

Peterson Institute for International Economics

Bridges and borders: Economic policy across North America

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[00:05:17.56] - Adam S. Posen

Hello everyone, and welcome back to the Peterson Institute for International Economics for our conference today, Bridges and Borders: Economic Policy Across North America. We at the Peterson Institute are very proud to be partnered with the Federal Reserve Bank of Dallas for this effort, the second in a Home in Home series conferences on important emerging issues in US-Mexican economic integration and Canadian as well. I do take some pride that the Peterson Institute, of which I'm president, I'm Adam Posen, has been at the forefront of working on issues of North American economic integration before NAFTA was a word, before NAFTA was a swear word, before NAFTA became COSMA, MUSCA, and Um, and I won't go through the whole list of books and studies, but the Peterson Institute was doing analysis before there was NAFTA and during the NAFTA debate and many times since, and continues to wish to contribute to constructive economic integration in the U.S. because the evidence in the analysis tells us that it is the right way to go and that unmanaged integration, which is what you get if you don't do it right, is worse. And with that cheery note, I want to also thank and acknowledge colleagues from the Federal Reserve Bank of Dallas, Luis Torres, Pia Arenas, Jesús Canas, and Enrique Martinez-García, all of whom we've known for some time and who've partnered with our team in putting together the substance today.

[00:07:03.32]

And I know that the Federal Reserve Bank of Dallas has been a leader in looking at not just integration in its district, though of course that is at the cutting edge of US-Mexico integration, but at migration and investment and trade issues across North America for some time. And so again, Thanks to our colleagues at the Federal Reserve Bank of Dallas. I also want to just acknowledge as part of our strengths here at the Peterson Institute, the three senior fellows at PIE who took the lead on this, Monica deBoll, Jeffrey Schott, and Alejandro Werner. And we're very pleased that they continue to contribute work not just on North American integration, but on many aspects of Latin American economies and their interaction with the world economy and

with the US. With that, let me call up my colleague Roberto Coronado, Senior Vice President of the Federal Reserve Bank of Dallas, to introduce our special first speaker.

[00:08:07.01]

Roberto.

[00:08:12.14] - Roberto A. Coronado

Good morning, everyone. It's a pleasure to be here, and we'd like to welcome all of you to our conference on Economic Policy in North America. I would like to begin by thanking our friends and colleagues at the Peterson Institute for partnering with us. This is, as Adam alluded to, this is our second installment. The first installment was held in Dallas back in April, and it was a resounding success, and we felt it was very important for us to continue the conversation, and we're thrilled to be here. And as Adam alluded to, you know, given the proximity we have with Mexico, the Dallas Fed has played a very important attention to our neighbors to the south. We do this from predominantly two main angles. Of course, one is through our research and analysis, and we have many of our scholars and fellows here through our Global Institute. Like Adam alluded to, the Global Institute is a policy-related research on global trade, capital flows, and migration, of course, with a specific emphasis on Mexico. But in addition to the phenomenal team that we have on our research department, we also take advantage of our proximity to Mexico and we engage in a number of different conversations with players and business leaders to really understand the nuance behind the complex relationship that we have with Mexico and the vibrant relationship we have with Mexico.

[00:09:26.59]

That's something that we take a pretty strong view and perspectives into understanding the dynamics on the ground. I think today we're going to have a phenomenal lineup of speakers. I want to thank all of the speakers and panelists for making the travel to Washington, DC and spend the day with us. Sharing their insights. We're going to be hearing on different fronts. We're going to be hearing, of course, on remittance flows, labor mobility, cross-border trade. These are topics that are essential to ensure that we have a resilient, productive, and regional cooperation in North America. We believe it's important to have an integrated, prosperous, and cooperation across North American partners so that we can benefit everyone in our three countries. Again, it's great to be here. I appreciate you joining us, and on behalf of the Dallas Fed, welcome to our conference. Now I would like to introduce our first panel, and it's by the two Luises. We have Luis Rosendo Gutiérrez Romano, who is the Undersecretary of Foreign Trade of Mexico. He holds a bachelor's degree in economics and political science as well, both from

the Autonomous Technology Institute of Mexico, ITAM, and a master's degree in development from the London School of Economics, and a master's and a doctorate in government from the University of Essex.

[00:10:49.42]

He's been a public servant for a number of years now, and is very, very much involved in the US-Mexico-Canada trade agreement, and of course in the negotiation that will start next year. Then one of my colleagues and dear friend, Luis Torres, who is a senior business economist with the research department. He's based in our San Antonio office, Part of his research agenda is precisely spend a lot of time thinking about the binational relationship from many different angles, but predominantly from the trade perspective. With that, I would like to invite both Luis Rosendo Gutiérrez to come to the podium and Luis Torres, and so we can begin with a productive session. Thank you.

[00:11:27.37] - Luis Torres

Thank you, Luis.

[00:11:35.24] - Luis Rosendo Gutiérrez Romano

Bueno, bueno.

[00:11:35.55] - Luis Torres

Es el invitado especial.

[00:11:45.41] - Luis Rosendo Gutiérrez Romano

So thank you, Roberto.

[00:11:47.45] - Luis Torres

And it's a— it's— thank you for being here. It's a pleasure to be here with all of you. And especially thank you, Secretary Luis Rosendo Gutierrez, for joining us. It's an honor to have you here.

[00:11:58.45] - Luis Rosendo Gutiérrez Romano

Oh, thank you.

[00:11:59.13] - Luis Torres

And I think people are really excited you're here. Waiting to see, to hear what you're going to say about what's currently happening with the trade relations between Mexico and the US. We talked about beforehand, do you want to start with an overview of what's happening with relations?

[00:12:18.35] - Luis Rosendo Gutiérrez Romano

Thank you very much, Luis, and thank you everybody for this invitation. It's a pleasure to be here with the Peterson Institute and with the Dallas Fed. I'm happy to be here and to see so many Friends, let me tell you that I thought that I was very nervous because today I will have a meeting with Ambassador Greer in 1 hour, but not. I am more nervous because I am seeing some of my teachers from my previous university. So I cannot have a minor error in this meeting. So it's a pleasure to be with you. Let me just start to start Talking about giving an overview about the trade negotiations that actually begun since the first day of Trump administration. Do you remember that we started with the first announcement for Mexico was 25% for all your exports because fentanyl and migration problems. So we started our relationship with the second administration of President Trump with this announcement, 25% for all the exports. So we started to work with the two teams, the Lutnick team in the trade secretary and with USTR, with the Ambassador Greer. And since the beginning, The strategy was to be very, very close to the American government, to the Trump administration, and I think that right now we have a very close relationship with them.

[00:14:07.45]

Let me tell you that since then, we have been advancing in so many issues and trying to reduce the impact of the old 32 orders of executive orders. And right now I think that Mexico has one of the most preferred treatments in terms of tariff around the world. 85% of our Mexican exports to the United States are paying zero tariff right now according to the census data until July because Given the shutdown, we don't have more data until July. We are expecting the new information from Census. Let me tell you that Mexico has been working with these orders, especially in the vehicles industry. You know that vehicles industry, vehicles and auto parts are almost, we were talking about this today, is almost 40% of our exports to the United States. 40% is autos and auto parts, more or less. And if you put in addition steel and aluminum, we are talking about half of our exports to the United States. So right now in the auto industry, We have this 25% of tariff, but we worked together with the Trump administration to try to reduce the impact in our supply chains, regional supply chains. And we have a discount of the US content in our auto exports to the United States.

[00:16:02.13]

This US content is between 50 and 60%. So we are paying right now about 12.5% tariff, the real tariff. So regarding our closest competitors like Japan, Korea, and Europe, we have a— we are more or less in the same level because they are in 15% for the auto exports and we are in 12.5, but we have another cost. Because we need to comply with the rules of origin. Actually, there is a study of the Federal Reserve that points out that the cost to comply with the rules of origin of the USMCA is 2.5%. So if we consider this kind of cost, maybe we are just behind Japan, Korea, and Europe. We did an analysis in our offices about the industrial structure in Korea, in Japan, and the American industry of auto, auto cars. And we saw that Korea and Japan in particular, they are more competitive. And if you impose a tariff, on them, like in Mexico, given that they are more productive, they are more competitive, they can absorb the tariff in a most important proportion than Mexico's. So right now we are working with the United States government to try to reduce, this is the objective one, to try to reduce the tariff on autos for about 10% with the US content to try to improve our condition regarding Europe, especially Germany, Japan, and Korea.

[00:18:15.31]

Let's see. Today we will speak about it, or we will talk about it in the meeting. The other thing is heavy trucks. We have another 25%, but again, we have a US content discount that is again around where we are paying 12.5. We are in the same level that vehicles, light vehicles. We are very worried about the steel and aluminum industry.

[00:18:46.44]

Why?

[00:18:48.55]

Because United States has a super habit with Mexico. It is the only country in the world in which the United States has a super habit. We don't understand why the tariff on the Mexican exports of steel and aluminum and derivatives that is very high, that there has a very important impact in our exports. So we are working again with the US government trying to consider Among other things, the US content in the steel production and aluminum production, trying to reduce at least in some level the tariff, the important tariff on— because it's 50%, you know. Let me tell you that with all these measures, Even with these measures and given the discounts, Mexico has a preferential treatment where our average tariff, considering all the sectors of our economy, is around 7% like Canada. Canada and Mexico have and share the best preferential treatment. And I think that this condition is important for the next 20, 30 years. If we stop right now, the

situation that we have with Canada and Mexico, with our trade agreement, Mexico can be benefited by this situation.

[00:20:32.22]

Why?

[00:20:33.26]

Because even when we can lose in some specific sectors like autos, We win in another sectors like electronics, all the sectors that are exporting right now to the United States with tariff zero, with zero tariff. So let me tell you one data that is very relevant. Our exports, our manufacturing exports are growing at 16% annual rate. 16% is very, very high. Even when autos reduced, the exports of autos were reduced in around 5%, the other sectors of the economy are growing very, very fast. They are gaining market share and it seems that we will see a structural change and some sectors will be favored by these policies and for this structural change in global trade. What we are seeing right now is that Mexico and the United States and Canada are working together. We have the basis of our trade agreement. The last 90 days, we have been working hard on the agendas of fentanyl and migration, but also in all the trade requirements that both countries, especially United States and Mexico, have each other in our relationship. So the United States and Mexico in the last 90 days have been working in environment issues, security things, obviously security, fentanyl, immigration, but also with some criteria that is important for both governments to share, for both countries to share.

[00:22:45.16]

Like for example, we were talking about the missile, missiles, missiles, missiles criteria. I didn't know that Mexico had missiles, but we were trying to have the same criteria, for example, for missiles, some software for our ports. We are in a geopolitical discussion. You can imagine what is the criteria. You are here or you are there. Obviously, what Mexico wants is to continue working with their partners, the commercial partners, United States and Canada. It's priority one for Mexico to work with the United States and Canada. I think that this has been very clear for the United States administration. In the last 90 days, we advanced in so many issues. Very different issues. Vaquita marina, for example, one, the protection of the vaquita marina, but glyphosate imports, CFIUS. Actually, we have been working in a CFIUS. This is a very important issue for the United States in terms of economic security. Mexico is working together with the United States to have the same criteria to do a follow, a traceability or a follow-up of the investment that are coming to our region. We just sent the last week the Mexican Sea Fuse

proposal to the president's office and they are reviewing the project and they will send to the Congress, I think that in this period.

[00:24:38.47]

This is the issues that we are working together with the United States. We are optimistic even in a complex arena. We are optimistic that Mexico will continue working together with the United States and Canada in our trade agreement, and that 2026 will be the year in which we will extend the trade agreement for another decade. This is more or less it.

[00:25:15.55] - Luis Torres

I found it interesting. I know maybe the audience also found it interesting, the part that we've been following the automotive industry. You made an interesting comment. You said you would expect a restructure of that sector. I imagine it's a key priority given the importance of the automotive sector in Mexico.

[00:25:36.22] - Luis Rosendo Gutiérrez Romano

Yes.

[00:25:37.01] - Luis Torres

I imagine going forward, rules of origin for the USMCA, as you mentioned, the renewal in 2026, is that going to continue to be key priority? But are you expecting a change then in the automotive, that the weight of automotive exports or the automotive industry in Mexico? And if that's going to happen, if you're expecting that, what policies do you think Mexico should implement, or what policies are you thinking of implementing for that change?

[00:26:04.07] - Luis Rosendo Gutiérrez Romano

Yes, this change is in relative terms. I think that There are sectors that will be affected by the Trump policies, like autos. I think that the auto industry in Mexico will continue working in very well terms, but in relative terms with another sectors, I think that some sectors of the Mexican economy will start to gain share in relative terms. Because right now autos and auto parts is more or less 40% of our exports. But I think that another sector like electronics will start to gain share proportion in our total exports. For example, it is very, very interesting the growing in electronic exports. The electronic exports in this year have been increasing in about 40% annually rate. It's a lot, especially related to computers. We are exporting to the world, but mainly to the United States, computers, CPUs. Come le chiamano ustedes? CPUs. It's like

computers. And this is a very important increasing parts of computers, screenings, et cetera. These kind of things are growing a lot. And let me tell you something, your question is very good. What we are doing to try to face this structural change? And President Sheinbaum announced Plan México in Mexico City 6 months ago and with a bunch of policies related to, mainly related to investment in infrastructure, ports, airports, roads, actually trains as well.

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We are starting to invest in trains in several projects in trains. One part of this Plan México, or Mexico Plan, and it's very important, is in our area, is this replacement input program.

[00:28:35.31] - Luis Torres

Yes.

[00:28:36.38] - Luis Rosendo Gutiérrez Romano

We don't like the import substitution phrase, but it's the input replacement program. Given that the United States is trying to increase resilience, and economic security in the region. We are considering to work together with Canada and the United States in the economic security of the region. That's the reason of the CFIUS, the Mexican CFIUS. But also we are trying to detect what we can do together in our region. Right now, United States has a trade deficit with China of around \$270 billions of dollars, and Mexico has a trade deficit with China for about 120 billions. So together, United States and Mexico have a trade deficit with China of around 400 billions. It's a very important amount of capital, and we are trying to detect what kind of inputs we can bring in the following decade to produce in Mexico and in the United States. This is a very important issue because we need to work together. We need to work together with the United States in a common strategy. We don't want to be the second China for the United States, and we would like to work together with an investment, investment process in both countries and work together, especially without tariffs.

[00:30:20.13] - Luis Torres

So just coming to that point of working together, a question I wanted to ask you is about the tariffs that Mexico is imposing on China. So is that based on working together? Do you think it's because Mexico has a deficit with China also that you're imposing those tariffs, or is it because more of a uniform, similar plan, like in Canada? We heard these phrases in Canada, fortress North America, they are working together. Is that the policy in Mexico, more about a fortress, working together, having that similar tariff structure as the US and Canada versus China?

[00:31:03.19] - Luis Rosendo Gutiérrez Romano

First, I don't think that is against China. Is towards the third parties, that all these countries that Mexico has not a trade agreement with them, is not only China, is Korea, for example, is Brazil, is Russia, is so many countries. So it's not against China. The second thing is that the main objective of President Sheinbaum was to protect the national industry. The Mexican industry because there were so many imports that were hurting our, for example, footwear industry, plastic industry, textiles, so many. We are integrating in this tariff plan about 70, no, 17 strategic sectors. We are, We are trying to protect these 17 sectors with this measure. We sent one month ago to the Congress 1,463 items, fractions, increasing tariff against third countries, third-party countries, or all these countries without trade agreements with Mexico. Trying to protect the national industry and also trying to reduce some practices, even in a very low percentage, but we just want to stop any possibility of transshipment from Mexico. We don't want that third parties, countries, use our trade agreement just to enter to Canada or the United States or Mexico. So we are in the same position to protect our region and yes, to work like a fortress for North America.

