Donald Trump and the Wall: Perspectives from South of the Border

If It's Not Broken, Why Fix It? NAFTA and U.S.-Mexico Trade in Trump's Campaign

by Luz María de la Mora | Centro de Investigación y Docencia Económicas (CIDE)
luzmaria.delamora@cide.edu

Donald Trump has become the Republican candidate in the 2016 U.S. presidential election. This may put him in a position to become the next U.S. president, which may mean a serious threat to U.S. trade flows and policy as well as to the U.S. and world economies. Trump has put U.S. trade policy at the center of his election campaign and has identified Mexico, along with China, as a source of job losses, factory shutdowns, and economic woes in the United States. Trump has not missed an opportunity to blame Mexico and NAFTA, as well as China and Muslims, for U.S. domestic problems—something that has gained him a wide electoral base among "white male fans" but also among "Americans who are disgusted and disaffected with the political and financial elites."[1] Trump has promised he will "make America great again" by building a wall along the Mexico-U.S. border, imposing a 35 percent tax on auto imports from Mexico, repealing NAFTA, and bringing back jobs.

Although Donald Trump has run as a Republican candidate, he is an outsider who, like Ross Perot and Ralph Nader, has ably centered his election platform on how much the U.S. economy and U.S. workers have suffered as a result of globalization and trade liberalization. Even if there is still a long way to go before Trump could eventually become the next U.S. president, the question that needs to be asked is what could be expected from a Trump presidency in U.S.-Mexico trade relations if he is elected president. Will his campaign promises solve the issues he intends to address or will they create even bigger ones? In fact, if we look at hard data and recent experience in U.S.-Mexico trade relations, we find that Trump's campaign platform may backfire.

In this piece, I focus on Trump's campaign promises as they relate to the U.S.-Mexico trade and economic relationship, specifically, those proposals that suggest repealing NAFTA, imposing a 35 percent tax on U.S. imports of Mexican vehicles, and forcing relocation of American companies back to the United States. I examine what would it mean if he made good on those promises and how much they would eventually cost not only the United States but also North America.

Repealing NAFTA

Trump has promised that if he becomes U.S. president he will abrogate NAFTA because "it is one of the great economic disasters" that has "destroyed" the United States.[2] In this way he will restore America's greatness and bring back American jobs and manufacturing to the United States.[3] Trump's opposition to free trade with Mexico and to NAFTA has resonated well among a wide base of voters including blue-collar districts and white working-class voters, as well as among people who have suffered from reduced incomes and increased income inequality.[4]

His NAFTA repealing proposal is by no means an original or unique idea. There are a few past examples of presidential candidates and nominees who have pledged that they would renegotiate or even derogate NAFTA. In 1992 Ross Perot ran his campaign as an independent claiming that NAFTA would create a "giant sucking sound" sending U.S. jobs south of the border.[5] That same year, when Pat Buchanan sought the Republican presidential nomination, he ran on an "America first" platform that included vocal opposition to NAFTA.[6] In 2008, 15 years after NAFTA became effective, during the presidential election both Democratic candidates, Hillary Clinton and Barack Obama, pledged to renegotiate NAFTA. At that time, Senator Clinton went as far as to say, "We will opt out of NAFTA unless we renegotiate."[7] Obama also promised to renegotiate NAFTA; nonetheless, as president he drew back from his pledge.[8]

For Trump, NAFTA is as an economic disaster because the United States has increased its trade deficit with Mexico from a $1.6 billion surplus in 1993 (the year prior to NAFTA's implementation) to US$58 billion in 2015.[9] To reverse it, Trump's solution is to abolish NAFTA. But is this a real solution? Let's look at the numbers. First, we should recall that the United States has maintained a 40-year world trade-in-goods deficit that in 2015 reached $759 billion. The U.S. trade-in-services balance amounted to a surplus of US$215 billion, thus the U.S. balance of payments (goods and services) showed a net deficit of US$539.7 billion.[10] Second, its largest trade deficits are with trading partners such as China (US$365 billion), Germany (US$74 billion), and Japan (US$68 billion), with Mexico ranking fourth (US$58 billion).[11] Last year Mexico's trade deficit with the United States contributed 7.9 percent of the global U.S. trade deficit. Compared to other key U.S. trading partners, the deficit with Mexico accounts for 16 percent of that with China and almost 80 percent of that with Germany.[12] Even further, if we compare the relative deficit to the absolute deficit (namely, the ratio of each country's deficit to the its level of trade with the United States), Mexico's relative deficit with the United States is the lowest among the top 10 largest U.S. trade deficits, with an 11 percent ratio vis-à-vis China (61.1 percent), Ireland (63 percent), and Vietnam (68.6 percent).[13]

While it is true that the U.S. trade deficit with Mexico has increased since 1994, in NAFTA's first 20 years bilateral trade grew by 532.5 percent.[14] Given that Mexico contributes a relatively small share of the U.S. trade deficit, the question is whether repealing NAFTA and putting the trade relation on the back burner will help the United States to effectively reduce its world trade deficit and alleviate whatever economic problems that deficit may be causing. It may well be the case that imports coming from Mexico will have to be replaced by imports from third countries and not necessarily from U.S. domestic production. We would also need to ask what problems the U.S. trade deficit is causing the U.S. economy, and what the most effective policy solutions might be. That question does not seem to be part of the Trump debate.

