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Policy Note

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# THE USMCA IS NOT COMPETITIVE AGAINST CHINA

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The governments of the US and Canada are pressuring Mexico not to import products or accept investments from China, such that Mexico would be forced to import products from them instead. As a result, Mexico would be unable to leverage Chinese investments that could compromise the interests of the US and Canada.

The Mexican government has yielded to such pressures and said it will reduce its relationship with China, choosing instead to buy from the US and Canada. The government is betting on greater integration and subordination with USMCA partners, despite a lack of improved development conditions for the country as a result. Mexico has not grown more than 2.4 percent on average per year and in the last six years the growth rate has been 0.7 percent on average per year, coupled with the foreign trade deficit and the growing dependence on capital inflows.

The economy has come to have less national industry. Mexico imports more manufactured products than those produced in the country and more than 50 percent of the basic grains the country consumes. Mexico has high levels of underemployment and, despite having increased the minimum wage, the salary structure has deteriorated. Seventy percent of wage earners earn between one and two minimum wages and the percentage of workers who earn more than two minimum wages has decreased. The crime rate is growing—which had not begun before this trade agreement was established—and thus, reflects that the fight against poverty claimed by authorities has not been successful and income inequality continues, reflected in high bank profits.

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The country's Secretary of Economy says that there is a "Plan B" to improve competitiveness against China, and that Mexico seeks to reduce the volume of imports from all Asian countries, and to increase the national content, but must work with exporting companies. The problem is that Mexico has no economic policy to boost competitiveness, beyond lower wages compared to the US and Canada. High interest rates and budget cuts prevent the creation of an industrial policy to promote investment growth, which could replace imports and increase productivity and competitiveness. Therefore, the process of increasing the national value added of exports would rely on foreign companies, which work with highly imported components. These components would, in this case, come from the US and Canada (rather than from China, as before) and would not generate internal multiplier effects, reduction of the foreign trade deficit, or economic growth.

It must be recognized that the USMCA countries do not have the conditions to improve competitiveness against China. According to the IMF, China's investment is 42 percent of its GDP. By comparison, the number is 22.6 percent in the US, 23.9 percent in Canada, and 24.6 percent in Mexico. Therefore, there is no capacity to confront China. The US share of world trade exports has decreased: from 12 percent in 2000 to 10 percent in 2023. By contrast, China's share has increased significantly and has surpassed that of the US: from 3.9 percent in 2000 it rose to 17 percent in 2023.

Mexico's economic policy—instead of continuing to bet on the USMCA, given that these countries will continue to be displaced by Chinese and Southeast Asian manufacturing—must concentrate on resuming promotion of self-sufficiency in energy and basic grains and, where possible, in manufactured goods. Mexico has oil, so it must develop its drilling operations, refineries, and production of petrochemicals. Above all, the country must advance utilization of gas found in the northeast, given that about 70 percent of what is consumed in the country is imported from the US and can be used by President Trump as a tool to pressure Mexico to implement policies favorable to US interests. Any blockage of gas supplies to Mexico would cause a severe crisis. Instead of making budget cuts and seeking to reduce fiscal deficits, public spending and investment should be increased to promote production of the country's basic grains and gas in order to reduce imports and achieve food and gas self-sufficiency, and to develop those manufactures that have a high internal multiplier effect. We must not forget that Mexico should transition to domestically sourced renewable energy.

These changes require an increase in public spending and investment, which would not be inflationary as it would increase production and reduce the foreign trade deficit, and thus would not put pressure on the exchange rate. The Organic Law of the Central Bank should be modified so that the Bank of Mexico can directly buy government debt at a low interest rate, enabling the government to make and promote the aforementioned investments.

Mexico should not accede to Canada and the US, thereby limiting its decisions regarding trade and investment relations with China. It is an intrusion by these countries into Mexico's sovereignty. If they threaten to expel Mexico from the USMCA, relations will continue as they existed before the free-trade agreement. Canada and the US require Mexico's products, and vice versa. Mexico's exports to the US before the trade agreement were 67 percent of all the country's exports and are now 79 percent. It should be noted that before the USMCA, Mexico had greater growth and a stronger industrial and agricultural base than it has now. Exports before the agreement provided more national value added than at present and most exporting companies were domestically owned rather than foreign, as is now the case.

