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NAFTA: Free trade, with uneven effects

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Since the North American Free Trade Agreement was enacted in 1994, automakers and suppliers have operated tariff-free in three countries as if those countries were one, building a powerhouse manufacturing and trading bloc.

But there's a paradox. While the industry now builds world-class vehicles in the U.S., Canada and Mexico, not all parties have benefited equally. The center of vehicle production has shifted south, from Canada and the U.S. Midwest to the U.S. Southeast and Mexico.

In the U.S., resulting blue collar outrage helped fuel the anti-trade populism of Democratic presidential candidate Bernie Sanders and Republican presidential nominee Donald Trump. And in current contract talks, Unifor, the union representing Canadian auto workers, is demanding that the Detroit 3 guarantee continued production in Canada.

"I think that Donald Trump is completely nuts, but if there's one thing he's right about, it's the impact it's had on not just Canadian workers but U.S. workers," said Jerry Dias, president of Unifor, in an interview.

Trump's promise to renegotiate the treaty or tear it up altogether, replacing it with a 35 percent tariff on goods from Mexico, has some auto executives privately worried. As the election approaches, the question hanging over the industry is what effect altering or withdrawing from NAFTA might have. The proposed 12-nation Trans-Pacific Partnership free-trade agreement, which would supplant NAFTA, is already in trouble.

"If Trump were to come in and do what he says he's going to do, it would destroy the industry," says Daniel Ikenson, director of trade policy studies at the conservative Cato Institute. "Everyone expects us to lead. When the U.S. engages in this kind of nonsense, it rattles the global economic foundations. It is very dangerous rhetoric.

"If President Trump were to think he could impose a 35 percent tariff, the whole system would come crashing down."

Flavio Volpe, president of the Automotive Parts Manufacturers' Association of Canada, says the auto parts business operates on slim margins: "A 35 percent tariff would be a reckless instrument that would put an immediate chill on anybody's investment in any of the three countries."

Industry officials such as Volpe credit NAFTA with allowing North America to be competitive in an increasingly global industry.

"The rise of Mexico as a free trading zone in my opinion is one of the catalysts that allow automakers to profitably go to a global product platform," Volpe says.

Steve Miller, CEO of International Automotive Components Group, a Tier 1 supplier based in Luxembourg with 33 plants scattered across the NAFTA region, believes NAFTA has been overwhelmingly beneficial.

"There are 50 states. What if every one of them had tariff barriers and you had to make cars in all 50 states?" Miller said in an interview. "It would be a very inefficient industry.

"The fact you can move intermediate products back and forth and do final assembly in the most efficient location is a great advantage."

Mark Muro, senior fellow at the Brookings Institution, argues that NAFTA may well have saved the North American auto industry: "By offering a low-wage platform, the Mexican plants have increased the scale of auto production in North America, allowed further investment and I would argue allowed increased U.S. employment."

Low-wage jobs that moved to Mexico would have been lost anyway, Muro says. But the efficiencies coming from NAFTA enabled the industry to restructure after the 2008-09 financial crisis.

He adds that NAFTA has helped promote the growth of what he calls "advanced industry" high-tech jobs in the U.S.: "The U.S. has clearly been a leader in new technology applications, the whole move into [autonomous vehicles], new lightweighting technologies, all these things that have supported a quite robust recovery from the crisis."

U.S. trade deficit

But others say auto jobs are not low-wage and that high-tech job growth has not made up for lost auto production employment.

"At least 75 to 80 percent of jobs in the auto industry are very good jobs with excellent benefits," says Robert Scott, analyst for the left-leaning Economic Policy Institute. "The number of these Google jobs is trivial compared to the 5 million jobs we've lost in manufacturing in the last 25 years. They have not been replaced."

Even proponents acknowledge that NAFTA has not produced equal benefits.

