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## The Detriments of Free Trade on Developing Countries

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### ABSTRACT

Worldwide, scholars continue to discuss free trade agreements and whether they achieve their intended purpose of bolstering international trade. Some assert that free trade aids smaller, struggling nations, by balancing exchange rates and providing cheaper labor. Others argue that free trade hurts these developing nations and their economies by putting them under a façade of economic growth. Upon examination, the detriments that free trade poses for developing countries include halting industrial development, stagnating poverty reduction, causing infant industries to compete with developed ones, and unfair disadvantages. The detriments of free trade on an international scale are evident, and outweigh its benefits, therefore a new worldwide economic principle must be implemented instead. This may include a return to the previous model of the General Agreement of Tariffs and Trade (GATT) or adopting protectionist policies. Regardless of the next trade model implemented, the current free trade system must be abolished to allow developing countries to achieve high levels economic growth without significant barriers.

**Keywords:** Free Trade, Developing Countries, International Trade, Protectionism, International Trade Agreements.

**JEL Classification Codes:** F10, F11, F13, F15.

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### 1. Introduction

The best things in life aren't free, especially in the case of economic systems. Free trade agreements exist across the modern world; they stretch across oceans yet can also be found in various cultural regions. The purpose of these areas is to create a zone where countries are able to trade without any additional tariffs, quotas, or additional restrictions. They often have a positive goal in mind to initiate positive trade relations among countries and offer another incentive to do so.

With their well-known presence and popularity, it would be expected that they provide great benefits to the international community, however, this misconception is entirely false. In the past, it has been recognized that free trade simply exacerbates existing inequalities among countries and industries. Some industries have reportedly become significantly poorer and large amounts of distress have been recorded within parts of certain countries that have engaged in free trade throughout the

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past.<sup>2</sup> Free trade continues to hurt participating nations more than help them, calling for new and improved economic policies that can eliminate these current shortcomings.

Past research indicates the shortcomings of free trade in general and how it has negatively impacted specific aspects of nations around the globe, developing and developed alike. This paper, however, delves into each of these previously found impacts and demonstrates how they connect back to developing countries suffering from this economic model. This paper serves as a comprehensive guide that synthesizes the negative impacts of free trade on developing countries specifically. This paper will begin by examining how poorly free trade accomplishes its intended goals. Afterward, the effects of free trade on aspects including industrial development, poverty reduction, environmental issues, infant industries, tariffs, and the population's opinions are included. Finally, alternate solutions like protectionism and GATT are explored and examined for how effective they would be in replacing the current free trade model.

## **2. Main goals**

Free trade zones are created with two main goals in mind: trade creation and trade diversion.<sup>3</sup> Trade creation refers to the increase in economic welfare or profits that a country experiences, often through the reduction in tariffs, and consequently prices. Trade diversion is defined as shifting imports from a more prominent nation to a different one, due to the creation of a free trade agreement. In the past, most instances of free trade including LAFTA (Latin American Free Trade Agreement), COMESA (Common Market for Eastern and Southern Africa), and the AGADIR Agreement have all noticed that there have been no considerable impacts in trade diversion.<sup>4</sup> However, what they did notice is that these regional-based agreements only increased trade among members of the group and left the rest of the world to suffer.<sup>5</sup> That is the exact problem within the institution of free trade, various parts of the world should not be left behind and face economic hardships because of the selfish nature in certain nations. Evidently, free trade has done very little to improve the well-being of the entire global community, and reaping benefits to only a handful does not achieve the goal of progressing our collective society forward. Nor does free trade achieve its two main objectives, trade creation and diversion, that it was created to achieve in the first place.

## **3. Industrial development**

For most nations that attempted to adopt free trade policies in the past, they experienced great success even when they were not fully developed yet. Examples include Germany and the US in the 1800s, Japan and Korea in the 1900s, and China in the 2000s. These nations faced their fair share of import barriers, investment regulations, and foreign competition but were able to emerge victorious while also establishing themselves as economic powers on a global scale after industrial development.<sup>6</sup> The unfortunate reality is, however, that the majority of nations are unable to accomplish these same feats and are stuck in the shadows due to their inability to overcome the barriers posed by free trade. Modern-day examples include Mexico, the Philippines, and the majority of African nations that are still unable to accomplish a decent level of industrial development.<sup>7</sup> With Mexico in particular, NAFTA stagnated the country's annual per capita growth to one of the lowest in the whole Western Hemisphere with an average of just 1.2 percent. Furthermore, wages in the country have declined and unemployment is at an all-time high.<sup>8</sup>

## **4. Poverty reduction**

Another promised, yet unachieved impact of free trade is a reduction in poverty for developing nations. It is often proclaimed that trade can play an important role in reducing poverty by boosting economic growth which is specifically known for helping developing countries improve their internal

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<sup>2</sup> Arndt 2000, 117-126.

