# Building Momentum: A Strategic Competitiveness Vision for the U.S.-Mexico Relationship

**By Duncan Wood and Christopher Wilson**

Paper submitted to the U.S.-Mexico CEO Dialogue, December 2013

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## Look how far we've come together

Linked by geography, migration, and the North American Free Trade Agreement (NAFTA), the economic futures of the United States and Mexico are deeply intertwined. In 2012, bilateral goods and services trade topped a half-trillion dollars. For Mexico, trade with the U.S. is one of the country's main engines of economic growth, with 78% of Mexican exports being bought by U.S. customers. U.S. trade with Mexico represents a much smaller share of its overall economy, but Mexico is nonetheless the second largest buyer of U.S. exports. The crux of the partnership, though, lies in the way cooperation within North America supports regional competitiveness in a global context. The U.S.-Mexico economic partnership has the potential to play a key role in strengthening supply chains and boosting exports to the rest of the world. At the agreement of President Obama and President Peña Nieto, bilateral relations have begun to focus greater attention on economic issues, and a U.S.-Mexico High Level Economic Dialogue was launched in September, 2013 to design and advance the economic agenda.

The U.S.-Mexico economic relationship is unique. While imports from most countries are what they appear to be, foreign products, the United States and Mexico work together to manufacture products, with parts and materials zigzagging their way back and forth across the border as finished goods, from flat screen televisions to automobiles, are produced. Testament to this special relationship is the fact that, on average, 40% of the value of U.S. imports of final goods from Mexico actually comes from materials and parts produced in the United States, and the domestic content in Mexican imports from the United States is also very high. This means that forty cents of every dollar U.S.

### Key Facts On The U.S.-Mexico Economic Partnership

- **U.S.-Mexico goods and services trade totaled $539 billion in 2012. This means there is more than a billion dollars of trade each day and more than a million dollars of trade each minute.**
- **The U.S. exports more to Mexico than to all of the BRICS (Brazil, Russia, India and China) combined.**
- **U.S. imports of final products from Mexico contain, on average, 40% U.S. content.**
- **The United States in Mexico's top export market, and Mexico is the United States' second largest market.**
- **Mexico is the United States' third largest source of crude oil imports.**

consumers spend on Mexican imports actually goes to U.S. companies and workers. Canada also participates in this economic alliance, but the same cannot be said for goods coming from anywhere outside of North America. U.S. imports from China, for example, have an average of only 4% U.S. content. The integration of the North American economy profoundly links our two nations and has synchronized our business cycles. Each country gains from the advances of the other, and to a large extent we will sink or swim together. Improved productivity in Mexico, for example, reduces the cost of goods made with U.S. parts, making them more attractive vis-à-vis their Asian or European competitors and thereby increases sales for domestic consumption and international export alike.

NAFTA was implemented in 1994, some twenty years ago, and over the past two decades the nature of the U.S.-Mexico economic relationship has fundamentally changed. Since the agreement took force, trade between the two countries has more than quintupled and the stock of bilateral foreign direct investment has increased six-fold. While NAFTA was not a free pass to the developed world for Mexico or a silver bullet solving irregular immigration to the U.S. as some suggested, the agreement clearly did accomplish its central goals of stimulating trade and investment.

Growth, however, has been far from uniform. During the last twenty years, there have been three distinct stages in the process of integration. Between 1993 and 2000, trade boomed, growing at an average annual rate of 17% and more than tripling in value. The tide turned in 2001, with recession in the U.S., the accession of China to the WTO, and the increased border security as a result of the terrorist attacks of September 11th all acting as a drag on bilateral trade. Between 2000 and 2008, trade growth cooled to just 5% per year. The emergence of China as the world's factory meant that Mexico was losing its edge as a source of cheap labor for basic manufacturing. Instead it had to more carefully find its niche, taking advantage of its higher-skilled workforce and especially its ability to nimbly produce and quickly and cheaply deliver products to the North American market. Unfortunately, this was complicated by the long and unpredictable wait times to cross the U.S.-Mexico border as a result of heightened security in the wake of 9/11, which threatened the integrity of just-in-time supply chains. A new round of changes—rising wages in China, currency depreciation vis-à-vis the yuan, increased transportation costs, and the development of an increasingly skilled labor force in Mexico—caused a resurgence in regional competitiveness and trade in the wake of the 2008-2009 recession.

