

Testimony

Transnational Commerce and Labor Flows

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This paper is a work in progress and has not been submitted for editorial review.

Hearing before the Texas House Committee on International Trade and Intergovernmental Affairs
Transnational Commerce and Labor Flows

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April 10, 2017

Good morning Mr. Chairman and members of the committee. Thank you for inviting me to share my thoughts on transnational commerce and labor flows. I will direct my remarks to Mexico, since the Mexico Center at Rice University's Baker Institute for Public Policy works to understand both of these important subjects and to figure out the best policies to manage such flows in an orderly and expeditious manner. I will address the issue of trade first, and then I will address the issue of labor flows and migration. Finally, I will make some remarks regarding Mexico's own fast approaching political changes and how they combine with the current state of affairs in the binational relationship. Throughout, I will try to shed some light on how I believe Texas is or will be impacted.

On Trade Flows

One of the crucial points of the new U.S. administration in attempting to revise the country's commercial relationship with Mexico, specifically the North American Free Trade Agreement, has been the U.S. trade deficit with Mexico—about \$60 billion. In fact, President Donald Trump has ordered an in-depth study of the origins of trade deficits in each of the United States' commercial relationships, including that with our southern neighbor. After studying the U.S.-Mexico trade relationship, however, we have concluded that focusing exclusively on the trade deficit can be misguided, especially if it becomes the basis to abrogate the accord, as a trade deficit (or surplus) is affected by several complex issues and cannot be considered a simple zero-sum game.

Indeed, to investigate the trade deficit with Mexico, one must research the overall structure of the commercial relationship. To do so, we at the Mexico Center examined data from the U.S. Census Bureau and the U.S. Bureau of Economic Analysis' Department of Commerce. After reviewing the data, we realized that the trade relationship is indeed not as simple as it may at first appear. And Texas is a prime example of how complicated this relationship really is. In the following paragraphs, I lay out the issues at hand, all of which must serve to provide nuance for any future decision on NAFTA.

First, trade between Mexico and the United States can be classified by its nature and character. The first is an exchange of goods and services that can be placed close to the end user in the trading relationship. In that sense, Mexico sells fruits and vegetables, medical equipment, and small cars. The United States sells a variety of agricultural products, machine tools, and high-end services. In other words, each country exports to the other those end-user goods for which it has developed a comparative advantage. On services, the United States had a surplus of \$9 billion in 2016, which makes sense, given that the expertise, technology, and know-how are more advanced in the U.S. On agricultural goods, Mexico had a trade surplus of about \$3 billion in 2016, given its comparative advantage on fruits and vegetables. If we consider this kind of trade—goods closer to the end user—the relationship appears fairly even.

A second, more complicated layer is intra-firm trade, often referred to as party-related trade or trade among affiliates. This portion of trade has been growing very fast overall. So, we wanted to understand how it is put together and how it contributes to the deficit. With the caveat that we have not finished this analysis, I can relay some initial reflections. For several decades, U.S. corporations have taken advantage of lower trade barriers in other countries—not just Mexico—to establish specialized manufacturing plants in order to capitalize on lower labor costs. These production chains are often integrated across several countries, and these firms move their own inputs back and forth, sometimes between several countries and several times across the border until manufactured goods are finished. NAFTA only accelerated this trend between the United States and Mexico. Establishing plants in Mexico made American companies much more competitive because they could take advantage of lower costs along the production chain in Mexico. The consequence of NAFTA is that intra-firm trade between the two countries has grown substantially.

Intra-firm trade is in fact a very important component of binational trade today. The United States' intra-firm trade with Mexico is now close to 43 percent, fairly standard for the U.S. overall, and Mexico's intra-firm trade overall is over 50 percent. Intra-firm trade is a sign of how integrated production chains have become in North America. In the NAFTA area, these goods cross the border sometimes several times and get lumped with all binational trade, when their nature is fundamentally different than those goods that are traded very close to the end consumer. We hypothesize that much of the trade deficit has to do with intra-firm trade, but research on this is still relatively tentative, from what I can see, and it is not yet well understood in the literature we have reviewed.

Now something about Texas: Texas has been Mexico's number one trading partner. But to understand the nature of trade, we have to consider Texas' role on the commercial relationship. Texas has about 60 percent of the U.S.-Mexico border. Trade with Mexico comes in through El Paso, Laredo, McAllen, Brownsville, the Port of Houston and other ports of entry, and Texas international airports. The relationship with Mexico is massive, and Texas is central to it. Revising NAFTA could have very important consequences for Texas, and the Texas delegation must be made aware of the state's interests in renegotiating the agreement. I want to suggest, in fact, that Texas' position should be to support the expansion, modernization, and enhancement of the agreement, not abrogating it. In this vein, I want to suggest that it is not trade that has hurt workers, but the inability or unwillingness of the government to invest in retraining and redirecting people to new economic sectors.

