CIGI

THE ROAD TO A REINVIGORATED NORTH AMERICAN PARTNERSHIP

SPECIAL REPORT

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CIGI was founded in 2001 by Jim Balsillie, then co-CEO of Research In Motion (BlackBerry), and collaborates with and gratefully acknowledges support from a number of strategic partners, in particular the Government of Canada and the Government of Ontario.

Le CIGI a été fondé en 2001 par Jim Balsillie, qui était alors co-chef de la direction de Research In Motion (BlackBerry). Il collabore avec de nombreux partenaires stratégiques et exprime sa reconnaissance du soutien reçu de ceux-ci, notamment de l'appui reçu du gouvernement du Canada et de celui du gouvernement de l'Ontario.

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PREFACE

This special report is prepared for the North American Forum (NAF). In 2015, CIGI's Global Security & Politics Program became the Secretariat for the Canadian leadership within the NAF. CIGI will be undertaking a program of research to support the Canadian contribution to the NAF in cooperation with our American and Mexican partners. In the coming months, CIGI will publish additional reports to support the work of the NAF.

In preparing this report, CIGI gratefully acknowledges the support of Thomas d'Aquino, CEO of Intercounsel Ltd. and the Canadian co-Chair of the NAF. We wish to thank Dominic Barton, CEO of McKinsey & Company, for his support in the research of this report. I would also like to thank CIGI Research Associate Simon Palamar for his excellent work in drafting this report.

The views in this report do not in any way represent the views of the NAF, Intercounsel Ltd. or McKinsey & Company.

Fen Osler Hampson

CIGI Distinguished Fellow and
Director of the Global Security & Politics Program

EXECUTIVE SUMMARY

Since the 1994 North American Free Trade Agreement (NAFTA), trade, investment and migration flows among Canada, Mexico and the United States have helped turn North America into one of the most dynamic and prosperous trade blocs on the planet. However, since 2008, North America has lost some of its economic momentum, and in a highly competitive world, Canada, Mexico and the United States' future prosperity will depend, in part, on how well the three countries take advantage of each other's complementary economies and knock down the remaining barriers to living and doing business across the continent's borders. In particular, Canada and Mexico have not taken full advantage of what the two countries can offer one another. So, while Canada-Mexico business success stories should be celebrated, the two counties should not rest on their laurels. With a new government in office in Canada, it is an ideal moment to renew the relationship between Mexico City and Ottawa. Even though the strength of Canada and Mexico's relationship is ultimately determined by citizens and companies, the executive branches of the two countries can help set the tone for the relationship, and coordinate economic and foreign policies to make establishing and maintaining cross-border ties easier. A renewed Canada-Mexico relationship that institutionalizes an annual executive branch meeting and that engages business and education leaders in both countries will not only be good for Ottawa and Mexico City, but can also lay the foundation for an ambitious North American policy agenda with the United States, covering issues ranging from regulatory harmonization to Central American migration to climate change. By renewing Canada and Mexico's relationship today, the two countries can build on already mutually beneficial relations to set the stage for a revitalized North American relationship.

INTRODUCTION

While Canada and Mexico's official diplomatic relations began in early 1944, the current relationship between the two countries started in earnest only 24 years ago. It was in 1991 that talks to create a free trade deal between Canada, Mexico and the United States (that would become NAFTA) began. Since NAFTA's ratification in 1994, Canada and Mexico have become important economic partners. Despite the success of the last two and a half decades, there is still enormous untapped potential in the relationship between Canada, Mexico and the United States. North America will not realize this potential without a concerted and deliberate effort from the continent's political, business and public leaders.

It is more important than ever that these three countries redouble their efforts to work together. The world's centre of economic gravity is swiftly moving away from the North American and European economies toward Asia. Furthermore, while Canada, Mexico and the United States have recovered much of their economic prowess since the global financial crisis of 2008-2009, the North American economy as a whole has lost momentum. The three NAFTA economies now trade less with each other — in both relative and absolute terms — than before the crisis. They also trade less with each other than other trade blocs, such as the European Union or Association of Southeast Asian Nations.

The decline of trade and investment within NAFTA matters because the global economy is becoming a more competitive place every year. On the one hand, countries around the world are knocking down trade barriers and economies are growing on the basis of their ability to produce and export high-quality goods and services, and be part of global value chains. This does not mean that the world is in a race to the bottom, where the lowest-cost producer always wins. Quality, value and innovation are also key to competiveness. For companies to access the specialized labour and expertise they need to succeed in the twenty-first century, those companies need to be able to cross borders. The recently negotiated Trans-Pacific Partnership (TPP) trade agreement will accelerate and amplify these trends once it is ratified.

Canadian Prime Minister Justin Trudeau and Mexican President Enrique Peña Nieto.

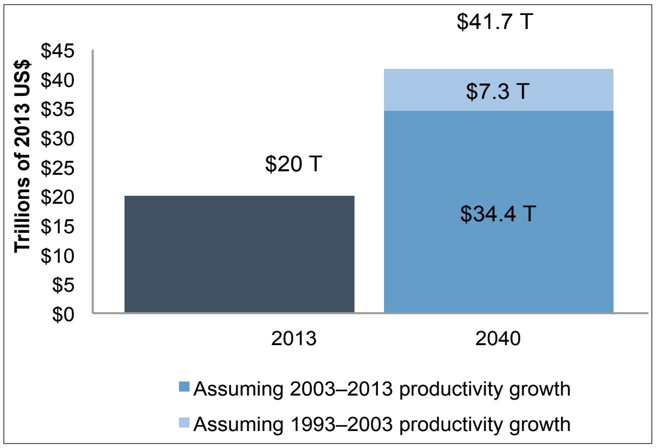
Unlocking North America's economic potential will only happen if Canada and Mexico make a concerted effort to strengthen their bilateral relationship. For too long Mexican-Canadian relations have been the weak plank in North America. That is not to say that ties between the two countries have not deepened, thickened and strengthened over the years — they have. However, Canada and Mexico lack the deep, institutionalized relationship that they both have with the United States. There is also a feeling in both countries that the relationship has been neglected in the past few years. To put it simply, Mexico and Canada can — and should — do better.

Resting on our laurels is not an option. The world is more competitive than ever, but that does not mean that NAFTA is a relic. The potential is there. To unlock that potential, Mexico City and Ottawa need to renew and revitalize their relationship. Investing new political energy and capital in the Canadian-Mexican relationship will open the way to policy changes that will help both countries get the most from each other. A stronger working partnership between the two governments could also improve both Mexico City and Ottawa's relationship with Washington, DC, especially if Canada and Mexico can rekindle the collaborative spirit of the early 1990s, when they worked together to broker a transformative three-way pact. Canada and Mexico's relations do not need to be routed through the White House, and a Canada-Mexico partnership on a host of public policy issues could stand to bring some balance into both countries' relationship with the United States.