Under NAFTA, the U.S. trade deficit with Mexico has increased, as has the weight of Mexico as a key U.S. trading partner and player in North American production. WTO (World Trade Organization) data reveals that Mexico has become a leading U.S. trading partner not only as a source of U.S. imports but that it also has become the United States' third top export market, accounting for almost 15 percent of total U.S. exports only after Canada (19.3 percent) and the European Union (17.1 percent). Likewise, Mexico is the number one export market for border states such as Arizona, accounting for 40.6 percent of that state's exports (Texas, 37.6 percent; New Mexico, 25 percent; and California, 16.2 percent). Mexico is also among the top three export markets for states like Michigan (20.9 percent), Nebraska (18.3 percent), and Ohio (12.8 percent).[15]

NAFTA has enabled regional production of manufacturing sectors such as automobiles and auto parts, aircraft, electrical machinery, and plastics, to name a few. These highly integrated regional value chains have increased U.S. exports to Mexico in sectors such as machinery (US$38.5 billion), electrical machinery (US$36.7 billion), vehicles (US$21.6 billion), and plastics (US$15.3 billion).[16]

On the other hand, being able to source Mexican imports has offered U.S. production affordable and high-quality inputs, thus increasing the United States' and the region's competitiveness.

Agriculture received a boost from NAFTA, creating markets where there were none. According to the U.S. Department of Agriculture, Mexico is the United States' third-largest agricultural export market after Canada and China, accounting for nearly 13 percent of all U.S. agricultural exports, which in 2015 reached US$17.7 billion. Top U.S. agricultural exports to Mexico include corn, soybeans, dairy, pork, poultry, and beef. Mexico accounts for 18 percent of Nebraska's total exports to the world and 16 percent of Iowa's.[17] Mexico has also become a top source of U.S. agricultural imports such as fresh fruits and vegetables like tomatoes, avocados, cantaloupes, onions, etc.

Last but not least, NAFTA has also liberalized trade in services, and Mexico is also an important export market for U.S. services (B2B, professional, technical, and financial services), which in 2012 added up to US$27.4 billion.

NAFTA's Article 2205 provides that "a Party may withdraw from the Agreement six months after it provides written notice of withdrawal to the other Parties. If a Party withdraws, the Agreement shall remain in force for the remaining Parties." Trump could use that provision. The question is if by disrupting these value chains the United States would be better off. Repealing NAFTA would most likely mean that U.S.-Mexico trade flows would come to a halt and U.S. exports to Mexico would likely diminish, which might end up hurting the U.S. economy as well as U.S. jobs. This again raises the question whether Trump has given serious thought to the pros and cons of derogating NAFTA.

Eliminating NAFTA is not a sound economic or business proposition; it would likely backfire and severely disrupt not only U.S. exports to Mexico but regional value chains.

Imposing a 35 Percent Tax on U.S. Imports of Mexican Vehicles

Trump has also suggested that he will impose a 35 percent tax on all Mexican auto imports as a first step to "level the playing field" and reduce the U.S. trade deficit in the sector. Moody's Analytics has found that if Trump were to apply such a tariff, and if Mexico were to retaliate by applying tariffs on U.S. exports, there would be an unnecessary trade war.

Trump has stated that even if he is "all for free trade . . . it's got to be fair. When Ford moves their massive plants to Mexico, we get nothing. I want them to stay in Michigan."[18] However, his words reveal a profound ignorance regarding how the U.S. automotive industry operates. In 2015, Mexico was the United States' third-largest export market for light vehicles (two million units) only after Canada and China, while exports increased by 50 percent between 2009 and 2014. Mexican auto exports to the United States amounted to US$52.5 billion in 2015 while U.S.-originating auto exports going south amounted to US$4.2 billion.[19]

Unilaterally imposing any import duty would amount to a NAFTA violation. Mexico could request a NAFTA dispute settlement panel under Chapter 20. If the U.S. measure was found to violate the agreement, the U.S. would have to eliminate it, otherwise Mexico could retaliate on an amount of US$18 billion, 35 percent of total Mexican vehicle exports to the United States in 2015 (10 percent worth of U.S. total exports to Mexico).