With this favorable economic environment in mind and a desire to correct what was perceived as an excessively singular focus on security cooperation, the Peña Nieto government sought to re-affirm economic relations at the heart of the U.S.-Mexico relationship. The Obama administration accepted, and as a result the U.S.-Mexico High Level Economic Dialogue (HLED) was launched. In this context, policymakers are looking to the private sector and civil society for ideas and support as they seek to deepen bilateral economic cooperation. The moment is ripe.

Nonetheless, the vision outlined above will not be realized without significant private sector support. This means increasing bilateral business-to-business ties and private sector involvement in the policy process.

Before NAFTA was passed, the business communities of Mexico and the United States came together to build a strong coalition and major advocacy campaign to push for its passage. It has been described as the largest foreign lobbying campaign in history. In fact, it was much more than this. It was a joining of forces of the U.S. and Mexican private and public sectors to achieve a common goal. However, having achieved this goal, in the mid-Nineties the coalition proceeded to fall apart, and coordination between the two groups has since been nearly non-existent. This is not entirely surprising. NAFTA presented a singular issue that was to face a straight up or down vote in the U.S. Congress around which a wide range of actors could unite. The organization of the private sector was strongly encouraged by the U.S. and Mexican presidents, and academics and think tanks were likewise engaged through the campaign.

In the absence of another NAFTA, reactivating the U.S.-Mexico business partnership will be more difficult. Potential gains from strengthening the regional partnership on economic issues today are as large as ever, however today's agenda is more disperse. Instead of a single, defining issue, pressure must be exerted to achieve tangible progress across a wide array of issues, including border management, energy policy, regulatory harmonization, transportation infrastructure, service sector integration, the development of human capital, innovation, entrepreneurship, and many more. In this context, the central challenge is twofold. A compelling narrative about the challenge of strengthening regional competitiveness in a fiercely contested global market must be crafted, and a binational (or trinational) coalition of private sector leaders, government officials and civil society must be formed. Defining the specific policy goals of such a coalition is, of course, also critical. Thankfully, a wide range of ideas and indeed government initiatives have been defined. What must be generated is the political will to drive them forward.

In this paper we identify four priority areas where business leaders can engage with policy makers to take the next major step forward in integration.

### 1. Border Facilitation and Ports: Liberating Potential through Investment

The need for secure and efficient borders in North America has been obvious since the beginning of the NAFTA experiment, but the two requirements have often seemed to be at odds. By focusing on issues such as pre-clearance, trusted traveler programs, improved staffing (quantity and quality) and infrastructure, the borders and ports of North America can be greatly enhanced.

Since 1993, merchandise trade between the U.S. and Mexico has increased more than six-fold. Unfortunately, investment in border infrastructure and the improvement of screening methods has not kept pace. Instead, the attacks of September 11, 2001 forced the United States to reevaluate border management, with improvements in security coming at the cost of efficiency. The border was thickened, and long and unpredictable wait times continue to present a costly burden that both individuals living along the border and companies with regional supply chains must endure. Indeed, research suggests the costs of congestion at the border are in the billions of dollars for both the U.S. and Mexico.[1]

In the United States, inadequate investment has added up to a $6 billion dollar deficit in infrastructure identified by U.S. Customs and Border Protection and a shortage of staff at the official border crossings identified by the U.S. Government Accountability Office.[2] Special care must be taken to differentiate between investment between the ports of entry—with the Border Patrol having more than quintupled in size since the 1990s—and investments at the crossings themselves, which are staffed by Office of Field Operations officers rather than Border Patrol agents. The disparity suggests the issue is not only one of tight government budgets but also one of priorities. Indeed, the payoffs for border investment are quite high. A recent study found that each additional CBP officer staffed to our ports of entry would lead to a two million dollar increase in U.S. GDP and would create thirty-three American jobs.[3]

The prioritization of security over efficiency is derived from a false dichotomy, and fortunately the governments of the U.S. and Mexico have embraced an approach based on strategies that simultaneously promote a safe and competitive border, as embodied in the 21st Century Border Declaration, which was made in 2010 and reaffirmed by presidents Obama and Peña Nieto in 2013. Within this framework, important progress has been made, but the incremental progress has not kept up with the quick pace of change in the global economy, the needs of regional industry, or the binational nature of life for so many residents of the border region.