With the election of a new government in Canada, Ottawa should take the opportunity to not only renew Canada's official relationship with Mexico, but to strengthen and improve it so that the two countries can make the right policy moves to help secure a prosperous future for North America. This means building on the already mutually beneficial relationship by deepening ties between Canada and Mexico, taking the relationship beyond trade and investment, and focusing the attention of *Los Pinos* and the Langevin Block on a few select policy issues that could greatly benefit all of North America.[1]

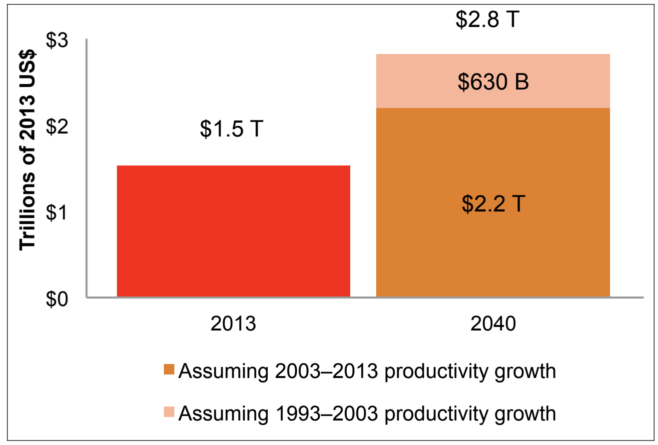
1 *Los Pinos* is the official residence and office of the president of Mexico; the Langevin Block is opposite Canada's Parliament Buildings and is home to the Prime Minister's Office.

Figure 1: North American GDP in 2040 — Two Scenarios



Data source: IHS/Global Insight and the Conference Board of Canada (2015).

Figure 2: Canadian GDP in 2040 — Two Scenarios



Data source: IHS/Global Insight and the Conference Board of Canada (2015).

NORTH AMERICA'S ECONOMIC POTENTIAL

Before delving into the details of Mexico and Canada's relationship, it is important to remember the North American context. The United States is still both Canada and Mexico's biggest single trade partner, and the principal geographic, cultural and economic bridge between the two countries. Together, the three North American economies still form the biggest economic region in the world, and the goal of strengthening the Canada-Mexico relationship is to make for a more robust North American economy that can thrive in a competitive world.

Thus, it is important that government and business leaders understand how great North America's economic potential still is. Over the last decade, media, boardrooms and halls of government have focused on the economic potential of fast-growing "emerging markets" such as India, Brazil and, of course, China. While all of these economies are destined to continue to grow and draw hundreds of millions more people out of poverty, we know they are not bulletproof, and can be prone to bouts of financial and monetary instability, often have opaque regulatory regimes and are not always friendly to foreign investors.

Canada, Mexico and the United States, on the other hand, excel in those aspects. All three boast solid government finances, relatively transparent legal systems and are open to trade and investment. These characteristics, along with North America's innovative business culture and natural resource wealth, have led some to dub the continent, "the next great emerging market" (Petraeus and Bhayani 2015, 1). This claim is not as outlandish as it seems.

If Canada, Mexico and the United States were to regain the productivity growth rate that the three countries had in the first decade of NAFTA, the economic effects could be tremendous.

Two forecasts of the size of the North American economy in 2040 illustrate why. Under the first scenario (see Figure 1) — the business as usual scenario — where productivity in Canada, Mexico and the United States grows at the same rate it did from 2003 to 2013, the North American economy could be as large as US$34.4 trillion. However, if North America can regain the productivity growth of the first decade of NAFTA — 1993 to 2003 — North America's economy could be as much as US$7.3 trillion bigger. For Canada (see Figure 2), the second scenario would mean over US$600 billion more in GDP — a 29 percent larger economy — than in the first scenario.[2]

It is important to remember that while the strong productivity growth in the first decade of NAFTA was caused in part because companies were newly able to exploit the efficiencies that easy, tariff-free cross-border movement of goods suddenly allowed, it was also a difficult decade for Mexico and Canada. In 1994, the Canadian government faced down a severe deficit and made cuts that saw public spending plummet. Mexico plunged into a currency crisis that same year, which culminated in several bank failures and a recession. In other words, while getting back to that higher rate of productivity growth may be difficult, it is not an insurmountable challenge.

2 Estimate using a variation of the assumptions and parameters provided by McKinsey (based on data from IHS/Global Insight) and the Conference Board of Canada (2015) data.

CANADIAN BUSINESS SUCCESS STORIES

There is no shortage of examples of Canadian businesses achieving success in Mexico. These examples, from Canada's financial sector, energy infrastructure industry, and manufacturing sectors speak to the depth of the engagement between Canada and Mexico's private sectors, and hint at the long-term potential of the commercial relationship.

Financial Firms: Caisse de dépôt et placement du Québec and Scotiabank

Caisse de dépôt is Canada's second-largest pension fund, managing around CDN$225 billion of assets for a range of public pensions, individual pensions and insurance plans. Given the size of the deposits the Caisse must manage, and the long-term nature of pension and insurance plans, the Caisse actively invests around the world in order to diversify its portfolio.

Recently, the Caisse has partnered with some of Mexico's largest *afores* (pension funds) to establish a CDN$2.8 billion infrastructure fund over the next five years. The Caisse will provide CDN$1.43 billion, while a consortium of Mexican *afores* and infrastructure investors will contribute CDN$1.38 billion of capital. The benefits to both Canada and Mexico are clear: the Caisse gets the opportunity to invest in long-lived, stable infrastructure projects, while the Mexican economy as a whole benefits from much-needed infrastructure projects.

Another Canadian financial firm — Scotiabank — is Mexico's seventh-largest lender, with six percent of the Mexican banking market and MXN$289 billion in assets (Ratner 2015; Scotiabank Inverlat, S.A. 2014). It employs over 8,000 people in Mexico, has a network of some 600 branches, and serves personal, business and government customers.

Scotiabank's history in Mexico can be traced back to 1992, when the Mexican government was reversing the 1982 edict that had nationalized Mexico's banking sector. From 1982 to the early 1990s, Mexico's state-owned banks stagnated, failing to adopt new technologies or to adapt to the needs of Mexico's consumers. When the Mexican government privatized Grupo Financiero Inverlat (GFI), along with 17 other banks between 1990 and 1992, Scotiabank, seeking to expand its presence in Latin America, bought eight percent of GFI (Campbell 2011). Mexico's 1994 currency crisis, which devastated the country's commercial banking sector and led to the failure of several banks, hit GFI as well. Scotiabank had to write down the value of its stake in GFI by 95 percent. Rather than abandon the market, Scotiabank increased its stake in GFI. The Mexican government subsequently awarded it a contract to manage the bank on the government's behalf, until Scotiabank purchased a majority stake. Scotiabank assumed majority ownership of GFI in 2000, and has since fashioned Scotiabank Inverlat (as it is now known) into one of Mexico's leading financial firms.

