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INSIGHT

President Trump's Possible Tariffs on Mexican Goods: Potential Economic Effects

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On May 30, 2019, President Trump issued a statement that he would be invoking authorities granted to him by the International Emergency Economic Powers Act (IEEPA) "to address the emergency" involving illegal immigration at the U.S.-Mexico border by imposing tariffs on all goods from Mexico beginning on June 10, 2019. The President stated that the tariffs would be removed as soon as "the illegal migration crisis is alleviated" through Mexican action. Mexican officials and numerous Members of Congress are reportedly meeting with the Trump Administration to resolve the issue. Mexico's President Andrés Manuel López Obrador responded to President Trump in a letter stating that the Mexican government was doing as much as possible to stem the flow of migration from Central America and that Mexico was willing to help find a solution.

Possible Tariffs on Goods from Mexico

President Trump stated that the United States would impose tariffs on all Mexican goods and gradually increase the tariffs, as follows:

- 5% on June 10
- 10% on July 1
- 15% on August 1
- 20% on September 1

The 25% tariff would remain in place until his Administration determines that Mexico "substantially stops the illegal inflow of aliens coming through its territory." At the same time, numerous experts argue that the action would face significant legal challenges.

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Potential Effects on U.S.-Mexico Trade Relations

The U.S.-Mexico trade relationship has been significant for the United States because of Mexico's proximity and the extensive economic ties under the North America Free Trade Agreement (NAFTA), which would be replaced by the U.S.-Mexico-Canada Agreement (USMCA) if approved by Congress and ratified by Mexico and Canada. In 2018, Mexico ranked second among U.S. export markets and third in total U.S. trade (exports plus imports). In the first quarter of 2019, Mexico surpassed China as the United States' largest trading partner. The United States is, by far, Mexico's leading partner in merchandise trade, with 80% of Mexico's exports purchased by the United States.

Table 1. Total U.S. Goods Trade with Top Three Partners: 2018 and 2019

(U.S. $ in billions)

Country	2018	YTD 2018 (January–March)	YTD 2019 (January-March)
Mexico	611.5	146.1	150.6
Canada	617.2	150.3	146.5
China	659.8	155.1	132.0

Source: Compiled by CRS using data from U.S. International Trade Commission.

CRS analysis finds that a 5% tariff on total U.S. imports from Mexico, $346.5 billion in 2018, could result in a cost of about $17.3 billion to U.S. consumers, businesses, and farmers. Tariffs could have indirect effects on the dollar/peso exchange rate; if the value of the Mexican peso were to fall as a result, then the economic impact could be absorbed by offsetting price reductions. The actual cost to U.S. importers could be higher, however, as components can cross the border several times before a product is completed, such that increased tariffs effectively could be applied multiple times on a final good.

Linking tariffs to nontrade issues such as immigration, some experts say, could undermine U.S. trade relations with Mexico and the extensive efforts put forth in building a solid economic relationship over the past 25 years under NAFTA. The action would represent a departure from U.S. trade policy in which the United States has worked with Mexico to bring down trade and investment barriers, negotiate trade disputes under agreed-upon rules, and cooperate on numerous issues, including trade, labor, and the environment. Free trade agreements (FTAs) generally are negotiated with the objective that a partner will uphold its end of the agreement and work to improve investor confidence in the region under FTA rules. Imposing tariffs for reasons unrelated to NAFTA or for other rules-based reasons under World Trade Organization (WTO) commitments could, according to some observers, adversely affect U.S. businesses, farmers, and workers by eroding confidence in trade rules and diminishing bilateral trust that both parties will adhere to their commitments.

Mexico became the United States' largest trading partner in the first quarter of 2019. Tariffs could cost U.S. importers billions of dollars and adversely affect the economy, especially in sectors with extensive supply chains, such as the auto industry. In addition, Mexico could impose retaliatory tariffs on an equal value of U.S. exports. Mexico is a top market for U.S. agricultural goods and Mexico would likely target U.S. agricultural goods for retaliatory tariffs. If U.S. farmers lose market share in Mexico, they could be challenged to develop new markets. If tariffs increase under President Trump's proposal, Mexico could choose to escalate tariff retaliation on U.S. goods. One study suggests that tariffs would lead to an increase in direct costs of about $28.1 billion each year, affecting consumers, producers, and supply chains throughout the economy. States with higher amounts of trade with Mexico, such as Texas and California, would bear a higher percent of the cost.

Broader Policy Effects

U.S. tariffs could also impact other aspects of the bilateral relationship, including Mexico's ongoing efforts to address migration. Negative economic consequences could decrease Mexico's resources to combat the issue. Some experts assert that Mexico has not had sufficient resources to manage the increased flow of migrants and that it has not applied a "consistent policy on how to treat and care for them." Tariffs could also make the Mexican government less likely to cooperate with the United States. Seven former U.S. ambassadors to Mexico issued a statement urging the Trump Administration to "de-link trade and immigration" and find other ways to address the Central American migration problem. They argue that the tariffs could damage Mexico's economy and "cripple its capacity" to tackle migrant flows and damage the economic growth that contributed to "net zero" Mexican migration to the United States today. For its part, the Trump Administration has been silent on the potential economic effects of these tariffs.

Tariffs could also make congressional consideration of the proposed USMCA more complex. More broadly, the proposed tariffs could raise questions and create more uncertainty about U.S. willingness to abide by its commitments under other U.S. FTAs, WTO, and future potential trade agreements currently under negotiation. Finally, some argue that implementing the proposed tariffs may raise concerns that the United State is a less-than-reliable trading partner.

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