

How To Damage US Manufacturing

Even the threat of tariffs will do a lot of harm



PAUL KRUGMAN

JAN 27, 2025

Just one day after his inauguration, Donald Trump suggested that he intended to impose 25 percent tariffs on Canada and Mexico by Feb. 1 — that is, by this coming weekend.

My sense is that financial markets discounted his statement, precisely because the tariffs would be such an obviously self-destructive move. Surely, investors probably reasoned, Trump would find some excuse for calling the tariffs off. For example, Mexico and Canada might make some vacuous statements about cracking down on drugs and migrants, and Trump would declare victory. Or maybe the tariffs would last for a few days, then be reversed in return for some symbolic concessions.

But as I've been saying for a while, you shouldn't assume that someone who understands how tariffs work has Trump's ear, or at any rate is willing to tell him anything he doesn't want to hear. And on Monday the Wall Street Journal reports that Trump aides want to impose tariffs first, and only then negotiate for concessions.

So it looks quite likely that Trump will indeed impose high tariffs on our neighbors in a few days from now. I don't know that this will happen, and even if he does he may have some reason to reverse the tariffs a few days later. But I don't think people fully realize how damaging even temporary tariffs on Canada and Mexico would be.

For one thing, the North American Free Trade Agreement — which Trump renames the U.S.-Mexico-Canada Agreement after some mostly cosmetic changes — is, in effect, a contract that everyone assumed was binding. NAFTA wasn't a declarative

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principles or intentions; it was a formal pact permanently eliminating most tariff other barriers to trade across our northern and southern borders.

Now a U.S. president is threatening to ignore this pact and unilaterally slap on his tariffs. In which case you have to ask, what's the point of negotiating with the United States? What's an agreement worth if a U.S. president can decide to ignore the agreement whenever he feels like it?

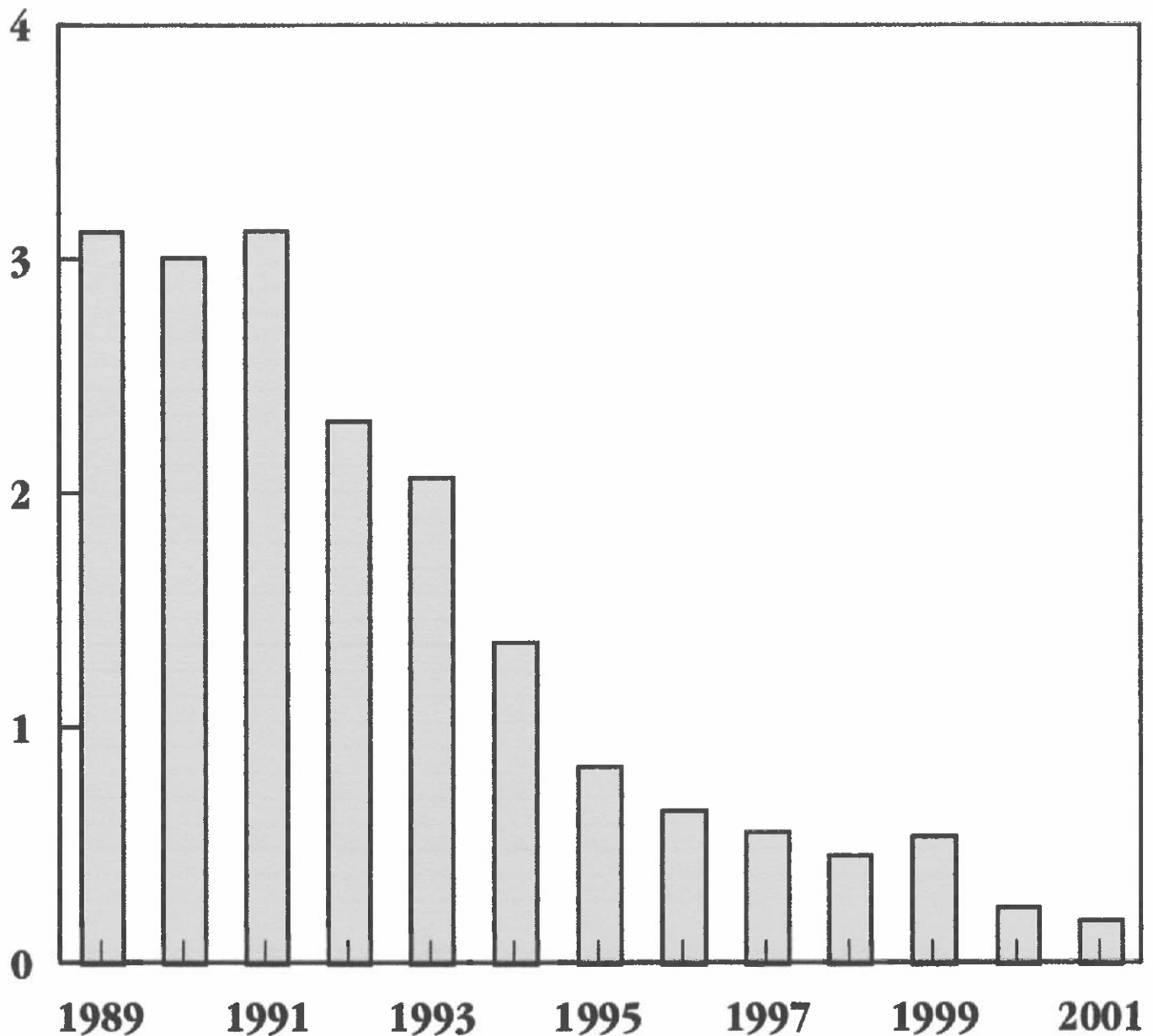
Of course, the loss of U.S. credibility extends to areas far beyond economics. In the future, what country in its right mind will trust U.S. guarantees that it will protect its nation's security?