Scotiabank Inverlat — like many other successful Canadian ventures in Mexico — is an excellent example of the benefits of long-term thinking and looking for complementarities between the Mexican and Canadian economies. Instead of gutting its Mexican operations to boost short-term financial results or abandoning the market after the 1994 financial crisis, Scotiabank took the long view and weathered the storm. This perseverance has paid off. Scotiabank is now Canada's most geographically diversified bank. After Canada and the United States, Mexico is Scotiabank's most important market, accounting for 3.7 percent of loans and acceptances (Canada and the United States respectively account for 69 percent and 5.4 percent) (Scotiabank 2014).

Energy Infrastructure: ATCO Group and TransCanada Corporation Limited

While the Caisse de dépôt and Scotiabank have become major players in Mexico's financial sector in part by providing the capital Mexico's economy needs to grow, energy infrastructure companies ATCO and TransCanada Corporation together have invested billions of dollars in Mexico's natural gas and electricity industries.

TransCanada has done business in Mexico since the mid-1990s, when it built and operated two of the country's first privately owned natural gas pipelines. Today, TransCanada owns and operates 675 km of gas pipeline, and is building another 940 km of pipeline, representing US$2.7 billion in investments (TransCanada 2014).

ATCO's entry into Mexico's gas market is very recent and was facilitated by Mexico's efforts to liberalize and open its energy sector to more competition. Mexico's Federal Electricity Commission (CFE) awarded the Calgary-based firm a contract to build and operate a 17 km natural gas pipeline in Hidalgo state, near the town of Tula, in October 2014. The Tula pipeline transports gas to the Francisco Pérez Ríos power plant, which is being upgraded to burn natural gas as well as fuel oil. Petróleos Mexicanos (Pemex), Mexico's national oil and gas company, has also hired ATCO to build a new natural gas-fired power plant in Hidalgo (ATCO 2015). Together, the Tula pipeline and Hidalgo power plant represent nearly half a billion US dollars in investments and activity.

Natural gas is an increasingly crucial part of the energy mix in Mexico. From 1996 to 2006, Mexico's publicly owned electricity generators went from using natural gas to produce 16 percent of their output, to 50 percent of Mexico's publicly generated electricity. Likewise, natural gas use among private electricity generators grew from 45 percent in 2001 to 69 percent in 2006 (Secretaría de Energía 2007). By 2011, 58 percent of Mexico's publicly generated electricity, and 73 percent of its privately produced electricity, came from burning natural gas (Secretaría de Energía 2012). Mexico's CFE is also in the midst of converting power plants that run solely on fuel oil to burn natural gas as well. Natural gas is not only cheaper, but also produces fewer greenhouse gas emissions per megawatt hour of electricity. Between 2014 and 2016 alone, CFE aims to convert 17 percent of its installed generating capacity to burn natural gas, at a cost of US$200 million (CFE 2015).

As the Mexican economy makes a major push to expand and upgrade its energy infrastructure, opportunities for firms such as TransCanada and ATCO are abundant. Mexico's electricity industry cannot make the shift to using more low-cost, low-carbon and abundant natural gas without foreign investment and expertise. Despite Mexico's abundant energy reserves, Mexico has only a tenth of the natural gas pipelines of Texas (there are approximately 8,850 km in Mexico and 93,300 km in Texas) (Ernst & Young 2014). In addition to Mexico's push to use more natural gas, recent reforms to the country's energy laws (which now allow foreign firms to compete for oil and gas drilling rights) and a campaign to build another 11,000 km of pipelines in the country, Mexico's energy sector offers a host of opportunities for Canadian firms (Morgan 2015).

Manufacturers: Bombardier, Linamar and Magna International

Mexico's share of the North American automobile and auto parts industry has seen tremendous growth in the last two decades. In 1987, Mexico made three percent of all passenger and commercial vehicles assembled in North America each year. By 2014, Mexico's share was 20 percent. There are many reasons for this, from the relatively low wages (given the skill level) of Mexican workers to the fact that Mexico sits at the centre of an elaborate free trade network (see Figure 5), making it an excellent place for manufacturers to export from (Keenan 2015). Linamar and Magna International have both taken advantage of Mexico's business environment and played a role in the rise of its automobile manufacturing sector. Linamar first entered Mexico in the 1990s, and today has four manufacturing facilities employing around 3,500 workers across Durango, Coahuila and Tamaulipas.[1] Magna's footprint in Mexico is even larger, boasting 30 manufacturing plants, and a research and engineering centre that employs 24,000 people (Magna 2015). As of 2014, Magna had more employees in Mexico than in either Canada or the United States (ibid.).

Bombardier has done business in Mexico since the 1980s. In 1981, Bombardier won a contract to supply cars for the Mexico City subway system (Represas and Vera 2012). That initial success led Bombardier to directly invest in Mexico by purchasing Constructora Nacional de Carros de Ferrocarril (Concarril) in 1992 (ibid.). Concarril gave Bombardier a foothold in Mexico, allowing it to compete for more contracts across the market, and Bombardier-Concarril won its first contract (to overhaul some of Mexico City's subway cars) in 1993 (ibid.). As of 2014, Bombardier's rail operations in Mexico employ around 1,800 people, and Bombardier has achieved remarkable market share, supplying all of the cars in the Mexico City and Guadalajara light rail systems, 74 percent of Monterrey's urban transit fleet and 60 percent of Mexico City's metro cars (Bombardier 2014).

Bombardier's activities in Mexico are not limited to trains and subways. In the mid-2000s, Bombardier Aerospace established a facility to manufacture parts for its business jets in Querétaro state. According to Bombardier board member Carlos Represas, Querétaro, compared with other parts of the world with similar labour costs, offered Bombardier a host of advantages: only one time zone away from Bombardier's headquarters in Montreal; constructive municipal and federal government partners; Mexico's impressive network of free trade agreements (FTAs); relative geographic proximity to Montreal; and a degree of cultural familiarity (Represas and Vera 2012).

Since establishing itself in Mexico over 20 years ago, Bombardier has taken the long view. This means it has not only competed for business in Mexico, but made its Mexican facilities and employees an integral part of its global business. To that end, Bombardier has invested over half a billion US dollars in its Querétaro facility since 2005 (Bombardier 2014). Bombardier has also collaborated with the Hidalgo government to train workers to meet Bombardier's needs, and over 10,000 welders have been qualified at Bombardier's Sahagún rail facility over the years (ibid.).

1 See www.linamar.com.

The Mexico City Metro System uses Bombardier subway cars manufactured in Mexico. www.bombardier.com.

GRUPO BIMBO AND CANADA BREAD

While Canadian firms have historically invested much more in Mexico than vice versa, there are encouraging signs that Mexican companies are beginning to see Canada as a good place to do business. In 2014, one of the world's largest bakery companies, Mexico's Grupo Bimbo, purchased Canada Bread Ltd. from Maple Leaf Foods for CDN$1.83 billion. Besides being a windfall for Canada Bread shareholders, Grupo Bimbo's purchase is also good for Canadian workers.

For Maple Leaf Foods, 2013 was shaping up to be a difficult year. One of Canada's largest food processing companies, Maple Leaf saw its earnings plummet by nearly 90 percent during the year's second quarter (McCain and Vels 2013). Maple Leaf's core packaged meat business was under pressure due to — among other reasons — high feed costs and economic problems in some of its export markets (such as Japan).

