

Driving Home the Importance of NAFTA

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The Issue:

Trade deals like the 1994 NAFTA agreement were widely chastised by both major party candidates during the presidential campaign. President Trump has called NAFTA “the single worst trade deal ever approved in this country” and has made its renegotiation a central part of his economic policy. But, in the two decades since it has been in place, NAFTA has ushered increased trade among the United States, Canada and Mexico. And much of this trade is within firms that have changed their manufacturing processes to make the most of the production advantages that each country has to offer. In particular, the auto industry has supply chains across all three North American countries, and cars bought in the U.S. today include parts and labor from all three countries.

A renegotiation of NAFTA towards a more protectionist stance would be very disruptive for the auto industry.

The Facts:

- **Although most critics of NAFTA focus on the growth of imports from Mexico, they often overlook the fact that U.S. exports to Mexico have grown just as fast since the treaty was signed.** Mexico and Canada are by very far the largest U.S. export markets, accounting altogether for over a third of total U.S. exports. In 2015, Canada was the top destination for U.S. exports, accounting for 19 percent of total U.S. exports, and Mexico was in second place at 16 percent of total U.S. exports. The growth rates of exports to these two markets was dramatic since the advent of NAFTA, with U.S. exports to Mexico growing 470 percent since 1993 while exports to Canada grew 180 percent (see here (<https://www.census.gov/foreign-trade/balance/c2010.html#1994>) for U.S.

Census Bureau Statistics on trade with Mexico and here (<https://www.census.gov/foreign-trade/balance/c1220.html>) for Canada.)

- **The top U.S. exports to Canada and Mexico are motor vehicles and motor vehicle parts. This is because NAFTA has enabled very large productivity gains for the automotive sector by consolidating the production of different parts across the three countries.** The U.S. and Canada tend to produce engines, transmissions, and gearboxes whereas Mexico produces relatively more labor-intensive parts such as dashboards, upholstery and seats. Vehicle assembly has also been consolidated across the three countries. Assembly of some smaller vehicles has moved to Mexico, which also serves as a hub for exports to Latin and South America. Assembly of many bigger vehicles has been consolidated in the United States. Volkswagen serves as a good example: It assembles Golfs and Jettas in Mexico, while the larger Passat is assembled in a new plant in Chattanooga, Tennessee. Passats were imported from Europe before the plant in Chattanooga came on line.
- **In general, a more protectionist stance on Mexican imports would lower production in the automotive sector in Mexico.** That would, in turn, lower production of key car parts in the U.S. In addition, the assembly of larger vehicles in the U.S. would become more expensive because of an increase in the price of parts such as dashboards and seats that are currently produced in Mexico. Eventually, fully consolidating assembly of those vehicles in the U.S. will become unprofitable because the parts would become too expensive. In this case, companies like Volkswagen may decide to start importing cars rather than producing them in the United States; cars would be imported from Europe again, with some parts made in Eastern Europe.
- **Recent research (<http://voxeu.org/article/consequences-brexit-and-trumpit-multinational-car-industry>) estimates that the repeal of NAFTA would not increase car production in the United States.** Mexico and Canada would be hardest hit by a repeal of the trade agreement in terms of lower car production. However, lower demand in those countries for U.S. cars, along with higher prices for parts would result in lower car production in the United States as well. Car producers in other regions – most notably Eastern Europe and Asia – would benefit from higher car prices in North America and respond by increasing production.
- **A decrease in U.S. car production would cost manufacturing jobs.** According to the Department of Commerce, U.S. exports of goods and services to Mexico supported an estimated (<https://ustr.gov/countries-regions/americas/mexico>)

1.1 million jobs in 2014 with 953 thousand supported by goods exports and 193 thousand supported by services exports. And some regions are particularly exposed. For instance, almost all of Michigan's exports are concentrated in the automotive sector going to Canada and Mexico. The U.S. Department of Commerce has estimated (<http://www.trade.gov/mas/ian/statereports/states/mi.pdf>) that 270,000 jobs are supported by those exports from Michigan.

What this Means:

The auto industry provides an important example of supply chain disruptions that would occur with the repeal of NAFTA. U.S. carmakers that depend on lower-cost parts and components imported from Mexico would face higher costs, which would make them less competitive with respect to foreign manufacturers. Losing market share to foreign car companies would lead to jobs lost in the U.S. auto industry. And, consumers would be left to foot the bill for more expensive cars. But the auto industry would not be alone in feeling the pinch. Other manufacturing industries have also become increasingly integrated into NAFTA-wide supply chains. While protectionist measures such as raising tariffs of Mexican imports would reduce Mexican imports, they could also place a significant share of U.S. exports at risk of retaliatory measures. Furthermore, U.S. consumers will face higher prices and less variety with protectionist measures.

TOPICS: INTERNATIONAL TRADE / MEXICO / NAFTA

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