The North American Free Trade Agreement and its Effect on a Texas Robotics Manufacturer

Daniel Allford

President

ARC Specialties Inc.

Testimony Submitted to the Subcommittee on Terrorism, Nonproliferation and Trade, House Committee on Foreign Affairs

December 12, 2017

The North American Free Trade Agreement passed congress in 1993 with strong bipartisan support. It went into effect in 1994. Since then trade between the U.S., Mexico and Canada has more than tripled. This is the same time period during which my company began exporting our U.S. designed and built machines around the world. As a machinery and robotics manufacturer we have benefited from sales to Mexico and Canada. Mexico needed machines for new manufacturing plants and Canada needed machines to build oilfield equipment for their oil industry. Unhindered by tariffs ARC Specialties was well positioned to supply these machines which enabled ARC to grow and provide jobs for U.S. citizens.

Industrial machinery, machine tools and robotics are used across the world in manufacturing. We have shipped automated manufacturing equipment and robots to 25 counties. We have encountered various trade barriers when exporting machines internationally. In Europe we were forced to comply with cumbersome certification requirements which entail $30,000 in compliance testing on each new design. In Russia there was endless red tape. In China the certification process is tedious and tends to reveal proprietary product designs. In most of the countries where we installed machines, tariffs made our products much more expensive than domestic units. In Brazil these tariffs could reach 40% of the price of the machine. In spite of tariffs we sold machines in countries around the world, including Brazil, but in smaller numbers. Each country offered unique challenges with two exceptions: Mexico and Canada. I attribute this to NAFTA and therefore I believe that the agreement should remain in force and any changes should be vetted to ensure that free trade remains unhindered.

One of the commercial advantages of the United States is the size of our country and the diversity of our population, thus creating opportunities through the division of labor. Specialization works because interstate trade in the US is nearly effortless. Trade allows each of us to do what we do best. NAFTA provides the same advantage by essentially eliminating almost all tariffs among the three nations, and allowing for the seamless flow of goods and supplies across borders.

NAFTA did not come without a price. Some jobs shifted to Mexico due to lower wages, consistent with historical trends. In the 1960s jobs shifted to Japan. Once Japanese wages rose, jobs shifted to China and more recently to India, Vietnam and other countries. The United States innovates. Other countries duplicate, then the cycle starts over and everyone benefits by increased productivity. When goods are produced at lower labor rates, Americans benefit by paying lower prices for electronics, cars, clothes and food. Lower prices are always the goal of manufacturers seeking a market advantage. Lower prices due to improved efficiency are an indication of progress. Productivity is a ratio of production output to what is required to produce it. Americans vote with their pocket book every time they look for lower prices.

When mature industries shift production to low cost labor countries this frees up capital and talent in the US to create new products and new industries. In 1900 over 40% of our population worked in agriculture, now less than 2 % do. Agriculture is the first automation success story. We never hear anyone complain about lower food prices or year around availability of fresh fruits and vegetables. No one has lamented to me that he would rather be plowing a field behind a horse. I don't believe that the U.S. jobs lost to Mexico and Asia are the necessarily the jobs we want in the future. Trade creates jobs. The U.S. Chamber of Commerce estimates that about 14 million U.S. jobs depend on trade with Mexico and Canada.[1]

As a Houston company we are primarily involved in the energy industry. NAFTA has had a substantial and positive impact on the energy sector. The North American energy market is highly integrated and interdependent. Heavy crude oil from Canada and Mexico flows to the US where it is well suited for Midwest and Gulf refineries. Canada and Mexico now account for half of our total energy imports reducing dependency on less reliable and frequently hostile alternatives. In the US this crude is refined, adding value and some is exported back to both countries. This is the free market efficiently allocating resources. Each trading partner supplies what they can produce efficiently and purchases what they cannot.