Maple Leaf then decided to sell Canada Bread. While Maple Leaf's bakery business was still profitable, its profit margins were shrinking, and growth had, in the words of one executive, "plateaued" (Harrison-Dunn 2014). Maple Leaf was consolidating and shuttering bakeries, and had determined that longer-term investments were necessary to return Canada Bread to its previous levels of profitability. Restructuring Canada Bread — while Maple Leaf's core business needed serious attention — simply made less sense than selling the bakery business.

Grupo Bimbo's business is baked goods. In 2013, Grupo Bimbo already sold bread, tortillas, buns and pastries in 18 countries, from Mexico, to the United States, Brazil and Spain (Grupo Bimbo 2014). Buying Canada Bread allowed Bimbo to enter the Canadian market (and the UK market, where Canada Bread owns several bakeries) with an established, profitable business. While Maple Leaf Foods wanted to get out of a line of business that was not part of its core operations, Grupo Bimbo wanted to expand its international footprint in a business it knows intimately.

While Grupo Bimbo has closed some Canada Bread facilities since buying the company, it has also expanded others, and has made additional deals to increase the size of Canada Bread's brand portfolio and range of offerings. Over all, Grupo Bimbo's purchase of Canada Bread has many of the hallmarks of a company making a major investment with plans to do business in Canada for the long haul.

CANADA AND MEXICO: THE STORY SO FAR

If we want to tap North America's economic potential, then the Canada-Mexico leg of the relationship needs to be strengthened. This claim may sound odd given the fact that, in many ways, NAFTA has been a great success. It is true, after all, that since NAFTA came into force, the economic relationship between Canada and Mexico has grown from minor to indispensable. The growth of trade and investment flows between Canada and Mexico over the last 20 years is a well-known story. But it has also been an uneven story: while trade between the two countries is healthy, investments have been uneven. Hence, a few statistics and figures are worth repeating, and the areas that could stand to be improved should be highlighted.

First and foremost, Canadian and Mexican businesses and consumers have all benefitted from remarkable growth in trade between the two countries.

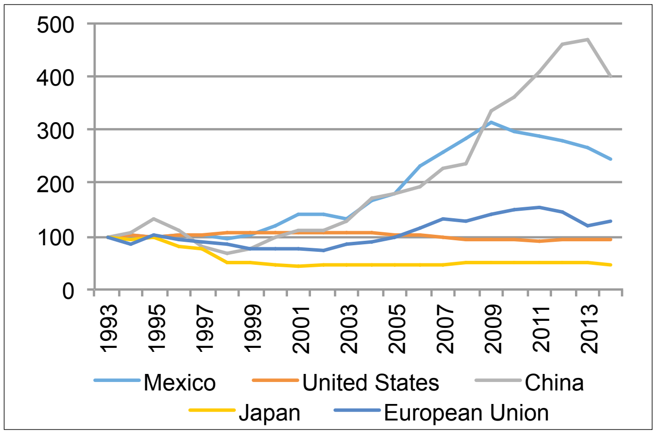
By 2014, Canada's annual exports to Mexico had grown 250 percent (as a share of all Canadian exports) from 1993 levels (see Figure 3). Mexico has been an important diversifier for Canadian exporters: while the share of Canadian exports going to the United States remained steady in the decades after NAFTA came into force, and the share of Canada's exports headed to Japan fell by half, Mexico's surged.

Likewise, Mexico's share of what Canada imports every year has grown considerably since the implementation of NAFTA. As of 2014, Mexican imports (as a share of all of Canada's imports) had grown nearly three-fold since 1993 (see Figure 4). The only major economy that has consistently outpaced Mexico as a growing trade partner to Canada is China, with 10 times the population of Mexico and an economy that is seven times larger.

Of course, both Canada's exports to and imports from Mexico have grown much more in absolute terms than they have in relative terms. Canada exported CDN $800 million of goods to Mexico in 1993. By 2013, this number had grown to CDN$5.5 billion. While Canada imported CDN$2.7 billion of Mexican goods in 1993, Canada imported nearly

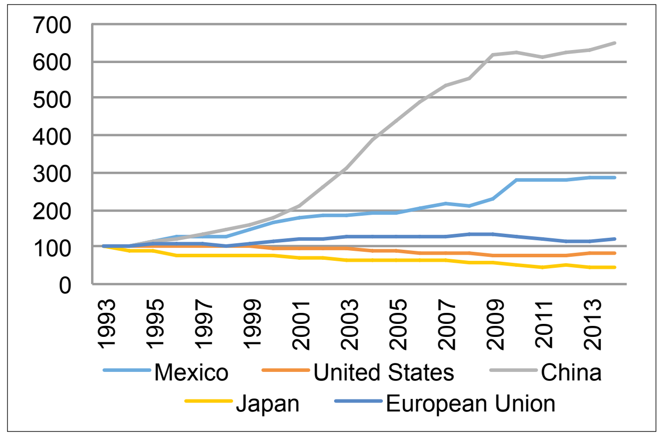
A Bimbo bread truck.

Figure 3: Growth of Canadian Exports to Select Markets, 1993–2014 (1993 = 100)



Data source: International Monetary Fund (IMF) (2015c).

Figure 4: Growth of Canadian Imports from Select Markets, 1993–2014 (1993 = 100)



Data source: IMF (2015c).

CDN$29 billion — a more than ten-fold increase — in 2014 (Industry Canada 2015).

When it comes to investing in each other's economies, the relationship has not been as symmetrical. Canadian firms have been important investors in Mexico, accounting for more than four percent of all foreign direct investments in Mexico since 2011 (IMF 2015a). As of late 2013, at least 3,300 companies in Mexico used Canadian capital (Export Development Canada 2014).

While Canadian firms have eagerly embraced Mexico, since 1993 Mexico's investments in Canada have rarely exceeded 0.1 percent of the foreign direct investments in Canada (Statistics Canada 2015). This difference is stark. In absolute terms, Canada's direct investments in Mexico were worth US$16.8 billion in 2013, while Mexico's direct investments in Canada were a mere US$113 million in that same year (IMF 2015a). The difference in portfolio investment (for example, passive investments that do not involve a major ownership stake or management role) between the two countries is similar, with Canada holding investments in Mexico worth US$6 billion in late 2014, while Mexico held Canadian portfolio investments worth about US$60 million (IMF 2015b). So, while Canada and Mexico are certainly trading much more than in the past, Mexican firms simply are not investing in Canada to the same extent that Canadian businesses are investing in Mexico.