<sup>3</sup> Kepaptsoglou 2010, 1-13.

<sup>4</sup> Kepaptsoglou 2010, 1-13.

<sup>5</sup> Kepaptsoglou 2010, 1-13.

<sup>6</sup> Bello 2019a.

<sup>7</sup> Bello 2019a.

<sup>8</sup> Carlsen 2013a.

conditions.<sup>9</sup> However, a study found that, in general, the decline in poverty rates for developing countries is nowhere near the same amount in developed countries, and often increasing as well.<sup>10</sup> The only nations experiencing any poverty reduction are more developed ones that did not struggle with the issue to the same extent as less wealthy ones. Due to this unfortunate reality, smaller nations see little to no positive impacts on their poverty rates because tariffs only affect them in a negative way due to the current structure of the free trade system.

Various examples exist to demonstrate the deterioration of poverty standards worldwide through this type of economic system. For example, cotton production in Bolivia has been declining in recent years because of a dip in commodity prices caused by the Asian crisis due to the international nature of free trade. Since a large proportion of seasonal migrant labor depends on this industry, this incident has left a large group of impoverished citizens with even worse conditions than before.<sup>11</sup> Another example is in a case study of Zambia where there are changes nationally in relative prices due to the entrance in a free trade agreement.<sup>12</sup> To this, a farmer in the country would typically diversify from growing traditional to nontraditional products, but it would require new seeds, tools, and methods that could not be attained by a low-class farmer.

## 5. Environmental issues

The first correlation between the environment and trade starts with the weak or nonexistent regulations in developing countries regarding pollution, in comparison with more aware, developed nations. These smaller countries then, consequently, attract industries that produce large amounts of pollution and cause environmental damage. Within itself, free trade seems to be inadvertently encouraging pollution production, and smaller nations are being taken advantage of due to the nature of the way this economic system is structured. Experts have recognized this problem in the past and have strongly advocated for trade agreements that include environmental-related policies in order for trade to continue.<sup>13</sup> Yet, for many developing countries, combining environmental issues with free trade agreements seems like an attempt by developed countries to inhibit trade for them. For poorer nations, this would take a toll on their economy and is extremely unfavorable due to how it disproportionately affects less industrialized countries. This is a central issue within free trade agreements: the harmful impacts experienced by developing nations. These countries are forced to deal with either heavy pollution due to flocking industries or they face trade barriers due to their inability to comply with high standards of environmental policies, both of which are caused by free trade. It is imperative to consider what improvements can be made to the existing system in order to better accommodate for the needs of smaller countries.

The World Trade Organization (WTO) itself has attempted to interfere in the past, observing these blatant inequalities. The group claimed that environmental policy that is an effort to protect human, animal, or plant life should be recognized as an exception to trade barriers, which would ease the stress off these previously harmed developing countries. However, this proclamation did not achieve the goals that it had intended. The Canadian Department of Foreign Affairs and International Trade studied the impacts that these WTO statements would have on its own agricultural industry, which it concluded to be minimal.<sup>14</sup> For a fully developed nation like Canada to open up trade with numerous partners in which it is a common member of free trade zones with, the expectation was that they would find a large number of benefits now that previously excluded members would no longer face barriers. Seeing that it did not make a statistically significant impact, it can safely be concluded that these free trade zones actively discriminate against developing nations on the unfair basis of environmental policies. Moreover, attempts to resolve this issue in the past have been unsuccessful allowing these nations to continue being targeted even now as free trade continues to persist.