[00:33:06.31]

I think that in the following years, Mexico and Canada will start to work in specific sectors like steel and aluminum, trying to protect the industry, the regional industries, from our— in our countries.

[00:33:25.32] - Luis Torres

And I have to ask this question because we were actually talking about the dinner last night and something we've done research on, nearshoring, right? I was going to ask you, how is FDI doing in 2025? Is it being affected by the uncertainty surrounding the current tariff policy in the US? Is there FDI coming through still? Is it related to to nearshoring. And the other question that everybody asked— you've seen all these conferences in Mexico about nearshoring a year ago. And they said, oh, can Mexico actually— if it's actually happening or it's going to happen, can Mexico actually take advantage of it energy-wise, infrastructure-wise, rule of law? People would say, yes, nearshoring is happening, but there's an issue with energy.

[00:34:16.06] - Luis Rosendo Gutiérrez Romano

Please. Yes, in terms of nearshoring, I think that in all the world right now, we are living a very high level of uncertainty. Not only Mexico, not in Canada, but in the rest of the world, everybody's living uncertainty. But even with this uncertainty, the levels of foreign direct investment in Mexico are higher regarding the rest of the world. In comparison, we have a very

important increasing. Actually, the last data that we have is an increasing of 10% annually. It's a lot in this uncertain arena. It's one of the best data, I think. I believe the data because we work on this data in my office. We have a foreign direct investment level of around \$34,000 million. That is a historical level. We must say that is not new investment. They continue investing among enterprises. We increase the new investment, but we need to increase more. That's true, but the level is still very, very high, very important for our economy. We are more worried about the private investment in Mexico, the national private investment. We are trying to do so many things to try to increase the private investment. The President Sheinbaum just announced the last week the new financial scheme to replace the PPP projects, to try to build public and private alliance in the idea of PPP, just taking care of some things that— to correct some abuses that we lived in the past with this figure.

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So we're doing many things to try to increase our private investment level in Mexico. And regarding to the nearshoring, I think that if you go right now to Tijuana, to Ciudad Juárez, all the border of Mexico, you will see that there is a big dynamism, economic dynamism. It is expected to increase the economic activity in the border. After we close the deal, we close the trade negotiations, I think that Mexico and the United States as well will start in another stage in its economic relationship. So we are seeing that so many data centers, for example, so many companies related to chips, semiconductors, computers again, are establishing like a new nearshoring. Even when they are slow, the comments that the industry is talking that afterwards closing the deal with the United States and Canada, the investment will increase in a very high percentage. I think that we will see another stage of nearshoring in the north border of Mexico.

[00:38:01.58] - Luis Torres

And you think, like, going back to the question, do you think that you can— Mexico can take advantage of it with the infrastructure? Are you thinking about the energy parts, all these things that are needed for Mexico to take advantage of the nearshoring boom if it happens?

[00:38:15.59] - Luis Rosendo Gutiérrez Romano

Yes, I think that obviously we need We have some challenges, of course, mainly related to energy and water. The president has clarity on these issues. In a weekly basis, we are doing follow-up to the projects of energy, water, mainly in the north border of the country. There is a specific investment program to try to detect what are the obstacles for investment programs or for investment projects. So you know that sometimes we have a, the bureaucratic processes are

very, very slow and there is a team specialize in trying to do the things faster for this kind of strategic programs.

[00:39:20.34] - Luis Torres

So you mentioned Plan México, and one of the objectives, I think you also mentioned that, is to increase value-added, Mexican value-added.

[00:39:29.17] - Luis Rosendo Gutiérrez Romano

Yes, Mexican content.

[00:39:31.08] - Luis Torres

Mexican content. So how do you see that?

[00:39:33.34]

What policies do you think—

[00:39:35.25]

you mentioned some of those policies. What other policies what Mexico is trying to do to achieve that. As you know, the issue with Mexico has been for a long time, Mexican economy, well, the subpar growth, 2% or less for many, many years. And the idea is here, I imagine, is also one of the other objectives by Mexico is for Mexico to become a top 10 economy in the world.

[00:39:57.02] - Luis Rosendo Gutiérrez Romano

Yes.

[00:39:57.59] - Luis Torres

So what role is foreign trade or foreign policy is going to play in that?

[00:40:04.21] - Luis Rosendo Gutiérrez Romano

Yes, it's very important what you are telling because we have several policies related to try to increase the Mexican content. One is the program Made in Mexico, Hecho en México, that is trying to promote the good ideas, the good projects from the Mexicans, and trying to give them

specific credits to try to develop this kind of projects in Mexico. The other thing is this input replacement program that is very, very important to work together with United States and Canada and to do industry, common industry from Mexico, like in auto parts industry. That's the example that we want to make in our region. With other industries. And in our discussions with several industries, they are starting to understand that if we will increase and we will be together in some specific sectors with the United States and Canada in terms of tariff, they will have a very important protection to start to develop industry and US and Mexican content in our region. So it's a good idea to produce in Mexico, but if you have zero tariff on China or Korea, I cannot compete with them. But if you will start to increase your tariff at the same level that the United States, again, third parties countries, it's a good idea to start to to build an industrial platform in our countries.

[00:41:52.14]

And that's the objective.

[00:41:55.07] - Luis Torres

So I know you have a hard stop in a couple of minutes at 9:45. So I think we have some time for, I wanna stop for questions from the public. Somebody has a question for the Secretary.

[00:42:09.29] - Luis Rosendo Gutiérrez Romano

Not from my teachers, please.

[00:42:13.52] - Luis Torres

I think there's—

[00:42:19.03] - Audience

Oh, hi, I'm Steve Kamen from the American Enterprise Institute, and I was wondering, Mr.

[00:42:23.35]

Secretary, Undersecretary, if you could talk a little bit about Chinese investment in Mexico. To what extent does it mainly function as a funnel for shipment? How much does it actually have the potential to increase Mexican productivity and growth?

[00:42:41.37]

And how do you think this is gonna be handled in future trade negotiations between the United States and Canada?

[00:42:49.20] - Luis Rosendo Gutiérrez Romano

Yes, I think that is a very important question. The role of Asia, not only China, but in general Asia will be one of the key issues in our trade negotiations. The first thing that I would like to establish is the main trade relationship of Mexico, of course, is United States and Canada. As I told you, priority one is United States and Canada for us, and we are working closer to these two governments, our closest allies. Second, Second is the Chinese foreign direct investment in Mexico is still low, even when the increasing, like in all Latin America, the increasing is very, very high. It's exponential in all the countries of Latin America. The Chinese foreign direct investment in Mexico is not among the 10 places, the first 10 places of foreign direct investment. I think that is in the 13th place right now. Another thing, we have been discussing about investment in autos and we don't have any factory of Chinese cars in Mexico. Actually, there are not, Chinese cars industry in Mexico or Canada. There is only one factory in California for trucks of BYD. It's the only factory of cars. And we are taking care that in some specific industries, we don't have, we will take care of the Chinese investment because we know that is important in terms of efficiencies and to protect our industry.

[00:45:03.37]

We need to protect not only the Mexican industry, but also the regional industry that we built in the last 30 years. This is the reason why we have been working in the CFIUS together with Canada, In Canada, they have, they don't call CFIUS, they call the Investment Act in Canada. Here is CFIUS. And we have been working with them, actually also with Europe, trying to develop this model to do the traceability of third-party countries, Russia, China, and other countries to try to review, to have the same criteria that Canada and the United States share in the traceability of investment projects. This is a common work. We are working together with our partners in investment and checking the kind of investments that we want in our region. We need to take care of technology, energy, ports, strategic infrastructure in our countries, because we are talking about many, many things, not only trade.

[00:46:31.11] - Audience

Yes. Ireneus with the Dallas Fed. Thank you for being here, Undersecretary. Thank you. I wanted to ask, one of the biggest advantages for the US to collaborate with Mexico in manufacturing is the labor costs in Mexico, of course, are very advantageous to companies, and so it's kind of a win-win situation. But labor costs have been rising in Mexico, and we've actually

seen along the border— you talked about the economic dynamism, but we've seen job losses in Juárez in manufacturing and so forth. I'm just curious, are those related to the rising minimum wage and those spillover effects, or is that productivity growth? And just love to hear your opinion.

[00:47:05.57] - Luis Rosendo Gutiérrez Romano

Thank you very much. It's a very good question because in the last years, Mexico has been trying to change the strategy in terms of labor. Traditionally, Mexico has been working with a low-wage economy, what is one of our competitive advantage. But right now, the Mexican strategy was to change this, to increase productivity, to try to focus on some strategic sectors, but trying to do not compete just through low wages. So we increased the minimum wage for a lot. Right now, the salaries are increasing. If you want to produce with low wages, you can go to another regions. We would like to have an economy not related to low wages, but related to productivity and with a value added in our country. It was very interesting. Two weeks ago, I was talking with people from Micron. And they told me that they wanted to go to Zapopan in Jalisco to develop AI technology, but the manufacturing they wanted to do in the United States. It was like, come on, here is the manufacturing, then the AI there. No, but we are starting to do manufacturing here and artificial intelligence in Mexico and together. So this kind of projects is what we are looking.

[00:48:58.46]

No, no, no, the low wages economy, but more value added, more productivity, and these industries for the next future.

[00:49:11.37] - Luis Torres

Yes, thank you. Let's thank him. Let's thank Secretary Alejandro Gutiérrez for being here.

[00:49:17.11]

Thank you.

[00:49:17.23]

It was a great conversation. It was great having you, taking the time. I know we know you're really busy right now at these times, but Thank you once again for being here.

[00:49:26.04] - Luis Rosendo Gutiérrez Romano

I come every week, almost every week. So whenever you invite me, I will be very happy to come here. Well, thank you.

[00:49:34.34] - Luis Torres

Let's give him a hand, please.

[00:49:35.48]

Thank you.

[01:06:21.50] - Pia Orrenius

in Texas. So my group does a lot of work on Mexico, but we also collaborate with Enrique Martinez's group, the International Group, and the Globalization Institute. And you'll hear from him a little bit later today. So I'll go ahead and introduce the migration and remittances panel, and then they'll come up one by one, and then we'll all join together at the end for our discussion. So let me start by introducing Michael Clemens, and I'll do very brief introductions since you can look up the bios in the conference materials. But Michael is economist. He does of the most insightful research there is on migration topics, so we're super happy to have him. He's currently professor at George Mason University and a nonresident senior fellow here at Peterson Institute. Following Michael, we'll hear from Jesús Cañas, who's my colleague at the Dallas Fed, where he's a senior business economist, and he's worked with me for many, many years. He really is our foremost expert on cross-border manufacturing. And integrated Mexico-US supply chains. He's also worked on remittances, which is what he'll talk about today. Monica de Bol is my new friend, and she's a senior fellow here at the Peterson Institute.

[01:07:39.46]

She definitely has the broadest expertise of anybody on this panel and certainly maybe even in this room, such a rich background. But she works on policy issues that really straddle economics and most other fields, I would say. And really looking forward to you sharing material on economic nationalism, and you just published a book earlier this year on that topic. So welcome to the migration panel, and Michael, we'll start with you.

[01:08:14.01] - Michael A. Clemens

Thank you so much. Can you hear me okay like this? So thanks a million for inviting me. What a great chance to learn from Dallas Fed research and Pia's research specifically, which I always do. I'm going to talk about high-skilled immigration. And in this sharply polarized country, there

is an issue which unites Americans across the political spectrum, and that is high-skill immigration. In national poll data, one-time Trump voters, one-time Biden voters are asked their preferences about high-skill immigration. Overwhelming majorities of both of those groups support not just current levels of lawful high-skill immigration, but more of it. The administration knows this. Marco Rubio, as a senator, was a leader in fostering lawful channels for high school immigration to the United States. The president during the campaign said, and I quote, "We should staple a green card," unquote, to the diplomas of foreign students coming to America so that they can stay and contribute to the economy. That makes it all the more odd that what we've seen over the past 10 months is exactly the opposite. Policy. There's been a wide range of policy steps to slash high-skilled immigration to the United States, far beyond the arbitrary and very high and unprecedented tax on employment-based high-skilled immigration.

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Federal funding to universities has been made contingent on denying admission to certain numbers of international students regardless of their merit and many other things. These steps have been justified on mercantilist grounds. They've been justified as active labor market policy to open up more employment slots for high-skill Americans. What's missing from that discussion is the effect on productivity, on innovation, on entrepreneurship, on economic growth. And so that's what I'm going to talk about today. And I'm going to use a particular— I'm going to talk about ongoing research here at Peterson about one particular channel of high-skill immigration and one particular policy in that portfolio. And it pertains to something called Optional Practical Training, which some of you know very well. Optional Practical Training is a work permit that attaches to F-1 student visas that, when it was originally put into its modern form in 1992 by Republican President George H.W. Bush, allowed a year of authorized work in the United States after graduation for foreign students on F-1 visas. Optional Practical Training is by far the largest single channel for high-skilled immigration to the United States. This is for STEM workers, specifically people getting a degree in science, technology, engineering, and mathematics disciplines, which are defined in regulations by Homeland Security.

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For every 100 foreign students who graduate in the STEM discipline with an F-1 visa in the United States, about two-thirds of them use Optional Practical Training to work. About half of those go on to H-1Bs. This dataset is in the— not just in the room, but actually on this panel. Jesús Caña took Optional Practical Training after graduation, transitioned to H-1B visa, and remains with us at the end of that pipeline. So the administration has announced plans to terminate Optional Practical Training entirely. I want to repeat that. The administration has announced plans to terminate the largest single channel of lawful high-skilled immigration to the

United States. This is the new head of US Citizenship and Immigration Services. He said in May that, "I want to remove the ability for employment authorizations for F-1 students beyond the time that they're in school." That means Optional Practical Training, or OPT. In August, he said, "We've got to do everything we can to make it abundantly difficult for foreign students to think they're just going to continue to live and work in the United States beyond the expiration of their F-1 visa." So there's an active policy of barring precisely these people from remaining in the United States.

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I'm interested in the effects on innovation, on productivity more broadly. But here I want to talk about just innovation as measured by patenting. Why would we think that Optional Practical Training students patent stuff? Well, most directly, we can look at individuals and the ideas that they patent. Kiana Aran is a— Currently a professor at UC San Diego where she co-directs something called the Center for Technologies for Healthy Aging. She is a— she came into the United States as a foreign student from Iran in electrical engineering at City College of New York. She got involved in innovation during school and just after school, was able to remain. Here she is 3 years after graduation filing a patent on ways to inject pharmaceuticals through mucous membranes without a needle. She's so far filed 31 more patents and is a serial entrepreneur. And these ideas are coming from her own head at a high rate. And she's not unusual in that regard. So in the broadest terms, if we look at how many patents that are later granted, patent applications that are later granted that are filed by university-educated STEM workers who are natives in the US, it's about 2 patents per 100 workers per year.