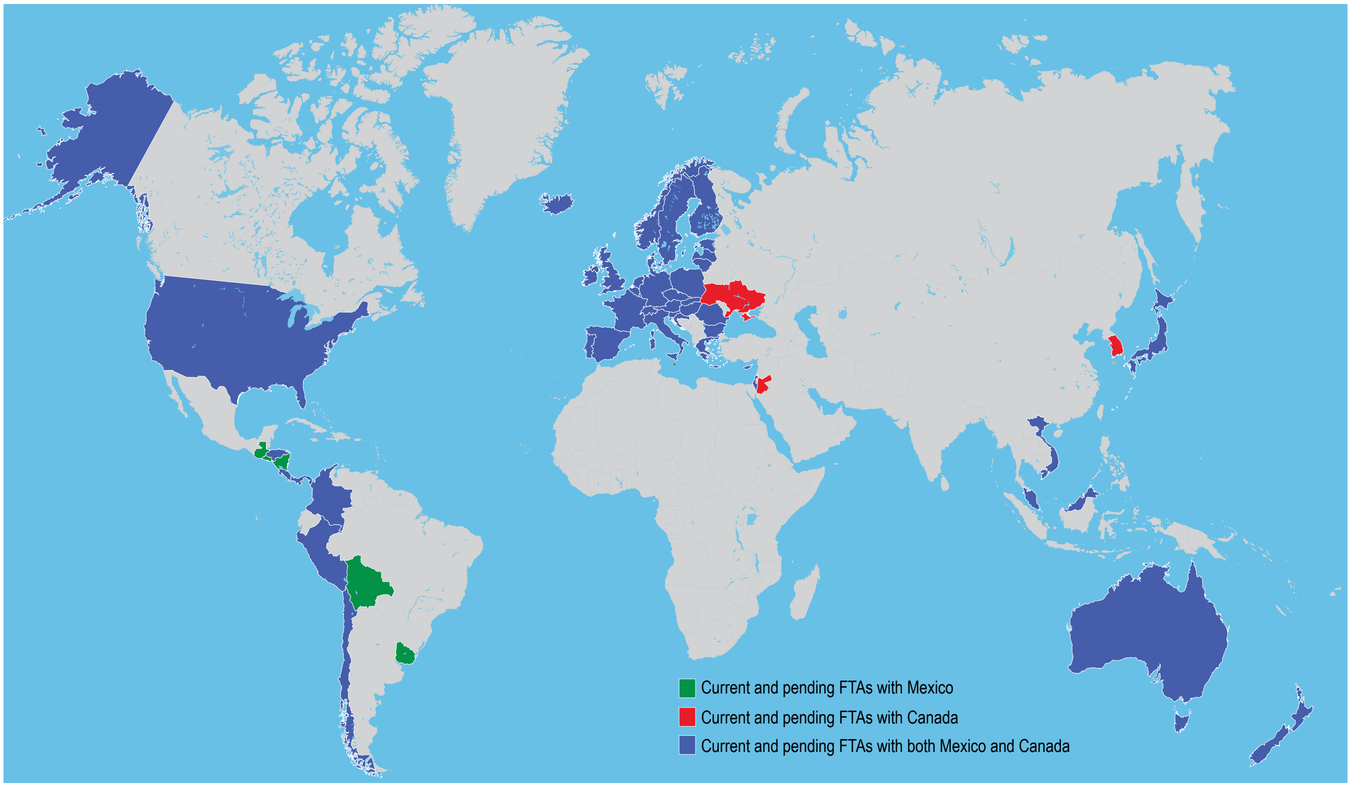
There are signs that this state of affairs is changing. Mexico's capital markets are small and shallow compared to some other middle-income economies, but are growing. The demand for investable assets in Mexico is also being driven by Mexico's pension fund industry, which held assets worth US$124 billion in 2011, and have grown at a 25 percent compound annual rate over the last decade (World Bank 2013). Recent changes in the regulations governing what *afores* may invest in and where they may invest means that the *afores* industry may allocate up to 20 percent of its portfolio toward foreign assets (this is a huge change from the late 1990s, when *afores* were restricted to investing solely in Mexican sovereign debt) (Garza and Orvañanos Márquez 2012). As demand for investable assets grows in Mexico, foreign assets will become a larger part of the mix.

An additional factor is the state of Mexico's large companies. América Móvil, FESMA, CEMEX, and Grupo Bimbo — just to name a few — do not only do business in Mexico. Increasingly, they rely on foreign markets in Central America, Europe, the United States and, increasingly, Canada. While Mexico's large firms are still vastly outnumbered by its small firms, Mexico is increasingly home to a host of large, sophisticated, world-beating multinational companies. As Mexico's multinationals grow and thrive, if they see attractive opportunities in Canada, investment will follow.

A growing Mexican economy with a growing middle-class, and a growing number of firms with global ambitions means that increased Mexican investment in Canada should be more a matter of when, rather than if. The key to making these investments happen is to ensure that Canada is an attractive destination for Mexican investors. For *afores*, this means the availability of low-risk, stable, long-life assets. For Mexican firms, this may mean increasing knowledge about the Canadian market and its opportunities. Saul Klein, of the University of Victoria, argues that firms that are looking to enter a new foreign market always "need someone who can essentially play that bridging role between your organization and the foreign country," and suggests that international students are excellent candidates to help bring companies from their home countries overseas (quoted in Attfield 2015).

Despite the tremendous growth in trade between Mexico and Canada, and the success of Canadian businesses that have invested in Mexico, in many ways 2007 was the high-water mark for the North American economy. That year,

Figure 5: Canada and Mexico Free Trade Network — Countries that Canada and Mexico Have FTAs With (Implemented and Pending)



Data source: Organization of American States Foreign Trade Information System (www.sice.oas.org).

US$8.8 trillion worth of goods, services and financial products flowed between Canada, Mexico and the United States. This represented 57 percent of the combined GDP of these three nations (Barton 2015). By 2013, trade in goods and services and financial flows within North America were only equal to 40 percent of Canada, Mexico and the United State's combined GDP (ibid.). In other words, the three economies do less business with each other today than they did seven years ago.

Furthermore, despite the growth in trade, and the notable success of some Canadian companies in Mexico, Canada and Mexico's "North American" trade and investment is still overwhelmingly aimed at the United States. Ninety-five percent of Canada's North American trade is with the United States; for Mexico, it is 96 percent (ibid.). Investment and immigration flows are similar (see Table 1). The United States still dominates North American economic activity. Despite the gains in trade and investment between Canada and Mexico since 1994, there is still room for that relationship to grow.

Trading with the rest of the world economy is essential for Canada's long-term prosperity, but Canadian firms will only get customers in far-flung markets if they can offer goods and services that are competitive on price and quality. Maximizing Canada, Mexico and the United States' competiveness means taking full advantage of what the three economies can offer each other. The case for Canada and Mexico to look to each other is simple, as the two countries complement each other economically and demographically.

Table 1: Percentage of North American Trade, Investment and Migration Flows Headed toward the United States

	Trade in Goods and Services	Foreign Direct Investment (outstock)	Immigration
From Canada	95%	98%	94%
From Mexico	96%	99%	98%

Source: Adapted from Barton (2015, 22).