Such a move would damage not only Mexico's industry but also U.S. consumers, who would face higher prices for vehicles produced in Mexico, mainly SUVs and medium-sized vehicles. For example, the Ram 1500 pickup truck could increase its base price by $9,000.[20]

Reestablishing import duties would hurt the North American auto industry's competitiveness since it would likely disrupt regional production chains. In fact, NAFTA has been a key source of competitiveness for the U.S. auto industry vis-à-vis Japanese and other Asian automakers. Although today the United States accounts for around 800,000 jobs, 350,000 fewer than in 1994, "without NAFTA, there might not be much left of Detroit at all" in terms of jobs, production, or exports. Imposing a tariff could also hurt U.S. production and export of auto parts that Mexico procures from the United States. Such parts are integrated into vehicles assembled in Mexico such as the Honda CR-V, which incorporates 70 percent of American and/or Canadian parts such as American-made engines and transmissions.[21]

Imposing a 35 percent tariff to protect the U.S. industry could have an effect exactly the opposite of Trump's stated intent and would amount to a violation of U.S. international obligations. It would eliminate U.S. jobs as the industry would need to reduce vehicle production to the extent that Asian automakers could become more competitive vis-à-vis the United States. American consumers would have to pay higher costs for Mexican vehicles while U.S. companies that sell goods and services to Mexico might have to eliminate jobs.

Bring Back Manufacturing Production and Jobs to the United States

Unlike more traditional Republican policy, and in an era of globalized production where interfirm and intraindustry trade represents more than 60 percent of world trade, Trump's opposition to trade agreements in order to reindustrialize America and bring back jobs to the United States requires further analysis. On the campaign trail he has promised: "If I win, Apple and all of these great companies will be making their products in the United States, not in China, Vietnam and all. And we're not going to be losing our companies."[22]

U.S. manufacturing has moved abroad, and specifically to Mexico, for purely economic reasons. In 2012, hourly compensation costs in Mexico were 85 percent lower than in the United States and 82 percent lower than in Canada. Likewise, in Mexico social security benefits represent only 5.2 percent of hourly compensation costs while in the United States they amount to 19.9 percent and in Canada, 23.3 percent.[23] Ford's chief executive Mark Fields explains that "at the end of the day, we are a multinational company, and we will do what's best for business." And U.S. companies have found that producing in Mexico makes good business sense.

Trump, however, has not considered that U.S. trade with Mexico has in fact been a source of job creation. In 2014, U.S. trade with Mexico contributed more than 4 percent of U.S. jobs; today around 10 million U.S. jobs depend on trade with Mexico.[24] If Trump were to repeal NAFTA then U.S. exports would likely decline as they would become more expensive, since those exports would no longer enjoy duty-free treatment. Most likely, such policy decisions would have a very negative impact on U.S. jobs that are directly and indirectly related to trade with Mexico.

The Road Ahead

Blaming Mexico and NAFTA for U.S. economic problems may have won Trump the Republican nomination, but implementing policy proposals that will undermine U.S.-Mexico trade may backfire; they simply make no business or economic sense.

Country bashing has been typical of U.S. presidential elections. In 1988 Richard Gephardt's presidential campaign had "Japan-bashing" as a central issue in the same fashion as today Donald Trump has fingered China and Mexico as the source of U.S. economic woes.

In addition, support for free trade and trade liberalization in the United States has continuously waned since the 1990s. According to the Bloomberg Politics poll, 65 percent of Americans prefer more restrictions on imported goods to protect U.S. jobs, while 22 percent support trade liberalization; 82 percent are willing to pay more for U.S.-made products. In addition, 44 percent consider that NAFTA has been bad for the economy while only 29 percent give it a positive grade.[25]

Mireya Solís, from the Brookings Institution, considers that "in U.S. trade policy circles there is deep concern that the erosion of consensus in favor of trade liberalization is much deeper and not just driven by the electoral cycle." In a context of growing economic inequality, trade is considered "more costly and the gains more uncertain."[26]

In spite of Trump's anti-Mexico and anti-NAFTA discourse, in late April 2016 the AmCham (American Chamber of

Commerce) president in Mexico, José María Zas, said that the U.S.-Mexico relation is a strategic one that cannot go backwards.[27] As clearly stated in the *Atlantic*, with his campaign proposals "Trump may be demolishing the house to fix a leaking pipe."[28] Hopefully he will realize that it is one thing to be campaigning and something completely different to be seated in the president's chair. While NAFTA has had mixed results and NAFTA opponents have been more visible than its supporters, this may well be the time to seek to reverse NAFTA myths and start talking about facts and realities. We might have a very different debate.

Notes

I would like to recognize the research assistance of Alonso Lozano in writing this piece.

1 Bryce Covert, "Make America Great Again for the People It Was Great for Already," *New York Times*, May 16, 2016; Iain Martin, "Trump's Message Resonates with Americans Who Are Terrified and Tired," CAPX, February 12, 2016.

