UNIT 207 – UPSC - FTAs

Free trade agreement (FTA) are aimed to reduce the obstacles to trade between two or more countries, which support to protect local markets and industries. Trade barriers normally emerge in the form of tariffs and trade quotas. FTAs also cover areas such as government procurement, intellectual property rights, and competition policy. Basically, Free trade agreements involve cooperation between at least two countries to decrease trade barriers import quotas and tariffs and to increase trade of goods and services with each other. It can be considered the second stage of economic incorporation.

Preferential trade arrangements include the following:

1. Free trade areas, under which member countries agree to eliminate tariffs and nontariff barriers on trade in goods within the FTA, but each country maintains its own trade policies, including tariffs on trade outside the region.
2. Customs unions, in which members conduct free trade among themselves and maintain common tariffs and other trade policies outside the arrangement.
3. Common markets, in which member countries go beyond a customs union by eliminating barriers to labour and capital flows across national borders within the market.
4. Economic unions, where members merge their economies even further by establishing a common currency, and therefore a unified monetary policy, along with other common economic institutions. The European Union is the most significant example of a group of countries that has gone from a customs union to an economic union.

Main intention of free trade agreements are to benefit consumers. In theory, increased competition means more products and lower prices. Many governments, throughout the world have either signed Free trade agreements or are negotiating, or considering new bilateral free trade and investment agreements. The agreements initiate international integration into a global free market economy. There are another way to guarantee that governments implement the liberalisation, privatization and deregulation measures of the corporate globalisation agenda. It is presumed that free trade and the removal of regulations on investment will head to economic growth reducing poverty and increasing standards of living and generating employment opportunity. Earlier facts

show that these kinds of agreements allow transnational corporations (TNCs) more freedom to exploit workers shaping the national and global economy to suit their interests. In simple terms it removes all hindrances on businesses. FTAs severely constrain future governments in their policy options and help to lock in existing economic reforms which may have been imposed by the IMF, World Bank or Asean Development Bank, or pursued by national governments of their own volition. It works towards eliminating all restrictions on businesses as other free trade and investment agreements perform. FTAs deal with traded merchandises.

For example, India and Sri Lanka signed a free trade agreement in December 1998 with India agreeing to a phase out of prices on a wide range of Sri Lankan goods within 3 years, while Sri Lanka agreed to eliminate tariffs on Indian merchandises over eight years. Major objectives was to the harmonious development and expansion of world trade.

Modern Free Trade Agreements include many different economic and political issues, which differ from trade in goods, such as competition, public procurement, subsidies. Historical records indicated that there has been a huge increase in the number of FTAs around the world since many years. According to WTO, at the beginning of 2009, there were more than 400 FTAs notified to WTO, with more than a half of them still into force. Currently, trade agreements are found in all regions of the world, for examples in such combinations, like the United States and Morocco, Japan and Mexico, or EU and Chile. According to OECD (2005) 55% of world trade was operating under trade agreements. There are numerous economic and political reasons for Countries to form free trade areas. Most fundamentally, by eliminating tariffs and some nontariff barriers, FTAs permit the products of FTA partners' easier access to one another's markets. For example, The 1989 FTA between the United States and Canada was formed possibly for this purpose. Developed countries have also formed FTAs with developing countries to boost them toward trade and investment liberalization. FTAs may be used to shield local exporters from losing out to foreign companies that might receive special treatment under other FTAs. Slow progress in multilateral negotiations has been another motivation for FTAs.

The procedure to establish an FTA usually begins with negotiations between trading partners to determine the practicability of forming an FTA. If they agree to go forward, then the countries undertake negotiations on what the FTA would look like. At a minimum, participants in an FTA agree to reduce tariffs and some other nontariff trade barriers and agree to do so over a specific time period. Additionally, the partner countries usually agree on rules of origin, that is, a definition of what constitutes a product manufactured within the FTA and, therefore, one that is eligible to receive duty-free and other preferential trade treatment. Rules of origin avert products from non-members entering an FTA market over the lowest tariff wall. Most FTAs also include procedures on the settlement of differences arising among members and rules on the implementation of border controls, such as product safety certification and sanitary requirements. Most recent FTAs contain rules on economic activities besides trade in goods, including foreign investment, intellectual property rights protection, treatment of labour and environment, and trade in services. The size and difficulty of the FTA will reflect the size and complexity of the economic relations among the partaking countries. U.S. FTAs with Israel and Jordan are comparatively basic, while the NAFTA (the United States, Canada, and Mexico) is very intricate.

Economic Impact of FTAs

Economists usually appraise the impact of FTAs on the concepts of trade creation and trade diversion. These concepts were first developed by economist Jacob Viner in 1950. Viner focused his work on the financial effects of customs unions, but his conclusions have been largely applied to FTAs and other preferential trade arrangements. His study was also confined to static effects of these arrangements. Trade creation occurs when a member of an FTA replaces domestic production of a good with imports of the good from another member of the FTA, because the formation of the FTA has made it cheaper to import rather than produce domestically. The creation of the trade is said to improve economic welfare within the group because resources are being shifted to more efficient uses. Trade diversion occurs when a member of an FTA switches its import of a good from an efficient non-member to a less efficient member because the removal of tariffs within the group and the continuation of tariffs on imports from non-members make it cheaper to do so. Trade diversion is said to reduce economic welfare because resources are being diverted from an efficient producer to a less efficient producer. In most cases, FTAs lead to both trade diversion and trade creation with the net effects determined by the structure of the FTA. Therefore, even if two or more countries are moving toward freer trade among themselves in an FTA, the FTA could make those countries and the world as a whole worse off if the FTA diverts more trade than it creates, according to economic principle.

The Free trade agreement between the United States of America and the Republic of Korea is a trade agreement between the United States and the Republic of Korea. Negotiations were announced on February 2, 2006, and concluded on April 1, 2007. The treaty was first signed on June 30, 2007, with a renegotiated version signed in early December 2010.

Benefits of Free Trade Agreement

Free trade agreements is advantageous in numerous ways.

1. Free trade agreements raise freer trade flows and create tougher ties with our trading partners.
2. Free trade agreements address behind-the-border barriers that hamper the flow of goods and services between parties, encourage investment, enhance cooperation, and can address other issues, such as intellectual property, e-commerce and government procurement.
3. Free trade agreements can increase productivity and contribute to higher GDP growth by allowing domestic businesses access to cheaper inputs, introducing new technologies, and fostering competition and innovation.
4. Free trade agreements promote regional economic integration and build shared approaches to trade and investment, including through the adoption of common Rules of Origin and through broader acceptance of product standards.
5. Free trade agreements can improve the competitiveness of exports in the partner market, and add to the attractiveness as an investment destination.
6. Free trade agreements can deliver improved trading opportunities that contribute to the sustainable economic development of less-developed economies.
7. Free trade agreements can continue to provide benefits to parties as the agreements are executed, including through phase-ins and in-built agendas that encourage ongoing domestic transformation and trade liberalisation.

Drawbacks of Free Trade Agreement

1. One of the disadvantages of Free trade agreements are the ability of dominant economies to impose their will over smaller, developing economies.
2. Free trade agreements have been enacted for foreign policy purposes instead of bilateral economic benefit.
3. Free trade agreements do not boost trade liberalisation as successfully as multilateral agreements.
4. Free trade agreements simply promote large, competitive trading blocs that could create economic unpredictability

To summarize, Free Trade Agreements are one of the forms of establishing integration between different countries. Since last few decades, the number of FTAs grew significantly and now occupies the majority of world trade. Free trade agreements are visualized by economic experts as a significant trade policy vehicle for the United States and for other major trading nations.