Canada and Mexico: Complementary Economies and Societies

Canada has deep and wide capital markets compared to Mexico: while Mexico's biggest firms can borrow at interest rates similar to large Canadian firms, small Mexican firms — which make up the vast majority of companies there — still often pay annual interest rates of 10 percent or more (Bolio et al. 2014). North America has the deepest capital market

CANADA, MEXICO AND THE TPP

In August 2015 during TTP talks in Maui, Hawaii, American diplomats, seeking to conclude an agreement, presented a proposal that would have required as little as 30 percent of an automobile to be produced inside the TPP in order to be sold tariff free. In contrast, existing NAFTA rules required around 62.5 percent of an automobile to be built inside North America to avoid tariffs. The American proposal, which the United States presented in order to secure Japanese support for the TPP, contained additional provisions that would have allowed Japanese manufacturers to use even less TPP content in their cars and trucks. Canadian and Mexican reaction was swift. Not only had Mexico and Canada been excluded from the talks between Washington and Tokyo, but the proposal would have placed Canada's auto parts manufacturers (who specialize in high-quality and advanced designs) and Mexico's industry (which has seen tremendous growth in recent years) under threat of a wave of cheap, lower-quality imports from southeast Asian economies that are not in the TPP.

Having a common interest, Mexico and Canada banded together to reject the proposal and worked with the United States to hammer out a compromise: that 35 to 45 percent of auto parts (with higher value-added parts, such as engines and transmissions requiring 45 percent) in a vehicle must be manufactured inside a TPP country in order for that automobile to be exported tariff free in the trade zone. While the compromise may not fully satisfy Mexican, Canadian and American auto parts makers, it is certainly better for them than the Maui US proposal. And, importantly, it was a product of Canada and Mexico working together and presenting a united front.

This effort echoes what former Prime Minister Brian Mulroney said about his government's goals when Canada inserted itself into the free trade negotiations between the United States and Mexico that eventually led to NAFTA. At the time, North America was heading toward a "hub-and-spoke" trade system with the United States at the centre. The United States and Canada had already concluded an FTA, which came into effect in early 1988. Then in early 1990, Mexican President Carlos Salinas proposed that Mexico City and Washington conclude their own FTA.

The successful resolution of a Mexico-US free trade pact would mean that the United States would then be the hub through which all North American commerce flowed. Canadian and Mexican firms would both face a tremendous incentive to invest in and export to the US market, while minimizing the creation of new direct relationships between Canadian and Mexican firms, and thereby missing out on opportunities in the two countries. President Salinas made his proposal to US President George H. W. Bush not out of any hostility to Canada, but out of a desire to gain access to the US market for Mexico (Mexico suffered terribly through the 1980s as oil prices plunged and interest rates rose, choking Mexico's oil-dependent economy). However, by approaching the Americans alone, Salinas was leaving potential gains on the negotiating table. Namely, a Mexican-American deal would create an economic environment where the United States would attract the lion's share of investments headed for North America, since the United States would be the best positioned economy for investors seeking to tap into the Canadian and Mexican markets. Needless to say, both Canadian and Mexican firms would suffer under such a scenario.

When the Canadian government learned about the talks between the Mexican and American governments, Prime Minister Mulroney recalls telling President Bush, "we won't become a spoke to anybody" (quoted in Gillespie 2014, 51). Canada subsequently lobbied both Mexico and the United States to allow Ottawa to participate in the talks. The end result — rather than two bilateral trade deals that would cause investment to flow out of Canada and Mexico into the United States — was the trilateral NAFTA deal.

Ultimately, Canada working with Mexico is not a matter of the two countries "confronting" the United States. Twenty-five years ago when Salinas approached Bush to negotiate a Mexico-US trade agreement, both parties were acting in their best interests. It took a Canadian initiative to identify an even better deal for the three nations. In 2015, the US proposal to lower the content requirement for cars during TPP talks was meant to secure a Pacific trade deal, not to harm the North American auto industry. Yet when the Canadian and Mexican governments worked together on the TPP, they were able to identify a bargain that the United States could use to secure Japanese support for the TPP, while minimizing the short-term harm to the US, Mexican and Canadian auto sectors.

When the Canadian and Mexican governments work together, whether in NAFTA or the TPP, they have generated new ideas, and identified better bargains that benefit North America as a whole. It is time for *Los Pinos* and the Langevin Block to deliberately take measures to make sure that pattern continues into the future.

of any region in the world, and the advantages of connecting capital-starved sectors of the North American economy with the financial sector are obvious. As Mexico's fragmented financial sector consolidates, Canadian financial firms are well-positioned to expand their Mexican operations and reach more Mexican firms and households.

Canada's population is older than Mexico's, and an unprecedented number of Canadian workers are nearing retirement. Mexican citizens already travel to Canada to work in Canada's agricultural sector (Canada and Mexico have formally cooperated for over 40 years to bring Mexican workers into Canada to work in hard-to-fill farm jobs), and in the future, as the size of Canada's working population decreases, Mexican workers could stand ready to fill some of that shortfall. By 2040, Canada could face an old-age dependency ratio of 42 people 65 years of age or older for every 100 persons aged 15–64. While Canadians are certainly working longer and retiring later in life than in the past, a growing cohort of seniors will strain public finances, making it difficult for companies to fill job vacancies. Mexico's population is much younger, and is projected to have 22 senior citizens for every 100 people 15–64 years old in 2040 (United Nations Department of Economic and Social Affairs 2015). Getting the Canadian and Mexican federal, provincial and state governments on the same policy page will be essential in order to make sure that workers can move between the two countries to fill job vacancies in the future.

Mexico's growing population, which may reach nearly 150 million by 2030, could also become an important source of demand for Canadian companies (ibid.). A growing Mexican population and economy does not just offer future opportunities for Canadian manufacturers and farmers, but for companies that provide financial, engineering and other professional services. Not only is Mexico's population growing at a faster pace than Canada's, disposable income is also growing more quickly. Since the bottom of the recession that followed the 2008-2009 financial crisis, real disposable income in Mexico has grown an average of nearly four percent a year, compared to less than three percent annual growth in Canada (Organisation for Economic Co-operation and Development 2015).

Mexico is also poised to enter a long growth phase as it implements the reforms in the ambitious *Pacto por México*. For example, to help restore the competitiveness of Mexico's oil and gas sector, the Mexican government has passed reforms that allow more foreign investment in the industry. Foreign capital will be essential to restore, upgrade and expand Mexico's oil and gas transportation infrastructure, which is too small for the country's needs. The Mexican government is targeting to draw US$350 billion of new investments into Mexico's oil and gas industry by 2019, and believes the overall reform package can boost GDP by about one percent per year, in the near term (Ernst & Young 2014). Beyond oil and gas, the Mexican government is aiming to invest nearly US$300 billion in communications, transport, water, health, housing and tourist infrastructure by 2018 (PricewaterhouseCoopers 2014). Whereas Canada is a slow-growing economy, Mexico is poised to become a quick-growing one.

Overall, Canada's workforce is also relatively more skilled and expensive than Mexico's, as GDP per Canadian worker is about 2.2 times greater than GDP per Mexican worker. This gap may be narrowing, though. In 2011, nearly 580,000 Mexican students were enrolled in engineering programs, which was more than in Germany (Case 2013). However, this productivity gap points to an obvious and intuitive division of labour: inside a single company, the Canadian operations might design a product, but it is assembled in Mexico. This benefits both countries in innumerable ways. It also suggests that there are still some relatively easy productivity gains to be made in Mexico.