With seventy-seven percent of all U.S.-Mexico trade coming across the land border, the majority by truck, the importance of efficient border operations is hard to overstate. The system of production sharing, with inputs often traveling back and forth across the border multiple times as products are being manufactured, creates a multiplier effect for any inefficiencies at the border. Having trucks full of goods wait in line for hours at the border before being able to cross is expensive once, but manufacturers involved in co-manufacturing with Mexico often pay what is essentially a border tax multiple times during the course of production. Fortunately, the inverse of this is also true: improvements in border efficiency have a magnified effect, improving the competitiveness of regional industries involved in production sharing arrangements in a major way.

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[1] For a summary of studies on the costs of congestion, see: Christopher Wilson, Erik Lee, eds., *The State of the Border Report*, Washington, DC: Border Research Partnership, 2013, pg. 70.

[2] Mikhail Pavlov, Customs and Border Protection, DHS, "Meeting Land Port of Entry Modernization Needs in Constrained Budgetary Environment," presentation to the Joint Working Committee, March 14-15, 2012; Government Accountability Office, Border Security: Despite Progress, Weaknesses in Traveler Inspections Exist, GAO-08-329T, Washington, DC: January 2008.

[3] Bryan Roberts et al., "The Impact on the U.S. Economy of Changes in Wait Times at Ports of Entry," University of Southern California Homeland Security Center, April 4, 2013.

**The Building Blocks of a Secure and Competitive Border:**

- **Setting goals and benchmarking progress**—Long and unpredictable wait times to cross the border are costly. Produce rots, factories depending on just-in-time deliveries idle, and customers complain (or in the case of cross-border tourism and retail, they just stay home). Unfortunately, because official data on wait times is problematic, we lack clear and reliable information on the extent of the problem. New methodologies, mainly based on RFID chips and Bluetooth devices, can resolve this problem. But more than just measuring wait times, we also lack goals. There is no consensus regarding what an acceptable crossing time is for an individual or cargo truck. Without efficiency targets and reliable performance measures, it is unsurprising that problems persist.

- Moderate investments are needed to **upgrade and expand port of entry infrastructure**. Most cross-border infrastructure was built years before NAFTA fundamentally altered the nature of the U.S.-Mexico economic relationship, increasing the volume of traffic and magnifying the importance of connectedness.

- Similar investments are needed to **staff** the border crossings. Too often, multiple lanes are closed to traffic due to inadequate staffing, even during high-traffic times of day.

- **Trusted traveler programs**—Global Entry, SENTRI, FAST, C-TPAT, NEEC—offer expedited passage to those individuals and companies that have voluntarily undergone extensive background checks and committed to security standards. By facilitating the flow of designated low-risk travelers, border officials increase overall throughput while freeing up staff resources to focus attention on individuals and shipments that present a higher or unknown level of risk. Efforts are needed to expand these programs. Global Entry and Sentri are achieving success in this regard; C-TPAT and FAST (the commercially oriented programs) are facing challenges in proving their value and increasing enrollment.

- **Customs preclearance**, which involves the placing of customs processing centers or agents within another country, can, when properly implemented, improve safety, efficiency and binational coordination by identifying potentially dangerous cargo away from crowded ports of entry, allowing pre-cleared shipments quick passage through border lines, and allowing customs officers to work side by side with their foreign counterparts. Three pilot projects (Tijuana, BC, San Jeronimo, CI, and Laredo, TX) have been designed that have the potential to become models for future cooperative border management efforts, but implementation has stalled due to political obstacles.

- **Public Private Partnerships** and other non-traditional funding mechanisms can complement government investment in border crossing infrastructure. A new legal framework is needed to encourage such investments.

- In their efforts to create a secure and efficient border, a willingness on the part of both U.S. and Mexican officials to experiment is of vital importance. Through an **increased use of pilot projects**, the ports of entry can become laboratories for innovations in border policy. With such an approach, new ideas for everything from inspection procedures to trusted traveler program enrollment strategies could be developed, tested, and, if successful, taken to scale across the border.

**A call for action**

- The immigration reform bills under consideration in the U.S. Congress are a potential vehicle for investments in infrastructure and staffing needed for a secure and efficient border, and an opportunity exists for business to encourage this approach. Greater emphasis on the ports of entry, rather than the areas between them, is needed.
- The 21st Century Border initiative provides a framework for border efficiency improvements, but ongoing citizen and private sector pressure is needed to overcome obstacles in the implementation of initiatives like customs pre-clearance and the expanded use of public-private partnerships.

