Good neighbour gone bad: policy risks for Mexico and Latin America under Trump

A report by The Economist Intelligence Unit

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Executive summary

The victory of Donald Trump in the US presidential election of November 2016 raises questions about his government's policy towards Latin America. In this paper The Economist Intelligence Unit assesses the regional implications of potential US policy measures under Mr Trump in various key dimensions, including trade, remittances, immigration, aid and diplomatic relations. Although Mexico will undoubtedly be the most affected by US trade protectionism, from a multi-dimensional risk perspective various Central American and Caribbean countries are more vulnerable overall. This is illustrated in a "heat map" at the end of the report (pg. 19).

- Mexico has received the brunt of Mr Trump's rhetorical attacks and is at the greatest risk of having its diplomatic relationship with the US sour. Trade dependency on the US is also highest, with exports accounting for 26.9% of GDP in 2015. It is less vulnerable on remittances which amounted to just 2.1% of GDP in 2015 and on immigration which has fallen drastically over the last decade. This suggests that the proposed border wall may turn out to be the Trump administration's biggest white elephant.

- Overall, Central America and the Caribbean are the two most vulnerable subregions in Latin America, particularly on trade, remittances and immigration. Remittances from the US in 2015 accounted for over 15% of GDP in El Salvador, Honduras and Haiti and trade dependency was also high, with exports to the US totalling over 10% of GDP in El Salvador, Haiti and Nicaragua. The equivalent of around 1% of the labour force in Guatemala and Honduras, and nearly 2% in El Salvador, emigrated illegally to the US in 2015.

- Apart from Mexico, diplomatic risk is highest with the region's socialist-leaning countries, mainly Venezuela and Cuba, the latter which is under threat of having the rapprochement begun under the Obama administration rolled back. Potential frictions could also emerge with drug-producing countries as well as the Latin American countries that are temporary members of the UN Security Council. US foreign aid is no longer substantial in Latin America with the exception of Haiti where it represents the equivalent of one-tenth of the budget.

- The region will be susceptible to the global macroeconomic risks of Mr Trump's policies, particularly on import taxes as well as the effect of US dollar appreciation and higher interest rates on external financing. Although none of these macroeconomic effects will be destabilising, it will ensure that regional growth remains subdued into the medium term.

- Despite short-term risks, the long-term impact of Mr Trump's policies may have a silver lining by fostering economic diversification away from the US, promoting intra-regional ties and supporting a push to strengthen domestic economies.

Trump and Mexico: building walls, burning bridges

Since he announced his candidacy for US president in June 2015, Donald Trump has taken a predominantly hostile stance towards Mexico. During the election campaign, Mr Trump accused Mexico of disproportionately benefitting from the North American Free-Trade Agreement (NAFTA) at the US's expense, as well as of not doing enough to stem illegal immigration and drug-trafficking. He also vowed to build a border wall—both a physical and a symbolic barrier between two countries that, despite being culturally distinct, have until now sought a shared future predicated on increasing economic integration. Despite repeated assertions by the Mexican government to the contrary, Mr Trump also insisted during his campaign that Mexico would pay for the wall.

Mr Trump began his term in office on January 20th and moved quickly to put many of his campaign proposals into action. To this end, he signed an executive order on January 23rd to withdraw from the Trans-Pacific Partnership (TPP), a large inter-regional trade agreement, and to renegotiate NAFTA. Another executive order two days later authorised the construction of the border wall. The Mexican government, led by the president, Enrique Peña Nieto, has responded by strongly condemning the wall and making clear once again that Mexico will not pay for its construction. To cap off a rocky start to US-Mexico relations under the new US administration, inflammatory statements made by Mr Trump on Twitter resulted in Mr Peña Nieto cancelling a planned visit to the US on January 31st. Tensions subsided somewhat in subsequent weeks, with Mr Trump and his staff speaking more favourably about Mexico in subsequent interviews and press conferences, but it appears that his commitment to his trade and immigration policies has not wavered.

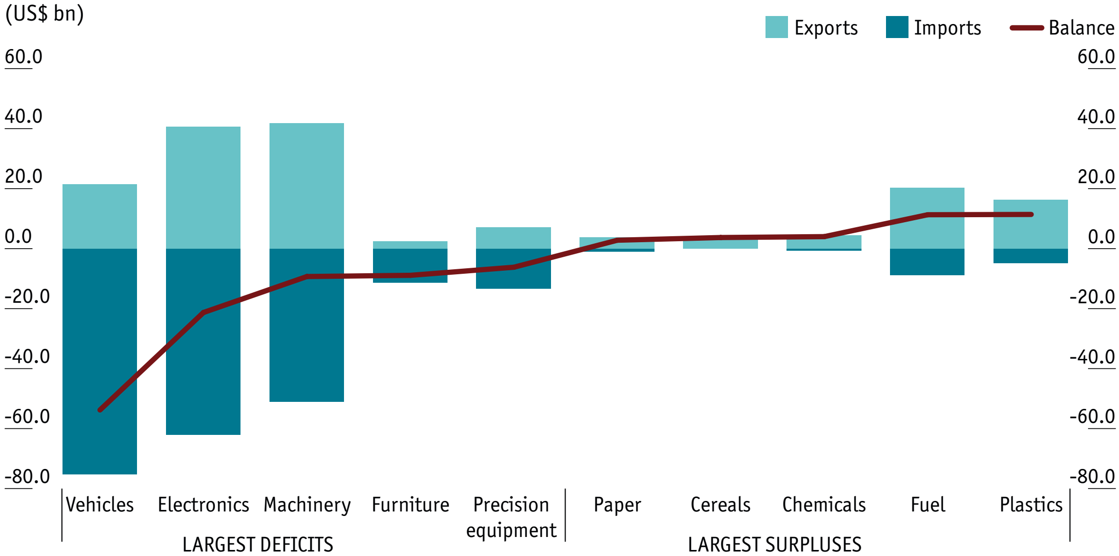
Mexico is therefore caught in the unenviable position of having to decide between appeasement and defiance. The Mexican government has been keen to convince its US counterpart that it is a strategic ally and that severing economic links would be mutually destructive. However, the colossal mismatch in hard power between the two countries makes it clear that Mexico has the most to lose if the relationship sours. A closer examination of the potential impact of US policy on trade, remittances and immigration follows.

Trade

Damage to the trade relationship is the most significant threat to Mexico presented by changing US policy, given Mexico's high trade dependency on the US. Mexico sends over 80% of its exports (valued at US$302.7bn in 2016) to the US, a share that has remained broadly unchanged since NAFTA came into force in 1994. In addition, it receives just under half of its imports from the US (worth US$179.6.bn). Mexico is also one of the US's most important trading partners, coming second only to Canada in the share of US exports (15.9% of the total in 2016), and second to China in the share of US imports (13.2%).