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For foreign-born high-skilled STEM workers, university-educated STEM workers in the United States, it's about 3. But specifically for US-trained high-skilled STEM workers born abroad, that is graduates from our universities, it's much higher. It's about 7. So that's a reason to think that there's something about these people that relates to patenting. I want to try to get at indirect effects, not just the ideas that are coming directly from the heads of people like Yan Aran. But how do they foster innovation in teams? What are spillovers to other immigrants and natives who work on teams, which are the basis for most of this innovation? What about knowledge spillovers across firms, both in the air and through workers moving across firms? By providing complementary inputs, an immigrant that starts a WeWork space in an innovation hub could foster innovation indirectly, even though their name is not on the patent. By demand effects. It could be that a bunch of immigrants doing innovation creates the incentive for natives to innovate in order to supply inputs that those companies are demanding. And there could even

be labor market effects. If somehow foreign students are crowding out or crowding in natives into innovative activities, that could indirectly affect innovation.

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How can I capture all of those? I'm going to study effects at the city level. That has limitations in that it inherently can't capture nationwide effects, but it can capture broad ripple effects within innovation hubs. And I'm going to use a sharp policy reform carried out by the son of George H.W.

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Bush.

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Republican President George W. Bush in 2008 extended by a lot optional practical training specifically for STEM graduates, at first to 29 months from the original 12 months to 29 months and later under President Obama to 3 years. So this was a very large supply shock of OPT workers in the US economy. This is starting in the year 2004, which is when I got, by FOIA request, full universe data on all of the Optional Practical Training recipients in the United States. You can see in solid blue the number of STEM— graduates on OPT. This is a stock, not a flow. In solid orange, that's non-STEM. And the dotted blue are people who are on the extended version of STEM OPT, that is beyond the first year into the second and third years. You can see a big shock there. And what's useful for research is that this shock is set by policy. So that dotted line is showing you If demand for these workers had been fixed in 2008, firm by firm, city by city, and the number of workers there had just been determined by the supply shock, then how many would there have been at the national level?

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And we can use that same strategy to measure the shock at the city level with a strategy that the researchers in the room will recognize as a shift-share design with a policy-fixed share. Is this a large shock? Yes. You can see the— in the previous figure, you can see that this is a shock of about an additional 125,000 OPT STEM workers per year. About half of those on an ongoing basis stay as H-1B workers and others, meaning that this is something like a positive supply shock of 5% or 6% in the total number of high-skilled STEM workers in America. So it's not unreasonable to think that this This could have macro effects, including on the level of innovation in the economy. I'm going to study this at the city level. Formally, these are CBSAs, or core-based statistical areas. They're basically cities. They're agglomerations of counties that

are designed to capture local labor markets where people live and work. So all of the counties comprising St. Louis are a single CBSA. All the counties comprising Chicago are a single CBSA. And I'm just going to ask in this first regression table, look, if I naively regress patents per worker on OPT workers per worker, I get a high number, a close correlation.

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But if I add city fixed effects and year fixed effects in the second column, and then in third column, I use this natural experiment. So I'm instrumenting for the number of OPT workers per worker employed. Using this policy shock, I get a coefficient of 0.21. That is 0.21 patents per year caused by each additional OPT STEM worker. Now, a big concern we might have is, is this being driven by just a couple of places? Is this just Redmond, Washington and Silicon Valley, for example? I'm going to do something which is normal in the literature, which is to take census regions and add a full set of region-by-year fixed effects so that all that's left is within-region variation. And if this were being entirely driven by something happening on the West Coast, this would wipe it all out. In the second column there, the coefficient goes down slightly, but it is not at all wiped out. So we're looking mostly at within-region variation there. In the third column, I just drop the top 5 patenting regions, which not surprisingly include San Jose, California. This is not being driven by just a few regions. It's happening in Columbus, Indiana, which is one of the— south of Indianapolis is one of the most patent-intensive places in America, where Cummins Incorporated and a satellite campus of Purdue have created an innovation hub.

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It's happening in the Laramie, Wyoming to Fort Collins, Colorado corridor. It's happening in Research Triangle.. It's happening around the University of Arkansas. It's happening in Southwest Idaho. This is a nationwide phenomenon. The biggest concern with the research design like this is that the baseline shares in 2008 were somehow endogenous, that there's— that the cities that were most exposed to OPT workers at the beginning, which are determining the size of the shock in this natural experiment, were places that were already on a higher innovation trend.. And you can see in this graph, that's not true. This is the trend in average patents per capita. And at the top, the cities that were the top quintile of most exposed to OPT STEM workers at the beginning before the policy experiment happened, the next quintile down below, the middle quintile, the second to bottom quintile, and the bottom quintile at the bottom, these are not cities that were on a different trend. Before this very large shock to supply. So that bolsters an interpretation of these results as causal. To do social science, we need to not just look for effects where we expect to see them, but make sure we don't see effects where we don't expect to see them, what economists call placebo exercises.

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And here are several placebo exercises. I would not expect to see an equivalent result from non-STEM workers. Because in big parts of literature, STEM workers specifically have an intimate relationship with patenting in the way that non-STEM don't. When I put in a fake natural experiment designed around non-STEM workers in the second column here, not only are non-STEM workers not associated with patenting, but they don't sap any of the effects of the STEM workers, which is exactly what I would expect to see if this isn't being driven by some sort of spurious correlation or attraction of immigrants in general to certain cities. A second placebo exercise is to ask, well, what about some patents that we would expect to be irrelevant? The last column here puts on the left-hand side not all patents, but patents in a category of patents that might have lower relevance to STEM disciplines— stone crushing, leather working, hats and footwear. The third column is patents that are directly relevant in that you have to do science in order to make them happen— nanotechnology, on nuclear technology. As expected, there's much less of an effect in the, in the last column, and I would be, I would be concerned if there were an effect there.

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What's the size here? What do we learn about spillovers from this? That 0.211 coefficient that you saw needs to be scaled up a bit because a lot of these people do stay. And in a different paper commissioned by the National Academy of Sciences that I wrote with some co-authors called Brain Freeze, we estimate the propensity of OPT students to stay. If I want to know how many workers should be in the denominator, it's not just one OPT worker, it's one OPT worker times about 1.63, reflecting the fraction who do stay and add to the stock of high-skilled STEM workers in the United States. That is, that translates to about 0.129 patents caused by each, OPT STEM worker, the number filed by them, remember you saw earlier, was about 7 per 100, meaning that this is a multiplier of about 1.7. All the spillovers to teams, to other firms, through demand effects, through crowding in or crowding out of the labor market, the total effect at the city level is much larger than the ideas literally coming directly out of immigrants' heads. I want to close by noting that a big theme in the innovation research literature is that patenting is not inherently valuable.

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You can file a patent and never do anything with it. This is an actual real patent filed by my grandfather, who was a plumber, which I still think was a really cool idea for a kind of fan-style shower curtain. He never did anything with it. This did not affect the US economy. This added zero value. And it's useful to know how much of the patenting activity caused by these immigrants is useless. To make a long story short, the fourth column here weights the patenting

effect by a measure created by Leonard Kogan et al. in a QJE article in 2017, where they measure directly the economic value of patents by linking patent assignments to stock market valuations of publicly traded companies and ask, patent by patent, what was the effect on the market valuation of that company? —for the full universe of patents, they're calculating the economic value of every single patent. When you weight this effect by the value of patents, it gets higher. So this is not the generation of a bunch of paper shuffling by these immigrants. The last column there is weighting by backward citations to the scientific literature in these patents.

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This evidence is consistent with this patenting doing exactly what we might think it's doing, which is taking ideas from the scientific literature through the work of high-skill STEM workers from abroad, translating it into economic value in the United States, creating more productivity. So just to finish, this evidence is consistent with OPT STEM extension of 2008, causing a large increase in real innovation and productivity in the United States, economically valuable innovation, with large indirect beyond inventors. It's not sufficient to just ask, well, how many patents are these people themselves individually finding? And it is consistent with the upcoming termination of OPT causing substantial harm to US innovation and economic growth. Thank you.

[01:25:09.48] - Jesús Cañas

Thank you.

[01:25:10.13]

Thank you very much for the invitation to be here in the headquarters of the Peterson Institute. This is a great podium for me. Most of the time I have to be like on my toes, so this is good design for short people. Let me add that, yes, I came to the US through OPT, but also Enrique and Roberto did it through OPT. So we are all beneficiaries of the OPT program here with you guys. Today I will present preliminary results of research that I'm doing with colleagues at Monterrey Tech, Miguel Flores, also colleagues at Colmex, Alejandro Parada, he's at Colmex now, and Christian Aupper and Rafael Guerra from the BIS. So this is the overview of the presentation. First, I will show you some trends about remittances, you know, US flows from the US to Mexico. And then I will show you an approach we are taking to link the flows from US states to Mexican states, because currently we don't have that, right? We only have data showing remittances from US states to Mexico, and then Mexican states getting those remittances, but we don't have the origin-destination link. So we, We show an approach to do that.

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And then we model remittances, right, by region. So we want to know how dependent are regions in Mexico from remittances sent from specific states in the US. And for that, we use the wage bill, right, for all states across all economic sectors. And then we add a dummy variable. To kind of identify the effect of current immigration policy in the US. So we basically divide the states by pro-migrant versus no pro-migrant following a criteria that I will show you in a minute. Finally, I will conclude with some preliminary results showing that it looks like the current fall in remittances to Mexico is not due to economic conditions, but quite likely to current immigration policy in the US. Okay, so let me show you what I just say. This is just showing some trends, right? As you might know, Mexico is the number 2 recipient of remittances in the world, right? Just after India and followed by Philippines, France, and China. Mexico gets around \$65, \$66 billion \$67 billion every year, more or less, what they used to. Now it's a little bit different. And as you might expect, remittances to Mexico basically follow the US labor market, right?

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I mean, labor conditions in the US, particularly wage growth, right? This chart here shows the correlation between wage growth and remittances to Mexico. This is total. I mean, not— I mean, all sectors, all employment, not, I mean, US employment, not only employment from Mexican nationals. And you can see that correlation, right? In the last 6 months of this year, remittances had fallen by 8%. So we want to explore why this is happening. As you know, remittances tend to follow economic conditions in the host country, So right now we are experiencing some kind of economic deceleration in the US, so we are going to see if that's the only reason behind. How dependent is Mexico on remittances in terms of GDP, right? The chart to my left, which is to your right, shows the macro level, right? Remittances represent between 3% and 4% of Mexico's GDP on average, right? However, if we look at different regions, you can see that some states, particularly in the southeast of Mexico, we have here Chiapas, Guerrero, Michoacán, all of them with more than 10%. Just look, Chiapas, around 15% of state's GDP. Zacatecas is another one with more than 10%, similar to Michoacán and Guerrero.

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And then if you read the top part of this chart, you can see Nuevo León is less than 1% of GDP. We have, depending on the region in Mexico, we have, I mean, the relevance is is greater most of the time in the poorest regions of the country, right? So why remittances are important to Mexico? Well, because they play a role, right, in helping economic conditions in these underdeveloped regions. This chart shows you here panel local projections showing the effect

of remittances in poverty. And you can see here two lines. The red line is composed by the states who are most, more dependent on remittances, like the Southeast that I show you. And as you can see, and the blue line shows here the states that are less dependent on remittances in terms of GDP. And you can see a clear divide between those two lines, right? It's quite important in lowering poverty in the regions that I show you in the Southeast. Then if we look at inequality, inequality, we more or less see the same pattern, right? It helps to reduce inequality considerably in the most dependent states in Mexico. And then if we look at how important remittances are to the Americas, well, we see same local projections, but now looking at economic volatility, right?

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And we show here, two sets as well, right? One for countries in the Americas highly dependent on remittances as a percent of GDP. That's the blue line or the red line in the chart to your left, right? And then, so I'm talking about countries like Honduras, Guatemala, El Salvador, right? They are in that blue line. Other countries, which is the red line, less dependent, like in this case Mexico or maybe Colombia. And you see a clear difference, right? And the big impact for some of those regions in the Americas, but also within Mexico. Okay, so what is our approach to this exercise? So again, we want to link origin and destination of remittances. And we want to know how dependent regions in Mexico are from regions in the US, right? Because remittances, I mean, they go to different states. I mean, like from California to Mexico, but they go to a different, I mean, a large number of states, not just one state, right? And then, once we have that, we want to test for, I mean, how dependent are regions in Mexico from pro-migrant states versus no pro-migrant states, right? So we use a gravity model.

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We control for several factors, but we definitely use the wage bill, right? And we have a special interest in the interaction of the wage bill with pro-migrant states versus no pro-migrant states. How do we do this matrix? Well, we basically, we use the NADID survey, the National Survey of Demographic Dynamics, that shows immigration flows from Mexico to the US, like from what state in Mexico migrants go to travel from and in what US state they reside, right? So they do, we use this matrix between 2013 and 2018. We are just doing the update for the 2024. So hopefully later we will have that in the matrix as well. And then, Yeah, so that's what we basically do, right? We match those immigration flows to the data that Banco de México provides in terms of remittances, okay? So this one here shows, these charts here show the growth in remittances between '23 and '24, right? So we know, I mean, remittances are going down, but not homogeneously, right? We have here a variation. So for example, remittances

went up in Yucatán, right? But failed in Sonora in that year. And then you can see the flows from the US, right?

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They went up in Delaware, right? But they failed in Arizona, right? So those are the flows that we have available. And then we use this, I mean, these are remittances, right? And then we have here migration flows, right? So we know from the NADID from what states are going to California, right? About, like, close to 9% of migrants going to California are from Michoacán, and then Oaxaca, Jalisco, right? So we just can, you know, we use this matrix and we just match them, right? And when we do that, okay, so we have now origin and destination, and we are able to match about 80% of the actual flows. Right? So we, from 2013 to 2018, the average of our estimates and the actual flows are about between 75 and 80%. So we have a good, a good match there. And then to identify migrant versus no pro-migrant states, we use this nice set of, I mean, this good database that the Immigrant Legal Resource Center provides. I don't know if you're familiar with them, but I mean, I really like the approach they follow, right? They basically look at state legislation, right? And they look and see how pro-migrant based on how cooperative they are with ICE and CBP, right?

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And then they give them a scale from 1, like, yes ICE, to 5, no ICE. Ice, right? And then you can see the map how the US looks like, right? Like a no ice state is definitely California, right? Like a yes ice state is Texas, for example, right? And then you have all in between. So we use that as a dummy variable in our regressions, right? And this is what we get. Let me get a sip of water. So here we show that, and then we look at the falling remittances between '24 and '25, right? So remittances have been growing at a decreasing rate for like 3, 4 years, right? But this year they actually fell. And so it's the first drop in like, in lots of years and the largest one, right? So the great majority of the drop, of the current drop is, from pro-migrant states, right? You can see here that blue line is, I mean, blue bar, section of the bar is a pro-migrant state, right? Okay, and then what about if we look at region? So here I show you the same, but by the regions defined by Banco de México, north, central, north, center, and south.

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And again, you see here that the great majority of the drop is coming from pro-migrant states, right? You see in like purple California, pro-migrant, and then the rest of pro-migrant states. So you can see that is basically the great majority of the drop is due to California flows, right, decreasing. Look, Texas is, I mean, the drop in from non-pro-migrant states is mainly from

Texas, but you can see the rest of pro-Migrants states. So is this drop— it's hard to differentiate between the drop given this kind of policy or the effect that the policy might be having in these states from current economic conditions. We know that we have a slowdown, right? But if we look at the wage bill in the last 2 quarters, which is the same that I'm showing here, what happened in the last two quarters of 2020, the first two quarters of 2025 versus the same period 2024, you see that the wage bill went up during the same period, right? So it's not the wage bill of Mexican workers. This is Mexican workers in the US by state and by sector, right? So it's not due to economic conditions. I mean, employment is dropped, is going down, but wages are going up.

