Insight

Mexico Isn't Paying for the Wall

JACQUELINE VARAS | JANUARY 8, 2019

President Trump argues that Mexico will pay for a wall on the southern border—if indirectly—through the new U.S.-Mexico-Canada Trade Agreement (USMCA). In his words, "What we save on the USMCA just with Mexico will pay for the wall many times over." This statement misrepresents what the trade deal, if passed, will do. There is no evidence that the USMCA will generate economic growth and therefore increase tax receipts. Thus, it cannot fund the wall.

At the heart of the president's claim that Mexico will pay for the wall is the assumption that the USMCA will lower the bilateral trade deficit with Mexico, generating a significant amount of income for the United States. There are several issues with that assumption. The first is a fundamental misunderstanding of trade. Yes, exports generate revenue for the seller, but imports do not reflect a loss of income. Rather, imports provide value to both U.S. buyers and producers, reflecting their demand for consumption and intermediary goods, respectively. International trade generates efficiency in this way by encouraging competition between producers and results in the efficient production of high-quality products. Furthermore, the flip side of imports is foreign direct investment—the U.S. dollars that were used to purchase foreign goods are reinvested in U.S. bonds, factories, and other assets. Because dollars used to buy imports flow back into the United States, it is wrong to think about international trade in the same way as one would think about the sales by a private company.

Second, there is nothing inherent in the USMCA that would lead to an increase in exports to, or a decrease in imports from, Mexico, because it did not drastically change the status quo. NAFTA had already lowered tariffs to practically zero before the renegotiations began; no new tariffs were eliminated. The USMCA did make progress opening up Canadian markets to U.S. dairy producers, but the United States already has a dairy trade surplus with Canada. More likely, the president is counting on stricter rules of origin in the auto sector to increase domestic auto production and therefore to decrease auto imports from Mexico. For a car to be traded under USMCA, at least 70 percent of its steel and 75 percent of its total content must be manufactured in North America. Furthermore, 40 to 45 percent of the car's content must be made by workers earning at least $16 per hour. This minimum wage requirement is explicitly designed to reduce auto production in Mexico, where the average factory worker earns just $2.10 per hour.

The more likely result of these restrictions, however, is that automakers will continue producing in low-cost nations like Mexico, pay the relatively low U.S. tariff of 2.5 percent to export cars into the American market, and pass that cost on to consumers. Increased rules of origin will not spur a dramatic increase in U.S. production or auto jobs; they will only divert trade and increase consumer prices.

Finally, there is no guarantee that the USMCA will pass the new Congress. It seems that it will be hard for the president to secure the support of congressional Democrats for his signature trade deal. The shutdown is also impeding the fulfillment of statutory requirements that must be met before a vote can be held, delaying USMCA's passage even further. Ironically, the current shutdown is obstructing the trade deal that President Trump so desperately wants.

The wall is clearly one of the president's top priorities. If he believes the wall is in the U.S. interest, a point over which there is genuine disagreement, he should make the case to Congress and the American people for

government funding. Barring a sudden outburst of fiscal generosity from our neighbors to the south, however, there is no reliable scenario in which anyone other than the U.S. taxpayer will foot the bill.