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# IMPACT OF FREE TRADE ON THIRD WORLD NATION IN THE CONTEXT OF INDIA: A CRITICAL ANALYSIS

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## ABSTRACT

Free Trade Agreement (FTA) is “a pact between two or more nations to reduce barriers to imports and exports among them”. Under a free trade policy, goods and services can be bought and sold across international borders with “little or no government tariffs, quotas, subsidies, or prohibitions to inhibit their exchange”.

“According to data provided by the Directorate General of Commercial Intelligence and Statistics, India's merchandise exports to countries/regions with which India shares trade agreements such as FTAs have registered a growth of 20.75% in the last five years.”

In this paper I will discuss the FTA in India which comes under the third world nation. Further, I will discuss the rule of origin and impact on Indian market and economy.

**Keywords:** Free Trade Agreement, Third World Nation, Rule of Origin, India.

## Introduction

A free trade is a concept which encourages the theory of laissez faire and it can be understood by the idea of free and minimal government intervention policy. This approach is supported with an agreement which is known as free trade agreement. This agreement is in between two or more countries to lower import and export restrictions. According to a free trade policy, there are “less or minimum government tariffs, quotas, subsidies, or prohibitions” that prevent the exchange of products and services across international borders<sup>1</sup>. The North American Free Trade Agreement (NAFTA), between the United States, Canada, and Mexico is one of the best-known Free Trade Agreements (FTAs).

In 1948, the United States along with more than 100 other countries agreed to the General Agreement on Tariffs and Trade (GATT), a covenant that reduced tariffs and other barriers to trade between the signatory countries. In 1995, GATT was replaced by the World Trade Organization (WTO). Today, 164 countries, accounting for 98% of all world trade belong to the WTO.

## Advantages of FTA

1. Free trade creates economic growth opportunities.
2. There are more opportunities for foreign direct investment.
3. It lowers the taxes that consumers and businesses pay.
4. Free trade creates more opportunities to solicit workers with expertise.

## Disadvantages of FTA

1. There are more risks for currency manipulation.
2. There can be fewer intellectual property protections because of free trade.
3. Environmental protections are minimal in free trade.
4. There can be fewer revenue generation opportunities in free trade.

## Third World Nation

The term “Third World” is defined to classify the nations which are developing or indigent. There are following points which are supported the idea of third world nation.

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<sup>1</sup> Adam Barone, “Free Trade Agreement (FTA)”, Investopedia (Jun 04, 2022), <https://www.investopedia.com/terms/f/free-trade.asp>.

- High rates of poverty,
- Economic and/or political instability,
- High mortality rates.

According to IMF, India comes under the modern theory of Third World Nation.

### **History and objective of third world nation**

The term "Third World" first came into usage during the Cold War to describe nations that did not support the Warsaw Pact or the North Atlantic Treaty Organization (NATO). We can say that this term describes the nations those did not choose a side in the Cold War. The "First World" was constituted of nations that allied with NATO, while the "Second World" was comprised mainly of those that allied with the Warsaw Pact.

The meaning of "Third World" significantly changed with the collapse of the Soviet Union in 1991. The concept is now used to indicate non industrialised or economically underdeveloped nations. According to the historical concept of the "Third World," nations like Finland, Switzerland, Ireland, and Austria would fall under this category<sup>2</sup>.

### **India associated with free trade agreement**

India is active participant in regional and bilateral trade discussions to broaden and diversify its export markets while securing access to the capital goods, raw materials, and intermediates required to support local manufacturing with added value.

- 🌐 Bilateral trade is the exchange of goods between two nations promoting trade and investment. The two countries will reduce or eliminate tariffs, import quotas, export restraints, and other trade barriers to encourage trade and investment.
- 🌐 A regional trade agreement (RTA) is a treaty between two or more governments that define the rules of trade for all signatories.

Through trade agreements, India currently offers preferential market access and economic cooperation to more than 50 nations<sup>3</sup>.

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<sup>2</sup> "Third World", CFI (Feb 11, 2021), <https://corporatefinanceinstitute.com/resources/knowledge/economics/third-world/>.

<sup>3</sup> *Trade Agreements*, INTERNATIONAL TRADE ADMINISTRATION (Oct 23, 2021), <https://www.trade.gov/country-commercial-guides/india-trade-agreements>.

After India opted out of the Regional Comprehensive Economic Partnership (RCEP) in November 2019, the 15-member FTA grouping that includes Japan, China and Australia, FTAs went into cold storage for India.

There are some examples of the regional and bilateral trade agreements.