The US has a large trade deficit with Mexico, stemming mostly from three manufacturing sectors: automotives, electronics and machinery. The US trade deficit with Mexico stood at US$65.9bn in 2016. The automotive sector registered the largest deficit, of US$53.8bn, followed by electronics (US$21.3bn) and machinery (US$9.3bn). This helps to explain why Mr Trump has singled out car manufacturers and threatened the sector with a 35% import tax. The sectors in which Mexico ran its biggest deficits with the US in 2016 included plastics (US$11.4bn) and fuel (US$11.3bn). But even in those sectors where Mexico registered its biggest trade surpluses with the US, there was a large US import component: over US$20bn in vehicles, and over US$40bn each in electronics and machinery in 2016. Furthermore, Mr Trump's claims that the US is being taken advantage of in global trade will strike a chord in Mexico: much of that same sentiment is felt towards Asia, especially China, with which Mexico runs a disproportionately large trade deficit. Indeed, Mexico is a net importer of electronics and machinery, despite running large trade surpluses with the US in those sectors.

US-Mexico trade balance, 2016
(US$ bn)



Source: ITC.

The US has numerous legal mechanisms it can use to impose trade barriers through executive order, although these would run afoul of NAFTA and World Trade Organisation (WTO) rules. There are various laws that the US government could invoke in order to slap temporary trade barriers on Mexican exports. In all cases, this is the result of vague wording in legislation regarding the type of national-security threat that would justify the use of trade barriers, and also regarding the barriers that could be applied to countries which are not the direct cause of the threat.

The two main pieces of legislation are:

- **Trading With the Enemy Act (TWEA) of 1917.** This law allows the executive to restrict trade during "national emergencies", although it was subsequently amended in 1976 to be applicable only "during time of war". In addition, the law allows the government to seize and freeze foreign-owned assets. Given that the US military is currently involved in several operations worldwide

(including Syria and Afghanistan), in theory any of these could be used to trigger the law. The TWEA has also been used to enforce the Cuban embargo.

- **International Emergency Economic Powers Act (IEEPA) of 1977.** The IEEPA is broader in scope as it can be invoked in the context of an "unusual and extraordinary threat". Unlike the TWEA, it can be used only to freeze foreign-owned assets, but not seize them. It has been invoked to impose sanctions on certain countries (such as Nicaragua and Panama), which could set a precedent for its future use.

Additionally, three laws could be applied within more specific contexts:

- **Trade Expansion Act of 1962.** Trade barriers can be imposed on imports that have an impact on national security. There is no limit to the restrictions that can be implemented.
- **Trade Act of 1972.** Trade barriers can be set on one or more countries with which the US has "large and serious balance-of-payments deficits". These barriers include import tariffs of 15%, quotas or a combination of the two for up to 150 days.
- **Trade Act of 1974.** Allows for retaliatory actions against countries that undertake discriminatory or unreasonable trade practices against the US. Such practices would include not just trade barriers, but also exchange-rate manipulation.

The legality of the proposed US border-adjustment tax (BAT) of 20% is dubious and could face a WTO challenge. The BAT is not a proposal by Mr Trump's government, but rather a component of a Republican Party-supported tax reform that seeks to replace the corporate income tax with a so-called destination-based cashflow tax (DBCFT). This would tax cashflows (such as sales in the US) rather than profits. Although similar to a value-added tax (VAT), the DBCFT has some important differences which have legal implications. First, labour costs can be deducted for the DBCFT, which is not the case with VAT. Second, whereas VAT is applied to imports at the point of importation, the DBCFT would be charged directly on companies. Because of these two key differences, the proposed BAT would almost certainly be subject to legal challenges.

Although Mr Trump would be able to apply protectionist legislation through executive order, this is likely to be challenged by Mexico either through NAFTA's or the WTO's dispute-resolution mechanisms. Mexico has a good track record of winning disputes through NAFTA, including major decisions on crossborder trucking and tuna. Its punitive tariffs (US$2bn alone in response to the truck ban) were also carefully chosen to target those industries that were most sensitive to select US legislators. Depending on the scale of US protectionist measures, Mexico could inflict significant damage to vital US export sectors, like agriculture, that are supportive of Mr Trump and the Republican Party. Nevertheless, challenging US trade barriers could result in the Trump administration fighting back and expanding protectionist measures, leading to an all-out "trade war".

Mr Trump will push for a renegotiation of NAFTA, but has threatened to pull out of it altogether. On January 23rd the US president signed an executive action to renegotiate NAFTA "at an appropriate time", but as yet there are no details on what this would involve other than ambiguous statements of

giving American workers "a fair deal". This is not new language: both the former president, Barack Obama, and Mr Trump's rival in the election, Hillary Clinton, called for a renegotiation of NAFTA while campaigning in states that had suffered from industrial job losses. Renegotiation may focus on the dispute-resolution mechanism, as well as raising the ceiling for rules of origin, which would limit the amount of inputs that can be used from non-NAFTA countries. The US could also push for stronger labour protection, as contained in the now-defunct TPP. This would provide a boost to Mr Trump's working-class base even though it stands at odds with his pro-business views. In the end, renegotiating NAFTA at the margins would do little to reduce the US's trade deficit with Mexico, which is largely structural on account of the country's cost-competitiveness.

Then there is the "nuclear option": a formal withdrawal from NAFTA. This would require only a six-month written notice, but could be undertaken unilaterally and without congressional approval. However, under WTO rules this would still leave Mexico with "most favoured nation" status, with top tariffs far below what Mr Trump has called for and with Mexico still able to resort to WTO dispute-resolution mechanisms. The US could go further and leave the WTO, a move that would have severe consequences for the global trade system but also for the US economy, as it would leave exporters at the mercy of trade barriers in any of the other 143 WTO members with which the US does not have a free-trade agreement (FTA). (The US has FTAs with 18 other countries outside NAFTA, but on aggregate these account for a very small share of world trade.)

Preventing outsourcing by making direct threats or providing incentives to companies is not a viable long-term strategy to keep jobs in the US. Even before Mr Trump took office, his attacks against outsourcing of US jobs and investment south of the border paid some quick dividends: on November 30th an airconditioner manufacturer, Carrier, announced that it would scrap plans to move 700 jobs to Mexico. On January 3rd a carmaker, Ford, cancelled an even larger US$1.6bn investment in a new factory in the Mexican state of San Luis Potosí in favour of expanding its plant in Michigan. Threats against other carmakers, including General Motors (US), Toyota (Japan) and BMW (Germany), have also been made, although all three have defended their decisions to manufacture in Mexico. We expect foreign direct investment in Mexico to decline in the short term as companies weigh the repercussions of investing while Mr Trump is in office. However, Mexico's competitive advantages as a destination for export-based manufacturing are unlikely to be badly affected in the medium and longer term.

