it represents a survival equilibrium for MSMEs, allowing them to regain price competitiveness against rivals like Vietnam and Bangladesh (both having 20 percent tariff).

India's commitment: (legal notice still awaits)
- Gradual exit from Russian oil
- Increased purchase of US oil, coal, and energy, technology and agricultural goods
- Reduction in tariff and non- tariff barriers.

The Impact of tariff on MSMEs

MSMEs operate on a tight margin, even small external shocks can have big consequences, since, unlike large multinational companies, they lack pricing power to pass on costs to consumers or the capital to absorb. Since they have limited pricing power in highly competitive export markets, MSMEs show low cost pass through elasticity, which means that costs increased due to tariff cannot be fully transferred to consumers, instead they are absorbed through compressed margins. This increases the adverse effects of tariff shocks on profitability. Thus tariffs act as a regressive tax on MSMEs.

- In sectors like Surat's diamond industry or chemical manufacturing, MSMEs hold about 40 percent share. The 50 percent US tariff created an immediate liquidity crisis.

- According to the 2026 Global Trade Report, 76 percent of trade professionals see high rates of tariff as a permanent fixture. It causes the disruption of supply chains. This leads the MSMEs to find alternatives, which are often less efficient, sourcing hubs to avoid duty heavy regions.

- Compliance burdens: The tariff policy intersects with ESG (Environmental, Social, and Governance) mandates. This has added regulatory friction, which requires the MSMEs to invest in complex data systems to prove origin of goods and environmental compliance.

The Economic Significance of reduction to 18 percent

Restoration of price parity

At 50 percent, a product costing $100 had a landed cost of $150, which makes Indian MSMEs difficult to survive in the US market.
At 18 percent, the landed cost of $118 helps MSMEs, which have a lower labour cost to stay competitive against Southeast Asian markets.
In many MSMEs, demand is highly price elastic, so when the tariffs were higher, demand reduced, and orders shifted to other countries. Now when the tariffs are reduced, buyers are considering India, and the demand increases.
Thus the competitive viability is restored.

Margin Recovery in Textiles and Rubber

Especially for MSMEs in Tripura (textiles) and Ludhiana (engineering), the reduction of tariff by almost 32 percent has a great significance. It has allowed firms to re-enter long term procurement contracts which were paused in 2025.

The "Plus-One" advantage

By securing 18 percent tariff rate, which is lower than China's 34 percent, and 19 to 20 percent tariff faced by some neighbouring countries, MSMEs of India are now the primary beneficiaries of the “China Plus One” Strategy.

Global buyers are reducing their dependency on China.
If India's tariff remained at 50 percent, buyers would never choose India. But now at 18 percent, and with China at 34 percent, India is becoming relatively more attractive. India is now a part of supply chain diversification, risk spreading strategy, and long term procurement planning.

Strategic Resilience

Lower tariff reduces the cost-push pressure, and improves the price competitiveness. This in turn restores the export demand. As export demand increases, the cash flow improves, and thus the working capital cycle stabilizes.
When the tariffs are high, export demand falls, orders become irregular, and the inventory increases, which causes the inflow of revenue to become highly uncertain.
This causes the MSMEs struggle to repay the suppliers, and they rely on short term borrowing. Consequently the working capital cycle becomes longer and unstable.
This causes liquidity stress.

Now when the tariffs are reduced, payments are received on schedule. The cash inflow is more regular, and thus the payments to the suppliers are made on time. Thus the working capital cycle becomes predictable and shorter. This also improves the credit worthiness of the MSMEs in the eyes of lenders.

While reduction in tariff from 50 percent to 18 percent provides some relief, the long term resilience of MSMEs depends on various factors like structural competitiveness, digital integration and financial deepening.
Currently MSMEs resilience in 2026 is built on three pillars:

Digital and Financial Hardening

The Union Budget 2026-2027 introduced the INR 10,000 crore SME Growth fund.
It will provide equity support (provide capital, and upgradation of machinery), liquidity support (as MSMEs repeatedly faced issues with having liquid assets), and professional and structural support.

TReDS integration: By digitizing receivables, the cost of credit of MSMEs are reduced significantly, partially offsetting the 18 percent tariff burden.

De risking Supply chain

The 18 percent duty required India to gradually exit from importing Russian oil.This initially caused a supply side shock, increasing energy cost for some MSMEs. However, the guaranteed market access at 18 percent offsets the increase in energy cost, and has provided the predictability necessary for capital investment.

India reduces sanction risk, and export access to the US becomes more predictable. Buyers see India has a stable sourcing partner.
This enables the MSMEs to take long term capital commitments.

Technology and Quality Upgrades

The MSMEs are moving from low value commodities to specialized components under the export promotion mission (EPM).
This 18 percent tariff rate has effectively removed some of the inefficient MSMEs, leaving more room for the High value MSMEs. These High value MSMEs not only compete on being the cheapest option in the market, but also compete on precision and ESG (Environmental, Social, and Governance) compliance.

Key Sectoral Impact

Sector	2025 Peak Tariff	February 2026 rate	Regional rival rate	Impact	Current Status
Textiles and Apparels	50 percent	18 percent	20 percent (Vietnam)	High Recovery	15 percent Global Surcharge
Rubber and tyres	50 percent	18 percent	19 percent (Indonesia)	High Growth	15 percent Global Surcharge
Gems and Jewellery	50 percent	18 percent	20 percent (Thailand)	Moderate	15 percent Global Surcharge
Auto Components	50 percent	18 percent	34 percent (China)	Strategic Win	15 percent Global Surcharge

Source Note: Figures synthesized from Press Information Bureau (PIB) India, "India Achieves Landmark Trade Victory," February 6, 2026 and White House Joint Statement on Executive Order 14257.

Resources

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