

# The Impact of Free Trade Agreements on Developing Countries: Opportunities and Challenges

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**Keywords:** Free Trade Agreement (FTA), North American Free Trade Agreement (NAFTA), United States-Mexico-Canada Agreement (USMCA), Developing Countries, Sustainable Development.

**Abstract:** Amid deepening globalization, Free Trade Agreements (FTAs) have evolved into rule-driven instruments prioritizing intellectual property, environmental standards, and comprehensive governance, exemplified by the USMCA. While FTAs offer developing nations market access and technological inflows, they pose challenges, such as heightened competition threatening local industries, regulatory pressures from stringent environmental clauses, and risks of economic dependency. This research found that developing countries must strengthen domestic industrial competitiveness through innovation and skill development while reinforcing social safety nets to mitigate inequality to navigate these trade-offs. Regional alliances and specialized negotiation teams can enhance bargaining power against asymmetric terms. Simultaneously, adaptive environmental policies and cross-border knowledge-sharing frameworks are critical to balancing economic growth with ecological sustainability. By adopting proactive strategies, industrial upgrading, institutional capacity-building, and multilateral cooperation-developing economies can transform FTA challenges into catalysts for equitable, climate-resilient development.

## 1 INTRODUCTION

For developing countries, joining FTA is often regarded as an effective way to promote intra-country economic growth as this can facilitate technology transfer within country and effectively attract Foreign Direct Investment (FDI) (Al-Balushi & Anderson, 2024). However, the challenges brought by FTA to developing countries could not be neglected. For instance, after some developing countries cut their tariffs under the framework of FTA, some domestic traditional industries may decline due to the higher intensity of market competition, which may lead to a decrease in the autonomy of domestic industries, thus further exacerbating social inequality and economic imbalance (Autor et al., 2016). Apart from the financial aspect stated above, the impacts brought by FTA to developing countries in other aspects are also controversial. For instance, compared to developed countries, the bargaining power of developing countries in FTA is relatively limited, thus causing them to make unfavorable concessions in areas such as intellectual property protection, environmental standards and sustainability and

sacrifice their long-term benefits (Baker & O'Malley, 2020).

This article will take USMCA as an entry point and analyze the specific impacts of the FTA on developing countries from economy, society, and environment through textual analysis, combined with texts of the research on it. This agreement was an edited version of the North American Free Trade Agreement (NAFTA) which came into effect in 1992. Statistics showed that NAFTA and USMCA brought an increase in FDI and upgraded manufacturing technology to Mexico, while at the same time, bringing a series of negative impacts. For instance, a shock to domestic traditional industries and an increased reliance on external market (Baldwin, 2016). This article analyzes and summarizes opportunities and challenges brought to developing countries on the basis of the case USMCA, discussing how to maximize the benefits brought to developing countries by FTA and avoiding the potential negative impacts and problems as well.

## 2 LITERATURE REVIEW

Arguments raised by existing studies on the question of the impact of FTA on developing countries fall into two main areas.

Some scholars believe that FTAs can bring great economic opportunities to developing countries. Developing countries can increase the effect of jobs in the country by participating in FTAs, while cooperation with other countries can not only help the country attract foreign investment but also promote the technological upgrading of domestic industries and the diversification of industrial structure, thus promoting economic growth to help the country to enhance competitiveness in the global economic market (Crossa, 2024). In the case of USMCA, Mexico has deepened the integration of its manufacturing industry chain with the United States and Canada after the implementation of the agreement, which has promoted the upgrading of Mexico's domestic export structure and the development of its high-value-added industries, thus further illustrating the opportunities that FTA brings to developing countries (Devdiscourse, 2022).

Other scholars emphasize the negative impacts of FTA on developing countries, arguing that free trade does not necessarily balance economic growth, social justice, and environmental issues. Although FTA may bring short-term financial benefits, in the long run, over-reliance on external markets may inhibit innovation in local industries, pose a great threat to local small-scale enterprises, and exacerbate social inequality (Gallagher & Carreón-Rodríguez, 2021). At the same time, for developing countries, joining the FTA may lead to over-dependence on developed countries with which they cooperate, leading to the weakening of their economic and legislative independence, and may even further weaken their voice on the world stage (Hufbauer & Schott, 2005). In addition, the FTA may also lead to the over-development of high-pollution industries in developing countries and increase domestic environmental pollution. After the USMCA came into effect, the local enterprises in Mexico were threatened by the competition in the US market, which exacerbated the problem of regional poverty (Jaumotte, 2004). At the same time, resources in some parts of the country have been over-exploited, leading to increased pollution problems (Jean & Bureau, 2016).

