



FINANCIAL LITERACY **FOR YOUTHS**



Free Trade



Free Trade

Free trade is a policy followed by many countries where the exchange of goods between countries are not subjected to any form of protectionist measures such as tariffs or quotas. Free trade was practised in Britain since the mid-18th century, while rest of the world started implementing free trade oriented economic policies post World War II.

The World Trade Organization (WTO) was established in 1995 in order to provide a framework for countries to implement trade agreements and make those countries adhere to a common set of values such as non-discrimination, reciprocity, binding and enforceable commitments, transparency, and safety values. It also plays a role in settling trade disputes between member nations. Today, most of the nations in the world are members of WTO, which limits trade barriers but is still far from completely eliminating them.

Benefits of Free Trade

Comparative Advantage

Comparative advantage in economics means a country can produce a certain good at a cheaper cost than another. For example, Malaysia could produce palm oil at a lower cost than USA while USA can produce corn at a cheaper cost. This may be due to differences in weather or natural resources available. As per this theory, it economically viable for Malaysia to import corn from USA and export palm oil rather than trying to grow corn in Malaysia for local consumption since it would cause an inefficient allocation of resources.

Lower Costs

By using the cheapest raw materials, businesses are able to produce goods at a cheaper price. This is because free trade allows companies to import cheaper raw materials. Certain companies even invest in countries with raw materials and manufacture the goods there and import it to the home country while still being able to market it at a more economical price since there are no tariffs.

Improvement in efficiency and competitiveness

With time, free trade forces companies and workers to be more efficient in order to not lose out against cheaper imported goods, creating a condition for more efficient industries to thrive. Hence, constant need to innovate and increase efficiency fuels competitiveness.

Drawbacks of Free Trade

Outsourcing of jobs

This problem affects developed countries more than developing countries. Let say a computer produced in US costs \$500 while a computer produced in China can be produced at \$300 due to lower wages. It will be harder for US companies to compete with imported computers since there isn't any form of tariffs on the imported computers. For the US computer company to survive, it has to outsource it's manufacturing plant, which causes a loss of jobs in USA. This perhaps is the biggest negative attribute of free trade.

Infant industry

It is no doubt harder for infant industries to prosper with free trade taking place. It takes time for industries to achieve economies of scale, and when their product is imported at a lower price it is almost impossible for an infant industry to establish itself.

Disregard to rule of law and regulations

Corporations can avoid high taxes by moving operations elsewhere, and in countries with weaker government, corporations may pressure governments to make decisions in their favour. Accounting, banking, and investment regulations can take a similar direction; countries interested in attracting investment may make their financial institutions laxer for short term political benefits. Many developing countries lack strong financial institutions that are needed for efficient functioning of an economy compared to developed countries. A large flow of capital would put undue stress on these institutions making space for corruption to take place.

Stages of Economic Integration

Economic integration is the unification of economic policies between different countries with the goal of abolishing tariffs and non-tariff restrictions among member nations. The first stage is preferential trading area; here participating countries acts as a trading bloc by reducing tariffs on goods exported by each other. Second stage is free trade area; it is when a region or a group of countries have signed a free trade agreement (FTA) and have agreed to reduce trade barriers.

Third stage is customs union; here the trade bloc has implemented a common external tariff against countries that are not inside the union. A good example of a custom union is Mercosur, made up of Latin American countries. Fourth stage is common market; here all barriers to mobility of labour and capital have been eliminated and some form of policy synchronization implemented. The final stage is economic union; here a common economic policy is followed by member nations. European Union is an example of an economic union which uses a common currency and a centralised fiscal policy.

Free Trade in the 21st century

Recent years have seen a wave of nationalism across Europe and North America where candidates that are populist or nationalist, with an anti-globalisation message, seems to gain ground. Following the inauguration of President Donald Trump, USA which was the centre of free trade would adopt more protectionist policies that would isolate themselves from rest of the world. What would this mean for the other countries when the world's largest economy closes its door to free trade?

For starters, the Trans Pacific Partnership Agreement (TPPA) made during the tenure of President Obama and was waiting to be ratified by the member nations might be put on hold or scrapped altogether. TPPA's political intention was to maintain US influence in the pacific and counter Chinese influence. Hence it is crucial that TPPA is implemented for the USA to maintain a global dominance. Asian countries may turn towards China or strengthen their own trading blocs like SAARC in South Asia and ASEAN in South-East Asia.



References

Futureofworking.com. (2017). *6 Advantages and Disadvantages of Free Trade* / *FutureofWorking.com*. [online] Available at: <http://futureofworking.com/6-advantages-and-disadvantages-of-free-trade/> [Accessed 27 Jan. 2017].

The Balance. (2017). *7 Pros and 7 Cons of Trade Agreements*. [online] Available at: <https://www.thebalance.com/free-trade-agreement-pros-and-cons-3305845> [Accessed 25 Jan. 2017].

Sinha, A. (2017). *What are the disadvantages of Free Trade ?*. [online] Preservearticles.com. Available at: <http://www.preservearticles.com/201012291888/disadvantages-of-free-trade.html> [Accessed 23 Jan. 2017].

Publications.gc.ca. (2017). *Stages of Economic Integration: From Autarky to Economic Union*. [online] Available at: <http://publications.gc.ca/Collection-R/LoPBdP/inbrief/prb0249-e.htm> [Accessed 26 Jan. 2017].