But back to economics: the crucial thing to understand about NAFTA is that it was not really about free trade, per se. Tariffs were already low before the agreement went into effect. What NAFTA did — or what everyone thought it did — was guarantee that the tariffs would *stay* low, thereby allowing businesses to make investments on that basis.

To help explain what NAFTA did, let me lift a few charts from a very helpful 2003 [Congressional Budget Office analysis](#) issued on the agreement's 10th anniversary.

First: U.S. tariffs on Mexican products were very low — around 3 percent — well before NAFTA was enacted, let alone before it went into effect:

Average U.S. Tariff Rate on Total Goods Imports from Mexico



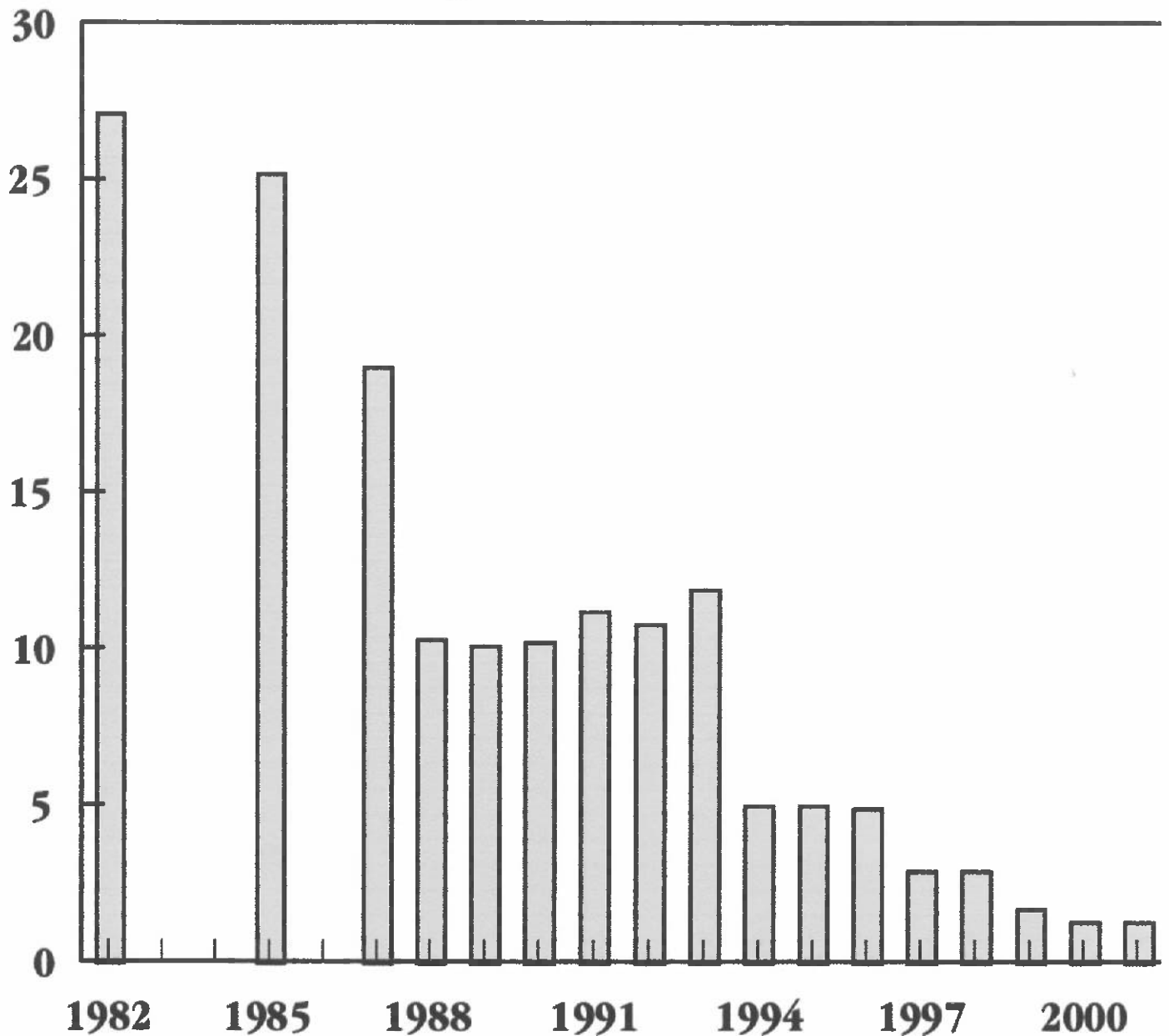
Source: CBO

Mexico, on the other hand, used to have very high tariffs. Like many developing countries, it spent several decades after World War II following a strategy of “import substituting industrialization.” This meant trying to build a manufacturing base at serving the domestic market, with tariffs and import quotas protecting domestic

industry from foreign competition. By the 1980s, however, many economists and policymakers had soured on this strategy, and were looking instead at the success of South Korea and other Asian economies that pursued “outward-looking” strategies of exporting manufactured goods to the world market.

This change in economic thinking had large real-world consequences. Mexico, in particular, radically changed its economic policies, drastically reducing tariffs:

Average Mexican Tariff Rate



Source: CBO

It's notable, however, that most of this tariff reduction took place before NAFTA basically between 1985 and 1988.

I guess I should mention that while Mexico was very successful at turning itself into a manufacturing exporter, it has been far less successful at turning that achievement into a

into rapid growth in per capita income and living standards. But the puzzle of Mexico's disappointing growth is a topic for another day.

