# Free Trade Agreement and Economic Liberalisation in The Modern Conceptual Ideas Growth and Myth and Reality

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***Abstract - Free trade refers to a situation where a government does not attempt to restrict what its citizens can buy from another country or what they can sell to another country. The classical trade theories of Smith, Ricardo, and Heckscher-Ohlin predict that the consequences of free trade provide both static economic gains (higher levels of domestic consumption and more efficient utilisation of resources) and dynamic economic gains (stimulates economic growth and the creation of wealth). David Ricardo's 'theory of comparative advantage' is regarded in economic literature as a proponent of free-trade. According to Ricardo, a country should specialise in the production of product(s) that it can produce most efficiently and trade them for product(s) produced by other countries. Again, all nations that participate in international free-trade will realise economic benefits, as trade is a positive-sum game and not a zero-sum game.***

***Keywords: Foreign Trade, Foreign Trade Agreement, Liberalization, Economic Development, Economic Zones.***

## I. INTRODUCTION

Foreign trade plays an important role in the Indian economy and creates approximately 14 million jobs directly or indirectly. As an emerging economy, India still has a lower percentage contribution in the world trade. India stands 20th in merchandise export and 13th in merchandise imports. While it stands at 7th as far as commercial service export is concerned (WTO statistics, October, 2011). India's share of world total export is only 1.44 percent while in import is merely 2.12 percent (2010)

The short term objective of the present foreign trade policy (2009 - 2014) is to arrest and reverse the declining trend of exports and to provide additional support especially by recession in the developed world (US & EU). By 2014 it is expected to double India's export of goods and services from the present level of 1.64 percent.

In the modern days, global trade and exchanges have become inevitable. Countries are earning prosperity by maximising exports and minimising imports. But, Indian foreign trade scenario is not very encouraging. India still has a very low percentage contribution in world trade. Higher import and lower export result in negative balance of trade and results in more outflows of the country's precious resources. Therefore, for accelerating the pace of growth the balance of foreign trade needs to be reversed. Export is the main thrust of India's trade policy. Here, the focus remains on bringing foreign investors to set up export-oriented units in India. Besides, trade policy measures, shift in focus to some markets and some products, trade facilitation, tariff reforms, etc. have helped in some measures, if India has to achieve a substantial share in world exports, well measured and diversified FTAs (Free Trade Agreements) will be needed.

## II. FREE -TRADE AREA

Free-trade area is a trade block whose member nations have signed a free-trade agreement which eliminates tariffs, import quotas, and preferences on most goods and services among nations in the free-trade area. It is considered as the second stage of economic integration. This is possible if the economic structures are complementary to each nation in the area.

The aim of a free-trade area is to reduce barriers to exchange so that trade can grow as a result of specialisation, division of labour, and most importantly via comparative advantage. The theory of comparative advantage argues that in a competitive market place each source of production will tend to specialise in that activity where it has comparative (not absolute) advantage. It also argues that the net result will be an increase in income and ultimately wealth and well being for everyone in the free-trade area. It refers only to aggregate wealth and nothing but the distribution of wealth. In fact there may be significant losers. In principle, the overall gains from trade could be used to compensate for the effects of reduced trade barriers by appropriate inter-party transfers.

Every customs union, trade common markets, economic union, customs and monetary union and economic and monetary union has also a free-trade area. Most of these multilateral agreements are signed between neighboring nations, but there are exceptions like the world trade organisation (WTO) agreements and the TPP (Trans-Pacific Strategic Economic Partnership) agreements. The operating FTAs are:

- AEAN Free Trade Area (AFTA)
- Asia-Pacific Trade Agreement (APTA)
- Central American Integration System (SICA)
- Central European Free Trade Agreement (CEFTA)
- Common market for Eastern and Southern Africa (COMESA)
- G-3 Free Trade Agreement (G-3)
- Greater Arab Free Trade Area (GAFTA)
- Gulf Cooperation Council (GCC)
- North American Free Trade Agreement (NAFTA)
- Pacific accord
- South Asia Free Trade Agreement (SAFTA)
- Southern African Development Community (SADC)
- Southern Common Market (MERCOSUR)

## III. FREE TRADE AGREEMENT (FTA)

An FTA facilitates enforcement of legally binding commitments made by its member nations, either to sequentially reduce or completely eliminate various types of trade barriers facing each other, but keep them to non-member nations. Thus, FTA members gain an advantage in accessing each other's markets compared to non-member.

India has taken strategic steps to deepen integration with global economy over the last two decade. India has substantially opened its trade borders through a variety of FTAs and now with 13 such deals in effect and 12 more under negotiation. As a result India's exports and imports of goods and services have more than doubled since the 1990s - from 23 percent of GDP to 50 percent in 2010-2011.

