

# STUDENTS' ECONOMIC FORUM

A monthly publication from South Indian Bank

*To kindle interest in economic affairs...  
To empower the student community...*



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**JUNE 2019**

Theme 331

**“TRADE WAR”**

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Theme No: 331: **“TRADE WAR”**

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A well informed customer will make the policy makers as well as organizations which produce goods and render services more responsive to the customer needs. This will also result in healthy competition among organizations and improve the quality of its products.

The “SIB Students’ Economic forum” is designed to kindle interest in the minds of younger generation. We highlight one theme in every monthly meeting of the “Forum”. This month the topic for discussion is “Trade War”

**What is a trade war?**

A trade war occurs when countries try to attack each other’s trade with taxes and quotas. A trade war happens when one country retaliates against another by raising import **tariffs** or placing other restrictions on the opposing country’s imports. One country will raise tariffs, causing the other to respond, in a tit-for-tat escalation resulting in international trade getting affected.

**Tariff**

It’s a tax on a product made abroad. In theory, taxing items coming into the country means people are less likely to buy them as they become more expensive. The intention is that they buy cheaper local products instead – which will boost the country’s economy.

**Why?**

A trade war starts when a nation attempts to protect its domestic industry and thus create jobs. Increased tariffs are supposed to give a competitive advantage to domestic producers. Their prices would be lower by comparison. As a result, they would receive more orders from local customers. This would add jobs. Trade wars are a side effect of **protectionism**, which are government actions and policies that restrict international trade. Protectionism is also a method used to balance **trade deficits**.

**What is Protectionism?**

A country will generally undertake protectionist actions with the intent of shielding domestic businesses and jobs from foreign competition.

For example take US's steel and aluminium tariffs. In May 2018, the US President announced a 25% tariff on all steel imports and 10% on aluminium. The Trump administration believes that the US relies too much on other countries for its metals, and that it couldn't make enough weapons or vehicles using its own industry if a war broke out.

In theory, taxing foreign steel and aluminium will mean US companies will buy local steel instead. The intention is to boost the US steel and aluminium industries, as more companies will want to buy their goods. Critics argue that protectionism often hurts the people by choking off markets and slowing economic growth and cultural exchange. Consumers may begin to have less choice in the marketplace. They may even face shortages if there is no ready domestic substitute for the imported goods that tariffs have impacted or eliminated. Having to pay more for raw materials hurts manufacturers' profit margins, which can lead to price increase of manufactured goods, thus sparking inflation in the local economy overall.

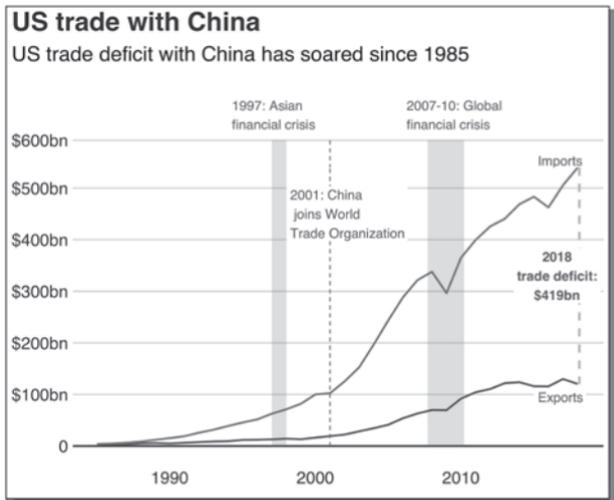
### What is Trade Deficit?

A trade deficit is an economic measure of international trade in which a country's imports exceed its exports. A trade deficit represents an outflow of domestic currency to foreign markets. It is also referred to as a negative balance of trade (BOT). It's a term meaning the difference between how much your country buys from another country, compared with how much you sell to that country.

### US- China Trade War

President Donald Trump wants to reduce the \$621 billion U.S. trade deficit. It has been the world's largest since 1975. Reducing the deficit is part of Trump's strategy to create more jobs. Most of the U.S. deficit resulted from American enthusiasm for imported consumer products and automobiles.

Beginning in January 2018, President



Donald Trump started the imposition of a series of tariffs on everything from steel and aluminum to solar panels and washing machines. These duties impacted goods from the European Union (EU) and Canada as well as China and Mexico. Canada imposed a series of temporary duties on American steel and other products. The EU also imposed tariffs on American agricultural imports and other products including Harley Davidson motorcycles. By May 2019 tariffs on Chinese imports impacted nearly US\$200 billion of trade between US and China. As with all trade wars, China retaliated and imposed stiff duties on American imports.

### **US - India Trade War**

Tariffs on apples, almonds, shrimps, chickpeas, boric acid and some other items imported from the US are set to go up as the government has finally decided to impose retaliatory duties on 29 products. According to the current notification, the retaliatory tariffs came into effect from 16<sup>th</sup> June. The action, which comes a year after the notification of the duties was first drafted in June 2018, is in response to penal duties imposed on Indian aluminium and steel at 10 per cent and 25 per cent, respectively, by Washington last year.

India had announced retaliatory tariffs worth \$230 million on 29 American goods in June last year. New Delhi has since been postponing implementation of these duties hoping to resolve trade concerns, including the withdrawal of the **Generalised System of Preferences (GSP)** by the US. Trump has often termed India a “tariff king” and repeatedly pointed to the 50% duty that India imposes on import of Harley-Davidson motorcycles.

### **The Generalized System of Preferences (GSP)**

The Generalized System of Preferences (GSP) is a U.S. trade program designed to promote economic growth in the developing world by providing preferential duty-free entry for up to 4,800 products from 129 designated beneficiary countries and territories. GSP was instituted on January 1, 1976, by the Trade Act of 1974.

#### **Benefits of GSP:**

- Indian exporters benefit indirectly – through the benefit that accrues to the importer by way of reduced tariff or duty free entry of eligible Indian products.
- Reduction or removal of import duty on an Indian product makes it more competitive to the importer
- This tariff preference helps new exporters to penetrate a market and established exporters to increase their market share and to improve upon the profit margins, in the donor country.

### **What is the impact of GSP withdrawal on India?**

- India exports nearly 50 products of the 94 products on which GSP benefits are stopped. The GSP removal will leave a significant impact on India as the country enjoyed preferential tariff on exports worth nearly \$ 5.6 billion under the GSP route .
- Removal of GSP indicates a tough trade position taken by the US; especially for countries like India who benefited much from the scheme. India is the 11<sup>th</sup> largest trade surplus country for the US and India enjoyed an annual trade surplus of \$ 21 bn in 2017-18.

### **The Pros and Cons of a Trade War**

#### ***Pros***

- ✓ Protects domestic companies from unfair competition
- ✓ Increases demand for domestic goods
- ✓ Promotes local job growth
- ✓ Narrows trade deficits
- ✓ Punishes nations with unethical trade policies

#### ***Cons***

- ∇ Increases costs and induces inflation
- ∇ Causes marketplace shortages, reduces choice
- ∇ Discourages trade
- ∇ Slows economic growth
- ∇ Hurts diplomatic relations, slows down cultural exchange

The advantages and disadvantages of trade war is a fiercely debatable subject. An ongoing trade war between the U.S. and other nations would adversely affect global economic growth, and could thus have a serious impact on global trade and governance.



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