Regarding Texas, the state's relationship with Mexico is even more complicated. First, trade requires enormous support from many sectors in the rest of the economy—storage, logistics, services, transportation, etc. Because Texas is the destination, origin, or transit area for nearly two-thirds of U.S.-Mexico trade, one can only conclude that thousands of jobs in these sectors would be directly impacted by a revision of NAFTA that would scale the agreement back. It is hard to calculate the jobs affected—I hardly trust the numbers I have read, but the number of jobs affected could easily be in the hundreds of thousands. We could also jeopardize many other future Texas jobs, especially now that the energy sector in Mexico has opened up. It is hardly necessary to remind you of the enormous opportunities for Texas in Mexico's newly reformed energy sector.

Similarly, Texas receives an estimated 8 million Mexican tourists per year, and it is the shopping destination of millions of Mexicans each year along border towns and in major cities. Some preliminary conversations point to the impact of the new political environment and the way it is affecting Mexicans' travel choices. Mexicans appear to be finding other destinations to visit. Tourism to Canada and Europe is already growing among middle class Mexicans, for example, and we do not know yet how much of it is at the expense of the tourism industry in the U.S. And we must understand the variables affecting these choices in order to not lose that preferential place among Mexican tourists and shoppers.

Overall, there is hardly any other state that stands to lose more from turning back the clock on NAFTA than Texas. Doing so affects not just trade and jobs but also tourism, the ability to attract foreign students, shoppers' willingness to visit Texas, foreign direct investment from Mexico in Texas, and so on.

On Migration and the Wall

I will now address the issue of the border wall and migration between Mexico and the United States. I argue that this story is one of labor market integration—informal, unauthorized, undocumented, if you will, but ultimately labor market integration. We have simply failed to address it as such.

The justification for building the wall is primarily the need to stem the flow of unauthorized border crossers—most of them seeking jobs. The wall, in my view, is 10 years late and largely unnecessary. By almost all statistics, from many different think tanks and from the government itself, immigration from Mexico has now slowed down to a trickle and the exodus of Mexicans from the United States has accelerated, partly through voluntary departures and partly through deportations. The unauthorized resident population in the United States has actually decreased in the years since 2008. Texas, home to about 1.7 million unauthorized residents, has not been the exception. Even legal migration, which peaked at roughly 250,000 green cards from Mexico 10 years ago, is now down to about 150,000 immigrants a year. Preliminary evidence points to the fact that even work visas are harder to come by these days. This could mean that companies will find it hard to recruit the right kinds of workers.

For public policy purposes, Texas must consider the types of visas its economy requires and lobby for an immigration reform that will expand those kinds of visas. Lowering the number of work visas granted can indeed hurt Texas' long-term growth, from high tech to agriculture to the services industry. Seeking a Texas-friendly immigration reform, however, must be accompanied by an assessment of how Texas retrains its displaced workers for growing economic sectors.

Central American migrants are important to mention as well. Many of them continue to flow into the United States, albeit at numbers about 50 percent lower in 2017 than in 2016, but Central American migration must be redefined as a binational issue. It is not purely an American issue and it is not purely a Mexican issue. And Texas is particularly affected in the binational cooperation dynamic because most of these migrants are currently coming to the Texas-Mexico border. Thus, precisely because most of them end up coming to the Texas border, it is important to involve Mexico in solving the Central American migration question.

Building the wall is also questionable for another reason. It is entirely possible to think that building a wall between Mexico and Texas could stoke nationalist feelings among Mexicans, for the same reasons that it is being built by the U.S.: It is a powerful symbol of rejection. The outrage in Mexico could grow so that Mexican citizens may seriously consider electing somebody who is willing to openly oppose the wall, including ceasing all cooperation with the United State and revisiting NAFTA from Mexico City rather than Washington DC. That much has been said by Andrés López Obrador, the front runner in Mexico's 2018 presidential election, who is now pushing back. The wall itself may make many Mexicans decide to stay away from visiting, shopping, and investing in Texas—we must consider that about \$17 billion in foreign direct investment from Mexico flowed to the U.S., and Texas is a major recipient of such funds. Clearly, a more anti-American stance in Mexico could hurt Texas interests. What Texans do—and especially, what the Texas congressional delegation in Washington does in defending the state's interests—is going to be crucial for Texas' future. Defending the U.S.-Mexico relationship is defending Texas.

On Mexico's Own Political Landscape

This last point leads me to say something about what is happening in Mexico. The Republic of Mexico is entering a complicated electoral season. In June 2018, just over a year from now, Mexico will hold a presidential election. Upon examining recent polls, it has become evident that the National Regeneration Movement (MORENA), the party of López Obrador, is poised to do very well and perhaps capture the presidency. López Obrador has two assessments that are similar to those of the U.S. administration. First, he does not believe that NAFTA has been good for Mexican workers. He has stated that he cannot wait to renegotiate NAFTA himself. Second, he has said that his energy policy will be the renationalization of hydrocarbons in Mexico, something that could affect Texas' business opportunities. These are complicated promises, and probably not likely to be accomplished easily, constitutionally, legislatively, or in terms of public policy, but he has taken advantage of the current U.S. positions to argue that he will revise the binational relationship himself. Texas may also be caught in the middle, especially given its strategic position on trade, energy, and the economic vitality of the U.S.-Mexico border.

Mr. Chairman, members of the committee: I know I have covered a lot of terrain in my remarks, but these are complicated issues. I am looking forward to engaging you in a further discussion on the issues I have brought forth today.