The benefits to the energy markets including oil, natural gas, and electricity provided by NAFTA, as supported by the American Petroleum Institute (API), also benefit equipment manufacturers in the US. [2]

ARC Specialties has built automated manufacturing equipment for companies in both Canada and Mexico. These machines are used in the produce equipment for the production oil and gas that may be imported into the US for processing in US refineries.

According to the National Association of Manufacturers, 2016 exports of manufactured goods to Canada and Mexico equaled the total of the next 10 largest trading partners.[3] In the last three years my ratio was very similar. Half of my exports were to Canada and Mexico. U.S. exports to Canada and Mexico supported the jobs of 2 million men and women at 43,000 firms across the United States. These jobs paid an average wage of $81,289 which is 27% higher than the overall average nonfarm wage. Export related jobs pay an average of 18 to 20% more than jobs not related to exports. At a minimum everyone in the world deserves the opportunity to work and provide for themselves and their families. This is a great stabilizer in society.

The Department of Commerce, International Trade Administration states that in 2015 Mexico was the largest export market for US machine tool manufacturers eclipsing China in both cutting and forming machine tool sales. [4] ARC Specialties is one of the last remaining manufacturers of large industrial robots in the United States. For ARC Specialties the loss of our two largest export markets due to tariffs would be devastating.

Much of the impetus for withdrawal from NAFTA comes from the U.S. auto industry. Most studies have shown that NAFTA benefits the auto industry. The Motor and Equipment Manufacturers Association commissioned a study by The Boston Consulting Group on the "Impact of BAT and NAFTA Reforms on the U.S. Motor Vehicle Industry". [5] This study concludes that "the economics of reshoring are not favorable for most motor vehicle products" and that "production in Mexico still more economical in the event of a border adjustment tax". Withdrawal from NAFTA with a 35% tariff would result in an increase of ~$1,200 per vehicle passed on to the consumer. The study states that "access to NAFTA low cost production is critical to compete in the global market". Germany relies on low-cost production in nearby Eastern Europe to keep cost down.

Ironically one probable response by automakers and consumers will be to "decrease content" or strip features to avoid cost increases. This decrease in content is predicted to cause the loss of 20 to 50k U.S. manufacturing jobs from the current 870k U.S. supplier employees. Charles Uthus at the American Automotive Policy Council said that the demise of NAFTA would be "basically a $10 billion tax on the auto industry in America"

Withdrawing from NAFTA would have an even greater effect on U.S. Agriculture which exported $38B to Mexico in 2016. Reverting to pre NAFTA tariffs levels would result in 75% duties on chicken and corn syrup, 45% on turkey, potatoes and dairy products and 15% on wheat.[6]

While working in former USSR countries I witnessed the devastating effect that central planning has on markets. When governments pick winners with subsidies and trade barriers, everyone else in the market loses. Quality declines, innovation stalls, service is degraded and prices are distorted.

In conclusion the North American Free Trade Agreement works. It stimulates trade and creates jobs. As a manufacturer who imports and exports, I believe that it is important to remain in NAFTA. I am proud to be involved with manufacturing because it is one of the few segments of our economy which creates wealth. Our robots and machines enable US companies to compete in a global economy and our exports of equipment help the balance of trade. I hope you will help me to continue to create wealth and create jobs in the United States of America by encouraging international free trade.

---

[1] https://www.uschamber.com/sites/default/files/legacy/reports/1112_INTL_NAFTA_20Years.pdf

[2] http://www.api.org/~/media/Files/Policy/Trade/North-American-Energy-Onepager.pdf

[3] http://www.nam.org/Issues/Trade/North-America-Drives-Manufacturing-in-the-United-States-and-a-Modernized-NAFTA-Would-Further-Boost-US-Jobs-and-Exports/

[4] www.trade.gov/topmarkets

[5] https://www.mema.org/sites/default/files/BCG%20MEMA%20BAT%20NAFTA%20Study%20Summary.pdf

[6] https://www.wsj.com/articles/trumps-nafta-threat-1508105756