One such example is seen in the US-Jordan Free Trade Agreement which included environmental regulations in its negotiations to ensure that the United States would not have any

9 Dollar, Kraay 2002.

10 Dollar, Kraay 2002.

11 Bannister 2001.

12 Bannister 2001.

13 Colyer 2003, 123-143.

14 Colyer 2003, 123-143.

significant environmental impacts through their trade. Jordan, however, observed that an increase in trade created large amounts of solid waste, which was dangerous considering Jordan's prominent mineral and natural resources industries. Furthermore, in efforts to keep pollution out of the United States' territory, more would occur near Jordanian borders and likely increase maritime traffic in the Gulf of Aqaba, creating risks for the biodiversity within the Red Sea.<sup>15</sup> The United States does not bear any of the same struggle and does not face large amounts of backlash for its pollution either due to the one-sided, selfish nature of their trade agreement.

## 6. Infant industries

Infant industries refer to those in developing countries where certain industries require protection from international competition until they are able to grow and actually compete on a global scale. Free trade, unfortunately, does not offer them with this protection and forces them to compete with older, much more developed industries and puts them at great disadvantages. Within smaller countries that have smaller domestic markets, firms and industries are unable to achieve the success required to compete internationally, and they face losses for this reason.<sup>16</sup> A common response by experts has been that governments must take the lead in this situation by choosing export industries that have the highest chances for prosperity and provide them with subsidies or assistance. The drawback with this argument, however, is that these government leaders put in charge have often attempted to resolve the situation with tariffs or import restrictions, which is simply not the right solution in this scenario. Turning to past precedence of how infant industries continue to struggle, it can be concluded that politicians are unable to find an effective solution to this situation as well, making them unsuitable for this particular task.<sup>17</sup> Without them, finding a potential savior for infant industries seems quite unlikely and will only leave them suffering due to the burden placed on them by free trade agreements worldwide.

The success of many East Asian economies in the past century has grown to become extremely noteworthy. One key contributor to their economic advancements lies in the government support and protection of their respective infant industries as they industrialized. In the late 1960s and 1970s, the Korean government worked on protecting infant industries in cement, petroleum refining, shipbuilding, and capital goods by supporting their development on a domestic scale before entering into international competition. Similarly, Taiwan and Singapore gave priority to their respective electronics industries before allowing them to compete internationally, and now each are performing decently well in addition to each of their national economies.<sup>18</sup> For these industries, in particular, the reason for their current and successful future prospects can be traced back to the preferential treatment given to them when they were first getting started.

## 7. Protectionism

The concept of protectionism has often been considered as an alternative to all free trade agreements that currently exist. The fundamental idea with a protectionist system is to continuously tax imports in order to best protect domestic industries. This is what continues to take place under the current structure but under the impression of free trade. With the optimum tariffs and xenophobic behavior, countries are already working to protect their own products from foreign competition yet continue to take part in free trade agreements, leaving developing countries with false hope regarding how their exports will be regarded by foreign powers. Although developing countries are able to tax their own imports now, larger countries can actually afford to pay these increases or simply find a new replacement nation that will not cost them as much. A developing country, however, does not experience the same luxuries and is forced to suffer any rise in import prices unfairly.

Protectionism, however, does not provide these poorer nations with an incorrect facade and requires them to prepare beforehand to these new economic changes that will be taking place.

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<sup>15</sup> Reubner 2001a.

<sup>16</sup> Arndt 2000, 117-126.

<sup>17</sup> Arndt 2000, 117-126.

<sup>18</sup> Glick 1997, 20-25.

The issue with this system is that it, once again, places a large burden on developing countries even if they know what they are getting into. When attempted in the past under the American Smoot-Hawley Act of 1931, tariffs increased by around 20% and due to the failure of international trade with a large number of nations that could no longer afford the goods, overall exchanges decreased by 67%.<sup>19</sup> Protectionism also inhibits any chances of foreign investment towards countries that need it and therefore lowers opportunities that this could have provided for national wealth and growth. When G20 members imposed 692 new financial barriers between 2008 and 2010, 40% of the impact was felt by the least developed countries.<sup>20</sup> Of this group, 141 felt at least some significant impact towards their economy entirely because of the newly established fees.<sup>21</sup>

Within America alone, the tariffs imposed by President Trump are projected to decrease international trade levels by 9%.<sup>22</sup> Other poor nations such as Costa Rica, Ethiopia, Bangladesh, and Sri Lanka will have to face tariffs of 40-50% when they simply cannot afford such high prices to trade with the United States.<sup>23</sup> Thus, despite the honesty, protectionism only continues to cause harm towards developing countries in the same way that free trade does.