2 Lien Yeung, "Donald Trump Says NAFTA 'Destroyed' U.S. at Rally near Canadian Border," *CBC News*, May 7, 2016.

3 John F. McManus, "Industries Still Heading for Mexico," *New American*, April 23, 2016.

4 InsideGov, "Donald Trump: 2016 Presidential Candidate," http://presidential-candidates.insidegov.com/l/70/Donald-Trump.

5 Don E. Newquist, "'Giant Sucking Sound' Is Theory by Perot Going down the Tubes," *New York Times*, May 16, 1993.

6 Jackie Lopez, "The Campaign against NAFTA: An Irrational Attack on Free Trade," unpublished paper, spring 2009, Duke University, p. 4.

7 Matthew Hennessey, "Let's Make a New Deal: Democratic Candidates Trade Jabs on Renegotiating NAFTA," *Policy Innovations*, 2016, http://www.policyinnovations.org/ideas/briefings/data/000036/:pf_printable.

8 Manuel Perez Rocha and Laura Carlsen, "Obama Reverses Campaign Pledge to Renegotiate NAFTA," Democracy Now, August 11, 2009.

9 United States Census Bureau, Foreign Trade, https://www.census.gov/foreign-trade/balance/c2010.html.

10 United States Census Bureau, Foreign Trade, https://www.census.gov/foreign-trade/statistics/historical/index.html.

11 Jeff Desjardins, "The World Map of the U.S. Trade Deficit," Visual Capitalist, March 1, 2016, http://www.visualcapitalist.com/the-world-map-of-u-s-trade-deficit/.

12 United States Census Bureau, "Trade in Goods with European Union," https://www.census.gov/foreign-trade/balance/c0003.html.

13 Félix González Sáenz, "Today's Chart: Absolute versus Relative Trade Deficits in 2015–Mexico and the USA," *Aspectos económicos y comerciales de México* (blog), https://fgsaenzfgs.wordpress.com/2016/05/20/todays-chart-absolute-versus-relative-trade-deficits-in-2015-mexico-and-the-usa/.

14 United States Census Bureau, "Trade in Goods with Mexico," https://www.census.gov/foreign-trade/balance/c2010.html.

15 US Department of Commerce, International Trade Administration, "tradeStats Express," http://tse.export.gov/tse/TSEOptions.aspx?ReportID=100&Referrer=TSEReports.aspx&DataSource=SED.

16 Office of the United States Trade Representative, Resource Center, "U.S.-Mexico Trade Facts," https://ustr.gov/countries-regions/americas/mexico.

17 Mexico, Secretaría de Economía, *NAFTA Works*, "U.S. Exports to Mexico by State 2014," http://www.naftamexico.net/u-s-exports-to-mexico-by-state-2014-1h/.

18 "Full Text: Donald Trump Announces a Presidential Bid," *Washington Post*, June 16, 2015, https://www.washingtonpost.com/news/post-politics/wp/2015/06/16/full-text-donald-trump-announces-a-presidential-bid/.

19 United States Census Bureau, "Country and Product Trade Date," http://www.census.gov/foreign-trade/statistics/country/index.html.

20 David Lawder and Roberta Rampton, "Trump's Tariff Plan Could Boomerang, Spark Trade Wars with China, Mexico," Reuters, March 24, 2016, http://mobile.reuters.com/article/idUSKCN0WQ0WG?utm_source=twitter.

21 Eduardo Porter, "Nafta May Have Saved Many Autoworkers' Jobs," *New York Times*, March 29, 2016.

22 Sahil Kapur, "Donald Trump's Tough but Plausible Path to Winning the White House," Bloomberg Politics, March 24, 2016, http://www.bloomberg.com/politics/articles/2016-03-24/donald-trump-s-tough-but-plausible-path-to-winning-the-white-house.

23 U.S. Department of Commerce Bureau of Economic Analysis, International Transactions, International Services, and International Investment Position Tables.

24 Enrique Hernández, "La relación entre México y EU no depende de Trump: AmCham," *Forbes*, April 22, 2016, http://www.forbes.com.mx/la-relacion-mexico-eu-no-depende-trump-amcham/.

25 Hernández, "La relación entre México y EU."

26 Mireya Solís, interview, May 16, 2016, Brookings Institution, Washington, DC.

27 Citlali Sáenz, "Relación EEUU y México es estratégica pese a dichos de Trump: AmCham," *Noticias MVS*, April 18, 2016, http://www.noticiasmvs.com/#!/noticias/relacion-eeuu-y-mexico-es-estrategica-pese-a-dichos-de-trump-amcham-18.

28 Uri Friedman, "What If Mexico Really Does Pay for Trump's Wall," *Atlantic*, April 5, 2016, http://www.theatlantic.com/international/archive/2016/04/trump-wall-mexico-foreign-policy/475581/. ■