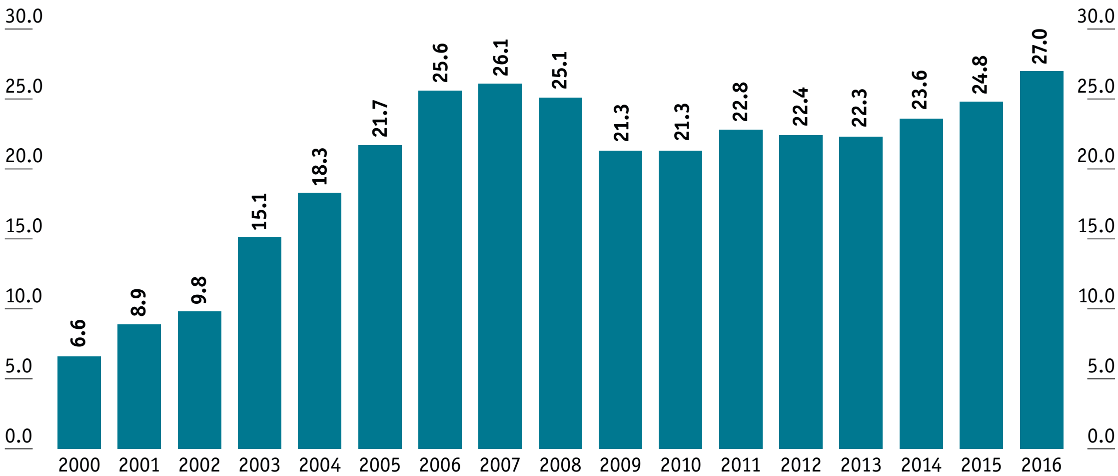
Remittances

Mexico is the largest recipient of workers' remittances in the world, but these account for a relatively low share of GDP, which lessens the impact if they are taxed or seized. In 2015 Mexico received US$24.3bn in remittances from the US (out of US$24.8bn total), which represents just under half of the total for Latin America. But as a share of GDP, this was only 2.1%, far lower than in many other central American and Caribbean countries. Remittances from the US rose to US$25.7bn in 2016 (out of US$27bn total) but this was still only 2.5% of GDP. Mr Trump has considered imposing a 35% remittance tax, ostensibly to pay for the border wall, and has also threatened seizure of remittances.

Even if implemented, the impact of such a tax on Mexico would be insignificant: the weakening of the peso since 2014 has caused the value of remittances to rise considerably in local-currency terms, by 60.2% in 2014-16 (compared with just 14.4% in US dollar terms). This will more than offset the impact of the proposed tax. Whether the tax is fully enforceable is another matter. Many remittances to Latin America are transferred through informal channels such as small shops or currency-exchange houses, which move the money among brokers already in country. A large volume of remittances is also moved in person. The use of crypto-currency like bitcoin has also been suggested; although this may initially be beyond the technical sophistication of remittance senders, they are likely to learn quickly out of necessity and also benefit from any third-party services that will inevitably emerge.

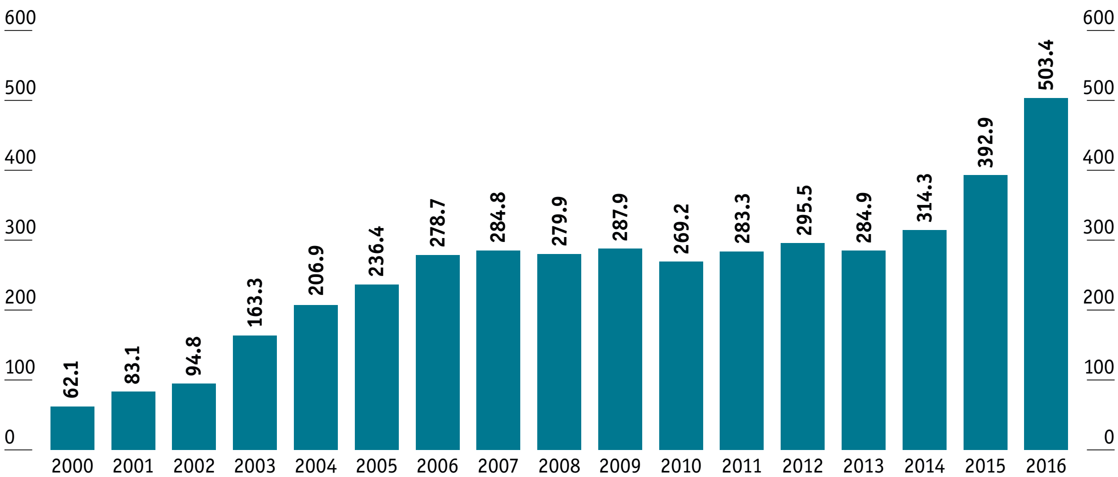
Total remittances in USD

(USD bn)



Total remittances in MXN

(MXN bn)



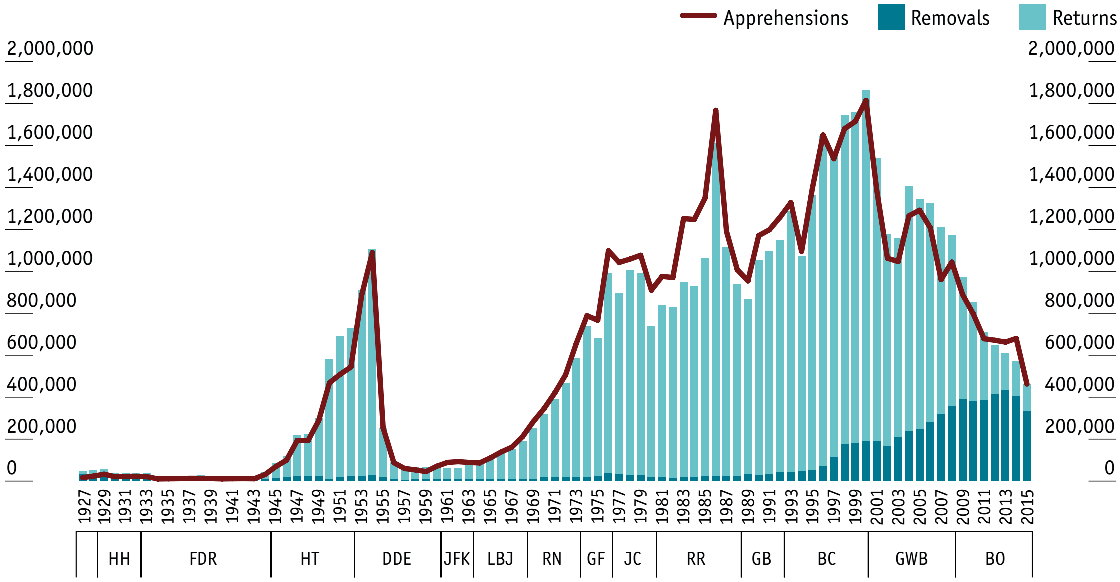
Source: Banco de México.

Immigration

The number of Mexican migrants travelling to the US has fallen considerably compared with the 1990s and 2000s, and this is not a source of major vulnerability if the US toughens border controls. Mexicans remains the largest source of illegal immigration to the US with 267,885 apprehensions in 2015, or 57.9% of the total. However, overall apprehensions have fallen from a peak of nearly 2m in the 1990s, when Mexicans accounted for a higher proportion of overall apprehensions (over 90%). Contrary to an oft-repeated claim, the Obama administration did not intensify the pace of deportations. Rather, this reflected a rise in removals, meaning those sent back to their countries of origin with a court order as opposed to returns, where there was no legal process involved, simply deportation. The sum of removals and returns, which roughly tracks that of apprehensions, has been on a clear downward trend since the last spike during the George W Bush administration. Other data from a US non-profit organisation, the Pew Research Center, show that net migration from Mexico has been negative since 2005. This largely nullifies the Trump administration's exaggerated claims of uncontrolled immigration, and minimises the practical impact that policies such as the border wall or increased deportations might have on Mexico.

