



HARRY G. BROADMAN

Trump's Treatment of Mexico Will Give Him A Bigger Headache: China In The U.S. Backyard

President Donald Trump's threat to change trade policy towards Mexico—widely seen as his trial run to taking on China—not only will prevent him from rebalancing the US-Mexican trade relationship more to his liking, but could actually backfire. The Mexicans will respond by inviting China to invest along the Southern border of the US.

During Trump's first week in office he announced Washington would impose a 20% tariff on U.S. imports of goods from Mexico. It would seem that someone in the White House forgot—if they knew at all—to tell the former NY businessman that Mexico is the second largest destination in the world for U.S. exports. Moreover, about 40% of Mexico's exports to the U.S. is actually comprised of products Mexico imports from the U.S. Threatening such a large customer and supplier does not seem like wise commercial practice.

But an even greater risk to Trump from his approach to our neighbor to the South is that in terms of merchandise trade, Mexico is far more integrated into global markets than is the U.S. In fact, by more than twice as much: Mexico's exports account for 37% of its GDP, and its imports constitute 36% of its GDP; the corresponding figures for the U.S. are 13% and 16%, respectively. The reality of Mexico's greater internationalization poses existential hurdles that Trump and his new economic team will face as they attempt to renegotiate NAFTA.

The overarching challenge will be to define with clarity of purpose U.S. negotiating goals. One of the most fundamental reasons for the U.S. to rigorously set out *ex ante* its trade negotiation goals is that NAFTA is, of course, a trilateral agreement, and opening it up will necessarily entail Canada's participation. But even more profound—from a US perspective—is that unhinging from Mexico opens up the possibility that Mexico pursues its own bilateral or regional trade agreements with others in the world that the US could well be less than thrilled about having their plants in its backyard.

It's one thing to postulate that NAFTA will devolve into three separate bilateral agreements—one between the U.S. and Mexico; one between Canada and Mexico; and one between the U.S. and Canada (actually the U.S.-Canada Free Trade Agreement, which came into force in 1988, was the building block on which NAFTA was later created.) But it's quite another as how best to unravel the existing agreement without allowing for seemingly detrimental effects stemming from one of the party's integration with wholly new third countries. This could cause significant investment uncertainty, perverse incentives to 'game the system' and thus disruptions in commerce across the continent. The risks of such developments are almost inevitable no matter how adroit the negotiators are to set out within the confines of an agreement a process for phasing-in a new trade policy regime.

In this context, given the current political tensions between Washington and Mexico City on the one hand, and Washington and Beijing on the other, both of which seem likely to only intensify, there is a significant risk that the opening up of NAFTA is like taking the top off a can of worms. As the English nursery goes, 'all the king's horses and all the king's men couldn't put Humpty Dumpty together again'.

Why would this be the case? Simply put, inasmuch as NAFTA came into force a quarter of a century ago, both the politics of the Western hemisphere as well as the structure of world economy—especially the rise of China and its economic threat to the US—have certainly changed significantly since then.

Two examples are illustrative. When NAFTA was being negotiated, the Mexicans took off the table any discussion about opening up the energy sector, especially oil, to foreign investment. At that juncture, the Mexican constitution—rooted in a long nationalist struggle that punctuated Mexico's modern economic history—stipulated that the state, in the guise of PEMEX, was to be the sole actor in the sector. In recent years, the constitution has been changed as PEMEX has grown increasingly eager for co-investment and technology transfers from foreign oil multinationals. China will be rubbing its hands to acquire portions of Mexico's oil sector. Imagine Washington's reaction to find SINOPEC or CNOOC just across the Rio Grande.

At the same time, the flows of international trade and investment in services, such as transportation, banking or retail, have not only grown tremendously, but the fundamental nature of the sectors themselves, especially the way in which transactions are mediated, also has significantly transformed. In 1994 if one had come to the NAFTA negotiating table proposing the inclusion of provisions governing cross-border trade in Alibaba-like services, they'd be sent to be drug tested.

The same be said for Chinese banks, railways, trucking companies, or shipping services. If Mexico is 'jettisoned' by the US during a renegotiation of NAFTA, Washington should not act surprised to see such Chinese firms sprouting up Southward.