FREE TRADE AGREEMENT

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FREE TRADE

- Ever since Adam Smith published The Wealth of Nations in 1776, the vast majority of economists have accepted the proposition that free trade among nations improves overall economic welfare.
- Free trade, usually defined as the absence of tariffs, quotas, or other governmental impediments to international trade, allows each country to specialize in the goods it can produce cheaply and efficiently relative to other countries. Such specialization enables all countries to achieve higher real incomes.
- Trade agreements is an accord between two or more countries for a specific terms of trade, commerce, transit or investment. They mostly involve mutually beneficial concessions.

TYPES OF TRADE AGREEMENT

- **Unilateral Trade Agreement-** These occur when a country imposes trade restrictions and no other country reciprocates. A country can also unilaterally loosen trade restrictions, but that rarely happens. It would put the country at a competitive disadvantage. The United States and other developed countries only do this as a **type of foreign aid in order to help emerging markets strengthen strategic industries** that are too small to be a threat. It helps creating new markets for U.S. exporters.
- **Bilateral Trade Agreements-** Bilateral agreements involve two countries. Both countries agree to loosen trade restrictions to expand business opportunities between them.
- **Multilateral Trade Agreements-** These agreements among **three countries or more** are the most difficult to negotiate. Once negotiated, multilateral agreements are very powerful. They cover a larger geographic area, which confers a greater competitive advantage on the signatories. All countries also give each other most-favoured-nation status—granting the best mutual trade terms and lowest tariffs.

LEVELS OF TRADE AGREEMENTS

Free Trade Agreement	• two or more countries agree to provide preferential trade terms, tariff concession etc. • Here a negative list of products and services is maintained by the negotiating countries on which the terms of FTA are not applicable
Preferential Trade Agreement	• two or more partners give preferential right of entry to certain products. • This is done by reducing duties on an agreed number of tariff lines. • Here a positive list is maintained i.e. the list of the products on which the two partners have agreed to provide preferential access.
Comprehensive Economic Partnership Agreement	• CEPA covers negotiation on the trade in services and investment, and other areas of economic partnership. • It may even consider negotiation on areas such as trade facilitation and customs cooperation, competition, and IPR. • India has signed CEPAs with South Korea and Japan.
Comprehensive Economic Cooperation Agreement	• CECA generally covers negotiation on trade tariff and TQR rates only. It is not as comprehensive as CEPA. • India has signed CECA with Malaysia.
Framework agreement	• It provides for some new area of discussions and set the period for future liberalisation. • India has previously signed framework agreements with the ASEAN, Japan etc.
Early Harvest Scheme	• An Early Harvest Scheme (EHS) is a precursor to an FTA/CECA/CEPA between two trading partners.

REGIONAL TRADE AGREEMENTS

- Regional trade agreements (RTAs) have risen in number and reach over the years, including a notable increase in large plurilateral agreements under negotiation. Non-discrimination among trading partners is one of the core principles of the WTO; however, RTAs, which are reciprocal preferential trade agreements between two or more partners, constitute one of the exemptions and are authorized under the WTO, subject to a set of rules.
- As of 17 January 2020, **303 RTAs** were in force. These correspond to 483 notifications from WTO members, counting goods, services and accessions separately.
- **The Committee on Regional Trade Agreements (CRTA)** considers individual regional agreements under the Transparency Mechanism for RTAs . It is also mandated to hold discussions on the systemic implications of RTAs for the multilateral trading system, as was reaffirmed by WTO members at the 10th Ministerial Conference in Nairobi in 2015.

FREE TRADE AGREEMENTS

- **Free trade agreements** are entered into by two or more countries who want to seal the economic cooperation among themselves and agree on each other's terms of trading. In the agreement, member countries specifically identify the duties and tariffs that are to be imposed on member countries when it comes to imports and exports.

The key terms of free trade agreements and free trade areas include:

- **Import goods** are products that were manufactured from a foreign land and are brought into another country and consumed by its domestic residents.
- **Export goods** are the opposite of import goods – a manufacturer located in one country sells its products to buyers in another country.

ADVANTAGES OF A FREE TRADE AREA

1. **Increased efficiency-** The good thing about a free trade area is that it encourages competition, which consequently increases a country's efficiency, in order to be on par with its competitors. Products and services then become of better quality without being too expensive.

2. **Specialization of countries-** When there is tough competition, countries will tend to produce more products or goods that they are most efficient at. This is because they take less time to complete and their output is higher.

3. **No monopoly-** When there is free trade, and tariffs and quotas are eliminated, monopolies are also eliminated because more players can come in and join the market.

4. **Lowered prices-** When there is competition, especially on a global level, prices will surely go down, allowing consumers to enjoy a higher purchasing power.

5. **Increased variety-** With imports becoming easier and cheaper, consumers will gain access to a variety of products that are inexpensive.

Disadvantages of Free Trade Area

Despite all the benefits brought about by a free trade area, there are also some corresponding disadvantages, including:

1. **Threat to intellectual property-** When imports come in more easily, domestic producers can easily access them, allowing them to copy the ideas and sell them as knock-offs. With many countries with little to no laws on intellectual property, it would be easy to steal ideas.

2. **Unhealthy working conditions-** Outsourcing jobs in developing countries can become a trend with a free trade area. Because many countries lack labor protection laws, workers may be forced to work in unhealthy and substandard work environments.

3. **Less tax revenue-** Since member countries are no longer subject to import taxes, they need to think of ways to compensate for the reduced tax revenue.

EXAMPLES OF FREE TRADE AREAS

- **EFTA:** European Free Trade Association consists of Norway, Iceland, Switzerland and Liechtenstein
- **NAFTA:** United States, Mexico and Canada (being renegotiated)
- **Mercosur –** Brazil, Argentina, Uruguay, Paraguay and Venezuela
- **SAFTA:** South Asian Free Trade Area comprising Afghanistan, Bangladesh, Bhutan, India, Maldives, Nepal, Pakistan and Sri Lanka
- **Pacific Alliance:** Chile, Colombia, Mexico and Peru
- There are many bi-lateral free trade agreements signed between two countries or between two regional trading blocs e.g. the recently-signed Australia - China Free Trade Agreement

Advantages of Trade Agreements to Indian exporters

- **Tariff reduction –** Widely known benefit of an FTA or PTA is reduced tariff for the offered product list for example in India-MERCOSUR PTA, MERCOSUR offered preferential tariff reduction ranging from 10% to 100% on 450 listed products. It allows exporters to access the market at lower tariff hence provides competitive final prices for the exporters of a partner country.
- **Access to new markets –** Trade with MERCOSUR saw a significant growth post the FTA. The FTAs give easier and competitive access to the exporters as well as importers in the partner countries. For example copper wires import from Malaysia saw a sudden spike post the signing of India –ASEAN FTA in 2010. It not just leads to trade creation as in the case of bituminous coal import from Indonesia but also causes trade diversion from one country to other.
- **Trade risk diversification –** Increasing the diversification in terms of product basket and diversification countries help in hedging the unfavourable consequences on global and national trade due to geopolitical turmoil e.g. Oil crisis after Iran imbroglio, rift in GCC and incidental issues that are on rise in 21st century.
- **Innovation and competition –** Generally better market integration tend to enhance competition thereby it pushes the industry towards innovation benefitting consumers in long run.
- **Technology transfer and increased integration –** Increased trade leads to better integration of market and also facilitate transfer of skills and technology.

THANKS