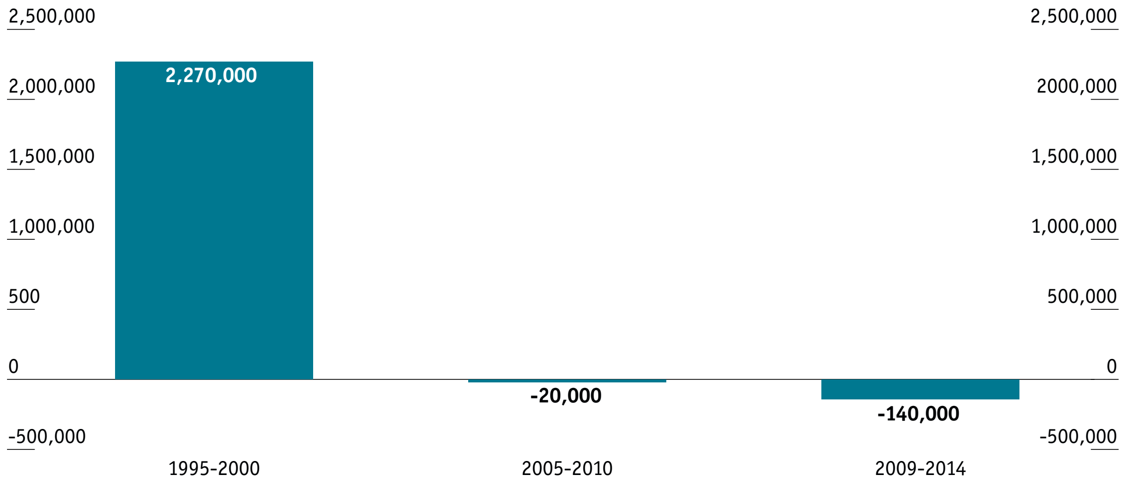
The Trump administration is likely to overturn the Deferred Action for Childhood Arrivals (DACA) policy, a moratorium on deportations of undocumented immigrants who entered the US as minors, which was introduced in 2012. There is also little chance of the proposed DREAM Act being passed in Congress; this would provide a path to citizenship to many of the same immigrants benefitting from DACA. Although this would be disruptive for many families, it would have relatively modest aggregate effects.

Immigration enforcement



Source: Department of Homeland Security.

Net migration from Mexico



Source: Pew Research Center

The proposed border wall may be the most symbolic manifestation of Mr Trump's animosity towards Mexico, but will be largely irrelevant in practice. Declining levels of Mexican emigration mean that the US$15bn-25bn wall may turn out to be the Trump administration's biggest white elephant. It is unlikely to make a significant dent in preventing drugs from flowing north, or guns from crossing south. Furthermore, failure to make Mexico pay for the wall directly could cost Mr Trump considerable political capital among his support base. The wall may also be short-lived: if it fails to have any meaningful impact, it could end up being torn down by a future Democratic administration seeking to mend ties with Mexico.

Trump and Latin America: watching the region drift away

Overview

The Trump administration's policy towards Latin America has yet to be fully defined, but its hostility towards Mexico has raised concerns among regional governments, which are likely to adopt a strategy of cautious co-operation with their unpredictable northern neighbour. Although US influence in Latin America has eroded significantly since the end of the cold war, it remains the region's principal trading and investment partner and is a key strategic ally for many countries on matters such as security. However, most countries will be acutely aware of Mr Trump's unpredictable temperament and will want to avoid creating unnecessary diplomatic rifts.

There is a strong chance that Latin America will fly under Mr Trump's radar if he focuses primarily on other global hotspots such as the Middle East and Asia. However, a potential return to excessive meddling in domestic issues—if not outright bullying—would generate considerable resentment, especially when contrasted with the Obama administration's treatment of the region as equals. For example, the US government stayed on the sidelines during the 2009 Honduras coup and has largely ignored anti-US provocations by the Venezuelan governments of Hugo Chávez and Nicolás Maduro. Mr Obama also managed to shake off decades of enmity with Cuba through a gradual rapprochement that has been widely applauded. Although a return to the "gunboat diplomacy" that was practiced a century earlier or even the interventionism seen during the cold war is out of the question today, a belligerent attitude by the US towards Latin America would likely lead to a deepening of intra-regional co-operation, as well as a strengthening of partnerships with Asia and Europe. In the longer term, this would accelerate the ongoing trend of diminishing US influence in a region that was long seen as its backyard.

Our "heat map" (see pg. 19) has shown that Central America and the Caribbean are, broadly speaking, the two most vulnerable subregions in Latin America to Mr Trump's policies, whereas South America is only modestly affected. In particular, the so-called Northern Triangle countries (Guatemala, El Salvador and Honduras) are more heavily exposed than any others excluding Mexico—all three have moderate to severe risk in most dimensions. The heat map also shows that the risk of adverse effects from US immigration and aid policies is highly concentrated on just a few countries, whereas trade and remittance risk is more broadly spread. On the diplomatic front, Latin America's left-wing governments are the most vulnerable.

Diplomatic relations

Political frictions may arise with the Alianza Bolivariana para los Pueblos de Nuestra América (ALBA), a loose coalition of socialist-leaning countries, making them the most vulnerable to diplomatic hostility. ALBA was founded by Venezuela and Cuba in 2004 as an alternative to US-led free-trade policies, and current members include Bolivia, Ecuador and Nicaragua. Many of these governments have engaged in recurrent anti-US rhetoric over the past decade, particularly Venezuela, which has frequently blamed the US for allegedly providing support to its political opposition and for undertaking an "economic war" against the country. The US has rarely responded to the provocations, although this is likely to change given that Mr Trump has a tendency of lashing out when challenged.

As a testament to the more pragmatic attitude taken by the ALBA countries, the administration of Mr Maduro in Venezuela has so far avoided any direct criticism of Mr Trump, although it has undertaken military drills and preparations for a "prolonged people's war" if invaded. We do not expect the Trump administration to threaten outright war with any of the ALBA countries. However, the risk that minor diplomatic rows could escalate is high. Venezuela is particularly vulnerable to economic retaliation in the light of its severe balance-of-payments constraints; crude oil sales are its sole source of foreign exchange and a significant part of these sales are to the US. It should also be noted that the new US secretary of state, Rex Tillerson, has previously sued the Venezuelan government while CEO of ExxonMobil and could harbour negative sentiments towards the country.

One specific piece of legislation targeting Nicaragua is the Nicaragua Investment Conditionality Act (NICA) which seeks to block international loans for that country unless various electoral and institutional reforms are enacted. It is currently pending Senate and executive approval and could lead to an important squeeze on the country's public finances. In 2015, US$317m out of US$1.1bn in bilateral and multilateral financing came from the World Bank and Inter-American Development Bank, the two institutions whose loans could be affected by the NICA act.