1. India ASEAN Trade in Goods Agreement
2. South Asia Free Trade Agreement
3. Indo Sri Lanka Free Trade Agreement
4. Indo Malaysia Comprehensive Economic Cooperation Agreement
5. India Singapore Comprehensive Economic Cooperation Agreement
6. Japan India Comprehensive Economic Partnership Agreements
7. India Korea Comprehensive Economic Partnership Agreements

### **Rules regarding FTA in India**

Under a trade agreement, duty concessions are required to be extended only to such imported goods which are ‘made in’ the exporting country. Each FTA contains a set of rules of origin, which prescribe the criteria that must be fulfilled for goods to attain ‘originating status’ in the exporting country. Such criteria are generally based on factors such as domestic value addition and substantial transformation in the course of manufacturing/processing. For instance, the originating criteria finalized under a trade agreement could be domestic value addition of minimum 35% plus substantial transformation through Change in Tariff Sub-Heading (CTSH).<sup>4</sup>

The goods imported under a trade agreement are required to be covered under a ‘Certificate Of Origin’ (COO) issued by the designated authority of the exporting country. The COO contains details of goods covered and originating criterion fulfilled.

### **Impact of FTA in India**

“India has seen some notable positives from the FTAs in the recent past as data shows a significant increase in the exports to some of the countries. According to data provided by the Directorate General of Commercial Intelligence and Statistics, India’s merchandise exports to countries/regions with which India shares trade agreements such as FTAs have registered a growth of 20.75% in the last five years. Additionally, India’s export to ASEAN has witnessed

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<sup>4</sup> [https://www.cbic.gov.in/resources//htdocs-cbec/customs/CarotarBrochure\\_8thOct2020.pdf](https://www.cbic.gov.in/resources//htdocs-cbec/customs/CarotarBrochure_8thOct2020.pdf)

an increase from \$25.13 billion in 2015-16 to \$31.49 billion in 2020-21. The same trend follows with other countries/regions as well, whereas India's export to SAFTA countries has increased from \$18.60 billion in 2015-16 to \$22.08 billion in 2020-21 and export to South Korea has increased from \$3.52 in 2015-16 to \$4.68 billion in 2020-21. More importantly, data provided by the Department for Promotion of Industry and Internal Trade suggest that cumulative investment received from the countries India shares FTAs in the last five years is to the tune of \$89.46 billion.”<sup>5</sup>

Recently, “the Government of India has signed the Comprehensive Economic Partnership Agreement (CEPA) with UAE and Australia-India Economic Cooperation and Trade Agreement aiming to give a push to bilateral trade and increase exports in the coming years. Moreover, India has shown enthusiasm and actively negotiating FTA deals with countries such as Canada, Israel, the United Kingdom and European Union.”<sup>6</sup>

“One of the areas of concern for India remains the negative balance of trade with countries such as ASEAN and Japan despite the increase in exports. India has accounted for a trade deficit of \$15.95 billion in 2020-21 with ASEAN countries. At the same time, the trade deficit with Japan remained \$6.49 billion in 20-21. In contrast, India has achieved a rise in exports to the USA and China despite not having any FTAs with both countries. The increase in export is part of India's increasing focus on making an export-driven economy as India achieved the highest ever exports of 37 billion US dollars in December 2021, which is 37% higher than December 2020. More importantly, India saw a slight improvement in the trade deficit with China from \$52.67 billion in 2015-16 to \$44.02 billion in 2020-21, despite not having any FTA with China. Thus, the data reflects that even though FTAs/RTAs give better access to new markets and facilitate exports, there is an urgent need of addressing the key issues such as reducing the trade deficit to make these FTAs/RTAs more effective.”<sup>7</sup>

India has previously brought up a number of concerns regarding FTAs and how they may affect domestic markets. The effect of FTAs on local supply chains is one of the main issues raised by the Indian government. Maintaining a balance between expanding local markets' exporting potential and global economic integration continues to be a concern for India.

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<sup>5</sup> Amit Kapoor and Akshay Bhambri, *A preferential route: Effectiveness of FTAs in Indian export*, The Economics Times (May 04, 2022), <https://economictimes.indiatimes.com/news/economy/foreign-trade/a-preferential-route-effectiveness-of-ftas-on-indian-exports/articleshow/91294341.cms>

<sup>6</sup> *ibid*

<sup>7</sup> *ibid*

## **Conclusion**

FTAs include clauses on trade facilitation and rule-making in investment, intellectual property, government procurement, technical standards and sanitary and phytosanitary issues and provide a possibility for countries to enhance trade and exports, access to new markets, trade risk diversification, enhancing innovation and competition, better integration of markets and facilitating the transfer of skills and technology.

This agreement impacts on the business in India is that Indian currency and products both are influencing the foreign market which is beneficial for economic growth.

Impact of FTAs in India has both effects somewhere it is good and somewhere it is not satisfactory. Government must take some steps to modify or enhance the regulations and guidelines to protect the local businesses as well.