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So at the end, the wage bill kind of stabilized in the last couple. I mean, it went up and then from '24, I mean, first quarter and then the second quarter stabilized. So it is not due to current economic conditions in the US, right? I mean, again, all this is preliminary, so we will continue working on it. So let me just conclude by, ah, and then if, oops, sorry, oyeme. Then if I wanna be a little bit technical, we did a set of regressions, right? And the coefficient of, of the dummy variable, the one that I show you, is negative and statistically significant, right, of that pro-migrant versus no pro-migrant states. So just concluding here, there is a large variation of origin and destination of remittances to Mexico. This is very important, right, for Mexico, particularly for those regions that I show you. And they are subject to whatever policy, state policies, is going on in the US that might affect those flows. And as you saw, there is a really, I mean, a great dependence, particularly from California and Texas. Again, this is just, these are not new news. The wage bill of Mexican workers in the US is the principal driving force for remittances, right?

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We have a higher and robust wage bill effect, particularly in pro-migrant states, right? But as I told you before, the fall in remittances right now is not due to economic conditions in the US. It is likely the current immigration policy is likely that the current immigration policy is impacting these flows, right? And one hypothesis could be that these migrant communities deal with trepidation, right? And maybe they are saving just in case they get deported, right? So they are not sending as much as they normally do because they are, I mean, afraid. And then this is also important because, as you saw, the great majority of these flows tend to go to the poorest regions of Mexico, right? So if these regions don't have this kind of cushion, right, that is helping them to keep consumption, to eat, to go to to send the kid to school, or that potentially can increase, I guess, the incentive for migrate to the United States, right? So with that, I conclude. Thank you very much.

[01:42:08.56] - Monica de Bolle

Thank you, Jesus. I'm happy you came right before me because I don't even have to touch the microphones, you know, given the height situation. So I will take a little bit— well, it's obviously what I'm going to talk about is very related to Michael's presentation and Jesus's presentation. But I want to focus specifically on remittance taxes. And in particular, as I will talk about, what has been introduced in the big beautiful bill and will come into effect in January 2026 here in the United States. I do want to do this discussion from the viewpoint of economic nationalism, and that is because the motivation that we have for this this policy instrument in the United States at this time has that aspect. It is a— there is a clear economic nationalist motivation behind this policy, which is what I'm going to talk about. But before I get into that, I should tell you that economic nationalist motivated policies tend to be contradictory in the end, or oftentimes ill-conceived. And we did an extensive analysis of that in a book that we published earlier this year in April, *The New Economic Nationalism*. In this book, we looked at a number of country cases from around the world at different points in time.

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We defined economic nationalism, which I will do in a second, and we looked at the policy dimensions that compose this thing called economic nationalism. Amongst those policy dimensions are immigration restrictions. So in the context of looking at these things, our interest here was to tease out from each of these policy dimensions that we stipulated in the book if there was an economic nationalist intent behind the policy, and we made an attempt to measure the intensity of that intent. Okay, I won't go into any of the methodological underpinnings of this because that's the book and that's not what I'm I want to talk about, I just want to say that the basis for what I'm going to be talking about today is this book. So economic nationalism, as we have defined in the book, it's an ism, right? So as all isms, it means different things to different people. So we, we try to nail down economic nationalism to the best of our ability in light of the country cases that we were looking at, and we came up with this definition. You know, it's a worldview that does challenge the World War II consensus of free enterprise competition, international integration, and so on and so forth.

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It is a worldview that does assume an existing conflict between national and foreign economic interests, and oftentimes you will see that baked into the policy motivations. And nowhere is that clearer today in the United States than in policies pertaining to immigration. We see that very clearly articulated in the debates around immigration here. The policy dimensions of economic nationalism that we looked at, there were 7 of them, immigration restrictions was amongst them. So obviously, we were interested in this particular aspect when we were writing the book.

Instruments of immigration restrictions, as we were going through these country cases in the book and looking at the different types of immigration restrictions that come up, Usually what you see are things like direct provisions to limit immigration. So they can come in the form of rules regarding worker visas, so things along the lines of what Michael was presenting with respect to OPT, but also everything else that he's done in his research. A revision of immigration programs, limits on citizenship, impediments in targeting people from certain parts of the world, like travel bans and things like that. These are the usual instruments that we see. We do not often see remittance taxes as an instrument of immigration policy.

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We see remittance taxes being applied for other reasons, so with other motivations, but not necessarily to ban immigration or to deter immigration in some sense. What are remittance taxes? Well, they're financial instruments that limit, they're aimed at, by limiting money transfers from the home country to abroad. You can aim to target migrants in that kind of a policy instrument, but that tends to be very difficult because you need to be able to identify precisely which individual and where that individual is from that is sending money, let's say, from the United States to somewhere else, and that can be very tricky, and I'll get into that in a second when I speak of the 1% tax that was introduced in the big beautiful bill. But here remittance taxes are to be understood as taxes that are directly imposed on these money transfers that are sent to, say, migrants to their home countries, though of course this can also impact a money transfer from a US citizen who has a kid studying abroad and is therefore paying for that by transferring money abroad in that sense. So remittance tax would, in this definition, affect those kinds of flows as well.

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So it's not just migrant-specific, yeah? And that would be very hard to do in practice anyway. Here are the countries that have adopted remittance taxes in the past or that currently adopt them. And you will see, you know, from this list, Tanzania, Kenya, Zimbabwe, Venezuela, Bolivia, Eritrea, Ethiopia, Algeria, and Iraq. These are obviously countries that have had massive issues, whether they be, you know, related to wars and sanctions and balance of payments problems of various kinds. In all of these cases, the reason why remittance taxes were used had absolutely nothing to do with immigration, but it had to do with just augmenting necessary capital controls to prevent resources from moving out of these places to somewhere else, because these were countries that were at one time or another or continuously cash-strapped, and thus they needed to contain, to limit the flows out of their countries for balance of payments and other economic purposes. That's why they use remittance tax. It was just another instrument in the toolbox or in the toolkit of capital controls that they had available to them.

Nothing to do with immigration whatsoever. In comes the US in January 2026. The US is going to adopt this remittance tax.

[01:49:13.58]

And this time around, the motivation is very clearly nationalist, which is what I'll speak to in a moment. So the US is joining this list of countries, but with a different motivation. These are the main recipient countries of US remittances. This is data as of 2023 from the World Bank, their NOMAD database. Everyone, I think, has that— this more or less in the back of their minds, you know, where remittances are going to from the United States. And as you can see here, there's some Asian countries, China obviously is in there, and then, you know, a whole bunch of— well, Mexico obviously, and then a whole bunch of Latin American countries. Of Central American countries and even Caribbean countries like the Dominican Republic. These are the migrants that are in essence being targeted with this policy instrument. The debate on remittance taxes in the US goes back a ways. It came back to life in 2017 in the context of both the border wall as well as in the context of an immigration deterrent. At the time remittance taxes were articulated, or the motivation, if one was looking at the debate at the time, it was being motivated as both an impediment to immigration as well as a means by which to finance the border wall.

[01:50:39.28]

There was a lot of discussion back in 2017 and 2018 about introducing these remittance taxes. But despite all of that discussion, They were never introduced because in part there are a lot of problems when you institute taxes of this kind or when you use this kind of instrument for the purposes that they say they want to use them. In 2025, remittance taxes came back and this time they were introduced, as I said, in the big beautiful bill. It's as of now a 1% tax that comes into effect in January 2026. It was originally formulated to be 5%, and it was lowered from that precisely because of some of the issues to do with implementation. So in other words, if you put a very hefty tax on remittances, you're taxing not only migrants, but potentially US citizens who are in this situation, you know, maybe sending money abroad to pay for their kid's college or something like that if the kid is studying somewhere else. But the debate continues. So even though the remittance tax is now coming into effect in January 2026, there is still a lot of debate among some Republicans, and it also tends to include some Democrats sometimes.

[01:51:56.56]

But amongst the Republicans, there's a very, very lively debate about what level the remittance tax should be. So that debate has not ended even with the introduction of the 1% tax in the bill. And in fact, there was a bill that was introduced by Virginia Representative John McGuire on

September 29th of this year, and it's a proposal to raise the remittance tax to 15%, so from 1% to 15%. I put here the rationale that is in this bill for the remittance tax because it gets straight to the heart of this economic nationalist motivation. And the economic nationalist motivation comes out in this argument about losses to the economy. So this idea that, you know, remittance flows are a loss to the US economy because it's money that leaves the United States and goes somewhere else. So that's one part of the argument. The other part of the argument is, of course, not only minimizing economic loss, but also disincentivizing— I hate that word— but disincentivizing illegal immigrants from abusing immigration laws. So in other words, there's a very clear articulation of remittance taxes as a block, as an impediment to immigration. And finally, there is this self-serving argument of how remittance taxes, you know, it's a tax, so in principle, it should increase fiscal revenue.

[01:53:26.49]

So there are some who fall in this camp of saying, oh, and on top of that, you know, we put in these remittance taxes and they'll be great because they're going to generate more government revenue. For the, for the US. And I want to focus on these three things to conclude. So obviously, I think all of us have a sense that this kind of instrument can backfire very clearly. The argument about loss to the economy obviously fails to consider that, yes, a remittance is a flow from the US to somewhere else, but that's somewhere else because as Jesús was showing in his presentation, it tends— these flows tend to go to areas and to countries that are, apart from everything else, trading partners of the US. They come back, right? So if remittance flows are going to, say, Mexico or to China or to India or to Vietnam or to the Dominican Republic, you know, these are economies that buy things from the US. So if you're helping through remittances to bolster these countries' economies, these countries are going to buy more US goods. So it's not a loss in terms of, you know, all the money goes and that's it, we never see it again.

[01:54:46.37]

No, it goes to a country and it comes back when that country is able to purchase more US goods precisely because it's getting a bump in its GDP from some of these flows. And for a lot of the countries on this list right here, For a lot of these countries, you know, say Guatemala, El Salvador, Honduras, yeah, they're small, but they're very highly dependent on the US. And that dependence is exactly what guarantees that the remittance flows that goes to one of these places comes back as an import from these countries of US goods. So the economic loss argument really doesn't stand on its head at all because it fails to consider the other side. The second argument that remittance taxes can be an instrument to deter immigration is also a hard one to rationalize because it overlooks the fact that if you really do have this impact, and we

saw from Jesus's presentation that we're seeing these drops in remittances occurring in Mexico, for example, this has an impact on those local economies. And given that this has an impact on those local economies, at the end of the day, if that impact is very negative, you could actually be driving more immigration and not less, because people will have, you know, worse opportunities in the places that are recipients of these remittances if these remittances are not coming.

[01:56:20.10]

So it's not at all clear that remittance taxes actually do serve as a deterrent to immigration. We have no evidence that supports that. Reports that, and it can go both ways. It can be a deterrent, but it can go the other way as well. So in that sense, it could backfire. Finally, because remittances are— can be sent through official channels, and if they are, they're visible and you can tax them, they can also be sent through very unofficial channels and very informal channels, in which case you're not going to observe them, and most likely you won't be able to tax them. And in— and that that makes the fiscal revenue argument just fall on its face because we all know that the moment you introduce instruments that can be evaded, and remittance taxes can very clearly be evaded, you are falling into a situation where there are no guarantees in terms of the fiscal revenues that you would potentially be able to generate from an instrument like this. So the whole logic, you know, which pertains to these three arguments, which is very economic nationalist in formulation falls precisely into this category of contradictions and ill-advised sort of arguments that don't really stand up, which is kind of the hallmark of economic nationalist policymaking, as analyzed in the book that I was telling you all about in the beginning.

[01:57:44.52]

So the bottom line is, you know, going back to that list of countries here, this one, Yes, remittance taxes do make sense when you are a cash-strapped country and your whole purpose is to institute capital controls because your economic situation is so bad that you have to rely on these instruments. It makes absolutely no sense for a country like the United States, which is, by the way, the issuer of the global reserve currency. So obviously there are going to be incoming flows and outflows all the time from the US, and there's just absolutely no reason to think that there is any motivation of, of whatever kind, let alone a nationalist motivation, that actually makes this whole thing make sense. So remittance taxes do not make sense from the kind of motivation that the U.S. is looking to motivate them with. And I'll end there. Thank you.

[01:59:15.26] - Pia Orrenius

Thank you all. Great presentations. Those were excellent presentations and just really informative and interesting. So maybe I'll start with like a round of hard questions first before I give you like the softball questions. So let me push back on some of these things. So let's just see. Michael, so starting with you, I mean, it's fascinating work and hot off the presses what you're showing us, that OPT admissions into the US have really stimulated a lot of innovation and obviously spilled over to productivity growth. There's a number of benefits here. But of course, is there any, you know, on the other hand, people might argue that because we're allowing in so much STEM talent from other countries, we're suppressing our own need to produce kind of native-born or U.S. domestic STEM talent? And is there any argument for saying if you suspend OPT that this will stimulate the production of native talent and that will kind of fill in the gap?

[02:00:21.13] - Michael A. Clemens

Say to me. Yes, so, so, so many things. So there are international students in general cause there to be more native students. This is a finding of Kevin Shi of UC Riverside in the Journal of Public Economics. He uses past large changes in the number of international students in America, such as restrictions on a certain— students from a certain set of countries after 9/11, to ask when the number of international students studying at a U.S. university falls, uh, how many slots does that open up for native students? And the answer is negative. Every 10 students, international students, that disappears from a US university due to a force majeure eliminates 8 slots for native students. Now, there is a countervailing tendency, which is that some research— I think it's by Catalina Muedo Dorantes and others, but I'm not 100% sure about that— suggests that the, the percentage of those students who are studying STEM when there are more foreign STEM students around goes down slightly. There's some— among a diminished set of— the disappearance of foreign STEM students among a diminished set of native students, the percentage of them studying STEM could be slightly higher. The question is, does that reflect students whose whose, whose best talent is in studying STEM, or students who are deflected into STEM simply because fewer other students are available.

[02:02:01.43]

I mean, to put it very bluntly, if we were to ban women from teaching math in the United States, would there be more math teachers who are men? Yes. Would that be efficient? Would that be the best thing for students? Would that be the best thing for the enterprise of math education? Certainly not, because that would by definition introduce men into the math teaching profession whose talents would be better used elsewhere and would eliminate women from the math teaching profession whose talents are best used there. So the fact that there is this finding that a certain percentage of— that the percentage of Native STEM students might rise due to

the elimination the upcoming elimination of large numbers of foreign STEM students is— should not be interpreted as welfare maximizing in the United States, first of all, because the absolute numbers of native students and graduates will go down, and second of all, because that does not mean that we're getting the same quality of innovation and entrepreneurship and other things that come specifically out of foreigners as they collaborate with natives, which is the reason why there is a positive effect impact of high-skilled foreign STEM workers on innovation and productivity in America in a very large and uncontested economic literature because they are not perfect substitutes for Americans.

[02:03:25.15]

They bring things to the table that are complements to Americans' efforts to raise productivity.