Mexico has been the agreement's biggest beneficiary. Since 2010, automakers including BMW, Fiat Chrysler Automobiles, Ford, General Motors, Honda, Hyundai, Mazda, Nissan and Volkswagen have announced Mexican investment plans worth more than $24 billion, according to a 2016 study by the Center for Automotive Research in Ann Arbor, Mich.

And nine of the last 10 auto assembly plants announced for the NAFTA region are being built or have been built in Mexico, the study says. (See box, right.)

But the study also shows that automakers have continued to invest heavily in U.S. production, especially since the 2008-09 financial crisis. U.S. investment topped out at $28.4 billion in 2015 compared with $4.5 billion in Mexico and $1.5 billion in Canada. The U.S. total includes commitments the Detroit 3 made in the latest round of UAW contract talks.

NAFTA has also helped to nearly double the U.S. trade deficit with Mexico in motor vehicles to $46.2 billion in 2014 from $23.3 billion in 2010, the study says.

Need for retraining

But some believe NAFTA has been a scapegoat for problems not of its own making. Those include the rise of China as the world's factory, the increased use of robots to replace humans on assembly lines, and currency fluctuations.

Luis Rubio, a political analyst for the Centro de Investigacion para el Desarrollo, a Mexico City think tank, says global trade has spawned rapid changes faster than industry workers can keep up with. Trade agreements have not made sufficient provisions for displaced workers, he says.

"Clearly Trump's base includes many people who didn't have the access or the means to go back to the labor market in different technological areas," he says. "NAFTA coincided in time with two other things: very rapid technological change and the opening to China. The combination of the three proved to be lethal for many communities."

IAC's Miller acknowledges, "We need to be sure we have adequate protection for people who are affected by trade so they don't get hurt. That should be for a limited amount of time until they can either get trade adjustment payments or are retrained for something that's more appropriate."

Others say that Mexico's rise has been aided by an aggressive trade policy that goes well beyond NAFTA.

Mexican automotive exports benefit from 44 free trade agreements with other nations. By contrast, the U.S. has signed free trade agreements with 20 countries, according to the office of the United States Trade Representative.

All those agreements gave Mexico tariff-free access to 47 percent of the global new vehicle market in 2015, according to the Center for Automotive Research study. Light vehicles assembled in Mexico were able to avoid tariffs of $1.2 billion in 2014, according to the study. The savings makes Mexico an attractive export platform for all carmakers -- and therefore an attractive site for plants.

Mexico produces about 20 percent of the light vehicles made in North America and passed Canada as the second largest North American producer in 2008, according to the study. (See chart, above.)

Muro says Mexico has transformed the geographical landscape of the industry with "Mexico greatly benefiting, Canada greatly harmed and the Midwest losing dominance."

What could Trump do?

Trade makes good fodder for labor negotiations (see related story, below) and on the campaign trail. During the 2008 presidential contest, Barack Obama promised to reopen NAFTA, but didn't follow through once elected.

Perhaps that's because it is easy to make campaign promises, but much more difficult to modify agreements. Despite Trump's vow of action, the president has limited power, says Cato's Ikenson: "Under the U.S. Constitution, Congress has power over trade policy," and the president could not raise tariffs unilaterally.

"You can't have an autocratic president come in and do that," he says. "Obligations at the [World Trade Organization] preclude us from raising tariffs against one country and not everybody else.

"Since the NAFTA debate in 1992 and since the debate between [Vice President Al] Gore and [Ross] Perot and the "giant sucking sound,' all presidential elections feature candidates running on an anti-trade platform. After the elections, the candidates tend to go back toward the center."

Volpe, of the Automotive Parts Manufacturers' Association of Canada, says Canada and other countries look to the U.S. to set an example.

Recklessness on the part of the U.S. would encourage other countries to disregard world trade rules, he says.

"Some of the rest of the world *does* cheat on those obligations," Volpe says. "But the solution isn't for the global trading leader to drop its standards in response.

"It's a tough spot to be in. But you're there for a reason. It's like Superman getting into a bar fight. Why?"