Madero Street in Mexico City, a major pedestrian thoroughfare in the city centre.

Both countries are also trading nations that have each secured free trade pacts with over 40 countries. Combined with North America's other advantages (innovative firms, plentiful energy supplies, a diverse and large labour force), these trade networks make Canada and Mexico (and by extension, North America) excellent places to do business globally. Firms can use both countries as launch pads to access a diverse array of markets from Korea to Colombia to Croatia (see Figure 5). Together, Canada and Mexico have FTAs in place (or pending) with 65 percent of the world economy, measured in nominal GDP (IMF 2015d).

Mexico also offers Canadian firms access to markets that they might otherwise overlook. While Canada and Mexico's trade networks overlap considerably (see Figure 5), Mexico offers both free trade access to Central and South American economies such as Guatemala, Honduras, El Salvador, Nicaragua, Bolivia and Uruguay, and geographical and cultural proximity to the Caribbean economies.

EXPANDING RELATIONS BEYOND TRADE AND INVESTMENT

Canada, Mexico and the United States have all the right stuff to ensure that North America's economy prospers well into the future, even in the face of a more competitive world. The decisions that citizens, companies and governments make today will help determine how prosperous North America is in 10, 20 or 30 years from now. Federal governments in all three countries can set the agenda — and set an example — by putting North America's future at the top of their priority lists. Prime Minister Justin Trudeau has signalled an early willingness to prioritize Mexico and North America by removing the visa requirement for Mexican visitors to Canada, and imploring his ministers to develop "a North American clean energy and environment agreement" (Trudeau 2015b).[3] These early suggestions are on the right track, but must be followed through, and must be ambitious.

However, the bottom line is that trade and investment between Canada and Mexico is ultimately done by businesses and individuals. Government can do many things to make

3 Similar language appears in the mandate letters for the minister of natural resources, minister of environment and climate change, and the minister of foreign affairs.

trade between countries easier, but cannot and should not dictate who businesses deal with. NAFTA has gone a long ways toward reducing barriers to doing business across North America. The priority for the Canadian and Mexican governments now should be to do what they can to eliminate other informal barriers to economic, educational and cultural exchanges between our two countries and, where appropriate, to show leadership and encourage various sectors of the two societies to reach out to one another.

One area that could benefit from some executive attention is student exchanges between Mexico and Canada. Since 2000, the number of Mexican college and university students entering Canadian schools has remained flat (and an insignificant number of Canadian university students go to Mexico to study). In fact, the number of Mexican university students heading to Canada in the twenty-first century peaked at around 2,300 in 2001 (Citizen and Immigration Canada [CIC] 2015a). The total number of Mexican post-secondary students studying in Canada in any given year has fared better, and approximately doubled from around 1,400 in 2000 to 2,800 in 2014 (CIC 2015b). Despite the doubling of Mexican university students in Canada, these numbers still pale compared to the number of Mexican students that go abroad each year. In 2013, for example, Mexico had 3.3 million post-secondary students, and 27,000 of those students left Mexico to study abroad (United Nations Educational, Scientific and Cultural Organization 2015). Around 1,600 Mexican students acquired permits to study in Canada that year (CIC 2015a). While language barriers might prevent more Mexican students from attending Canadian institutions, in comparison, 6,400 Saudi, 6,000 South Korean and 3,700 Japanese students received permits to study in Canada that year (ibid.).

Canada does not lack for globally competitive universities (*Times Higher Education* placed 15 Canadian schools in the top 250 worldwide in 2014-2015, while Shanghai Jaio Tong University's Academic Ranking of World Universities ranks 20 Canadian institutions among the world's top 500). It does lack for a global mixture of students. Whatever the barriers — language, finances or simply a lack of knowledge about the opportunities for Mexican students in Canada (and vice versa) — they are surmountable if governments, schools and businesses deliberately collaborate to encourage and facilitate exchanges.

The federal governments in both countries could take an important step forward by convening university and private sector leaders to make increasing the number of Mexican students in Canada (and vice versa) an aspirational priority. The US and Mexican governments are already taking action with their Bilateral Forum on Higher Education, Innovation, and Research, which has produced the *Proyecta 100,000* policy, which aims to have 100,000 Mexican students studying in the United States by 2018. is time for Canada and Mexico to begin a conversation about increasing their student exchanges.

Canadian firms, such as ATCO, Bombardier, Linamar, Magna International, Scotiabank and TransCanada Corporation (among others) have had great success in Mexico, and their investments there have been good for Mexicans and Canadians. However, future Canada-Mexico success stories will need a new generation of skilled, enthusiastic people who understand both countries. Student exchanges do not just benefit the students who participate — they lay the foundation for a strong and vibrant future among the two countries.

CANADA, MEXICO AND THE UNITED STATES

A stronger, collaborative relationship between Mexico City and Ottawa also means that Canada and Mexico — as smaller partners to the United States — will be in a better position to work with Washington on North American issues. Rather than continuing the practice of Ottawa and Mexico heading separately cap-in-hand to Washington and competing for the United States' attention, a rejuvenated Canada-Mexico relationship means that the two countries can coordinate their policies toward the United States and enter into future negotiations with the United States as equal partners, rather than undermining one another by cutting bilateral deals with Washington. The recent TPP trade negotiations as well as Canada-Mexico cooperation on US Country-of-Origin Labeling requirements for beef and pork are both good examples of how collaboration between Mexico and Canada can serve their mutual interests while also working jointly with their American partners to serve the interests of North America as a whole.

THE NEED FOR EXECUTIVE LEADERSHIP

Getting the most out of the North American relationship will require some work. While businesses will ultimately be the ones identifying opportunities, creating jobs and investing in Canada and Mexico, the governments of the two countries need to lead by example, and do what they can to ease the way for deeper and wider business and cultural relations between the two countries. Mexico City and Ottawa need to also remember that all their relations do not have to go through Washington first. While in some ways the relationship between the two countries is better-institutionalized than ever before (such as the Canada-Mexico Partnership), it still needs a dose of attention from the highest levels of government. There are many political gestures the Canadian prime minister and the Mexican president can take in the short term to help put Canada-Mexico relations on the right track. Prime Minister Trudeau's order to Citizenship and Immigration Canada to eliminate the requirement that Mexican citizens acquire a visa to visit Canada is a welcome and long-overdue first step. Here are several more to consider.

Establish an Annual Canada-Mexico Executive Branch Meeting

Hold an annual bilateral meeting of the heads of government and cabinet ministers. While the North American Leaders' ("Three Amigos") Summit is essential (and should be resumed on a regular basis as soon as possible), nothing can replace a one-on-one meeting of the two heads of government. An annual meeting would give the Canadian prime minister and the Mexican president an opportunity to not only privately discuss important and sensitive issues, but having both heads of government together creates the conditions for the sort of bold decision making that requires a meeting of minds between chief executives. While the Canadian and Mexican heads of government have a long history of bilateral meetings, setting a formal, recurring annual encounter will help sharpen the focus of both leaders on areas where the relationship can and should be improved, and maintain momentum from one year to the next.