FTAs have opened new export markets, but simultaneously exposed to greater import competition to Indian firms. With a slowdown in EU&US – India's major two export markets – likely to cut India's export growth, 11 percent in October, 2011, down from 82 percent in July, 2011. In a period of depressed export growth, a more managed approach will be critical to ensuring that future trade liberalisation, including ongoing FTAs.

India has contributed and benefited much from the multilateral trade liberalisation process from her independence, as one of the founder member of GAAT (General Agreement on Tariff and Trade) in 1947. However, the slow rate of process in multilateral trade and examples of success stories of FTAs influence India's to rethink of prospect by preferential trade agreements (PTAs). This resulted in several FTAs and Comprehensive Economic Cooperation Agreements with other nations.

## IV. POTENTIAL BENEFITS OF FTA:

Adam Smith, the father of economics, made the argument that free-trade was a better solution for trading countries like ours. An analysis of the major theories of global free-trade, the basis (or motives) of FTA initiatives are:

1. FTAs lead to specialisation and division of labour, which offers benefits to all the member nations.
2. FTAs always lead to the expansion of the world's supply of goods and services, as it reduces supply chain costs and access new markets.
3. Through FTA, scares resources can be equitably distributed among the member nations.
4. Develop a diversified geographic portfolio that mitigates economic risk and lead to reduction in the cost per unit of output because of economies of scale.
5. Attract investment in enhancing efficiency of capital, labour and technology to successfully compete against cheap imports.
6. Boosting agricultural products exports further in Europe, USA, and other developing countries.
7. Growth in exports of services, thanks to IT exports in general and outsourcing of job by Indian IT industry.
8. Inflow of FDI in various industrial units will boost the economic life of the economy.
9. Reduction in the balance of payments (BOP) deficit. When a country purchase a product from another country with money, essentially send the exporting country non-interest IOUs in exchange for real goods. The exporting country, though, must use that money within the country that imported the products.
10. Increased employment opportunities. When productivity increases in exporting and importing, employment and wages tend to rise.

11. As countries work together professionally, mutual respect for the countries' customs and cultures increases. Fears and prejudices diminish, and countries are less likely to fight each other.

## V. POTENTIAL CONCERNS ABOUT FTA:

It should also be noted that the above gains depend on factors like, the terms of trade, elasticity of demand, competition in the international market and the scope for improvement of productivity. There are some concerns about FTA -

1. **Loss of Jobs:** As FTA encourage business to open manufacturing, warehouse, and headquarters outside of their domestic countries, creating a huge job loss to domestic workers.
2. **Product Dependency:** FTAs often rely on comparative advantages, as countries set up trade agreements to match their natural resources. On one hand, this works out because countries gain access to products that they can't produce themselves and they get them at a reduced rate. However, this also creates a dependency on foreign goods.
3. **Cultural Imperialism:** It is worried that FTA is simply another form of colonisation, especially when trade between two countries is not balanced.
4. **Poor Labour Condition:** Companies engaging in global free-trade often open new plants in countries with relaxed labour laws. So employees should work more hours for lower wages. This will creates an unhealthy environment and dangerous cycles, as workers are forced to accept lower wages just to keep their jobs.
5. **Increased Competition:** When countries open their international borders to FTA nations, they also open themselves up to the possibility of fierce competition which may come from other nations in the same area. All the countries within the area would be competing with one another for the same market.
6. **Corporate Restructuring:** Companies in free-trade area are always in competition with one another, lead to restructuring. Unless companies that are at a competitive disadvantage restructure their operations, they may be in a position to catch up with their competitors. Restructuring is an expensive endeavor in the case of small and medium enterprises.

## VI. DISCUSSION

Over the last decade, India's integration into the global economy has coincided with strengthening of trade ties with other emerging markets. The percentage of India's exports to emerging economies increased by almost 20 percent from 46 percent in 2000 to 65 percent in 2010. Imports from emerging market have grown at a slower pace, increasing from 51 percent in December, 2000 to 59 percent in December, 2010. Trade growth between India and emerging market is only likely to accelerate based on the FTAs under negotiations with emerging economy.

FTA is a double-edged sword. On the surface it appears as unique opportunity for everyone in the pact. While it has some advantages, it also carries some concerns. The extend of such concerns for our country is directly related to the level of technology, level of infrastructure, restructuring management and function of small and medium enterprises (SME) and the activism of government in monitoring the progress of the FTAs. In India, the potential benefits of FTAs can only be derived of by having a measured (balanced) FTA and thus can achieve long-term inclusive growth.

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