Mr Trump has criticised the US-Cuba rapprochement begun under the Obama administration and has threatened to take a harder line against the Cuban government. The rapprochement has led to a relaxation of travel and some trade and financial restrictions (Cuba's first export to the US in half a century, of charcoal, took place in January). In November Mr Trump implied on social media that US-Cuba relations would depend on the Cuban government accepting greater democracy on the island. Since then, there have been no concrete pronouncements, although the White House has affirmed that its Cuba policy is under review. The response by the Cuban-American community towards a tougher

stance against the island will be mixed; younger members of the community tend to favour a relaxation or elimination of US sanctions, while older Cuban-Americans strongly objected to Mr Obama's policy and are likely to support a tougher stance by Mr Trump. In Cuba, anti-US sentiment will rise if Mr Trump becomes hostile, scuppering interest for closer ties between the two countries.

Mr Trump has taken a strong anti-drug stance and could put pressure on drug-producing countries to do more to stem the flow of drugs into the US. He has repeatedly described the "drug war" as primarily a problem of inflows, which shifts the blame to drug-producing and drug-trafficking countries rather than its own demand for drugs. Three South American countries are listed by the US as "significant illicit drug-manufacturing countries"—Colombia, Peru and Bolivia—which allows them to be earmarked for anti-narcotics assistance (except Bolivia, which refuses US aid altogether). Inability to bring drug consumption and drug-related violence down in the US could result in a more hostile position by the US government against these countries. This would force them to take more drastic action to eradicate drug-producing areas, against the threat of sanctions or some other retaliatory measures, such as a reduction or elimination of US financial assistance.

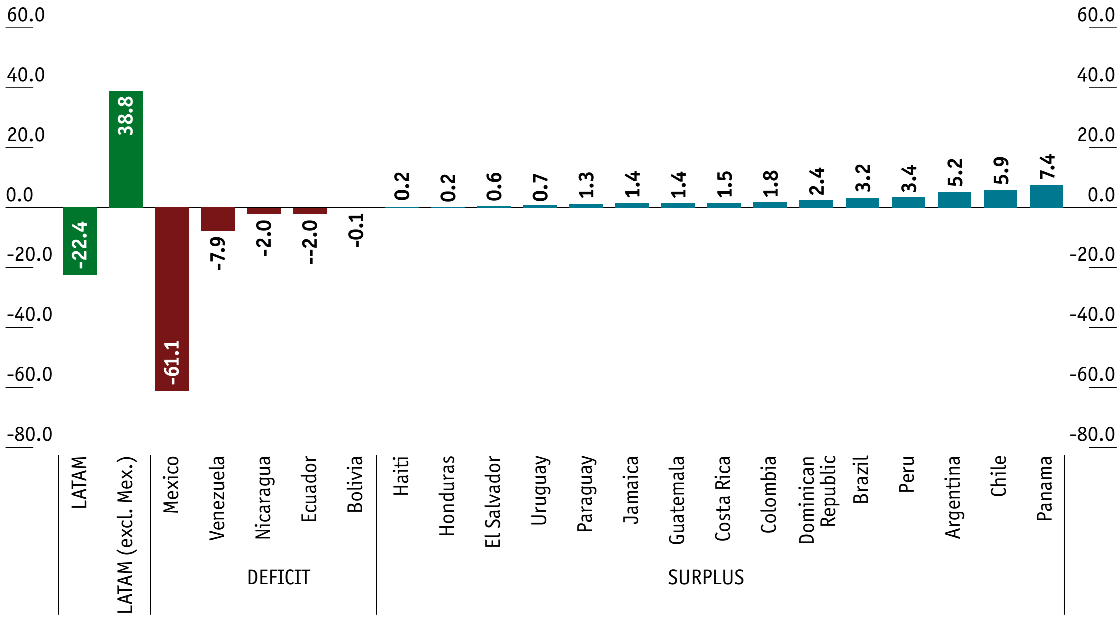
Bolivia and Uruguay are currently non-permanent members of the UN Security Council (UNSC), which could put them at odds with the US in the event of a security crisis abroad. The situation could echo that of 2003, during the prelude to the Iraq War. At the time, there were two Latin American countries in the UNSC, Chile and Mexico, both of which were under heavy pressure to support the war (neither did). Various other Latin American countries did join the so-called coalition of the willing, but partly as a result of heavy arm-twisting by the Bush administration, which included threats to cut military assistance as well as trade and financial benefits. The lesser dependency on the US of the two current UNSC members should help them to maintain an independent position on global security issues regardless of pressure.

Trade

In 2015 the US had a US$22.4bn trade deficit with Latin America, but this figure is mostly attributable to the shortfall with Mexico. Excluding Mexico from the regional average, the US deficit swings into a US$38.8bn surplus. Among the major regional economies, the US has trade deficits only with four of them besides Mexico: Venezuela, Nicaragua, Ecuador and Bolivia. Interestingly, these are all ALBA countries and the bulk of US imports from them are composed of commodities—crude oil in the case of Venezuela and Ecuador, and metals for Bolivia. Nicaragua is unique among these countries in that its exports to the US are primarily manufactures, namely garments. It is also the only country in Latin America besides Mexico with which the US has a trade deficit as well as an FTA.

The US has small to moderate trade surpluses with all other major Latin American economies. By and large, the US trade profile with Latin America consists of commodity imports and manufacturing exports. One exception is Brazil, from which the US imports a growing volume of aerospace equipment (over US$3bn in 2015) as well as machinery (US$3.3bn), although commodities comprise most of the remainder. Precision equipment is also the dominant import from Costa Rica and the Dominican Republic. As with Nicaragua, garments are the most important imports from El Salvador and Honduras, reflecting the importance of their *maquila* (domestic assembly for re-export) industries.

US-Latin America trade balance
(US$ bn)



Source: IMF DOTS

Mr Trump has not singled out for scrutiny any other FTA signed in Latin America besides NAFTA. Currently, the US has FTAs with ten other Latin American countries, including bilateral FTAs with Colombia, Chile, Panama and Peru, and the multilateral Dominican Republic-Central America Free-Trade Agreement (DR-CAFTA), which also includes Costa Rica, El Salvador, Guatemala, Honduras and Nicaragua. Non-NAFTA FTAs represent a market of over US$1trn in nominal US dollar terms (nearly as much as the Mexican market alone) and nearly US$2trn in purchasing power parity terms. However, there is a much lower intensity of trade with these countries, and supply-chain integration is weak, unlike the case of NAFTA.