Convene Canada and Mexico's Business and Education Leaders

Federal governments should take the lead in an effort to raise awareness about Mexico in Canada, and vice versa, by engaging other sectors of society. A good start would be by engaging with and convening leaders from across Canada and Mexico's business communities and both countries' post-secondary education sectors to encourage more Canadian students to attend Mexican educational institutions, and vice versa. Engaging a broad swath of Mexican and Canadian society is crucial, as is identifying Canadian and Mexican businesses and educational institutions that are willing to invest time, money and energy in the relationship.

Invite the Mexican President to Give a Joint Address to Canadian Parliament

Canada should immediately resume the tradition of inviting the Mexican president to give a joint address to the Canadian Parliament. Starting with President Luis Echeverría (1970–1976), every Mexican president — except for President Enrique Peña Nieto — has addressed Parliament. It has been more than five years since President Felipe Calderón spoke before the Canadian Parliament. It is time for Prime Minister Trudeau to invite President Peña Nieto to do the same.

Work with Mexico to Craft a North American Policy Agenda

Finally, Ottawa should propose that the Canadian and Mexican governments work to jointly develop and promote an ambitious North American policy agenda, with the aim of getting the United States firmly on board with a revitalized effort to address a number of North American issues. Given the disparity in size between the three economies, Canada and Mexico have a much better chance of getting North American issues on Washington's agenda if they act together. There are also many policy issues that need all three North American countries to work together in order to get the best outcome. In the past, both Mexico and Canada have eschewed trilateral efforts and have instead competed for Washington's attention and favour. Rather than repeating that pattern, Mexico and Canada should be working together to get things done.

A comprehensive North American agenda will be far-ranging, and touch on many public policy issues. Here are several that should be at the top of any list.

First, when it comes to economic policy, harmonizing regulations in the three economies should be front and centre. While the US has bilateral regulatory working groups with both Mexico and Canada (the United States-Mexico High-Level Regulatory Cooperation Council and the United-States Canada Regulatory Cooperation Council), there is no equivalent Canada-Mexico arrangement, and no trilateral body. Instead, the two existing councils attempt to coordinate with one another. While Prime Minister Trudeau (2015b) has instructed Minister of International Trade Chrystia Freeland to "reduce impediments to trade between our countries and to strengthen North America's global competitiveness," the government should go further. Ottawa should approach Mexico City and suggest that the two governments jointly propose to the White House that together they develop a permanent trilateral working group on regulatory harmonization. Talks to make sure that harmonized cross-border standards for trucking and other parts of the transportation sector are made permanent could also be included.

Second, climate change policy and energy should be on the agenda. Again, the Canadian government has said the right things on this file. Prime Minister Trudeau has tasked his government to work toward "a North American clean energy and environment agreement" (Trudeau 2015a). Since the Canadian government has already publicly committed to negotiating a broad energy and environment deal, it should double down and ensure that the proposed agreement explicitly includes climate change policy. Canada, Mexico and the United States can take a leadership role and help set the standards for a future global climate compact by coordinating their own climate change policies or negotiating a trilateral pact before signing onto a broader multilateral deal. As the United States, Canada and Mexico are, respectively, the world's largest, fourth-largest and tenth-largest oil producers, and produce around one-fifth of the world's CO_2 emissions, the three economies are well-positioned to define the parameters of any global effort to tackle climate change. Doing so will strengthen Canada, Mexico and the United States' hand in the twenty-second session of the Conference of the Parties to the United Nations Framework Convention on Climate Change and beyond. A comprehensive North American climate accord could become the NAFTA of the twenty-first century by giving Canadian, Mexican and US businesses and consumers a single set (or three compatible sets) of climate rules and regulations, which could amount to a considerable advantage in a world where carbon is increasingly taxed and regulated.

A drilling platform near Cozumel, Mexico.

Canada and Mexico also produce similar grades of heavy oil (Western Canada Select and Maya, respectively), which often compete for the same American oil refinery market. While competition is often healthy, it can also have serious downsides. As Mexico strives to reform and rejuvenate its gas and oil sector, the proposed trilateral environmental agreement would be an ideal place to include provisions that help ensure that Canada and Mexico's energy industries do not undercut each other's climate change efforts.

Third, the agenda should include infrastructure, from road, to rail, to pipelines and (air)ports. Getting the most out of the North American economy means being able to ship goods and materials seamlessly throughout the continent's three countries. The Canadian and US governments have cut their spending on infrastructure, as a percentage of GDP, by half since 1970 (Barton 2015). Renovating, upgrading, and building new infrastructure is becoming essential. Airport delays, congested borders, shutdowns at ports and clogged rail lines impede the ability of North America's firms to compete globally. Fixing the infrastructure deficit will require coordination among governments, and getting capital from the private sector invested in public infrastructure projects. As the Caisse de dépôt has demonstrated, there is an appetite in capital markets for infrastructure investments. Some leadership to develop bi- or trilateral public-private partnerships might be able to bring even more capital to bear on North America's infrastructure woes.

Finally, a trilateral policy agenda should go beyond addressing purely economic policy issues. One increasingly important item that should be on the agenda is Central American migration: every year, tens of thousands of migrants from Central America's Northern Triangle (El Salvador, Guatemala, and Honduras), fleeing crime and seeking economic opportunity, cross Mexico's southern border in a bid to make their way to the United States. As in 2014, these waves of migration can become politically incendiary, creating political tensions in (and between) the United States and Mexico, and impeding cooperation on other issues. Canada should partner with Mexico and the United States to help find solutions to the criminality and corruption that plague the region's migrants. By committing to be an active partner and to take on some of the burden of addressing the challenge, Canada may be able to help ease political tensions among its neighbours.

CONCLUSION

In an increasingly competitive global economy, every advantage counts. While NAFTA was controversial when it was introduced two decades ago, today Canadians, Mexicans and Americans largely take it for granted. As a consequence, we look to far-off emerging markets for our economic future, and overlook the huge potential that our North American neighbours offer.

With a new government in Ottawa, it is an ideal time for Canada to make a stronger, deeper relationship with Mexico a crucial plank of a plan to secure a prosperous future for North America. Canada and Mexico are two countries that have enjoyed excellent relations for two decades, but have also left many opportunities laying on the table. Making an ambitious and energetic push to institutionalize relations between the two countries' executive branches now will lay the foundation for future cooperation on a range of issues from regulatory harmonization to fighting climate change. Better relations between Mexico and Canada not only means more opportunities to take advantage of the two countries' economic and social complementarities, it also gives the two countries the opportunity to closely work together to get the United States on board with an ambitious North American agenda to secure the continent's economic future.

Canadian Parliament Buildings, Ottawa, Ontario.

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CIGI Masthead

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CIGI

67 Erb Street West
Waterloo, Ontario N2L 6C2, Canada
tel +1 519 885 2444 fax +1 519 885 5450
www.cigionline.org