On Behalf Of Carrier, A Word Regarding Trump's Tariff

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August 22, 2016

Carrier, a manufacturer of air conditioners, has received more than its fair share of attention during this political year. Throughout the campaign, Donald Trump has expressed his displeasure that Carrier and a related firm have decided to move 2,100 manufacturing jobs from Indiana to Monterrey, Mexico, where the company has existing production facilities.

Back in February, Trump threatened that as president he would offer Carrier the choice of keeping its factories in the United States, or else subject itself to a tariff on air conditioners imported from Mexico. "I'm going to tell them, 'Now I'm going to get consensus from Congress and we're going to tax you.'" This protectionist reaction ignores the underlying reasons that likely are driving Carrier's decision.

A more constructive approach would be to improve the U.S. business climate by reforming policies that create unnecessary burdens for companies.

Carrier's official statement regarding the relocation says that it is due to "ongoing cost and pricing pressures driven, in part, by new regulatory requirements." Although the statement does not mention the difference in wage rates, lower hourly costs in Mexico may have played a role. Carrier's expenses for employee salary and benefits average about $34 per hour in Indiana, while those costs in Mexico are only about $6 per hour.

However, much of that differential likely would be offset by lower productivity (less output per hour worked) in Mexico than in the United States. Data compiled by The Conference Board indicates that the value of output generated per hour by the average U.S. worker in 2016 is 3.2 times greater than for the average Mexican worker ($67 vs. $21 per hour). Interestingly, that gap has widened significantly since NAFTA was implemented in 1994. Then the average U.S. worker generated $48 of output per hour (adjusted to 2015 U.S. dollars) while the average Mexican produced $19. Productivity gains have boosted the value generated by an hour worked in the United States by 40% over 22 years, while in Mexico the gain has been only 10.5%.

What inferences might be drawn from trends in labor productivity? One is that the U.S. economy appears to be reinventing itself faster than the Mexican economy. U.S. companies have invested effectively in technologies that are helping workers to produce more per hour worked. Another inference is that there generally is less incentive today (compared to years ago) for U.S. firms to move factories to Mexico due to lower wage rates. If the wage gap didn't prompt a move in years past, why should it do so now when U.S. productivity gains are outpacing those in Mexico?

What other factors could have inspired Carrier's move? U.S. businesses frequently are critical of what they see as burdensome regulations imposed by government. Those range from policies dealing with energy and the environment, to rules pertaining to labor relations and taxation. One often overlooked issue is the burden placed on manufacturing firms by antidumping and countervailing duty (AD/CVD) measures. AD/CVD duties are imposed to provide protection for U.S. companies that face import competition. Many industries that seek AD/CVD protection are in the business of making basic products that are used as inputs by downstream manufacturers. The simple reality of the marketplace is that protected firms tend to receive higher prices. Those higher prices translate directly into higher costs for value-added manufacturers that use the protected product as an input.

Steel provides a great example. The United States has imposed roughly 150 AD/CVD orders to limit imports of steel from numerous countries. The extra duties help steel mills to compete, but they also reduce the competitiveness of steel-consuming firms that must pay those extra costs. AD/CVD measures cause a few steel producers to be winners, while a whole lot of other firms end up as losers.

Since steel is required to make air conditioners, there is little doubt that Carrier is one of the losers from AD/CVD policies. Perhaps more important than steel, AD/CVD measures also apply to imports of copper tubing and aluminum extrusions, both of which are used to accomplish the essential heat-exchange function. Carrier can avoid those policy-imposed costs simply by moving to Mexico.

Years of operating on both sides of the U.S.-Mexico border have taught Carrier a lot about what it costs to manufacture air conditioners in each country. There seems little doubt that the decision to move to Monterrey indicates that senior managers believe it to be in the best long-term interests of the firm. If the United States wishes to encourage companies to manufacture in this country, a good start would be to improve the business climate by revoking AD/CVD orders that raise the cost of imported components.

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