## 2. North America's Energy Bounty: New Resources and New Opportunities

Despite the revolution that has taken place in the hydrocarbons industry over the past five years, and the impressive steps that have been taken towards both regional energy self-sufficiency and meaningful reform of the Mexican energy sector, substantial challenges remain. Central to a resolution of these challenges is the need for enhanced regional planning in energy policy, institutionalized bilateral cooperation, spending on energy infrastructure, regulatory collaboration and cross-border transmission.

From widespread fears about energy security, the debate in the United States in recent years has shifted to how the abundance of natural gas and significant new oil reserves are fundamentally altering the U.S. energy relationship with the world. North American energy independence is rapidly becoming a reality, with the United States now confident that it will be able to satisfy declining national demand for oil through a combination of domestic, Canadian and Mexican supply, fuel efficiency measures and a long-term shift from gasoline and diesel to natural gas-based fuel for transportation.

It has now become commonplace to talk of North America as the "new Middle East". The abundance of conventional and unconventional energy sources in the region mean that rather than worry about discovering new sources of supply, the challenge for both policy-makers and industry now lies in building and financing the infrastructure needed to get energy to market and in making energy markets more efficient.

The three areas of hydrocarbons potential that continue to drive change in the regional energy industry are shale gas and tight oil, the Albertan oil sands and Mexico's remaining conventional and unconventional reserves. Alberta's enormous potential is rapidly being realized with total Canadian oil output projected to surge by 50 per cent by 2020, according to the Canadian Association of Petroleum Producers (CAPP), and will more than double to 6.7 million barrels a day by 2030. At the same time the United States has seen a dramatic increase in national oil production, adding over 1 million barrels per day from tight oil and shale fields in the past 5 years. With exciting changes afoot in Mexico (which has estimated 3P plus prospective reserves of 130 billion barrels of oil), the region will not only satisfy its own demand, but will be a major source of hydrocarbons for the world.

The "shale gale" that has revolutionized hydrocarbons production came about in the United States thanks largely to two factors: a legal framework that allows the ownership, by private citizens, of subsoil resources, and the evolution of hydraulic fracturing (fracking) technology. The result has been record-low natural gas prices and significant new supplies of oil flooding onto U.S. energy markets. The same technology has also been applied to tight oil formations in places such as North Dakota, where major new reserves are being exploited. Although it will prove more difficult to repeat this experience in other parts of the world where the first condition does not apply, the industry has become a highly efficient and dynamic area of economic activity, and is looking for opportunities outside of the United States. The most obvious place for it to expand would be Mexico, given the extension of the Eagle Ford geological formation across the border. If the Mexican Congress is successful in approving a major energy reform before the end of 2013, this will become a realistic option.

In fact the reform process in Mexico represents a paradigm shift that promises to have a similarly major impact on oil production. With private investment in the oil industry prohibited since the late '50s, Mexico has been unable to turn its national oil production around over the past decade by relying on the national oil company, Pemex, alone. With a new legal framework in place, Mexico hopes to attract billions of dollars in private and foreign investment, and to raise national oil production by over a million barrels per day by 2030. If Mexico can also find the right legal and contractual model to attract investment into the shale gas sector, natural gas production will increase significantly and North American energy security will be ensured for the foreseeable future.

The importance of these two elements, major new flows of oil and low-cost natural gas, lies in the advantage it gives to the national and regional economies of North America. Both the oil and gas sectors are major sources of technological innovation, economic growth, and well-paid employment. Cheap and abundant gas means that fuel costs remain low, electricity prices fall, and the competitiveness of a wide range of businesses is dramatically improved. The return of manufacturing from China (and other countries) to the United States and Mexico over the past few years is a direct reflection of that energy-based competitiveness. But just discovering and producing the energy is not enough. Getting the energy to market will require major investments in infrastructure, in particular in pipelines and electricity transmission lines.

Despite the enormous optimism that exists over energy production in North America, significant challenges remain and will be exacerbated by the increased production. Pipeline and transmission infrastructure needs have already been mentioned, but there is also an urgent need to consider the shortfall that will emerge on a regional basis in the refinery business. With millions of barrels of new production coming from Canada, Mexico and the United States, and with no new refineries having been built in the past two decades, a failure to build new plants will result in a zero-sum contest for access to refining facilities and a need to export crude and re-import refined product. Mexico appears to be particularly vulnerable in this regard, with concerns over access to U.S. Gulf Coast refineries due to the arrival of cheaper Canadian crude.

