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Trump-Mexico relations hit new low after 20% border wall tax mooted

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Relations between the US and Mexico appeared to be heading for crisis on Thursday after Enrique Peña Nieto cancelled a meeting with Donald Trump and the White House retaliated by suggesting a new 20% tax on imports from its southern neighbour to finance the construction of a border wall.

The proposal came amid a new low in relations between the Trump administration and Mexico, following a bitter election campaign in which Trump referred to Mexicans as "rapists" and insisted that the country would pay for the wall.

The White House press secretary, Sean Spicer, made the announcement to reporters on Air Force One as Trump returned from addressing the congressional Republican retreat in Philadelphia.

Spicer painted the border tax as one aspect of a broader tax reform policy. "When you look at the plan that's taking shape now, using comprehensive tax reform as a means to tax imports from countries that we have a trade deficit from, like Mexico," said Spicer.

"If you tax that $50bn at 20% of imports – which is by the way a practice that 160 other countries do – right now our country's policy is to tax exports and let imports flow freely in, which is ridiculous. By doing it that way we can do $10bn a year and easily pay for the wall just through that mechanism alone. That's really going to provide the funding," he said.

The comments sparked confusion in Washington. Republicans in the House of Representatives saw it as endorsement of their own proposals for a border adjustment tax to help exporters while Trump's chief of staff, Reince Priebus, appeared to walk back on the proposal, describing it as one of a "buffet of options." Spicer later said it was "one idea" to pay for the wall.

Tax increases would need to be passed by Congress. However, the president has the authority in certain situations to impose tariffs on imports if he considers US interests are threatened.

The Mexican foreign minister, Luis Videgaray, said such a tax increase would pass the cost of Trump's wall on to US consumers. "A tax on Mexican imports to the United States is not a way to make Mexico pay for the wall, but a way to make the North American consumer pay for it through more expensive avocados, washing machines, televisions," he told reporters.

The move would however prove disastrous for Mexico, whose economy has become deeply entwined with that of the US since the North American Free Trade Agreement (Nafta) came into effect in 1994.

Mexico is America's third-largest goods trading partner, after Canada and China, with $531bn in total (two-way) goods traded between the two countries in 2015.

Earlier this month, Mexico's economy minister, Ildefonso Guajardo, warned that a border tax would unleash consequences around the world and could trigger a global recession.

Spicer's announcement came hours after President Peña Nieto cancelled a scheduled visit to the White House after Trump signed an executive order on the building of the wall.

Peña Nieto tweeted on Thursday that he had informed the White House that he would not attend the meeting with Trump that had been scheduled for Tuesday.

"Mexico reiterates its willingness to work with the US to achieve agreements which benefit both nations," he added.

Speaking to congressional Republicans in Philadelphia, Trump claimed the decision to cancel the meeting with Peña Nieto was mutual and repeated his criticism of Nafta, the US free trade agreement with Canada and Mexico, describing it as "a terrible deal [and] a total disaster for us since its inception".

John McCain said he was "deeply concerned" by Trump's remarks. "Any effort to restrict or impose new barriers on our ability to trade with Mexico and Canada could jeopardize the future of this trade agreement and have serious consequences for Arizona and the country," he said.

Republican senator Lindsey Graham tweeted: "Border security yes, tariffs no. Mexico is 3rd largest trading partner. Any tariff we can levy they can levy."

The two countries' economies are so integrated that Mexican exports to the US contain approximately 40% US content and cars built in Mexico are assembled with parts produced in the other two Nafta nations.

"I would assume that this is the start of a trade war," said Jonathan Heath, independent economist in Mexico City. "And I'm assuming that Mexico would be retaliating with the same and this will also go to the World Trade Organization."

Heath says a trade war with Mexico would bring consequences for US manufacturers, farmers and consumers. As an example, he pointed to supermarkets – such as the stores owned by Walmart, Mexico's biggest retailer – which stock US-grown produce. He also noted some 75% of auto parts made in the US for export are shipped to Mexico.

"It's going to create, big, big problems on the Mexican side, but in the US too," Heath said. "It's the second or third trading partner of the US. You're not talking about a trivial amount of trade. You're talking about an extremely integrated region."

Daniel Ikenson, director of the Herbert A Stiefel Center for Trade Policy Studies at the Cato Institute, said the suggestion had put the US in "dangerous waters".

"There are a few statutes under which Trump could impose a 20% tariff on all Mexican imports and likely be within the letter of the law," he said.

One such statute was last invoked by president Richard Nixon in 1971 in response to a balance of payments crisis involving Japan.

"Nixon imposed a 10% surcharge on Japanese imports for one year under this law. Trump might claim that the loss of manufacturing jobs or the influx of illegal immigrants from Mexico is a national security crisis that justifies his invocation of this law, and imposition of the tariff. Whether the action would pass muster in a Nafta panel or at the WTO is another matter. There has never been such a case brought to dispute settlement," he said.

"I suspect that if Trump acts in this manner, the Mexicans will most certainly retaliate. We are in very dangerous waters here."

The rift with Mexico comes at a time when there are significant gaps in the US foreign policy establishment that would otherwise be working to heal the divide.

The nominee for secretary of state, former oil executive Rex Tillerson, has yet to be confirmed and there are still no announced candidates for scores of top posts at the state department.

Meanwhile, key people in the department's senior management are leaving this week. Most of them are political appointees, who routinely submit their resignations at the beginning of new administration.

A former senior state department official pointed out that what was not routine was that there was no one in line to replace them.