For now, my point is that the United States and Mexico had fairly free trade with other, with low tariff barriers, before NAFTA went into effect at the start of 1994 you might have expected the agreement to make little difference. In fact, however NAFTA was followed by rapid growth in cross-border trade:

Summary Figure 1.

U.S. Trade in Goods with Mexico

(As a percentage of U.S. GDP)



Source: CBO

Why did this happen? There's no great secret involved. Much international trade result of long-term planning. To create something like the modern North American auto industry, a deeply integrated system in which various components of a finished car may be manufactured in all three countries, with parts sometimes crossing the border seven or eight times, businesses needed to make a lot of cross-border investments and carefully restructure the geography of their production.

They were only willing to make those investments and engage in that kind of long-term planning because NAFTA gave them confidence that more or less free trade in North America was a settled issue. Now, suddenly, it seems that this confidence was misplaced.

So even if Trump only imposes tariffs briefly, we can expect companies to start planning for an era in which solemn trade agreements are treated like mere suggestions, subject to revision or abrogation at the whim of whoever sits in the White House. This will lead to a gradual reduction of the geographical integration of North American industry — a gradual shift toward national self-sufficiency. And this in

competitiveness.



If Trump really does impose those tariffs and keeps them in place, the economic disruption will be immense. But even if he doesn't, the United States has already suffered a damaging loss of credibility. And credibility, once lost, is hard to regain.

MUSICAL CODA

Sorry, I don't know any songs about free trade agreements. But I'm feeling pretty sad today — some people I know have already seen their jobs disappear in the face of Trump's purges — and somehow this seems to fit my mood: