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Towards a More Competitive North America: Build on the Existing Foundation

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The second decade of the 21st century increasingly mirrors the world's political and economic environment of a century before when nationalism, protectionism and isolationism occupied center stage in the global political economy. The key drivers of economic growth and development—neoliberal economic policies and free market-oriented institutional reforms—have fallen out of favor or been rejected to a great extent by a number of governments and large segments of their citizenry the world over. Not surprisingly, the animus towards "globalization" itself has increased with doom-and-gloom naysayers (including many formerly pro-globalization voices) concluding that globalization is dying, if not dead already.

Just what are the implications of these developments for North America, specifically regional economic integration as embodied in the USMCA? What are the principal arrows in the quiver of North America that can energize its competitiveness regionally and globally?

Canada, Mexico, and the U.S.—individually and collectively—possess assets that can contribute to a significantly more competitive North America.

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To begin, *the political and economic fundamentals* in all three countries serve as an anchor for stability which is vital for growing prosperity. While controversy, polarization, frustration, and scandal have plagued the leaders, administrations, and political parties in all three nations, dramatic—even violent—upheaval is highly unlikely as is the rejection of the basic economic model that has fueled growth for decades.

Increasing levels of inflation with their impact on prices and debt, along with a marked rise in interest rates, will not deter the countries of North America from prudent economic policies and a pro-growth agenda. GDP in all three countries will register between 2% and 3%, and bank lending rates—vitally important for business growth—will rise to 3.5% in both the U.S. and Canada and 6.5% in Mexico. And while Mexico's lending rate is nearly double that of its North American neighbors, one should keep in mind that the lending rates for its South American competitors Argentina and Brazil surpass 30%. Compared to the past, credit is readily available, as are the multitude of sources for accessing credit. This bodes well for small as well as larger businesses in all three countries and enhances private sector competitiveness.

Turning to *human capital*, if we go by test scores, the human capital base for all three countries presents a mixed picture. According to the OECD's PISA scores of 15-year-olds' performance in reading and math, Mexico ranks below average and the U.S. and Canada score above in reading and the U.S. below in math. Be that as it may, averages tell us very little about the amount and quality of human capital necessary to perform at a satisfactory level.

The three nations do have the labor pool necessary to produce and excel, and all three nations have a network of vocational and technical schools that collaborate with the private sector as well as excellent universities in engineering, computer science, business, and the physical sciences. Some of the most notable are the University of Waterloo and McGill, UNAM and Tec de Monterrey, and MIT and Carnegie Mellon. Additionally, there are well-funded public and private research centers and national laboratories dedicated to R&D. Important as well is the cooperation between

North American universities. For example, Canada's and Mexico's higher education associations have formal collaborative agreements, and Arizona State University has a credit transfer partnership with four of Mexico's top universities.[1] More than one-third of Mexican universities have linkages to U.S. and Canadian universities and nearly 40% of Canadian universities have ties to U.S. and Mexican universities.[2]

American high technology companies are also involved in developing human capital in Canada, the U.S. and Mexico. In 2021 Microsoft Canada announced the addition of eight post-secondary institutions to its Canada Skills Program, bringing the total to 20 schools in six provinces across Canada, and IBM has expanded its P-Tech apprenticeship program to Mexico, committing to training 400 university students in new technologies such as artificial intelligence (AI), cloud, and quantum computing. Cemex has joined forces with UNAM and Tec de Monterrey to promote R&D projects, and Bombardier funds a broad range of research and training activities at Centennial College in Toronto.

A nation's technological base and ecosystem of innovation and entrepreneurship are key to competitiveness. Fortunately, all three North American countries have a host of industries such as electronics, pharmaceuticals, energy, aviation, automotive, and industrial and consumer goods manufacturing that compete effectively in the global marketplace.

Another set of assets in North America is *industrial clusters*. These are geographic areas that comprise co-located companies representing either a single or multiple industries. Driven by talent, location, government incentives, networks, transportation, and other infrastructure. Several large firms can source talent from local universities and import and build supply networks for products and services. The auto industry is a perfect example. In all cases, major funding from the public sector, significant financial support from the private sector, and extensive partnerships with universities and research organizations and industry associations comprise the winning formula for clusters to take root, grow and thrive.

One should note, too, that the attraction and retention of talent is essential. Waterloo, Ontario, is a perfect example. The city tops the CBRE list of North American emerging tech talent markets and is itself a cluster for computing.[3] Notable too is Montreal where Facebook launched its AI research lab in 2017 and where Microsoft plans to double the size of its AI research lab.

Canada, in fact, has gone all in embracing the cluster concept. It created 5 Superclusters in 2018 with nearly $1 billion in federal funding matched dollar for dollar by the private sector. Those superclusters comprise: the Ocean Supercluster based in Atlantic Canada, harnessing innovation to improve competitiveness in fisheries, oil and gas, and clean energy; the SCALE AI Supercluster based in Quebec; the Advanced Manufacturing Supercluster in Ontario; the Protein Industries Supercluster based in the Canadian Prairies; and the Digital Technology Supercluster established in British Columbia.

In the case of Mexico, many clusters have formed around the maquiladora industry; and around the broader production for North American markets has exists nationwide. For example, aerospace clusters are prominent in the states of Querétero and Sonora. Automotive clusters are well established in Chihuahua and Saltillo. Medical devices are flourishing in Baja California-San Diego transborder region. And the best-known cluster—IT and electronics—in Jalisco is home to Oracle, Intel, HP, and IBM, and not just in manufacturing but with R&D as well.