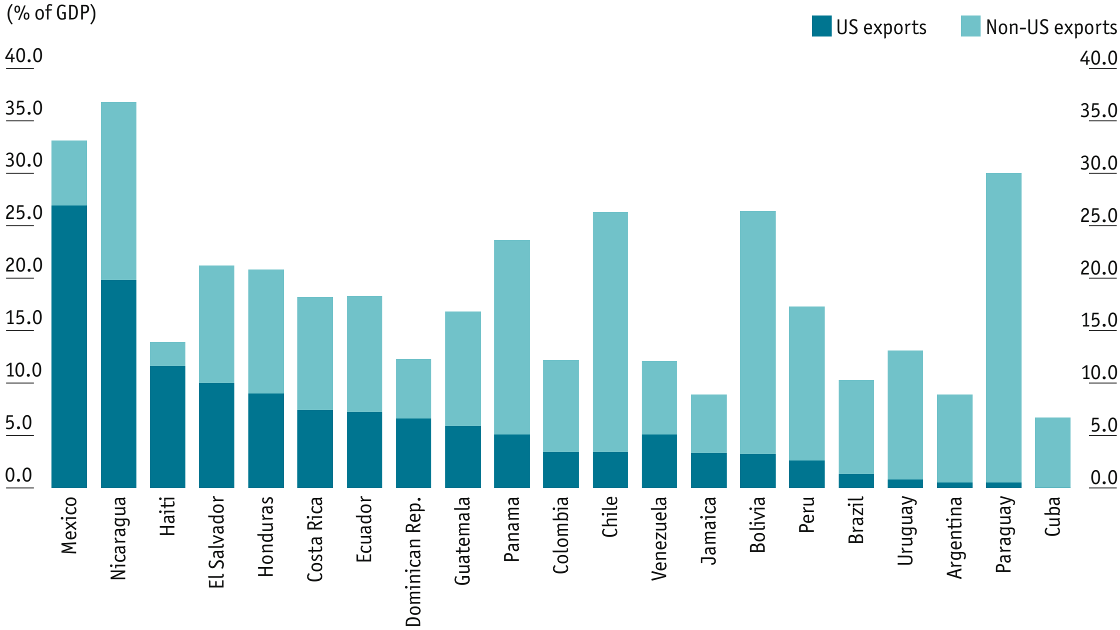
In the absence of a critical sector for high-value-added outsourcing as well as its relatively low volume, US trade with Latin America outside Mexico does not appear to be under any specific threat. However, some countries would be vulnerable to general US protectionism, such as the proposed BAT, or more exceptional measures, like withdrawing from the WTO. Currently, Mexico's exports to the US account for just over a quarter of its GDP, more than any other country in Latin America. However, Nicaragua comes a close second, with exports to the US comprising nearly one-fifth of its GDP. Eight other countries display moderate vulnerability given that their exports to the US are equivalent to over 5% of GDP, all of these Central American and Caribbean countries with the exception of Ecuador.

Remittances

Small Latin American economies in Central America and the Caribbean are the most vulnerable to any actions taken in the US to tax or seize remittance flows. Although Mexico receives by far the largest volume of remittances in Latin America, many other countries are much more dependent on remittances as a share of GDP; Haiti tops the list with an extraordinary 26.1% in 2015, of which

Exports as share of GDP, 2015

(% of GDP)

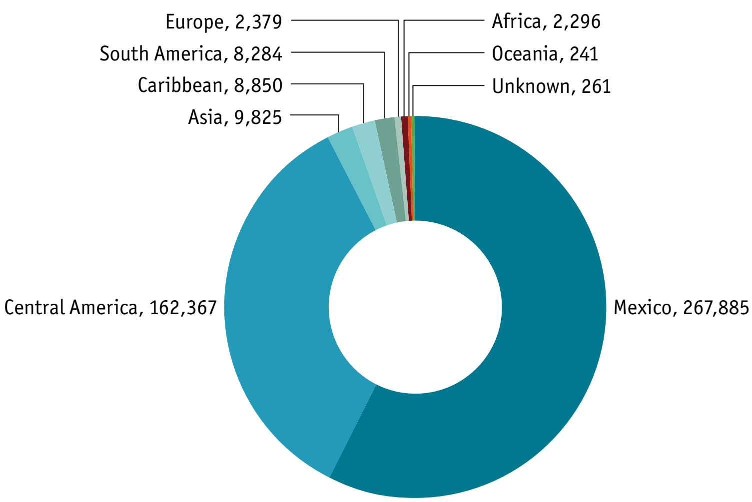


Source: ITC.

around three-fifths comes from the US. Honduras, El Salvador and Jamaica all had remittance inflows equivalent to over 10% of GDP in that year, with Guatemala and Nicaragua falling just short of this threshold. With the exception of Bolivia, all South American economies have remittance inflows well below 2.5% of GDP and in some countries, like Uruguay, Brazil and Argentina, it is negligible. Due to exchange rate controls, remittances in Venezuela are also nearly nil.

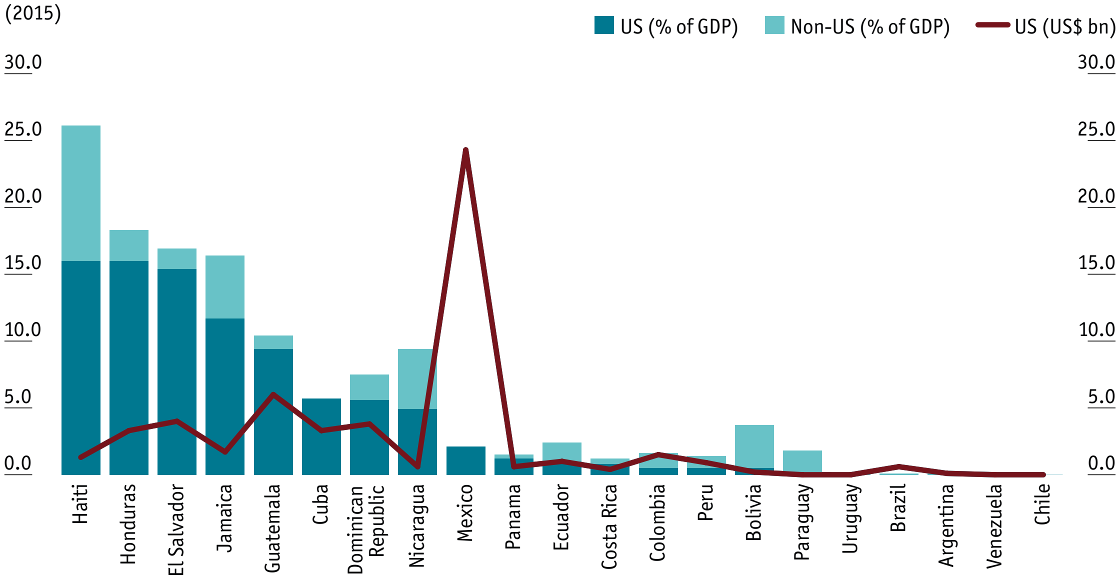
Diluting the impact of US restrictions is the fact that Europe (particularly Spain) is also an important source of remittances to South America, especially for the Andean countries. In Ecuador, for example, remittances from Spain amounted to 36% of the total in 2015 and in Bolivia they were 41.7%; in the latter case this was well above the US share. There is also an important volume of intra-regional remittance flows. Both Argentina and Chile have positive net remittance outflows, with most going to the Andean countries; Chile is Peru's second-largest source of remittances after the US, and

Apprehensions by region (2015)



Source: Department of Homeland Security

Remittances
(2015)



Source: Pew Research Center.

Argentina is Bolivia's third main source, behind the US and Spain. Nicaragua also received 37.2% of its remittance inflows from neighbouring Costa Rica, which has a large resident Nicaraguan population.