## 8. General Agreement on Tariffs and Trade (GATT)

The General Agreement on Tariffs and Trade (GATT) was first introduced in 1947 by 23 nations as a system to eliminate barriers that currently existed towards international trade including quotas, tariffs, and subsidies. Although replaced by the World Trade Organization (WTO) in January 1995, the WTO has repeatedly found itself under fire for its actions and inability to condemn unfair hostility that exists towards developing countries. For this reason, the best method of reforming the current global trade environment is to reassess the previously successful system under GATT's leadership.<sup>24</sup>

In the 1980s, when GATT was still present, the role of developing countries seemed to be gaining traction within international trade after a round of multilateral trade negotiations were made in their favor. After analyzing the type of economic policies that they prefer, GATT managed to establish a worldwide economic system where their desires, alongside those of more developed nations were represented proportionally for the first time. Specifically, the developing countries wished for special-and-differential treatment, given that they should be considered due to the disproportionate impact that they face in comparison to developed countries. This gave them more support from the GATT towards their domestic economies, as well as preference over other nations towards trade in foreign markets. In fact, Article XVIII of GATT specifically concerns the role that they play with economic development. The significance of this clause is obvious, unlike past systems that have neglected developing nations, one of the key priorities and expectations of GATT is that it will actually provide the support that nations need in order to prosper internationally. Under this new system, developing countries would actually have a chance to find a way out of the current cycle of economic injustices that they continue to face, with a transition to oversight under the GATT as opposed to the WTO and individualized free trade attempts.

It is imperative to note that this proposition will still include a fundamental free trade system on an international scale, however, the key difference is within the oversight. Everything is expected to meet the expectations of ideal liberalism when GATT is put in charge; all tariffs are removed, and this policy is strictly enforced to achieve fair economic standings on a global scale. Although the World Trade Organization is in charge of doing this in the status quo, it finds itself doing most of the earlier negotiations to sort out some plan but then leaves free trade for the countries to manage themselves, allowing for each of these injustices to take place. Under stricter oversight by GATT, however, developing nations will not be neglected as they currently are, and these free trade agreements will be monitored effectively in order to ensure their legitimacy and benefits for both parties involved. GATT already has a track record of advocating for a true free trade system as it promises through Results of

19 Feenstra 1992, 159-178.

20 Feenstra 1992, 159-178.

21 Feenstra 1992, 159-178.

22 Hostetter 2018a.

23 Hostetter 2018a.

24 Ossa 2011, 122-52.



its decisions over the years include nullifying the British tariff on bananas in 1961 and restoring copyright restrictions globally in 1986.

## 9. Conclusion

Evidently, free trade is a system built upon various imbalances, especially those disproportionately affecting developing countries inadvertently. Despite the facade that is often put up regarding its success, free trade does not even achieve the two main goals that it was established to achieve. Environmentally and economically, developing countries face a variety of disadvantages that only hurt these countries more. Turning to numerous case studies of developing countries that were either upset with their exploitation under free trade or oblivious to it until it was too late, it becomes blatant that the current system must be reformed.

Two propositions can be made at this point: either a protectionist society that is completely free from any form of free trade and economic alliances, or an improved, revised free trade system that has structural oversight with GATT to prevent the misdeeds that take place right now while also targeting each of the aspects mentioned in this paper to eliminate the existing flaws in the system. Turning to past precedence, protectionism has a long history of solely favoring developed countries and only further discouraging global trade, giving it the same impacts as free trade, but without the impression of being “fair” for all. The second option under GATT, has shown to prioritize attempts for developing nations to boost their economies in the past, alongside developing compromises to meet the needs of both wealthy and poor nations. This system has proven to be effective in the past and will likely be a much more representative and just version of the free trade system currently in place under the WTO. If either of these are implemented effectively, developing countries will no longer be faced with the current injustices and a mutually beneficial economic system will allow the global economy to prosper well into the future.

This paper serves to develop past research done on free trade’s impacts on developing countries specifically, however the detriments presented inevitably reach much further beyond that. Future research can be done to cohesively collect the negative impacts on developed countries as well and coming up with a true alternative by drawing inspiration from the two discussed within this paper to the current failing system. Furthermore, an increase in public awareness of these detriments is particularly necessary to help contemporary realize the negative impacts and reduce their dependency on this economic model.

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