Based on these different perspectives, this article argues that FTA brings both economic benefits and certain social risks to developing countries as forms of opportunities and challenges (Venkata, 2024).

Although FTA can promote technological progress, it will also bring a series of serious problems if it lacks effective national policy support. Therefore, when signing FTA, developing countries should pay more attention to the balance between economic growth, social equity and sustainable development, while avoiding the imbalance in economic structure and the aggravation of social problems caused by blind dependence on external markets.

## 3 IMPACTS BROUGHT TO DEVELOPING COUNTRIES BY SIGNING FTA

### 3.1 Overall Impacts Brought to Developing Countries by Signing FTA

Based on existing research, this article will explore the role of FTA in promoting economic growth, industrial upgrading and technology transfer in developing countries, and at the same time analyze the potential risks of increased market competition and weakened industrial independence.

#### 3.1.1 Opportunities Brought to Developing Countries by FTAs

Under the framework of FTA, developing countries can open up their markets. Meanwhile, FTA provides developing countries with a platform to have access to comparatively more advanced technologies. By signing FTA with developed countries to establish closer trade relations, local enterprises in developing countries are more likely to introduce advanced production technologies and management modes of developed countries, thus promoting the modernization of the industry and efficiency, bringing about industrial upgrading. Furthermore, FTA brings developing countries the opportunity to receive foreign direct investment (FDI) from developed countries, which generally focus on advanced technology and efficient production systems, thus further promoting the technological upgrading of local enterprises to obtain the effect of FDI (Kotschwar, 2017).

At the same time, the signing and establishment of FTA significantly reduces the import and export transaction costs, improving the convenience of local firms entering other countries' markets. With the expansion of the export market, the scale of

production has expanded, the demand for labor has significantly increased, and the number of jobs in the country has also increased, especially in labor-intensive industries such as manufacturing. Taking the Comprehensive and Progressive Agreement for Trans-Pacific Partnership (CPTPP) as an example, which has contributed to the rapid expansion of export-oriented manufacturing industries in member countries such as Vietnam and Malaysia by eliminating tariff barriers and promoting intra-regional investment flows, thus driving a large number of employment opportunities in industries such as garments and electronics (Lin, 2012).

### 3.1.2 Challenges Brought to Developing Countries by FTA

Developing countries may suffer from regional development imbalances and weakened economic independence. While FTA can facilitate the integration of developing countries into international trade markets, this economic impetus is often spatially selective. Trade and investment may be more concentrated in regions with good transportation and infrastructure. At the same time, for the sake of trade facilitation, investments targeting export-oriented firms may be concentrated in coastal areas, while in contrast, inland and rural areas are less likely to enjoy the economic dividends brought by FTAs, leading to imbalances in regional development (Moerland, 2017).

At the same time, FTA may also bring weakened economic independence to developing countries. With the increase in FDI, developing countries may gradually develop due to the economic ties of trading partners. After signing FTA, developing countries' economic policies may also be influenced by external economies in order to cater to other economies. And further dependence on trading partners may lead to the possibility of more constraints on their economic autonomy, further affecting their independence and negotiating power in the international economy, which in turn may lead to the weakening of developing countries in the areas of industrial protection, tariff policies, and even the loss of autonomy (OECD, 2021).

In developing countries, FTA also tends to lead to problems of social inequality due to the uneven distribution of wealth and resources. With the intensification of competition in the international trade market, the more competitive and advantageous industries and infrastructure, and the relatively developed educational level of the region will receive more investment and be further developed, while the

less competitive regions and industries will be marginalized, resulting in the downsizing of enterprises, thereby bringing about the problem of unemployment. For example, rural areas and traditional industries are often difficult to reap dividends from FTA, which will lead to the further widening of the gap between the rich and the poor (Rao, 2024).

After signing the FTA, developing countries may lower their environmental standards and allow highly polluting industries to enter the country in order to further attract FDI and expand exports, but this will also lead to increased ecological degradation (Trejo-Nieto, 2022). At the same time, developing countries may face the risk of developed countries transferring highly polluting and energy-intensive industries into the country, such as petrochemicals, mining, and steel, among others. Although it can bring short-lived economic growth to developing countries, it tends to increase support for export-oriented industries, especially highly polluting industries that developed countries do not want to over-exploit in their own countries.

## 3.2 Impacts Brought to Mexico by Signing USMCA

This chapter analyzes the economic, social, and environmental impacts of the USMCA (formerly NAFTA) on Mexico, comparing them to the impacts of FTA on developing countries summarized in the literature.

### 3.2.1 Industrial Upgrading and Economic Restructuring

USMCA facilitated the liberalization of trade between Mexico, the United States and Canada, making it an important link in the North American supply chain, meanwhile, having the effect of significantly advancing Mexico's internal manufacturing industry, with exports in the automotive and electronics assembly sectors growing by 12.7% and 9.4%, respectively, from 2020 to 2022. Especially in the automotive industry, Mexico has become one of the world's leading automotive production bases. USMCA has also contributed to the upgrading of Mexico's industrial structure by requiring the use of more components from the U.S. and Canada in the country's manufacturing sector (Urata, 2022). In addition, the USMCA introduced stricter Rules of Origin and labor standards, which effectively prompted some multinational enterprises to transfer low-end production to Mexico to meet the

proportionate requirements of the regional value chain, thereby promoting local employment and technology transfer (Villarreal & Fergusson, 2022).

Furthermore, Mexican manufacturing FDI inflows reached \$31.8 billion in 2021, an increase of more than 15% from 2019, demonstrating the potential of the USMCA to attract long-term capital.

However, while the USMCA has brought technological upgrading in the manufacturing sector to Mexico, some of the country's traditional sectors have not been able to enjoy the dividends it has brought. The development of foreign trade has led to strong external competitive pressures on the agricultural sector, and as a result, some inefficient agricultural production models have been phased out. Additionally, the USMCA framework also requires Mexico to improve its high-pollution, high-energy-consumption industries, environmental and labor standards, continuously optimize its industrial structure, and gradually transition to a higher value-added industrial system.

### 3.2.2 Employment Growth and Social Inequality

The implementation of USMCA has contributed to employment growth in Mexico, especially in the manufacturing and service sectors. After implementing USMCA, the inflow of foreign investment into Mexico increased dramatically, especially in areas such as automobiles and electronics. This has not only led directly to the expansion of firms and thus to a large number of jobs but has also contributed to an increase in labor productivity. As a result, Mexico's overall employment rate has increased.

However, USMCA also poses the challenge of social inequality in Mexico. While the more developed northern region has benefited greatly from the agreement, agriculture and low-skilled labor have been greatly challenged (Baker & O'Malley, 2020). The agricultural sector faced strong competitive pressure from cheap agricultural imports from the United States and Canada. Small-scale farmers lost market share and were forced out of the market. This exacerbated economic disparities between urban and rural areas, regions and social classes. In addition, the influx of foreign investment has been concentrated in industrial parks and free trade zones, where workers tend to have higher levels of education and skills, while conversely, low-skilled laborers are under pressure to lose their jobs and see their wages fall, further exacerbating social inequality.

### 3.2.3 Environmental Pollution and Countermeasures

Although the tougher environmental provisions of the USMCA compared to NAFTA may have a positive impact on the environment in Mexico, due to its near implementation, it cannot reflect the long-term impact on environment, therefore, this article will speculate on the possible environmental impacts of the USMCA through the environmental impacts of NAFTA on Mexico.

The implementation of NAFTA has led Mexico to face serious environmental pollution problems. In order to attract FDI and expand exports, Mexico relaxed its environmental provisions. At the same time, the U.S. and Canada moved some highly polluting industries, such as chemicals, oil and mining, to Mexico, leading to increased local environmental pollution. According to data provided by the Mexican Environmental Protection Agency (Secretaría de Medio Ambiente y Recursos Naturales, SEMARNAT), between 1994 and 2008, Mexico's industrial carbon dioxide emissions increased by 30%. As some local governments in Mexico lack sufficient resources to implement environmental protection policies, these highly polluting industries have caused long-term damage to the ecosystem.

To address this challenge, the Mexican Environmental Protection Act was amended in 2000 to emphasize industrial pollution control and require companies to adopt stricter measures for exhaust emissions. In addition, the Mexican government has promoted the development of green technology and renewable energy industries, particularly in the areas of wind and solar energy. Nonetheless, the implementation of NAFTA still exacerbated environmental problems in parts of Mexico, especially in areas where manufacturing and heavy industry are concentrated (Kotschwar, 2017). Based on NAFTA, the USMCA established more stringent environmental provisions. However, due to Mexico's high dependence on external economies, balancing environmental development with economic growth remains a major challenge for the USMCA to face.

## **4 COPING STRATEGIES OF DEVELOPING COUNTRIES UNDER THE FRAMEWORK OF FREE TRADE AGREEMENTS**

### **4.1 Optimizing Economic Structure**

Developing countries should improve the competitiveness of local industries and social security systems. When signing FTA, low-end industries in developing countries are often eliminated by fierce competition, causing the whole economy to be over dependent on external markets and a greater income gap as well. So, developing countries should formulate targeted industrial policies in this regard and guide foreign investment into high value-added industries. Governments should also increase their support for local industries in terms such as tax incentives, subsidies, technological research and development, so as to enhance their capacity for independent innovation and improve the competitiveness of domestic industries in the world market, thereby reducing the excessive dependence on external markets that may be brought about by free trade liberalization. To minimize the negative impacts brought by FTA, developing countries can also help affected groups transform into new industries through policies such as providing social welfare and provision of enhanced vocational training.).

### **4.2 Enhancing Bargaining Power**

Developing countries should strive for more favorable FTA terms for themselves. Compared with developed countries, in the negotiation process of FTA, developing countries are usually in a disadvantaged position. Therefore, developing countries should strengthen regional cooperation and jointly participate in negotiations, so as to enhance their collective bargaining power and strive for more favorable terms for their own countries. Developing countries should also strengthen the construction of expert teams in international economic law, allowing them to conduct in-depth research on the provisions of trade agreements and put forward professional and constructive recommendations to ensure that the country obtains relatively favorable conditions in terms of tariffs, intellectual property protection, etc., and to identify provisions that could lead to long-term economic losses for the country.

### **4.3 Strengthening Environmental Regulations**

Developing countries should strengthen environmental regulations and promote sustainable development within their countries. Developing countries should set stricter pollution control standards and avoid industrial development at the expense of the environment. Meanwhile, developing countries can also use the FTA as a platform for international cooperation to introduce green technologies and sustainable development models of partner countries that are worthy of reference, so as to promote green ecological development within the country. In addition, the government can also reduce the dependence on high-pollution industries and encourage the development of renewable energy industries through subsidies for green industries, thus realizing the coordinated development of the domestic economy and the environment.

## **5 CONCLUSION**

This article takes USMCA as an entry point, taking existing literature into consideration and uses textual analysis and comparative research method to study the opportunities and challenges brought to developing countries by FTA from economy, society and environment, which can be correspondingly expressed in the upgrading of industries and the increase of jobs, and the imbalance of regional development, weakening of economic independence, rising social inequality and environmental pollution. Moreover, the article analyzes and raises several coping strategies that could benefit developing countries, mainly including optimizing economic structure, enhancing bargaining power, and strengthening environmental regulation.

As a crucial tool in promoting global trade liberalization, FTA plays an important role in promoting economic growth, attracting FDI, upgrading industries and improving technology transfer. Nevertheless, negative impacts brought by FTA could not be neglected, for instance, the weakening in competitiveness of local industries, increased social inequality, environmental pollution, etc. This article takes USMCA as a case, discusses the impacts brought to developing countries specifically on economy, society and environment and puts forward corresponding policy suggestions to optimize their economic structure, enhance their bargaining power and maximize their benefits under the FTA framework, while avoiding potential risks.

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