There is also a need to hold discussions between the NAFTA partners on how to address the issue of climate change in a coordinated fashion. The Mexican congress passed legislation this year creating a national carbon tax on fossil fuels (this legislative session), Mexico's financial exchange, and the *Bolsa Mexicana de Valores* (BMV), is finalizing the launch of the first carbon offset credit exchange in the Latin American region, whereas in the United States, the EPA has begun regulating carbon emissions as a pollutant. These divergent approaches to the question of limiting carbon reflect national political realities but also highlight the need for a bilateral (and regional) conversation between policy makers on the future of climate change mitigation.

Similarly, the future of the renewable energy sector long ago ceased to be a purely national question. Renewable energy regions, such as the U.S. Southwest/Mexican Northwest, frequently cross national borders. Canada has for years been exporting hydro-electric power to the United States, and has benefited from engagement with U.S. energy planners. Similar strategic engagement between U.S. and Mexican policy makers would do much to improve planning across their shared border.

It is therefore imperative that the three NAFTA countries engage in a collaborative planning process for regional energy needs. Here is where the business leaders of the two countries can play a significant role in driving forward a policy agenda that pushes both countries' governments to collaborate on regional energy infrastructure needs. In the early years of the new century, the North American Energy Working Group (NAEWG) was formed to engage in focused discussions about the shared energy challenges in North America. From 2001 to 2007 the NAEWG brought together energy policy officials from Canada's Natural Resources Ministry, the U.S. Department of Energy and Mexico's Secretaría de Energía, to discuss themes such as natural gas, nuclear energy, regulatory cooperation, infrastructure, energy statistics, energy efficiency, science and technology and unconventional oil. The NAEWG was a source of important policy and statistical documents and its loss after 2007 has been deleterious to the region. A new incarnation of the NAEWG should be sought, but this time a private sector counterpart should be created as a feed-in mechanism for the discussions. This will not only keep the mechanism vital and well-informed, it will give added political weight to the work of the group.

**A call for action:**

- Urge policy makers to bring back the North American Energy Working Group (NAEWG)
- Create a private sector counterpart alongside the NAEWG to feed into the policy process
- A new focus on infrastructure needs and energy planning is urgently needed

**3. Deepening Regional Integration:**

For North America to be the most competitive region in the world, it need not aspire to a European-style integration with an institution-heavy structure and a single currency. Instead, policies to connect markets and thereby reduce the costs of crossborder transactions and interactions must complement domestic reforms. Above, we outlined the costs of fragmented energy markets and barriers to trade at the border, but there are several other points of friction that add costs and eat away at competitiveness in the continental market. Among these crucial elements that must be addressed, we find the liberalization of services trade, investment in transportation infrastructure, the harmonization of standards and regulations, and the compatibility of the NAFTA with other free trade agreements such as the Trans Pacific Partnership (TPP) and the Transatlantic Trade and Investment Partnership (TTIP). At the same time it is crucial to improve the image of the NAFTA among the citizenry of North America. To address this perpetually thorny issue, we suggest a number of actions that can be taken by governments and business to improve that image through an emphasis on the concrete benefits of integrated production across borders.

Trade deals with extra-continental partners can either shallow or deepen regional integration, depending on how they are negotiated. In recognition of this and the deep integration of our manufacturing sectors, the U.S., Mexico and Canada should, whenever possible, negotiate trade agreements as a bloc.

When NAFTA was negotiated more than two decades ago, it was innovative and ultimately transformative. The lowering of trade and investment barriers led to huge increases in cross-border commerce and forged an economic partnership among the nations of North America. Since the early Nineties, though, the world has changed. The WTO now has 379 regional trade agreements on the books, meaning the special relationship carved out with tariff reductions among the NAFTA countries is not quite so special any more. Furthermore, newer agreements tend to address in greater depth 21st Century issues like data flows, services trade, and e-commerce.