Estimating Cuba's economic vulnerability to remittances is difficult given that its overvalued exchange rate artificially raises the size of its economy in US dollar terms. There are also no official statistics on remittances for Cuba. The US-based Havana Consulting Group estimated that remittances reached US$3.4bn in 2015 and highlighted that this number has been growing faster than in any other Latin American economy, on account of the relaxation of restrictions by the Obama administration and the increase in flights bound for Cuba from the US. However, the threat of a deterioration of the US-Cuban relationship would have an impact on remittance flows if recently opened channels for the movement of capital are closed.

Immigration

Central America, and specifically the Northern Triangle (comprising El Salvador, Honduras and Guatemala), is most vulnerable to restrictive US immigration policies. In 2015 US border patrol apprehensions totalled 160,615 for these three countries, which represented 89.5% of total apprehensions from Latin America excluding Mexico. The recent surge in immigration from this region (which contrasts with the decline from Mexico) has been largely fuelled by gang-related violence in those countries, which have some of the highest homicide rates in the world; El Salvador tops the global rankings with a rate of 104 per 100,000 in 2015. In 2014 a migrant crisis erupted as a result of a massive number of unaccompanied children from these three countries crossing into the US. Another such surge took place in 2016. Although tougher enforcement along the US-Mexico border would prevent many migrants from crossing into the US, pressure by the Trump administration on Mexico to improve policing of its own southern border (possibly with US material assistance) could also help to cut back on the number of illegal immigrants.

Apart from Mexico and the Northern Triangle, emigration to the US from Latin America is negligible. Only six countries had more than 1,000 of their citizens apprehended by US immigration authorities in 2015. These included four countries from the Caribbean (Haiti, the Dominican Republic, Cuba and Jamaica), one from Central America (Nicaragua) and one from South America (Colombia). Among these, the Dominican Republic had the most apprehensions, with 2,797, which illustrates the massive gap separating Mexico and the Northern Triangle countries with the rest of Latin America in terms of current immigration patterns.

The end of the "wet feet, dry feet" (WFDF) policy with Cuba will temper a recent spike in immigration The WFDF was implemented during the administration of Bill Clinton in 1995 and allowed the US authorities to repatriate any Cuban migrants caught at sea, but allow those that had arrived on US soil to remain and seek residency or citizenship. In recent years the policy had been criticised because it afforded Cubans different treatment than other migrants, and also gave them the incentive to undertake a more hazardous journey (typically via Central America and Mexico), which put them at the peril of people-traffickers. The renewal of US-Cuba ties led to an immediate spike in immigration, with 56,406 Cubans entering the US in 2016, more than double the figure two years earlier. These volumes are unlikely to be sustained, since Mr Obama ended the WFDF policy before leaving office in January 2017. Mr Trump has not spoken specifically about his immigration policy on Cuba, but it is highly unlikely that any special new deal like the WFDF will be implemented.

Aid

Foreign aid is no longer an important component of US-Latin American relations compared with the cold war era. However, a small number of countries would be affected if it were to be rolled back. The US has pledged over US$1bn in aid to the region in 2017, with security, democracy and governance, and development being the three main areas targeted for aid. This is a considerably lower figure than in the past, and also just a fraction of the total US aid budget of US$34bn this year.

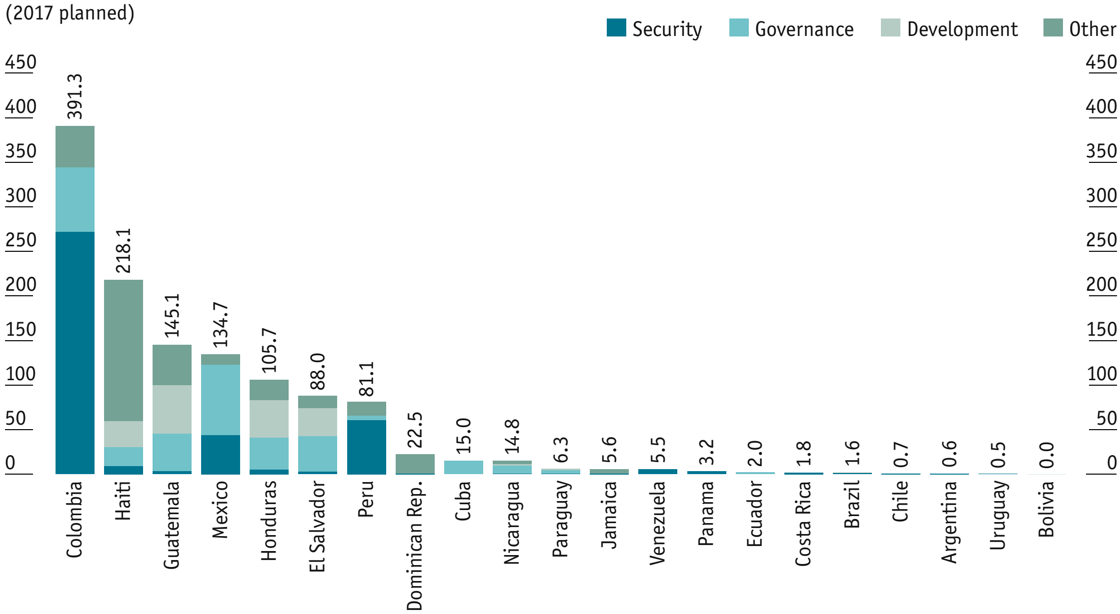
Colombia is the single-largest recipient of US aid, with US$391m pledged in 2017. Around two-thirds of this is security-related as part of the so-called Plan Colombia, an anti-narcotics and counter-insurgency assistance programme that was launched in 1999 in order to combat the country's powerful drug cartels and guerrilla groups like the FARC. An improved security situation, which culminated in the signing of a peace agreement with the FARC in 2016, has helped to reduce the size of US aid to Colombia, and the 2017 level is far below its peak under George W Bush. US aid accounts for a low proportion of Colombia's overall budget, at just 0.4%. However, the US$272m pledged for security aid is substantial when compared with the share of the Colombian defence budget earmarked for procurement, which amounted to US$379m in 2016.

Haiti is the only country in Latin America that has substantial budgetary dependency on US aid, and is the second-largest recipient in absolute terms. The US has pledged US$218m in aid to Haiti in 2017, with the majority of this earmarked for health programmes. As a share of Haiti's budget, however, this figure rises to nearly 10%, which suggests that major cuts would be deeply damaging, considering the country's severe socioeconomic needs as well as ongoing rebuilding efforts from the devastating 2010 earthquake (which killed over 100,000 people) and Hurricane Matthew, which struck

in 2016. To a much lesser extent, the Northern Triangle countries also have some degree of budgetary dependency on US aid, topping at 2.3% in Honduras. In addition, Peru is a noticeable recipient of security aid, second only to Colombia, reflecting its status as a major drug-producing country (mainly of opiates).