[02:03:31.17] - Pia Orrenius

There could be dynamic effects here, right? You could have like a short-run effect versus a medium to long-run effect, which I think would have something to do with capital flowing into this sector. Can you talk a little bit about that?

[02:03:43.28] - Michael A. Clemens

I— so, so, so, say one more sentence about—

[02:03:46.23] - Pia Orrenius

so if you're thinking about— I'm thinking if you're doing a study, like, immediately, yes, you might see an impact on the number of, of, of US-born students studying STEM, but, uh, but over time— so that's kind of the relative effect— but over time, the absolute number might not be as large because you wouldn't have as much investment into the sector because you wouldn't have as much talent if you cut off the foreign STEM students.

[02:04:08.13] - Michael A. Clemens

Exactly. And there's a fascinating paper in this area that I highly recommend if you're interested in immigrants and innovation, maybe the best work in this area recently. And I include my own in the category that's— this is the best. Shai Bernstein of Harvard Business School, Rebecca Diamond, and their co-authors have this fascinating study where they studied the effect of immigrant inventor death on inventions by others that they worked with in the past. So they get a database of inventors and patenting, link it to Social Security data, through which they can identify the foreign-born, and they can identify age, and also people who died before age 60,

plausibly an unpredicted death, and ask if you're a native who has worked with an immigrant in the past, to create patents, what happens to your patenting as a native when your immigrant collaborator is suddenly and exogenously removed from the equation by an unfortunate death? Natives' patenting goes down immediately due to an immigrant death. Other native collaborators' patenting goes down when a native collaborator passes away, but the effect of removing the, the inventor, by this unfortunate death is much larger when that's an immigrant. And note well, that doesn't mean that immigrants are inherently smarter than natives.

[02:05:35.37]

It means that there was something about the collaboration of natives and immigrants bringing different ideas to the table, bringing different skills to the table that caused more productivity than just natives and natives, immigrants and immigrants. And that's a particularly striking piece of evidence in a much broader literature suggesting long-windedly that your model is exactly right, that there could be a negative productivity effect on the entire sector dependent on the innovation-producing skills of these people that could have negative longer-term effects, even if in the short term natives are crowded in.

[02:06:10.28] - Pia Orrenius

Michael, this is the problem for economists. This is why nobody likes economists. We need people to die to prove a point. I mean— Sadly, that's the identification strategy.

[02:06:22.49] - Monica de Bolle

I don't know if we need people to die necessarily, but we certainly need people to be able to work or if they can't do their job, you will see the same effect. I just want to illustrate what Michael was saying with a personal experience. A few years ago, I was doing a biomedical degree at Georgetown University. At the time, I was working in a lab that was doing work on on HIV novel therapies. And the principal investigator in that lab is someone from Argentina. And the other people in that lab, there were Americans, but there were a lot of— there were people like me. And there were a lot of people from China. And the research was going really well. And it actually came to a point where we could see the potential for this particular therapy based on a very— just a particular molecule to actually come on stream as an adjuvant treatment for HIV. Well, the grant that this lab used to run on is from the NIH, and that grant was cut. And so that particular principal investigator is now no longer able to conclude this research which has had implications for the entire lab, meaning all of the collaborators, foreign collaborators and native collaborators, some of which were learning from this principal investigator.

[02:07:57.44]

So I think this illustrates precisely the kind of thing that you're saying and the things that happen when we do these things with— Yeah, that brings it home.

[02:08:07.11] - Pia Orrenius

Absolutely. This is turning to your work on ribonuclease So I'm going to push back on you too a little bit. So I know with the AMLO administration in Mexico, when he came in, they really ramped up spending for the poor and programs for the poor. And there were tremendous transfers. I think now they may be struggling with some of these fiscal obligations that they have. But they really were very successful in lowering the poverty rate in Mexico. And I think it's maybe by 10 or 15 million people fell out poverty as a result of these programs for the poor. And so I'm wondering, you said that remittances are really more of a function of economic conditions here. But I'm saying that it seems to me that this improvement in the conditions of poor families in Mexico, could that not be an additional or one factor in why remittances have come down?

[02:09:00.53] - Jesús Cañas

Yes, yes, you're right. Yeah, it could play a role. I just recently looked at this research study by the World Bank looking at, I mean, what was behind this drop in poverty, and about 70% was mainly due to wage increases, right, in Mexico, the ones that you mentioned at the beginning of the conference. And then the other 30% was almost evenly distributed between remittances and the social programs, right? So yeah, definitely, I mean, they play a role, but not, it looks like not that huge in that sense, but we are, exploring other controls to kind of account for that.

[02:09:57.17] - Pia Orrenius

Yeah, that might be something you want to incorporate into your analysis. And also, I mean, on that note, you said that it doesn't look like worse economic conditions in some of these states like California is driving the decline in remittances. But, you know, also migrants are, you know, it's not really about the overall wage bill. It's like they're disproportionately, and your own research shows this, employed in construction industry, for example. We know that construction in many states is actually, you know, bordering on a recession state. It's definitely— construction activity is falling. And so I'm wondering also, have you explored that angle? Are you confident that that's not driving any of this change?

[02:10:40.01] - Jesús Cañas

Yeah, so we look at employment— I mean, the wage bill by sector. So we somehow account for for all these, you know, the relevance of construction in each of the states, for example. But yeah, we're still looking at some other set of controls, particularly to hopefully measure what is not in the wage bill, right? Like all these, I mean, we know that lots of immigrants do work and not necessarily get paid through the formal channels. And that might also be affected right now due to the current environment in some of these states. Right.

[02:11:21.17] - Pia Orrenius

So all the wages may not be observed, if you will, in the official data. Right. Thank you. Monica, turning to you, I think you talked about the unique motivation for remittance tax in the US, but I also wanted to push back a little bit there in the sense that we are unique, right, when it comes to immigration. Especially undocumented immigration. I mean, I don't think there's another country that has as large of an undocumented population as we do, which is now estimated about 14 million people. So is that— so are we really an exception, or is it just that we're just like no other country in that respect?

[02:11:57.46] - Monica de Bolle

But I do think the US is an exception in the sense that if you look at the use of this instrument, remittance taxes. What are remittance taxes typically used for? The point I was trying to make here was to say, whenever you've seen remittance taxes in the past, they have been used as part of this larger array of capital controls. It has had a lot more to do with balance of payments pressures than with any concerns over immigration. Now, of course, the countries that I have on that list, are not exactly countries that are huge recipients of migrants, right? They are not. But that being said, that's the rationale. But more than that, when we looked at the issue of immigration restrictions in the context of the economic nationalism book, what you see as being typically used to restrict immigration when that is a concern are measures that have nothing to do with remittance taxes. They tend to be the other types of measures that I mentioned. So changes to the way that you distribute visas or other changes more along the lines of what Michael was saying in terms of the OPT and things like that.

[02:13:13.28]

They're not— you don't use a blunt fiscal instrument to do any of these things. And in that sense, the US is unique because in the case studies that we looked at, there are a number of countries that are recipients of migrants not as large as the US, of course, but there are a number of European countries that we looked at. And when you look at the kinds of immigration

restrictions that they are putting in place, they're not using remittance taxes for many of the reasons that we discussed here.

[02:13:43.11] - Pia Orrenius

Thank you, Monica. Let me turn it to the floor and would like to take questions from the audience.

[02:13:53.50] - Marcus Noland

Hi, I'm Marcus Noland from the Institute. My question's for Michael Clemens. This is a conference on economic policy across North America, and so I'm wondering, is it possible in your data to drill down and see the nationalities of the OPT students? I would be curious about, um, uh, the presence of Canadian and Mexican students in that group. And then a follow-on question, which is probably outside your domain, but maybe could be addressed in the next section, is if there's really any kind of thought of a Fortress North America and we are imposing these new sorts of restrictions, would it be possible in the context of some future USMCA to exclude Mexican and Canadian students from this restriction?

[02:15:01.53] - Michael A. Clemens

Thank you so much. The short answer is I don't know. I haven't done that analysis. The nationality— so I got a full universe data on all the OPT students from 2004 to 2022, every single one, where did they work. Where did they graduate from, what their discipline was. So it would be possible in principle to disaggregate them. I know off the top of my head that H-1B visas, where half of these people go, 73% are Indian. A large share of the remaining ones are Chinese. I would expect North Americans to be a limited fraction of the OPTs. And it would be hard to think of a research design to isolate their effect specifically on on innovation, but just in policy terms, is there any justification at all for any barrier on North American students in this category? What is the harm to anyone caused by Jesús Cañas? I think our null hypothesis should be that no harm or benefit was done, and we should require a randomized controlled trial to push us off that null hypothesis. That any harm— that a benefit was created rather than the reverse. I mean, stapling a green card to every diploma is an extraordinarily generous policy, and we certainly don't need something like that in order to massively benefit the United States by regulating these students better.

[02:16:28.07]

But certainly, what we should really have is a work visa specifically for people who studied in this country. It is kind of weird. And the people who complain about OPT have a point when they

say, why exactly is there a work permit attached to a student visa lasting years after graduation? A visitor from Mars would think that doesn't make much sense. And it truly doesn't make much sense. It's a product of decades of political conflict about exactly these people. But just terminating the program, which insiders let me know is indeed upcoming from the White House, is such a drastically harmful measure. I was told by people who were present at the beginning of the NAFTA negotiations that from day one, any sort of lower-skilled migration was just sort of ruled out by the US side, that if you want to talk about creating a low-skilled work visa, that's where the negotiations end. And so there was the TN visa, but why not a student visa? Specifically for North American graduates from U.S. universities. What, what evidence of any kind does anyone have that that wouldn't be tremendously beneficial to the U.S. on net? I know the field pretty well and I've never seen it.

[02:17:46.56] - Pia Orrenius

Can I follow up on Marcus's question just briefly? I mean, you've also looked at— we've got the situation with OPT, which may go away soon, and then— but we also have these visa fees on the H-1Bs. H-1Bs. Michael, you've looked a little bit about that. Can you give us a little summary of what you think the impact will be on the H-1Bs? Oh my gosh.

[02:18:06.53] - Michael A. Clemens

I mean, the biggest problem with the H-1B tax is not the amount of the tax or the nature of the tax. It's the completely lawless, arbitrary policymaking process, which was literally on a Friday afternoon, I'm announcing a tax. That I made up, and it goes into effect tomorrow night. And it's not exactly clear who it applies to, and we're going to be tweeting on Saturday night about who it applies to as panicked Indian workers leave planes about to take off, not knowing if they'll be able to get back into the country. Weeks later, it was kind of clarified that it doesn't apply to graduates of US universities, but the fact that it's not being done by I don't know, legislation or rulemaking or any of the ways that we make policy in Washington, DC, but instead by a presidential proclamation citing blanket unlimited discretion to exclude any alien for any reason, a paragraph, a misinterpretation of a paragraph from a 1952 law means that the tax is \$100,000 now and doesn't apply to US graduates now. But tomorrow at 10:37 AM, it might be \$300,000. And yes, apply to US graduates. And just that environment of uncertainty is an enormous tax that will massively deter use of this visa, especially when combined with a flotilla of other policies restricting use of the visas for entry-level jobs, which is another proposed rule from the administration.

[02:19:43.49]

Limiting foreign students in various coercive ways. Foreign students are 40% of H-1Bs right now. Foreign graduates of US universities are foreign— were about 40% of H-1B visas in fiscal year 2023. All of these things are going to drastically reduce use of the visa. And not just that, but impair its productivity effects on the United States. Because as I mentioned, particular users of H-1Bs have measurably different effects on productivity. And the innovation differential between graduates of US universities in STEM, foreign graduates of US universities in STEM, and other foreign workers is very sharp. So it will change not just the number, but the productivity-shaping effect of the entire visa program.

[02:20:37.20] - Pia Orrenius

Well, let me indicate— did you have a question? I thought you raised your hand. Oh, great minds. We can take a last question if there's any burning.

[02:20:52.08]

Alejandro.

[02:20:57.13] - Audience

Thanks, Pia. I mean, a couple of questions. I mean, following up on your answer to the H-1B, the OPT. If there's a political economy quantity constraint, what would be the best system to assign these visas? I mean, how you do— would you redesign the system to reap the highest benefits? Also, what does the literature on academic paper citations tell us regarding the OPT? Because I'm pretty sure neither Jesús, Luis, or Roberto have any patents, but I'm pretty sure they have some papers. So to know the value— That's true. —to society on that side, on visas, because I'm— and to what extent the extension or the increase in OPT permits per year has been progressively distributed to less scientific disciplines. Now, I think that's another criticism, no, to what extent we are granting more visas to social science and another type of things that fall under an amplification of the qualification of STEM, no. I think a lot of disciplines that maybe 10 years ago were not considered STEM now are considered STEM.

[02:22:26.28] - Michael A. Clemens

Thank you so much. So, there's never been a study that I know of that studied the effect of OPT on scientific publications. OPT is intimately linked to H-1Bs, and there is a literature finding that H-1Bs cause additional scientific publications, another of many indirect signs of a larger productivity effect. Each of these are a piece of the puzzle, patenting, et cetera. That would be very interesting to look at. So the fact that H-1Bs are increasingly used for non-science and engineering disciplines— I— that OPT— you mean within the STEM extension that fewer and

fewer of them have been science and engineers? Is that the case? I don't believe that that is the case. It is true that, for example, at my university, our economics program was not considered a STEM discipline until we lobbied for it, and now it is. But the— but the— I do want to point out that in the evidence that you saw, I'm just looking at— I'm using the DHS official designation of STEM and finding that there is a large effect on patenting. So if that includes a lot of useless economists like me who have never patented a shower curtain or anything else and probably detract value from the US economy.

[02:23:51.52]

What we're looking at there is the total effect of all of the brilliant scientists and engineers alongside the social scientists. Although the numbers you saw are a total effect from 2009 to 2022. And if there were a downward trend in the patent generation of OPT at the end, my design wouldn't capture that. So it's possible, but I don't know if it's factual that there's been a substantial trend away from scientists and engineers within OPT. It could be, but I just don't know.

[02:24:25.42] - Pia Orrenius

I think that's a wrap. We're going to break for lunch, and we'll reconvene at noon with the future of the USMCA. Panel. Thank you.

[03:05:44.18] - Jeffrey J. Schott

Last minute rush to the dessert table, I see. Good afternoon, everyone. My name is Jeffrey Schott. I'm a senior fellow here at the Institute, and I'm the moderator of the session on the future of the US-Mexico-Canada Agreement. It's a good question. Is there a future for the US-Mexico-Canada Agreement? That's what we will discuss with an excellent, excellent panel that I will introduce in a moment. But I wanted to remind you, thinking about economic integration in North America, that 60 years ago we had the signing of the US-Canada Auto Pact, which really accelerated the process of thinking about economic integration among three countries of North America. That led over time to the Canada-US Free Trade Agreement that was signed and went into effect on January 1st, 1989, but that created a lot of pressure to bring in Mexico as well. In the North American Free Trade Agreement that entered into force on January January 1st, 1994. That was 31 years ago. And we've done pretty well. If you look at the tables that were shown in the opening sessions, countries have profited from working more closely together. And of course, the last iteration in this series of integration steps was the— entry into force of the US-México-Canada Agreement on July 1st, 2020.