The central challenge to North America from the negotiation of plurilateral trade agreements comes from the expansion of preferential access to the U.S. market, which will increase imports from outside the continent and thereby increase competition faced by some North American industries as they serve the regional market. On the other hand, given the depth and importance of North American economic and especially manufacturing integration, it makes sense for the NAFTA countries to negotiate improved access to markets around the world as a bloc in an effort to make North America an export platform with global reach. Indeed, the U.S. and Mexico each already have an extensive network of free trade agreements giving them preferential access to many of the largest markets around the world. Mexico has a particularly wide web of FTA partners, including 45 countries that comprise over half of global GDP. The United States and Mexico share a commitment to open markets and a rules-based international trading system, making them natural partners in plurilateral and multilateral negotiations.

Three of the agreements under negotiation are of particular importance to the United States and Mexico. The Trans-Pacific Partnership is being negotiated by twelve Pacific Rim countries, including the United States, Mexico, Canada and most recently Japan. Mexico and Canada did not join the negotiations until 2012, and while it was the right decision for each of them to seek accession to the group and for the United States to support their entrance, the late entry of the two show the TPP was not designed as a mechanism to boost North American exports and integration. Nonetheless, it presents an opportunity to do so if three conditions are met. First, the countries of North America must decide to make regional competitiveness one of their negotiating goals and negotiate as a bloc. Second, since the NAFTA partners are all included, the TPP has the potential to deepen regional integration without reopening the still-politically-divisive NAFTA. Finally, rules of origin are of prime importance. Products co-manufactured with materials and parts from throughout North America may or may not qualify for preferential access into the markets of our negotiating partners depending on the nature of the rules of origin incorporated in the agreement. If regional supply chains are a positive force for regional competitiveness, then we must take care in our global agreements to support systems of regional production.

The Transatlantic Trade and Investment Partnership, being negotiated between the United States and Europe, is enormously important because of its size—the EU and the U.S. are the two largest economies in the world. Given that Mexico already has an FTA with the EU (and Canada is in the process of implementing one), it makes sense to either include Mexico and Canada in the agreement now or immediately after a U.S.-EU deal is reached. Without linking the three agreements together, products made in North America may face barriers in Europe that European products do not face here.

The Pacific Alliance is being developed among Mexico, Colombia, Peru, Chile, and, most recently, Costa Rica as a high-quality and far reaching regional integration scheme. The United States and Canada have joined the group as observers, and it would make sense to look for ways to deepen their engagement in and support for the group.

In striving to build an export platform that is globally competitive, physical infrastructure is at least as important as trade policy architecture. Just as American natural gas terminals are being adapted to export, rather than import, broader efforts are needed to **design a North American transportation network** to deliver regionally manufactured goods to markets around the world. To do so, greater collaboration between the transportation secretaries of each country is needed, as is the involvement of state leaders and transportation agencies from each of the key transportation corridors. In recent years, much focus has been placed on building infrastructure to import goods from Asia and deliver them to the U.S. market. Some of that infrastructure will also work for exports, but we must ensure the key centers of manufacturing are connected to the correct ports, and that those ports have adequate export capacity for the manufacturing boom that is just beginning in North America. In order to make strategic rather than political decisions about where and how to build infrastructure to connect the United States and Mexico and connect the continent to the world, better analytical tools are needed. We need to map key North American supply chains and identify opportunities to reduce transportation costs.

Every country develops safety standards, on everything from food and agricultural products to construction and motor vehicles, with the goal of protecting their population from unnecessary risks. Though there are examples of misguided regulation, this effort generally fulfils its central goal of making people safer. Too often, though, despite the adequacy of the different standards developed around the world, they are incompatible, forcing companies to run separate production lines for goods destined for each country. The **U.S.-Mexico High-Level Regulatory Cooperation Council** was created in 2010 for this reason, but frankly little progress has been made. The effort is in need of an assessment and revision. Some lessons could be drawn from the U.S.-Canada Regulatory Cooperation Council, which has achieved much greater results, and indeed it may be valuable to have the U.S.-Mexico group meet with its northern counterpart to identify those U.S.-Canada achievements that could be likewise be implemented in the U.S.-Mexico context. The ultimate goal, of course, should be to create a set of North American standards that are fully compatible across the continent.

While merchandise trade has always been the heart of the U.S.-Mexico economic relationship, services may be the future. To date, though, it still represents a relatively untapped opportunity. Transportation and healthcare are areas particularly ripe for advance, and an open skies agreement, which would allow U.S. and Mexican customer airlines and cargo flights greater access to routes including stops in the other country, would be a good place to start. The current pilot program to allow trucks access to deliver goods throughout Mexico and the United States without unloading and reloading at the border should also be expanded and made permanent. Similarly, at a time when the population is aging and healthcare costs are rising in the U.S., it makes sense to find ways for Americans to take advantage of the lower-cost care available in Mexico while promoting the use of high-tech treatment options for Mexicans in the United States. Key issues include the portability of Medicare abroad, the international certification of Mexican hospitals, and U.S. state-level insurance regulation.