When it comes to the U.S., one typically thinks of Silicon Valley and the Northeast's Route 128 when mentioning clusters. But, like Mexico, the proliferation has been nationwide: Colorado (computer integrated systems and programing), Albany (nanotechnology), Pittsburgh (advanced materials and energy) and Minneapolis (cardiovascular equipment), for example. There is also a plethora of start-up and later stage communities like Austin, Salt Lake City, Boulder, Miami, and Seattle that could evolve into the clusters of tomorrow.

Finally, there is the phenomenon of *cross-border* clusters beyond San Diego-Tijuana mentioned above, as one finds with the Arizona-Sonora technology hub. Tech Parks Arizona is known as "Optics Alley," since it produces cameras, lasers, and sensors. University partners collaborating there are the University of Arizona, Mexico's UNAM, and Ben-Gurion University of the Negev in Israel.

In terms of *consumer markets*, the North American consumer market is a lucrative yet challenging one for companies, with the availability of free consumer review websites and social media accessible to shoppers. That includes "aspirational consumers" ones–those at lower income levels. The wide availability of credit cards to all income segments along with an increasing level of disposable income present expanding opportunities for firms within and outside the North American market. While the consumer behavior of the various socioeconomic classes in all three nations is quite similar, there are distinguishing features that are worth mentioning and the three governments are focused in USMCA in expanding participation in cross-continental production and commercial networks for Small and Medium Enterprises (SMEs) as well as to disadvantaged populations.

Looking at Mexico's consumers, the largest age groups are the young and the elderly. These consumers are brand loyal, and the biggest factors in their purchasing decisions are quality, practicality, and price. Mexicans are the 4th biggest network users, and the country is the nation with the most e-commerce, where 85% buy a least one product online. As for Canadian consumers, while affordability and quality are the most important features of their consumption decisions, what distinguishes that nation is the population's championing of a customer-centric strategy.[4] Canadians place an emphasis on companies that show empathy to their customers and employees as well as other stakeholders. They highly value brands that have an authentic purpose and value diversity, inclusion, and the environment.

When it comes to American consumer markets, they were strong even during the pandemic. A unique feature is a consumer base that is more diverse than ever. Among Millennials, 44% belong to an ethnic or racial minority; and there are subsets of this group, GenX, and baby boomers.[5] As would be expected, especially among younger shoppers, more and more purchasing is done online; and feeding this is the intense growth of live streaming (influencers, celebrities). Today, 97% of Americans shop online while brick and mortar stores continue to decline.

Another armament in North America's arsenal of competitiveness is co-production and its relationship to nearshoring. In the Mexican States near the US-Mexico border, these manufacturing sites are known as maquiladoras. They are low-cost production facilities that produce goods mainly for export (principally to the U.S.) They capitalize on the cheap labor force in Mexico and the benefits of the free trade agreement between Mexico, Canada, and the United States, which include imports of intermediate goods from the US. A maquiladora enjoys favorable tax treatment, such as duty-free and tariff-free imports.[6] After NAFTA was passed in 1994, the numbers of plants exploded and now

consist of over 3,000. Everything from consumer electronics to aerospace.

With recovery from the global pandemic underway, exports of non-petroleum goods by Mexico grew by almost 27% in February compared to a year earlier. Grupo Financiero BASE estimates that exports will grow another 6% in 2022. Foreign investment for this type of production is coming back, as well. Mattel, maker or Barbie dolls and Hot Wheels toy cars has announced that Mexico will become the site of its biggest plant in the world, investing $47 million towards consolidation and expansion.[7] And Mexican suppliers saw a 514% increase from 2020 to 2021 in bids from U.S. buyers.[8]

As for co-production and Canada, the Canadian and U.S. steel and aluminum industries are deeply integrated and underpin continental supply chains that strengthen the global competitiveness of the North American economy. In aluminum, Canada and the U.S. share a highly integrated market with combined trade of $12.3 billion in 2020. About 83% of Canada's primary aluminum production is exported to the United States, where it is used as an important input for further processing into products for U.S. domestic and export markets.[9]

Unquestionably, it is the automotive sector where co-production is most extensive and always has been. Americans and Canadians make cars together seamlessly. In fact, this has been the case for nearly 60 years. Companies on both sides of the border routinely trade parts back and forth five or six times before a final vehicle rolls off the assembly line.[10]

Returning to the USMCA and its predecessor (NAFTA), the accord has turned out to be neither an apocalypse nor a panacea but a facilitative commercial framework that reflects and supports commerce in the North American space for over half a century.

In reality, in the post-pandemic world North American integration has been resilient—it is not falling apart. Truth be known, we are trilaterally more interdependent than ever before. And companies outside North America continue to set up shop in the region for the reasons (assets) mentioned above. South Korea is an excellent example. There are over 2,000 companies with South Korean investment in Mexico, including Samsung, LG, Kepco, Posco, Hyundai, KIA and several other auto part manufacturers. This nearshoring saves time and money without compromising quality.

Admittedly, the USMCA is not perfect. For example, there have been disputes over dairy between the US and Canada, and debates over biotechnology, corn, and seasonality between the US and Mexico.[11] Great concern remains over Mexico's polices and regulations in the energy sector affecting US and Canadian companies. And anti-competitive rules of origin requirements prove harmful to producers and consumers alike.[12] Nonetheless, the positives do outweigh the negatives.

If, as Aristotle asserted, "the whole is greater than the sum of its parts," then it behooves all three USMCA partners to effectively address their respective deficiencies in economic and social policy; governance; and legal, regulatory, and administrative policies, and in so doing boost competitiveness in North America. The foundations for expansion and growth are exceptional.

Endnotes

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12. This heavily impacts the automotive sector. USMCA raised local content requirements from 62.5%, as existed under NAFTA, to 75%. It also requires that 40% of cars and 45% of trucks must be manufactured by workers who earn at least $16 per hour. Additionally, the same percentage increase (62.5% to 75% applies to all steel-intensive products.)

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