## Tariffs as a US Economic and Political Instrument

President Trump is imposing high tariffs to force countries to reach trade agreements intended to establish favorable conditions for US economic growth. These include the increase of US exports and the reduction of imports and trade deficits. Thus, for tariffs to achieve their goal of boosting US industry and employment, companies must increase investment and focus on import substitution. In the face of tariffs, these measures would help to make US industry and employment competitive. For investment to increase, there must be profit expectations which will depend on demand growth, the duration of the tariffs, interest rates, and government subsidies. For many products, it will take time to establish new production plants or to expand existing ones.

### *The Impossibility of Economic Growth and Reduction of Inflation Rate to Target*

The high level of tariffs imposed by the US on imports will cause higher prices, either because importers will have to pay the tariffs and will pass the expense to consumers or because—by not buying imported products—the shortage of domestic production will translate into higher prices. For prices to drop again, US companies will need to become more self-sufficient and increase productivity to meet domestic demand at lower prices. The US will take time to reach the productivity and cost levels of their adversaries in order to lower inflation and tariffs, and thus, inflationary pressures will persist in the meantime.

In addition to the impacts already outlined, President Trump's high tariffs on copper will increase costs and prices on products that require copper, such as pipes, solar panels, electric cars, refrigeration, and the electrical grid. The US imports nearly 50 percent of the total amount of copper they use. Copper tariffs, combined with the impact of other tariffs, will make it impossible for inflation to fall to the 2 percent target and reach the interest rate desired by President Trump, resulting in a failure to achieve target economic growth.

### *Tariffs and US Hegemony*

President Luis Ignacio Lula da Silva of Brazil responded strongly to the White House letter imposing a 50 percent tariff on his products—the response exacerbated by President Trump's opposition to the lawsuit filed against former President Bolsonaro for the attempted coup d'état in Brazil. Such an action taken by the US goes beyond reasonable economic considerations. This is a direct interference with Brazil's sovereignty, a practice frequently used by the US to exert political and economic pressure on countries that do not submit to its interests. Brazil has said it will respond with the same percentage of tariffs on imports from the US. Brazil's advantage is that it has China as its main trading partner, to which it directs most of its exports, and its trade is highly diversified. Only 12 percent of Brazil's exports go to the US, although nearly 80 percent of those exports are manufactured products. Brazil, as a member of BRICS, will be able to take advantage of the agreements established within the group to relocate their exports. It is expected they will also try to reallocate exports within Latin America. Latin American countries should negotiate as a bloc with the US and avoid entering into bilateral trade agreements therein, where the US exerts its power to obtain favorable conditions. The additional 10 percent tariff imposed by the US on the BRICS countries for not using the US dollar in their commercial transactions reflects the US concern about dollar hegemony. They fear the US dollar will lose its status as the reserve currency and international legal tender, as this would compromise its economic power. If international demand for dollars were to decline, the US would no longer be able to maintain its fiscal and foreign trade deficits, given that these deficits have been possible because global economic actors save US dollars and use them in commercial and financial transactions in their international reserves.

There are proposals in the US Congress to impose high tariffs on countries that buy Russian oil, in order to economically impact Russia and pressure it to end the war with Ukraine. This is another example on how tariff policies are used for geopolitical motivations in maintaining and exerting US hegemony. Tariffs, however, have also caused backlash for the US geopolitically. Exacerbated by their support for Israel against Palestinians, the US administration is left facing opposition from international partners who will attempt to distance themselves from the US commercially and politically. This will ultimately affect the US economically while weakening its geopolitical power in the face of rising multilateralism.

US tariffs imposed on Canada (35 percent) and Mexico (30 percent), aimed at reducing the US foreign trade deficit and boosting economic growth, are not sustainable given the strong industrial integration between the three countries. It is expected that, sooner rather than later, the tariffs will be reduced by the US. Mexico should not give in to the conditions the US seeks to impose in its favor in the trade negotiations currently underway.