[03:07:46.23]

One of the provisions of that agreement was to have a review that would take place 6 years from the date of entry into force. A review of the implementation of the agreement with the idea that Don't let it get stale. Make sure that it stays up to date and benefits to the most, to the extent possible, the three economies of North America. That review is now scheduled for next summer, and countries are beginning to prepare for it. There are four pathways that could take place in the course of this review. One is the review could sit down and say, well, We've taken stock of what we're doing. Extend the agreement as is until the next review, which would be 6 years further down the road. Another pathway could be to update and revise the existing pact. And some people have said, this is going to have to be a renegotiation, but that would take place based on this review. Then there are two other possible outcomes. There is a review exit clause in that article of the USMCA that allows the three countries to begin a 10-year phase-out of the pact with reviews each year.

[03:09:21.21]

And so they're signaling that they're going to downsize get slowly get out of the deal, but continue to work and see over that 10-year phase-out period whether, whether that's desirable. And the final option would be any of the three countries invoking the, the provision to withdraw, the withdrawal clause that allows exit from the pact within 6 months of notification. And all of those are possible outcomes that we have to plan for and worry about in the coming months. Now, the review is complicated by Trump's tariff policies. And these policies, as we've discussed to some extent and we'll discuss more in this session, provide preferential treatment to some extent for Mexico and Canada versus other U.S. free trade area partners, but more barriers than previously under the USMCA pre-Trump. The U.S. tariff changes, though, have created a great deal of uncertainty because they change. They go up, they go down, and without a lot of warning. And this, because of this, the USMCA has lost what I call its insurance policy value against protectionist impulses. Trade agreements, the rule of law, provides some, not foolproof, but some insurance against these sharp policy movements. And without that insurance policy, or with the devaluing of the insurance policy, it means that traders have to hedge and/or self-insure.

[03:11:22.55]

And that increases the cost of doing business. Yet another cost of doing business that undercuts the value of the relationship. So these are just some of the overview comments that I think are important to put on the table that will be discussed in more detail by our three excellent speakers. We will start with Miguel Mesmacher, who is— and I will keep these introductions very short so we can leave them more time to talk. Miguel Mesmacher is Dean of Social

Sciences at ITAM and the former Chief Economist and Undersecretary for Revenues and for Finance in the Ministry of Finance of Mexico. Miguel has a PhD in economics from Harvard. He's done lots of great stuff, but you, you can talk to him about it after the, after the program. My colleague Alejandro Werner is a non-resident senior fellow here at the Peterson Institute, is the founding director of the Georgetown Americas Institute, Institute and previously was Director of the Western Hemisphere Department of the International Monetary Fund. And earlier in his career, he served as Undersecretary of Finance and Public Credit and Director of Economic Policy and Chief of Staff at the Finance Ministry in Mexico.

[03:12:45.04]

And last but not least, we have Enrique Martinez Garcia, Assistant Vice President at the Federal Reserve Bank of Dallas and also affiliated with the Globalization Institute and is the lead scholar for the International House Price Database and the Database of Global Economic Indicators at the Federal Reserve Bank in Dallas. He notably won the 2023 Central Banking Award in Economics, a great distinction that I think indicates the quality of the work that he does. So without further ado, let me turn the podium over to Miguel.

[03:13:37.43] - Miguel Messmacher

Good afternoon, everybody. It's really a pleasure for me to be here. I would like to thank Jeff for his initial comments and the Dallas Fed and the Peterson Institute for the invitation to be here. In this great event. I will also have the major challenge of being the speaker right after a very short lunch, so I hope to keep you guys awake, and I'll try to do my best. Getting directly to the question, and I'll try to go very much to the point. So first of all, will there be a USMCA 2.0? And I'm already calling this USMCA 2.0. My impression is that yes, we will see that due to several reasons. First, the US administration, and to make it clear, obviously, whether we get a treaty or not depends to a very large part on the US administration. As you saw from some Undersecretaries Gutierrez comments, Mexico is very keen on maintaining the relationship with the US in an important way. So to a very large extent, it will depend on views in the US. And so far, members of the administration or close to the administration have made signs and signals that Mexico is very important for the US.

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So in that respect, I think that we probably would not have doubts regarding the fact that Mexico is an important partner. It's an important player. And therefore, this suggests that the US will want maintain an important relationship with Mexico. Security and immigration are major topics. There is this whole thing of whether Mexico in geopolitical competition with China is going to be

an important complement. In that respect, the views in the US administration seem to be that Mexico does matter. Second point, in the first USMCA, what I would call USMCA 1.0, Personal relationships were fundamental. I'm sure all of you remember Luis Videgaray turned out to make very important relationships with President Trump's son-in-law, and that was a major factor actually in pushing the negotiations going forward. While the relationships are not as close this time as they were last time, President Sheinbaum and President Trump seem to have established very good relationships. Again, it's not exactly the same thing, and it's not as close as it was last time, but President Sheinbaum has a very long experience of dealing with Andrés Manuel López Obrador, which in some respects is somebody who has certain similar characteristics to President Trump.

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So in that respect, and sort of in an almost idiosyncratic environment where personal relationships and personal decisions matter a lot. She has a lot of experience with dealing with somebody who has a very similar personality. So in that respect, and I think it shows in the fact that Mexico seems to be having and maintaining a good working relationship with the US. A third term, both administrations speak a very similar language. They can sit down, they speak in terms of messages, in terms of symbols, politics is a major issue, technical considerations, not that much. Here, I can say, and we were discussing this a little bit over lunch, when we had the technical teams coming in the USMCA 1.0 negotiation, sometimes we would have issues with our counterparts, for whom political considerations were perhaps much more important than for our technocrat teams coming down to negotiate. Now my impression is that they're very similar. They speak very similar language. So potentially agreements are perhaps easier. Mexico is already sending very strong signals of commitment to the US. Undersecretary Gutiérrez did not mention it, and he gave a different justification for the tariff barriers versus non-treaty countries.

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But to me, it suggests that there is a lot of communication going out, and those are really strong signals that Mexico is all in. If it's not something that already has been spoken with US authorities, they are certainly very strong signals that Mexico wants to go full in with the US almost whatever it takes. In that respect, Mexico, This, for example, contrasts a lot with a Canadian attitude and the Canadian position, which has been more distant in that respect. One issue where I would have more doubts than I used to have before is whether it's still going to be one three-party agreement or three bilateral agreements. In particular, whether USMCA will continue to be a US-Mexico-Canada thing or whether we will end up with bilateral agreements with either one of the countries. This is purely speculative, but clearly the fact that you have much more tensions now between Canada and the US than you had before, and less

tensions between Mexico and the US, gives me a little— I mean, I would venture that the central scenario still is that you will have a trilateral agreement. I would think that that's still possibility, but the probability is that you have bilateral agreements, I think, is higher than it was before, with Mexico and Canada having different positions in their negotiations and their talks vis-à-vis the US.

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Again, in USMCA 1.0, there was a lot of anecdotal comments that perhaps the US was already starting to discuss on whether to make arrangements with Canada or with Mexico, and not necessarily at the same time. Mexico was very insistent at the time that, look, we want to have the negotiation with Canada included. And Mexico made a very strong point, and given the very strong relationships that Mexico had with people in the Trump White House, sort of that was the view that was valid. But I would have a little bit more doubts this second time around. Again, my central scenario would be we continue to have one three-party agreement, but the probability that we end up with bilateral agreements, I think, is higher than it was before. It's a bit more of a risk than was the case before. Now, these were points that I made before hearing Undersecretary Gutiérrez, but now I'm more confirmed in my views because it's very similar to what he actually said. From a static point of view, my impression is that the current situation regarding tariffs seem workable for Mexico. Undersecretary Gutiérrez made similar comments along these lines in her intervention this morning, that if the treaty ends up with a current status quo, then perhaps it's not a bad deal for Mexico, and that was the point of this slide.

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And let me show you. So in theory or in principle, there is this tariff of 25% of Mexican imports that don't comply with USMCA. And then there is these other add-on tariffs on steel and aluminum and auto parts and finished automobiles. But the effective tariff is actually much lower. And let me go over this. Let me go over this. This table. Obviously, the tariff that Mexico pays depends on how much, clearly, given that they're going with zero tariff on the USMCA. Obviously, something that matters a lot is how much Mexican exports to the US actually are able to go through USMCA. The numbers observed in 2024 is that of Mexico's exports to the US, close to 50% came through USMCA, were USMCA compliant. Potentially, a lot more exports could be USMCA compliant, for you guys to know, but as Undersecretary Gutierrez mentioned, there are some compliance costs. If tariffs were very low without the treaty, then it didn't make sense necessarily to pay the cost to bring things through the treaty, if you maintain the same structure of only 50% going through USMCA, apparently the weighted tariff, these are not calculations by me, these are by Citi, but the weighted tariff apparently is about 15%.

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But that's maintaining the same structure as was observed in 2024. Some estimations are that, look, if you do pay sort of these, if you do, pay these compliance costs, perhaps you can take exports of Mexico to the US compliant with USMCA all the way up to 80%. If that is the case, the effective tariff would go down already to 9%. Now, these first two numbers, the first two rows are actually estimations. They are not observed numbers. We didn't have the tariffs in 2020, before, and then the second scenario is a hypothetical scenario if 80% of your exports actually became compliant with USMCA. Now, the third thing is what have we actually observed from March to July once the tariffs came into effect? And the way in which this calculation was done was by looking at actual customs data in the US where you can actually observe from the customs data How much revenue was collected on the basis of how much exports Mexico made into the US? So that's literally the observed number. And on the basis of the collected taxes and the collected tariffs, you can calculate what's the implicit tariff rate. And it turns out that the tariff, the implicit tariff rate observed in customs numbers is only 4%.

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So it's even below this theoretical estimation if you had 80% compliance with USMCA. In this context, if really the effective tariff on Mexican exports to the US is in the order of 4-5%, that seems to be given current circumstances, is not necessarily what I would wish or what I would recommend, but given current circumstances, it doesn't necessarily appear as something that would be a disaster.. That's clearly the position also of the Mexican government, which we're seeing. Let me go a little bit faster. One issue which seems to be very important for authorities in the US is that Chinese companies may be using Mexico to avoid tariffs. Actually, Undersecretary Gutierrez made some comments along those lines. The data doesn't really support that a lot of this is going on for you guys to know. If you look at exports from China to the US, it doesn't seem like there is a major surge associated with then exports coming to the US. There doesn't seem to be a major surge of FDI in China into Mexico. The data does not seem to support this, but obviously perceptions matter in politics, and the fact that you have perception means that probably you have to do something about it.

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My take here is that this unilateral increase by the Mexican government is a very strong signal that they take the concern, even though they might not necessarily agree with the evidence and would argue that there is not a lot of evidence in favor of that. The fact that Mexico is willing to unilaterally increase tariffs versus third countries is a very sharp suggestion that they want to send a signal to the US that they're going to avoid this. What this would suggest to me is that Mexico probably, in whatever new agreement the agreement we have, will

be willing to have much stronger restrictions on rules of origin and limits on FDI from third countries than you actually have in the current USMCA. So that would be an interpretation I would have along these lines. Some other topics of concern for the US. The US, and this is something that a lot of authorities in the US continue to mention, this issue on whether that labor in Mexico is too cheap and there is unfair competition in the labor sector. And sort of strengthening labor laws and the labor framework in Mexico was actually a major point that the US pushed in USMCA 1.0, something that the Biden administration insisted upon.

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So my guess is that there might be some things along those lines. Actually, Sheinbaum's government will be very sympathetic to continuing a discourse of strengthening worker rights. So I would argue that there will be a lot of sympathy for including some additional things here. The only issue is that with all of the minimum wage increases and the legal changes that have already happened in Mexico, margins are getting tighter. So additional changes will probably have stronger effects on competitiveness than the initial changes had beforehand. There was a mechanism to assess if interventions in exchange rate markets were leading leading to competitiveness problems. Interestingly, that never really was an issue with Mexico, and I wouldn't expect major changes there. US authorities actually pushed that to have that arrangement in USMCA so that they could actually push it with other free trade agreements, and apparently they are doing that now. In reality, it was an exemplary provision, set of provisions that they could actually use with third countries. Countries. It never was much of an issue with Mexico, so there's probably not going to be a lot of pressure in that respect. Might there be requirements as are happening in other free trade agreements of other kinds?

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Probably for announcement purposes. I wouldn't venture necessarily that there is a commitment for budgetary resources going to security or to drug trade. But might there be some symbolic issue of a requirement of investment by Mexico and the US? There might be something. Here we don't know how these arrangements are going to be implemented. If the way in which you can implement it is by reallocating the investment of the international reserves of the central bank, then it might be done without many major costs. Perhaps if they negotiated that way, they could attend that. Then there are a couple of other things which might actually be positives for Mexico. To some extent, might they insist on opening to investment by the private sector in the energy sector? That would actually be a plus, I think. Potentially, concerns about tax administration and the new judicial system, if that forced for a more institutional approach, that might not even be bad news in a sense if some of these things might happen. Now, independently sort of of these details, my impression is that the positive effects of the treaty that

is agreed upon will be more limited. And here my view is that the most important dynamic effect, positive dynamic— sorry.

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Here my view is that the most important positive effect from free trade treaties is the certainty it provides on investment. But then the use of trade policies to negotiate with Canada and Mexico or with other countries in other issues in spite of USMCA 1.0 is probably going to be limiting that effect, and that would be my views. Here, I mean, this is not an econometric sophisticated analysis. These are just graphs. Here, what you can see is after the first area that is highlighted, that was the negotiation of USMCA 1.0. USMCA 1.0, what you can see is that during the negotiation, and this is investment in machinery and equipment, which is the one that I think in Mexico, which is the one that I think is most sensitive to trade considerations. What you can see is that during USMCA, it flattened out, it didn't come down, but it basically flattened out. After USMCA, it's not that suddenly you had an upsurge of investment. Again, many things were happening, López Obrador won, There were changes in Mexico, different things. COVID came, no, many things were happening, but it's not like you suddenly had a major surge associated to nearshoring after USMCA won.

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Then what you are actually seeing is that in 2025, you actually have a major drop in investment in machinery and equipment, very discrete, very concentrated. Here clearly, the uncertainty effects are having some impact. Just to conclude, some suggestions for the Mexican government. I'm not involved, but these are some ideas. USMCA, according to my view, it will imply higher tariffs, perhaps not very high, but higher than what we have, tighter rules of origin, weaker effect on investment. Mexico is actually going full in with tariffs with third countries, so obviously, there might be some divestment, sorry, some problems there due to distortions in trade. Some ideas to try to compensate. Security and migration will be major issues of concern for the US. Here, one idea would be for Mexico to try to send a signal that Mexico is a major geopolitical partner of the US and that this substitute for the certainty that originally came from the free trade treaty. Try to complement and try to compensate for more uncertainty associated with a free trade pact with very strong arrangements and very strong complementarities on other topics. Second, obviously, carry out actions to reduce uncertainty from local sources.

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That hasn't necessarily been happening, but that would be something that's very important. That would be in the hands of the administration, And finally, sort of explore options for temporary

workers. The stuff that was presented on remittances was really interesting. Something which I think would be very interesting would be to sort of explore already how— I mean, Mexico has a long story of temporary arrangements for workers coming here, to sort of retake that, explore that, because that could be a basis for sort of arrangements of temporary workers going forward. With that, let me finish. Thank you.