**A call for action:**

- Create a joint production and export platform by negotiating trade agreements as a North American bloc and coordinating strategic infrastructure investments.

- Greater private sector and civil society engagement is needed in the U.S.-Mexico High Level Economic Dialogue. Engage policymakers to design mechanisms for this engagement.

- U.S.-Mexico regulatory harmonization has lagged, in part due to a lack of stakeholder engagement, and needs to be reinvigorated.

## 4. Human Capital and Innovation

To secure long-term regional economic competitiveness, there is an urgent need to focus on the long term challenges for human capital in North America. An emerging issue that had previously been little discussed in the public sphere is that of educational cooperation, it has become one of the axes of the bilateral relationship under presidents Obama and Peña Nieto. Several experts and government officials have long recognized this as a potential growth area in the bilateral relationship, but there are now greater opportunities than ever to further develop educational collaboration.

Mexico urgently needs to build its human capital to move from a middle income to high income country. Indeed, the Peña Nieto government's first major legislative effort has been a constitutional reform of the K-12 system to improve the quality of education. However, a second area that requires major attention is undergraduate and graduate education, especially in STEM subjects (science, technology, engineering and mathematics) and innovation. At the same time, the United States needs to develop the cultural and linguistic capacities that would allow Americans in professions ranging from nursing to teaching to business to better communicate with the growing Spanish-language population in the United States and to take advantage of commercial and investment opportunities in the Western Hemisphere. There exists, therefore, a powerful logic for the two governments to work together to seek mutually beneficial solutions to their educational needs.

Mexico’s higher education system faces a significant challenge, with public and private university enrollment rising as Mexico’s middle class grows. The National Association of Universities and Institutions of Higher Education (ANUIES) has estimated that it will be necessary to increase the capacity of universities to enroll students by 48% between 2010 and 2020. This means there will be a total student population in higher education of 4.7 million in 2020, 1.7 million more than were registered in 2010. Although the demand for private education is certainly growing in Mexico, the vast majority of students will find their way into the public university system, posing challenges in terms of funding and the availability of high quality undergraduate and graduate programs. At the same time as the total number of students in public sector higher education is growing, the amount that the federal government spends in subsidizing each student’s education has also increased, rising from just over 39,000 pesos in 2006 to around 48,000 pesos in 2010. While this investment in education is needed, providing students with a quality higher education will prove a major challenge for the Mexican government. Looking to collaborative international programs and exchange opportunities is one way in which that challenge can be met.

Government and business in the United States, on the other hand, are increasingly aware of the need to attract talent from around the world to satisfy labor market needs. The recent immigration debate in the U.S. reflected this, with an emphasis on skilled immigrants in general and expanding the number of available H1B visas in particular. A shortfall of engineers, scientists and software experts means that the private sector is spending enormous amounts of time, effort and money scouring the world for human resources, hoping that they will be able to secure work visas for this talent once it is identified.

In partial response to this challenge, May of 2013, Presidents Obama and Peña Nieto announced the creation of the High-Level Forum on Higher Education, Innovation, and Research, which goes by its Spanish acronym FOBESII. The Forum is aimed at encouraging broader access to quality post-secondary education for traditionally underserved demographic groups, especially in the science, technology, engineering, and mathematics (STEM) fields. Central to its work is the issue of expanding educational exchanges, promoting joint research on education and learning, and sharing best practices in higher education and innovation. The forum brings together government agency counterparts to deepen cooperation on higher education, innovation, and research. It also draws on the expertise of the higher education community in both countries. Already significant progress has been made in bilateral talks, but serious challenges remain.

The FOBESII dovetails with the State Department’s "100,000 Strong in the Americas," an initiative announced in 2011 to increase international study in the Western Hemisphere. Its purpose is to foster region-wide prosperity through greater international exchange of students. However, the initiative suffers from the same problem as FOBESII, namely a weak funding structure. Both FOBESII and 100k Strong rely heavily on private contributions to reach their full potential, but to date the response from the business community has been disappointing. In the case of the FOBESII, the Mexican government has contributed funds to move the project forward, but in the United States there has been little success in attracting either public or private funding.