Foreign assistance

(2017 planned)



Source: http://beta.foreignassistance.gov/explore

CONCLUSION

The Trump administration has had an erratic start, but seems determined to carry out its policy agenda on trade and immigration. Much will depend on whether those measures that appear to violate US laws or principles, as well as international law, can be successfully challenged and repealed. However, given the strong hand afforded to the US presidency, Mr Trump is free to enact many of his measures through executive order, thereby ensuring at least some temporary impact. Nevertheless, Mr Trump may be persuaded to soften his stance on key issues. For example, despite his myriad threats on how the border wall will be paid (a tax on remittances or a tax on Mexican imports), government officials have suggested that the BAT will be the mechanism through which Mexico pays for the wall—even though this tax is not specific to Mexico and was not even originally proposed by Mr Trump.

Although Mexico has received the brunt of Mr Trump's rhetorical attacks, various Central American countries are the most vulnerable to his policies overall. The heat map below shows that El Salvador is possibly the country most at risk given its moderate-to-high vulnerabilities in all five categories: diplomatic relations, immigration, trade, remittances and aid. Honduras, Haiti and Guatemala round up (along with Mexico) the five countries most exposed to negative effects from Mr Trump's policies. The least exposed countries are in South America, particularly the Southern Cone countries of Argentina, Chile, Paraguay and Uruguay, as well as Brazil. Links between these countries and the US are weak and there are few outstanding issues between them and the US that could lead to diplomatic conflicts.

The region will be susceptible to the global macroeconomic risks of Mr Trump's policies, particularly on taxes. According to some estimates, the BAT of 20% could cause the US dollar to strengthen by 15-25% by increasing the attractiveness of US goods and lowering demand for foreign goods in the US. In addition, gradual monetary policy tightening by the Federal Reserve (the US central bank) will raise interest rates and, therefore, the cost of dollar financing, with a particularly strong impact on those countries with a high share of external debt. Weaker local currencies should, in theory, help to boost export competitiveness, but the benefits will be modest for two reasons. First, in Mexico's case, its manufacturing exports have a large share of US import content, which will become more expensive. Second, for the rest of the region, most exports are commodities whose prices respond to their own supply-and-demand dynamics. Although none of these macroeconomic effects will be destabilising—the region has much stronger fundamentals than in the past, even though many countries are emerging from recent slowdowns or recessions—it will ensure that regional growth remains subdued into the medium term.

Despite short-term risks, the long-term impact of Mr Trump's policies may have a silver lining by fostering economic diversification away from the US, promoting intra-regional ties and supporting a push to strengthen domestic economies. For example, the members of Mercosur (the Southern Cone customs union, comprising Argentina, Brazil, Paraguay, Uruguay and Venezuela) are already attempting to accelerate negotiation with the EU for an FTA. The ebbing of the so-called Pink Tide (which

preceded Mr Trump's election) has resulted in centre-right governments in South America's two largest economies, Brazil and Argentina, and this should result in closer links with the trade-friendly Alianza del Pacífico (comprising Mexico, Colombia, Peru and Chile). This will help to blur the barrier between the open, liberal Pacific economies and the more protectionist Atlantic economies. For Mexico, the threat of NAFTA unravelling should lead to a greater emphasis on strengthening its underdeveloped domestic-focused economy, which has languished compared with its export-oriented sectors.

The Trump risk heat map

This heat map measures the exposure of every major Latin American country to risks emanating from potential US policies under Mr Trump in the dimensions of diplomatic relations, trade, remittances, immigration, aid and external debt. Except for diplomatic relations, which uses a qualitative approach, all other dimensions use relative metrics. This was done in order to avoid bias against Mexico, which has disproportionate exposure to the US in absolute terms, but mostly on account of its much larger economy and population. The result of using a relative approach is the conclusion that certain smaller countries, mainly in Central America and the Caribbean, are the most vulnerable to Mr Trump's policies.

	Diplomatic	Trade	Remittances	Immigration	Aid	Overall
Argentina		0.5	0.0	0.00	0.00	0
Bolivia	I, D, S	3.2	0.5	0.00	0.00	3
Brazil		1.3	0.0	0.00	0.00	0
Chile		3.4	0.0	0.00	0.00	1
Colombia	D	3.4	0.5	0.01	0.43	3
Costa Rica		7.4	0.8	0.01	0.02	2
Cuba	I, P, C	0.0	5.7	0.89	0.02	7
Dominican Rep.		6.6	5.6	0.06	0.16	4
Ecuador	I, P	7.2	1.0	0.07	0.01	4
El Salvador	I, C	10.0	15.4	1.86	1.32	15
Guatemala	C	5.9	9.4	0.96	1.46	9
Haiti		11.6	16.0	0.02	9.99	11
Honduras	C	9.0	16.0	1.19	2.16	12
Jamaica		3.3	11.7	0.09	0.14	4
Mexico	C, H	26.9	2.1	0.51	0.05	11
Nicaragua	I	19.8	4.9	0.05	0.37	7
Panama		5.1	1.2	0.01	0.02	2
Paraguay		0.5	0.0	0.00	0.11	0
Peru	D	2.6	0.5	0.00	0.12	2
Uruguay	S	0.8	0.0	0.00	0.00	1
Venezuela	I, P, C	5.1	0.0	0.00	0.00	5

	Number of issues	% of GDP (US only)	% of GDP (US only)	Apprehensions as % of labor force	% of budget spending	1 point per degree of risk
Very low	None	< 2%	< 2%	< 0.25%	< 0.25	0 to 2
Low	1	> 2%	> 2%	> 0.25%	> 0.25	3 to 5
Moderate	2	> 5%	> 5%	> 0.5%	> 1	6 to 8
High	3	> 10%	> 10%	> 1%	> 2.5	9 to 11
Very high	H	> 15%	> 15%	> 1.5%	> 5%	> 11

Diplomatic relations: *considers probability of diplomatic frictions arising from (I) ideology (such as being ALBA members or strongly left-wing), (P) past tensions and enmity, (C) current contentious issues (such as immigration), (S) belonging to the UN Security Council, and (D) being a major drug-producing country. Where overtly hostile attitudes (H) have already been taken, the maximum risk is automatically awarded (currently just Mexico).*

Trade: *considers risk of trade protectionism by measuring US trade as a share of GDP in 2015 (Source: ITC).*

Remittances: *considers risk of taxing or seizing remittances by measuring US remittances as a share of GDP in 2015 (Source: Pew Research Centre).*

Immigration: *considers risk of increased border controls and higher pace of deportations by measuring the share of apprehensions relative to the labour force in 2015. (Sources: Department of Homeland Security; The Economist Intelligence Unit)*

Aid: *considers risk of diminished foreign assistance by measuring aid relative to fiscal spending in 2017 (Sources: ForeignAssistance.gov; The Economist Intelligence Unit)*

Overall: *Sum of every degree of risk across each dimension from 0 = very low risk to 4 = very high risk.*

Notes:

1) The GDP of Cuba and Venezuela in US dollar terms has been reduced by one-third in order to factor in overappreciation of pegged currencies for assessing trade and remittance risk.

2) Cuba immigration includes apprehensions plus entries to the US to account for the WFDF policy.

3) GDP and budget figures for aid are 2017 Economist Intelligence Unit forecasts.

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