[03:33:04.25] - Alejandro Werner

Thank you very much, Jeff. Thanks, Miguel, for coming, and everybody from the Dallas Fed. From a great collaboration for this conference. And let me start with some remarks following on, on what Jeff and Miguel said. First, I think the USMCA and NAFTA has— NAFTA eventually evolved from a happy marriage where the two parts wanted to make a life together, a family. They have common goals, et cetera, to living together, couples therapy, financial considerations, and make us stay where we are. That's where we are. I think neither the US government nor the Mexican government values the certainty, values tying their hands through the agreement not to implement discretionary policies. And they also do not value ceding some sovereignty to have a super sovereign judicial process to provide certainty to investment, et cetera. That were some of the keys of this treaty. So I think when we analyze what is going to come out of this negotiation, we have to be a little bit less gung-ho on having a treaty. We have a reality. In which we will have some lower tariffs, preferential access to both markets, some protection of investment, but a lot of uncertainty that things can change with a treaty or without a treaty.

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I mean, at the end of the day, that's the new geopolitical reality. And these are two partners that are tied together, that are super integrated, and I think that would continue to be the case. With a much more amorphous reality, even if we have a treaty. Second, a general comment. I think some people have said, if you move towards a three bilateral treaties, the US will have to go through Congress because that will be a new treaty. And if that's the case, I think just avoiding that will have a lot of value, so you might end up You might end up having different treatments to the different neighbors within the same treaty. I think a judicial or a legal discussion might come up of whether that represents a new treaty that was not ratified by Congress or not. To what extent a revision became a renegotiation and a new treaty. If eventually you cross that line, that that's for legal experts to debate. That new agreement would have had to go through Congress and might be challenged or can be challenged in some courts. So let me start with the presentation. Just look at how the Mexican economy is doing in 2025.

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And intuitively, Mexico's avoiding a recession thanks to the US. At the end of the day, you see these are biannual levels. Basically, GDP is slightly up on seasonally adjusted terms and also on the original series. Semiannual consumption has been flat. Investment is falling significantly, as Miguel said, and exports have been super dynamic. And imports have not increased that much. So the external sector is providing a significant impulse to domestic demand in Mexico that is having maybe on accumulated terms, maybe we have a small positive rate of growth or 0.1, 0.2, or 0.3 up to the third quarter. Even if you assign half of the drop in investment to the uncertainty of the USMCA, in terms of their contributions to growth, the impact coming from the external sector, X minus M , is much larger than the negative income impact coming from investment. So the frontloading of exports, that might also explain a little bit of the low effective tariffs that Miguel was saying. In customs, you're seeing a lower tariff because a lot of exporters exported a lot of their preemptively before the tariffs came into effect. So it's also a little bit of a misleading—the theoretical exercise might be a little bit misleading, and the custom exercise so far might be a little bit or significantly distorted by the preemptive exporting that a lot of people did.

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But that's what the Mexican economy, the conjunctural data, Mexico growing between 0 and 0.5% during this year, basically led by the exporting sector. We saw around the world a significant surge in exports in the first half of the year, and that has been very good for Mexico. The second part of my presentation is just putting some pictures into what Miguel said and Luis Rosendo said. These are some bullets just to know how important and why Mexico has this negotiation strategy that is called *sí señor*. No? At the end of the day, what's our plan? *Sí señor*. We have to accommodate. No? We don't have a lot of negotiation power and we accommodate and deal with nudges, problems that they oversaw. That they didn't know and that the US private sector I think is lobbying significantly to fix, like the crediting of US value added in Mexican automobile exports. We're not gaining any comparative advantage by getting—that will completely leave us out of the market. At the end of the day, the Mexican value added should be taxed at 25%, not the US pieces that are going across the border and 3 times. Just tariffing that 3 times will be crazy.

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It was a mistake, it was fixed. The US private sector is doing a lot for that. Mexico exports 82% of all its exports to the US. That represents around 28% of GDP. It represents a lot for Mexico. We have to accommodate, is the right strategy. It is very good that we have a left-wing government focusing on that, knowing that our strategic alliance is with the US. Again, another silly remark, but Milei wants to be the geopolitical partner of the US. Mexico is, needs to be,

doesn't have an alternative. But it's very good that this government is recognizing that and we're not generating uncertainty from the Mexican side. All the uncertainty is being generated by what the US wants to do. Mexico is certain on what it's going to get out of these negotiations is to maintain this strategic relationship. Close the third largest bilateral trade surplus with the US behind China and the European Union. Remittances, as it was said, it's 3.5% of GDP. Tourism, it's 1.2% of GDP, and the US represents around 44% of our FDI. Exports represent 28% of GDP. Very important for Mexico. Remittances, as we said, have been falling as percent of GDP also because of the appreciation of the peso.

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This is a little bit of the composition made by the OECD of the value added in Mexican manufacturing exports, going from 30% in some sectors to 13% in other sectors. The US value-added component in Mexican exports. This is a description of where we are. I think it's very hard to know what will be the USMCA revision and what is the general tariff discussion. I mean, this thing has already started. There are a lot of clues that we can extract from what has been going on already, and this will continue throughout 2026 until there's a strong signal of where the endpoint of the negotiation is getting us. Up until this point, it has been mostly about tariffs. As Luis Rosendo and Miguel said, we have non-USMCA-compliant goods pay 25% tariffs. All the USMCA-compliant goods, not all, most of them pay zero tariff, and then we have 25% tariffs on finished automobiles. There was a 25% tariff on auto parts that so far has been waived. We have a 50% tariff on steel and aluminum, a 17% tariff on tomatoes. As you can see, automobiles and auto parts, it's 40% of our exports to the US. So this negotiation is mainly about the auto That's the key for Mexico.

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The average tariffs that the IMF has calculated put Mexico paying a 9.3% tariff, Canada almost 7%. This is better than the rest of the world. And I would say, as Miguel was saying, dynamically having 9.3, but with zero and 18 is very good because through the zero window, you can get a lot of investment. And through time, you will be significantly reducing your average tariff because a lot of goods will be expanding through that window. The unilateral announcement by Mexico of imposing increasing WTO-compliant tariffs on non-treaty countries, it's mainly about China, South Korea, Taiwan. Chinese exports to Mexico have been increasing. Not that differently than to other countries. At the end of the day, China has reshuffled its export destination with a significant decline of its exports to the US, and Mexico has followed a pattern similar to other countries, but definitely it's a big concern to the US. I would say that the willingness of Mexico to move ahead in the negotiation imposing these tariffs mainly represents

a negotiation tactic, but I think it also represents a little bit of a revision in terms of their foreign policy, foreign trade policy attitudes and intentions.

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I think there's a bit of protectionism there that we saw from the undersecretary protecting sectors that have been affected, etc. So the US is asking for it, the Mexican corporate sector, part of that is asking for it, why don't do it? And also we get some revenues in an environment in which we have to close a 6% of GDP deficit that we have in 2024, eventually to 3% in 2, 3 years. So this will help. I hope this is not a tendency, but for example, in the auto sector, Chinese cars are not being produced in Mexico. They're not being re-exported to the US. The Mexican consumer is benefiting from cheaper electric vehicles coming from China. Why concede that now? If it's part of an auto sector package where we get commitments on investment or we get some agreement that would let us to continue to grow the Mexican automobile sector or auto parts sector according to Mexican government objectives, and the Mexican government has to concede on consumer welfare by lowering tariffs, that's maybe a good negotiation you have. But just doing unilaterally something that should not be affect— just adopting pure protectionism in the EV sector, It doesn't make a lot of sense, so hopefully Mexico will get something out of this.

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I mean, thinking about the negotiation in very general terms, I mean, the objectives for the US is to align Mexico's migration and security policies to US interests for strict geopolitical alliance, extend US protectionism to North America, secure strategic complementarity in manufacturing, protect US economic interests for Mexico to maintain our main development strategy that is basically being a manufacturing platform with significant number of free trade agreements, basically with the US market as an objective, minimize the perceived intrusion by the US in domestic affairs, and maintain discretion in domestic policy matters. I think both sides need some kind of agreement. I think these objectives are better served being in an agreement than actually pushing Mexico out of the agreement. And for Mexico, definitely, For its whatever certainty will be left in terms of a strategic economic integration with the US, Mexico needs an agreement. In terms of what should be the objectives of Mexico in this negotiation, one is maintain the zero tariff for USMCA-compliant goods. Second is to achieve an agreement on the auto sector that is better than the agreements in the auto sector that is being signed with other countries, with Europe, with Japan, et cetera.

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I mean, at the end of the day, the logic of strategic complementarity of US firms, auto firms in Mexico should be very strong for them to get a better agreement in Mexico than to get the agreement that they're signing with the European Union. Policies against versus third countries, moving a little bit disagreement into a customs union with FDI constraints or processes such as CFIUS that the Undersecretary mentioned and the tariffs that we are seeing is something that we will see in that agreement. But Mexico should be a little bit more focused on the Mexican consumer and Mexican competitiveness of Mexican exports to third countries, not the US, that will not be concerned about that. I would say broaden the NatBank's mandate and significantly increase its capital. If we're going to be more integrated with the US to pursue some of the industrial and security objectives that they want, and if we're going to concede on some labor policies, we should create a stronger and more powerful instrument in terms of having access to better terms in financing for specific infrastructure projects. I think if an agreement is reached along these lines, Mexico can easily restore its potential rate of growth at its 2% or slightly higher than 2% after this agreement is signed.

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And I think it would be very good if Mexico and the US start negotiating some parallel bilateral security agreements in security and migration to support this integration. Finally, in terms of rerouting imports from China, I think it's also Mexico should force a significant agenda by the US private sector and the US government on how we're going to redesign our sourcing mechanisms to significantly reduce sourcing from China. At the end of the day, most of these are Mexican companies producing— sorry, US companies producing in Mexico to export to the US. So if the US companies and the US government get together and agree on something, do that in Mexico. You're welcome to do that in Mexico, but it's— we have to know how fast, how easily that could be substitutively given the objectives that the US government has. And hopefully that work is going on to at least provide some, some logical timing for that process to take place. Thank you very much.

[03:50:11.59] - Enrique Martínez-García

All right, thank you so much. It's hard to follow Miguel and Alejandro, but they have given you a lot of wisdom and a lot of information about the context of USMCA renewal and what's at stake. What I'm going to try to do in however much time I have, which is probably not as much as I like, is to give you in a nutshell some of the work, a glimpse at some of the work that we've been doing or that I've been involved with, trying to quantify some of the scenarios around what a USMCA renegotiation would look like. Jeff, don't worry, we are not going to go into the catastrophic scenario withdrawal or exit. It's mostly different options that we think ought to be at least considered. Before I get ahead of myself, let me remind you that this is my views and not

those of anybody else affiliated with the Federal Reserve Bank of Dallas, and that work that I'm going to present here is not just my own, but that of colleagues and co-authors that have been very influential in helping me shape up both the presentation as well as the content. Of this.

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In terms of sort of setting the stage, I think much has been said already about this, so I'll try to be very brief. US renewal is happening in a context in which for a while there has been a change of the wind, so to speak, in the views about trade and the role of trade. Much has been made about the importance of openness in global trade. I would argue that one of the best things the US has ever done to lift the living standards of the world is this emphasis on openness in the post-World War II period. But definitely even before the recent administration in the US, the winds have been blowing in different directions. Issues about security concerns, the exposure of overextended or a perception of overextended supply chains and the risks associated with that have started to weigh heavily on policy. And then there is the issue of tariffs, a very significant change in the approach that the US takes to trade policy. And all of this seems to be moving in the direction of building regional blocs, or some would say developing a sort of bipolar world in which one of the key poles is likely to be the US.

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And naturally, Alejandro and Miguel have pointed this very clearly, North America is very much whether they like it or not, going to be dependent, at least for now, on that very strong link with the US. So all of this is happening, and then we get to review USMCA. And that requires rethinking what is it that we ultimately can do. Alejandro has done a very good job, I think, at laying out some of the objectives that the different sides of the negotiation might have. What is possible is framed, I think, by the key provisions of USMCA. I would argue that USMCA is in itself already a step in the direction of introducing greater conditionality. And greater regionalization. So there are different aspects of the, or different provisions that might be worth considering, but most of the emphasis I'm going to place is on what can happen with market access and rules of origin and the potential economic impacts that this might have. But there is different dimensions and something that to me What is quite significant as well, although I will not get to talk much about this, is this issue about services trade and the potential issues relating investment, and especially if there is the perception that investment, which is in itself a positive, is being perceived or could be perceived as a way of tariff jumping., and that becomes an issue of concern.

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So let me focus for a second on the issue of tariffs and the issue of rules of origin. And some of this has come up already in conversations that we've had during the entire event, even early this morning with Undersecretary Rosendo's remarks. So one has to factor two things, at least two things in evaluating the consequences of a framework that is tilted towards regionalization or towards creating a more regional cohesive bloc. One is the issues of compliancy. Itself that imposes an administrative burden on firms. And in an environment in which you could trade with the US without necessarily having a much higher cost, it might not be worthwhile for you to do so. But it does have a cost. And having to switch from trading with the US under non-compliant terms, under most-favored nation or whatever, in whatever other capacity, to being compliant has a potentially large cost that in the upper bound of estimates available by some of my colleagues at the board, Paudel and Kamal, can come up to 2.5% for the auto sector. So non-trivial amounts. But the other thing that I think is more relevant for me and is going to be relevant for, for some of the exercises I'll present in a second is that the rules of origin ultimately act as barriers to trade, and they are non-trivial barriers to trade.

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One of the costs, apart from the administrative burdens that we need to consider, is the fact that by complying with the rules of USMCA, you might be prevented from sourcing goods or inputs from other countries or other places which would be more cost efficient. Obviously, you would tend to not go the USMCA route if the costs are substantially high, this economic cost of sourcing, having to source your supplies from, let's say, a firm in Canada. So these two costs are going to have a major play. Whatever happens, there are costs associated already with these particular aspects of USMCA. Now, everybody has been talking about these numbers. My value added, and this is thanks to my colleague Ron Mao, he's working on this and then we are hoping to put some of this stuff out in a Dallas Fed blog post soon. But this is just a perspective, historical perspective since the beginning of NAFTA of how much of the trade has been compliant with the rules set by the treaty. You can see at the very end that by July, we have reached both Canada and Mexico, levels that we have not seen before. We didn't see anything like this during the tariff episodes in 2018, 2019.

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There is a bit of a dip around 2020 when USMCA became effective, and there has been a slow gradual decline since the— in the post-global financial crisis period, probably a time in which more of the trade of Mexico and Canada itself dependent on longer and longer supply chains. So very interesting and significant change, and it has the consequences that have been alluded before, that it is helping cushion the impact of tariffs for both countries. So for them, for Canada and Mexico in particular, it makes a lot of sense that the survival of USMCA can make a big

difference. It can give them potentially a competitive advantage relative to other competitors. A small point I wanted to make here, which is that it's not necessarily, it's not obvious that imports from Mexico or Canada have declined. It's just that they are entering into the US as USMCA compliant at greater rates. Now, all of that is to give you an idea that ultimately there are costs associated even with the status quo. But then we have to factor in what has happened or what are the potential macro consequences of changes to that status quo. And I want to start with a baseline and some way of quantifying things.