The issue of innovation is also a priority shared by the two nations, and the two countries’ governments have created a mechanism called the Mexico-U.S. Entrepreneurship and Innovation Council (MUSEIC). Although the MUSEIC is organized by the two governments, the main participants are private businesses. SMEs gather through the organization to discuss a range of themes related to entrepreneurship and innovation and the participants are organized into seven subcommittees focusing on Legal Framework, Women’s Entrepreneurship, the Latin Diaspora, SME Development Infrastructure, iClusters, Technology Commercialization Chains, and Access to Capital. This is a valuable effort that has already delivered results in the form of financing deals for some business ventures in Mexico, as well as important conversations on the entire range of subjects listed above.

On the topic of innovation, Mexico faces a number of challenges. A 2013 global study by GE of national innovation ecosystems found that the framework for innovation in Mexico is perceived as quite challenging for innovation by business executives, with only 15% of global respondents regarding Mexico's framework as innovation-conducive. This puts the country in the 24th position of the ranking based on this indicator. 91% of Mexican business executives believe that innovation is a strategic priority but only 48% of Mexican business executives report that their country has an innovation-conducive environment. Issues connected to the efficiency and levels of governmental support for innovation were found to be particularly problematical.

However, a nascent policy conversation has recently emerged in Mexico over the issue of innovation policy, and it is in the interest of the U.S. government and business to engage with Mexican policy makers to encourage the development of legislation, financing and infrastructure to encourage the creation of good policies in this regard. A recent project between the Woodrow Wilson Center and Fundación Idea brought together a group of Mexican legislators from all major parties in Washington, DC to discuss innovation policy, and it is hoped that these Senators and Deputies will form the basis of an "innovation caucus" in the Mexican Congress. Further contact with this group and promotion of an innovation agenda will be essential in consolidating progress already made.

**A call for action**

- Private business should assist in the process of education reform in Mexico by collaborating with government to identify priority skills and human resource areas.

- Business should engage with the FOBESII to jointly fund student exchange and collaborative research with government and universities.

- Innovation policy in Mexico must be seen as a priority by legislators and the executive branch; business leaders should encourage this focus through engagement with the policy debate.

**Conclusions – The Need for a Regional Approach and the Central Role of the Private Sector**

The current optimism about the process of structural reform in Mexico, and the growing acceptance of the importance of Mexican competitiveness for U.S. economic success, combines with the current focus on economic cooperation in the bilateral relationship to create a golden opportunity for business to participate in the policy conversation between Mexico and the United States. By focusing on the theme of regional competiveness, business leaders should identify priority areas for engagement with their colleagues from the other country, and with policy makers across the border.

Although NAFTA was a groundbreaking trade agreement when it was negotiated and signed, we now need to move beyond that 1980s-style mentality. Using the language of regional competitiveness will help to move the agenda forward, and will be useful in avoiding the American public's negative association with the NAFTA. Instead, a policy focus on creating jobs and strengthening regional industry so that our manufacturers are globally competitive will be much more effective in terms of both identifying core issues and ensuring public acceptance.

This paper has pointed to four areas where the CEO Dialogue might fruitfully engage with policy makers and where business leaders from both countries and has identified concrete policy actions that can further the integration agenda. On issues of integration, borders, energy, and human capital and innovation, business stands to gain from encouraging policy makers to take the necessary steps to move bilateral cooperation forward. The CEO Dialogue has the potential to form a unique stakeholder group that possesses the knowledge and tools to influence the bilateral policy conversation on these issues, and the resources to be able to partner with policy makers on implementation. Although a long-term grasp of the importance of these issues is needed, some of the benefits will be felt in the short-term, with border infrastructure investments providing almost immediate pay-offs in terms of increased efficiency and savings for companies that depend on cross-border trade.

The momentum behind economic integration in North America has been building for twenty years and has already generated considerable wealth and advances in national and regional competitiveness. However, the three NAFTA countries face new challenges in the form of global competition and a constantly changing economic environment, and business must be prepared to work alongside government to identify priority policy areas and to put resources behind new initiatives that will move the region forward. North America's strength lies in the complementarity of the three national economies and the synergies that have come to be accepted as a normal part of the economic relationships between them. By working together, the business and public sectors of the region can fully realize the potential of these relationships.

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