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FREE TRADE AGREEMENTS

Summary

Free trade allows for the unrestricted import and export of goods and services between two or more countries. Free trade agreements (FTA) are forged to lower or eliminate tariffs on imports or quotas on exports. These help participating countries trade competitively.

Background

The doctrine of mercantilism (now called protectionism) dominated the trade policies of the major European powers for most of the 16th century through the end of the 18th century. The key objective of trade, according to the mercantilists, was to obtain a “favorable” balance of trade, by which the value of one’s exports should exceed the value of one’s imports. From the early 19th century, trade was a divisive issue in American politics—and the fault-line fell between slave and non-slave states. Northern manufacturers sought the protection of high tariffs on competing imports; southern cotton producers backed open trade policies to promote their exports.

British economist David Ricardo, who first articulated the classical argument for free trade, did so on the basis of comparative advantage in 1812. Comparative advantage argues that free trade works even if one partner in a deal holds absolute advantage in all areas of production—that is, one partner makes products cheaper, better, and faster than its trading partner. Comparative advantage stipulates that countries should specialize in a certain class of products for export but import the rest. Ricardo’s argument was quickly accepted and remains so among economists to this day.

Public sentiment has vacillated between protectionism and liberalization. Times of economic turmoil, when they come, usually lead to an increase in protectionist sentiments. The Smoot-Hawley Act of 1930 raised tariffs by an average of 40-50%. Soon after, Franklin Roosevelt signed the Reciprocal Trade Act of 1934, reducing tariff levels and promoting trade liberalization. Under this Act, the President’s negotiating authority was initially limited to bilateral agreements with individual foreign nations. After World War II, the U.S. led the creation of the multilateral General Agreement on Tariffs and Trade, known as the GATT. Under this framework, the major world trading nations concluded a series of negotiating “rounds” to further lower trade barriers.

Current Status

An FTA is an agreement between two or more countries where the countries agree on certain obligations that affect trade in goods and services, protections for investors, and intellectual property rights, among other topics. For the United States, the main goal of trade agreements is to reduce barriers to U.S. exports, protect U.S. interests competing abroad, and enhance the rule of law in the FTA partner country or countries.

Documenting how a product originates, or meets the rules of origin, can make using the FTA tariffs a bit more complicated, but other opportunities frequently found in negotiated FTAs include:

- the ability for a U.S. company to bid on certain government procurements in the FTA partner country;
- the ability for a U.S. investor to get prompt, adequate, and effective compensation if its investment in the FTA partner country is taken by the government (expropriated);
- the ability for U.S. service suppliers to supply their services in the FTA partner country;
- protection and enforcement of American-owned intellectual property rights in the FTA partner country; and
- the ability for U.S. exporters to participate in the development of product standards in the FTA partner country

Impact

The United States currently has 14 Free Trade Agreements (FTAs) with 20 countries in force. The reduction of trade barriers and the creation of a more stable and transparent trading, and investment environment, make it easier and cheaper for U.S. companies to export their products and services to trading partner markets.

RESOURCES:

America’s Uneasy History with Free Trade (Harvard Business Review)
Free Trade: History and Perception (Foundation for Econ. Education)
A Brief History of International Trade Agreements (Investopedia)
U.S. Free Trade Agreements (Export.gov)
FTA Tariff Tool (International Trade Administration)