[04:00:20.09]

The way in which we are going to quantify things is we are going to use a state-of-the-art trade model. Mike Sposi and co-authors have worked extensively on this. It was presented also, some of these results, in a previous event we have in April. Now, these types of models rely heavily on isolating one particular channel. In particular to make it easy to understand or as easy to understand as possible. The ultimate idea is that large economies like the US, by introducing tariffs, have the ability to shift terms of trade in their favor, or in other words, shift some of the burden of the tariff to the exporting countries. Now, that's exactly what this, this chart reflects. I want to put the emphasis on the yellow bars. Those represent predicted changes according to the model between January, the status quo in January, and the tariff schedules prevailing in September 2025. So there is no changes, last-minute changes to tariff schedules in here beyond 2025 at this stage, but it gives you a broad idea qualitatively of the consequences on output in these economies. The blue bars represent potential values of customs revenue as a share of output.

[04:01:58.37]

The difference between those two is attributed to the impact it has on real incomes, in part from higher prices. I will be focusing from now on on two particular bars, the impacts on output, the yellow bars, and the impacts on customs revenue, the blue bars. The first exercise that I want to think about is, let's think there is a renegotiation of USMCA, and let's imagine that this renegotiation is shaped by trying to tinker with different features of the current program or the tariffs that are in place. The two scenarios that I propose involve either tightening tariffs on key sectors that are for non-USMCA-compliant goods, or enforcing stricter rules of origin. And enforcing stricter rules of origin in this context, what it means essentially is that we are living in a world in which barriers with non-USMCA countries, barriers that are non-tariff, become significantly higher. Now, just to explain, I'm going to show you 3 charts very quickly with the same layout. The bars unfilled in black, those represent the baseline I just showed you. And the colored bars are going to represent the 2 scenarios that I laid out for you very briefly., and the impact that they have both on consumption or on output, that's yellow, and on revenues, blue.

[04:03:58.06]

The key message of this is tightening of this chart and of these scenarios is that tightening the rules of origin in particular, but even increasing tariffs has a negative effect, most significantly aggravating the potential loss process for Canada and Mexico. And the consequence of rules of origin is that you don't have revenue. So if what you want is to put some barriers, you can generate at least some revenue by replacing rules of origin with higher tariffs. That's sort of the message. The second option is— I'm going to call it because this is the term that has been used '64, the idea of Fortress America. And this is not quite a customs union per se, because a customs union might involve some common decision-making or some shared decision-making on, on tariffs and some shared resources from the customs revenue that maybe could be redistributed to try to help out some of the losers of the tariffs. But anyway, let me call it for a second Fortress America. What will be the consequence of that type of coordinated monetary policy— excuse me, tariff policy? By the way, I should mention that, again, I have two scenarios in mind, one in which Essentially, Canada and Mexico mimic the tariff schedule of the US in September 2025.

[04:05:44.53]

The other one is a bit more contained and Canada and Mexico join forces with the US and have a common tariff on China in particular. The differences are not too large. The consequences are stark, significant revenue gains for Canada and Mexico, It doesn't make much of a difference relative to the previous exercise for Mexico. It's very— for the US, it's very limited, but it mitigates the losses that, at least through the lens of this model, the losses that Mexico and Canada would incur from the overall higher tariffs. Then I have a more provocative scenario, which is what would happen in a scenario in which this Fortress America is sort of engages in a policy where tariffs are significantly higher on China, up to the point that there is effectively a degree of decoupling from China. And one of the reasons to show this exercise is to show that there are scenarios, depending depending on what type of common tariff one puts in place, which industries are affected, which other countries are affected, in which Canada and potentially Mexico can come ahead. They can benefit from trade diversion and from economic activity in the US. I'll finish very briefly because I don't have more time, just to say here that the one that is not going to do well from that escalation of the confrontation with China would be the the US.

[04:07:28.34]

Long story short, and this is my final takeaway, is every model has its limitations. There are very significant insights though that one can take from this. A lot rides on what happens ultimately with USMCA, not just for the US, but I would argue even more so for Canada and Mexico. I'm very much A lot of what I've been telling you about very much depends on where these negotiations ultimately, the negotiations ultimately land. But it also depends on decisions that individual countries are going to make themselves. In the case of the US, it's quite obvious. A great deal of the results that I've shown you, in fact, the results I have shown you assume that there is no retaliation from other countries, there might be a point in which that's no longer the case. A great deal of some of the more benign outcomes depend on how tax revenues from customs are shared or used by the fiscal authorities, and that matters a great deal as well. And for Mexico and Canada, the challenge is even if you get to mitigate or even to get ahead as a result of these USMCA negotiations, It remains to be seen whether they can leverage that and generate spillovers to the rest of the economy.

[04:08:53.29]

And since I'm over time, I'll stop there. Thank you so much.

[04:09:25.37] - Jeffrey J. Schott

Well, we have had three excellent presentations, and I had to cut short each one of them because there were so many important things to say that the time time provided wasn't sufficient. But we have about 10 or 12 minutes left for questions. Since the questioning period is shortened, I will open it up if someone has a question from the floor, because we want to make sure that we accommodate everyone who is here. If there's not an immediate question on the floor, my question to the group is all of these prospective changes increase the cost of production in Mexico. And it, it's not like the United States is going to want to buy more expensive stuff when they can get it cheaper elsewhere. And so is this, is this a practical constraint to the change that can can occur in US-Mexico bilateral trade relations? And is there a limit to how much Mexico can accept in terms of changes and rules of origin in particular that will increase the cost of producing automobiles and other manufacturers in— for export to the United States? Just a simple question. Alejandro, do you want to start?

[04:10:58.50] - Alejandro Werner

I mean, I guess one hopes that, I mean, all of this is being calibrated at least with some kind of a model following the lines of what Enrique was doing. So to what, I mean, you would tend to think that North America could benefit in terms of production at least in an environment in which its increases in cost of production are lower than the increase in the tariff difference that is

coming out of the negotiation process. Then when you go into quantitative restrictions that are much harder to translate into a tariff equivalence, you might end up making mistakes and actually hurting the competitiveness of your North American sector, no? That's at the end of the day, the trade creation versus trade diversion thing. Enrique's model shows that there's significant scope for benefits from trade diversion, but if you calibrate that appropriately, no?

[04:12:14.50] - Miguel Messmacher

I agree. I agree with Alejandro. Perhaps just to elaborate a little bit, I mean, obviously a thing that we haven't discussed, and it's a big issue on the table, is clearly sort of how much do industrial policies in China themselves generate distortions in terms of trade patterns themselves, which is sort of an issue that we did not discuss. As Alejandro mentioned, I'm a little bit concerned that perhaps Perhaps the positions are changing towards more protectionistic positions nevertheless, but some degree of tariffs and some degree of sort of common tariffs and perhaps increases in cost and increases in prices might be justified if one does believe that perhaps excessive subsidies from the point of view of production in China do generate some type of distortions that it's worthwhile attending. So in principle, again, perhaps one might calibrate sort of a very careful response taking this thing into account, and that would lead sort of a best, a better situation for countries involved. Unfortunately, I'm not sure that that process is taking place, and my belief is that to a large extent, the level of tariffs fixed by Mexico, discussed by Mexico, is following to a very large pattern what is being being decided and determined in the US, and they are taking that as a base.

[04:13:46.43]

So, and the probability therefore that those levels are not necessarily optimal is relatively high.

[04:13:56.54] - Enrique Martínez-García

Yeah, let me say just a few things. I think I agree with both Miguel and Alejandro. One thing that I want to follow up that Alejandro said is there is a great deal of tension here between trade creation and trade diversion. And if you do some back-of-the-envelope calculations of the effects that come through the model, most of the scenarios that I laid out for you, the overall effect on North America would be a loss, even if there are some countries that end up winning. So that tells you that, yes, these costs are non-trivial. And lead to welfare losses. I know you want to jump in, but let me add one more comment. And one of the things that I would argue as well is that this is just looking at the trade side of things. There is concern, or at least I do, I am concerned that some rules of origin on FDI or similar policies that might come to play into the

negotiations might also contribute or be a factor that diminishes the competitiveness of overall North America. So there are a lot of challenges ahead of us, I think.

[04:15:18.16] - Alejandro Werner

Two things very quickly. One is trade diversion versus trade creation in North America. I totally agree. I mean, the US, I mean, according to these models, according to us, the US is hurting itself. Yes. But looking at Canada and Mexico, maybe the situation might be a little bit more favorable towards trade diversion dominating trade creation effects, but I think that's— it's great that you have a model and I hope that the Mexican government and the US government has something similar to play with and to calibrate what we're doing. And just with respect to Miguel, I don't. We used to teach, we used to learn, and we used to say as public officials that if China or a country wants to subsidize a sector that does not have rents, we should send them a thank you note. We shouldn't be putting a tariff. So if there are no rents, I would rather stop doing shoes and start doing shorts and take their shoes that are subsidized. And that should not change, or at least I think we should have evidence that China, by subsidizing, is taking economic rents away from Mexico.

[04:16:37.05] - Jeffrey J. Schott

What we're talking about are changes that might occur, and the review is only starting next July, though one could argue that the negotiations of the review have already started. In these types of conversations and in discussions between government officials. But it must be putting a chill on plans to invest in Mexico, because you don't know the size of the distortions and the cost increases. And is there a point where Mexico has to think about, well, where are the other sources of investment besides the United States? Because if Mexico imposes a lot of barriers for trade, for economic relations with China, it's going to cut off China's access. They'll go through another country in Latin America to try to service the U.S. market. Any thoughts on looking out over the next couple years for the duration of the Trump administration, whether this is going to be a bit of a burden on Mexican economic growth and diminish prospects for taking advantage of any revision of the trade agreement. Any comments or thoughts on that? Or I haven't said it very clearly. Miguel.

[04:18:11.37] - Miguel Messmacher

I mean, just to complement, again, I wouldn't be that much concerned vis-à-vis China, at least in the very short term, perhaps in the medium term and long term for sure. But once again, I mean, Chinese investment does not represent a very large part of FDI investment in Mexico. I would have more of a concern, and that is certainly something that one needs to take into account and

to look into, Mexico did receive or does receive an important amount of FDI, particularly from European countries, and European manufacturers or other types of firms where potentially, I mean, those would be affected as well. So a lot of the discussion has been vis-à-vis China, but Mexico does receive a lot of FDI from other regions, particularly Europe, and definitely an effect of tighter rules of origin, tighter limits on FDI, et cetera. Mexico should try to make sure that do not apply to those other areas, but that will be an issue for negotiation. And that is something that we haven't necessarily discussed and people don't necessarily have in mind, but it certainly is a major factor.

[04:19:28.52] - Alejandro Werner

You're totally right that, I mean, uncertainty has increased, and Relative uncertainty, I mean, we would have to measure that vis-à-vis countries that would compete for the same investment. But I think there are many dimensions on which the Mexican government can reduce uncertainty for investment domestically with domestic policies. Electricity supply, can the Mexican government move forward and guarantee that electricity will be available? That's a source of uncertainty that has have been holding up investment. On judicial issues, at least the perception of the private sector and every legal scholar is that the judicial reform is going to hurt investment by generating more uncertainty. I think you're totally right. If you have bet your development strategy on integrating with the US and that is being questioned, you have to look for a reduction of other sources of uncertainty that you can manage, You can do them relatively quickly or at least send very strong signals. The government in some direction is trying to do it, in others I think is moving in the opposite direction.

[04:20:40.35] - Enrique Martínez-García

Yes, just one word on this. I will again echo a few of the things that have been said. I think uncertainty is an important factor and is an important factor especially or FDI geared towards relocating capital into Mexico or other parts of North America to serve the North American market. Because if you don't know exactly the rules of the game, that limits things. That limits your ability to plan and to make those investments reasonably. Now, having said that, one of the challenges that Mexico and Canada face is that but they lack external markets. Their economy is very much geared towards relations with the US. Even between them, Canada and Mexico don't trade that much. So it's easier said than done. But another thing in which Mexico needs to spend some of his human capital thinking about is whether they can diversify their productive structure and diversify their markets. They are an open door. They have been traditionally an open door to Europe as well as to Asia. They should start probably leveraging some of that to their advantage.

[04:22:05.25] - Jeffrey J. Schott

Well, I would want to go and build on that last comment, but we are out of time if we want to listen to Marcus Snoelen, which we all want to do. But I fully agree and just leave you with the thought that Canada and Mexico are members of the CPTPP, the Comprehensive and Progressive Agreement for Trans-Pacific Partnership, which includes 10 other countries, and there are opportunities to build on that, and I know the Canadians are moving much more aggressively than Mexico to try to diversify, 'cause they're in the bullseye of the Trump administration. But we've taken too much time on this panel, but we should save one more moment to say thank you to Enrique, Miguel, and Alejandro.

[04:23:01.05] - Enrique Martínez-García

Thank you, Jeff.

[04:23:05.28] - Marcus Noland

Thank you so much for your patience—

[04:23:21.32]

tripping of ending an interesting panel in order to listen to me! So, a bit over 200 years ago, in the summer of 1825, a man named Stephen F. Austin and a party of 300 or 400 white Americans and some Black African-descended slaves set off from Natchitoches, Louisiana for Spain. They were going to establish a colony there. And when Austin and his party reached the city of San Antonio, they were informed that they were not in Spain. They were in Mexico. Unbeknownst to Austin and his party, somewhere between Natchitoches and San Antonio, Mexico had declared independence. And so the question was, what did he do with the documents that the Spanish government had given him? And so he was persuaded to present these documents to the New Mexican authorities, and the Mexican authorities accepted them and allowed him to establish his settlement. Some Mexicans think that was a horrible mistake. Alejandro described it as a bad marriage and Mexico as having a strategy or a tactic of *sí señor*. I actually would think that's a bit harsh. Americans and Mexicans have been dealing with each other for 200 years, and it's not always been happy. But there is a— I would prefer to describe it as pragmatism.

[04:25:08.31]

Last night at dinner, one of our Mexican colleagues was discussing this with one of the Americans, and he was describing kind of dodging and feinting and nudging which is essentially

a pragmatic accommodation of a weaker power to a stronger power. And Mexico has 200 years of practice at doing that. But I think the pragmatism extends to the American side as well. As a boy growing up in Texas, I was once down on the border region, and an older family friend pointed and he said, "That's Mexico." And then he added, "They were here before we were, and they'll be here after we're gone." And so there's a kind of acceptance that we are bound together, happy or not, and we have to get along with each other. And I guess it's worth reminding, I don't think this group needs reminding, but NAFTA was a Mexican initiative. It was a Mexican initiative brought to a New Englander transplanted to Texas as an oilman. And George H.W. Bush and his Texan assistant, James Baker, brought that to fruition. And I think that the people in the Dallas Fed's region are generally accepting and pragmatic about the degree of integration between the two countries and our need to get along.

[04:26:52.59]

So I am quite honored and— or we, the Peterson Institute, is quite honored and pleased to host the second installment of our conference series with the Federal Reserve Bank of Dallas. I would like to especially acknowledge Undersecretary Luis Rosendo Gutierrez Romano for giving us a, a really informative tour of the horizon on short notice. Our two conference sessions addressed immigration, remittances, taxation of remittances, and the future of the U.S.-Canada-Mexico FTA. And I will not try to summarize these discussions, but simply to observe that sitting through the two sessions, I was really struck by the fact that these discussions of highly politically sensitive issues have been evidence-driven, and which I think speaks well both of the Peterson Institute and the Dallas Fed. Unlike my opening remarks, these— our discussions were very evidence and data-driven. So in conclusion, I would like to thank the staffs of the Dallas Fed and the Peterson Institute for their conscientious work to make this conference possible. And for those who— of you who have traveled here, I wish you safe travels home. And with that, I declare this conference adjourned. Thank you.