# Upstairs, Downstairs

With the US being a 17 trillion dollar economy, it can sometimes be easy to forget that both of its neighbours, Canada and Mexico, are in the trillion dollar club as well. Canada is the 10th largest economy in the world by nominal GDP and 17th by purchasing power parity (PPP)-adjusted GDP; Mexico is the 15th in the world by nominal GDP and 11th when adjusted for purchasing power parity. Outside of the US or EU, in fact, Canada and Mexico are already the two largest economies in the world within the same trade bloc. With continued decent GDP growth—both are expected to grow 2-3 percent in 2017—they may soon overtake more EU economies in size too:
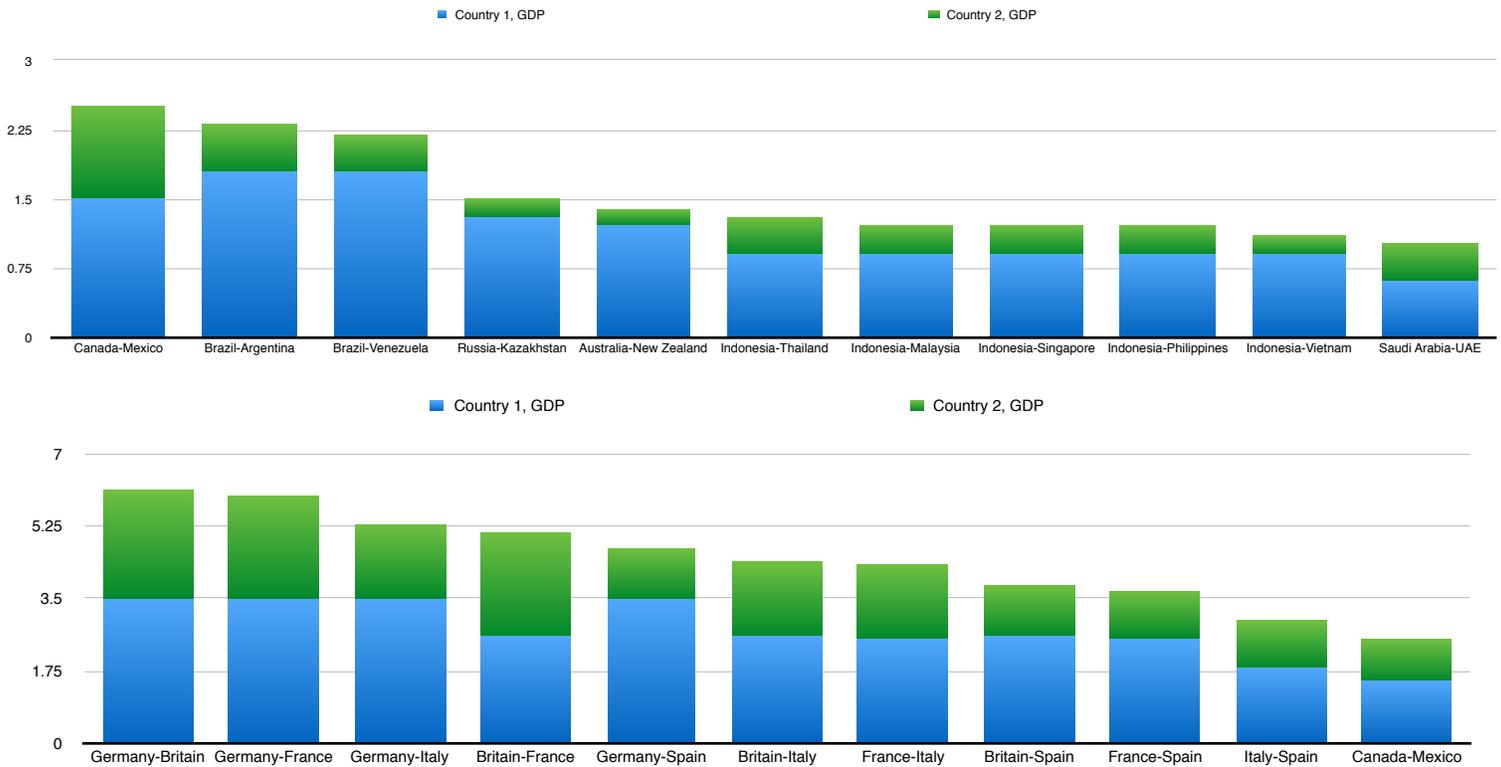
And yet, as the NAFTA renegotitation begins its second round of formal talks this week, the trade bloc shared by Canada and Mexico may to some extent now be on the chopping block. Not surprisingly, the two countries are now attemtping, diplomaticaly, to stand shoulder to shoulder with one another, to present a unified front to the US. But this can be hard to do, especially when those shoulders are separated by a few thousand km of US territory. It may be, then, that the US will divide and conquer them, economically speaking, and get the best deal for itself.

That said, there are many other reasons to believe Canada and Mexico's economies will draw closer together—perhaps far closer together—in the months or years ahead. These reasons include:

1. Mexican Growth —

    Along with the US and the BRIC countries, Mexico is the only state in the world to be ranked in the top fifteen in terms of economic size, population size, *and* territory size. In terms of GDP per capita, Mexico also ranks alongside most of the BRICs: Mexico, China, Brazil, and Russia are all estimated to have per capita GDP's (in nominal terms) of between $8000-$9000.

    Yet Mexico's near-term growth prospects are perhaps higher than those economies are, because Mexico (unlike Russia, Brazil, or many other developing economies) is not too dependent on exports of commodities, the prices of which mostly crashed in mid-2015 and have not yet recovered. Also, because Mexico, unlike China or Russia, still has a youthful population.

    Mexico has a lot of growing to do if it wants to catch up to the average North American GDP per capita, which is roughly $55,000. If Mexico does continues to grow, so too will its trade with Canada be likely to. Mexico has a propensity to trade with Canada that is higher than some might think, given that the two countries still do not trade together so much in absolute terms:
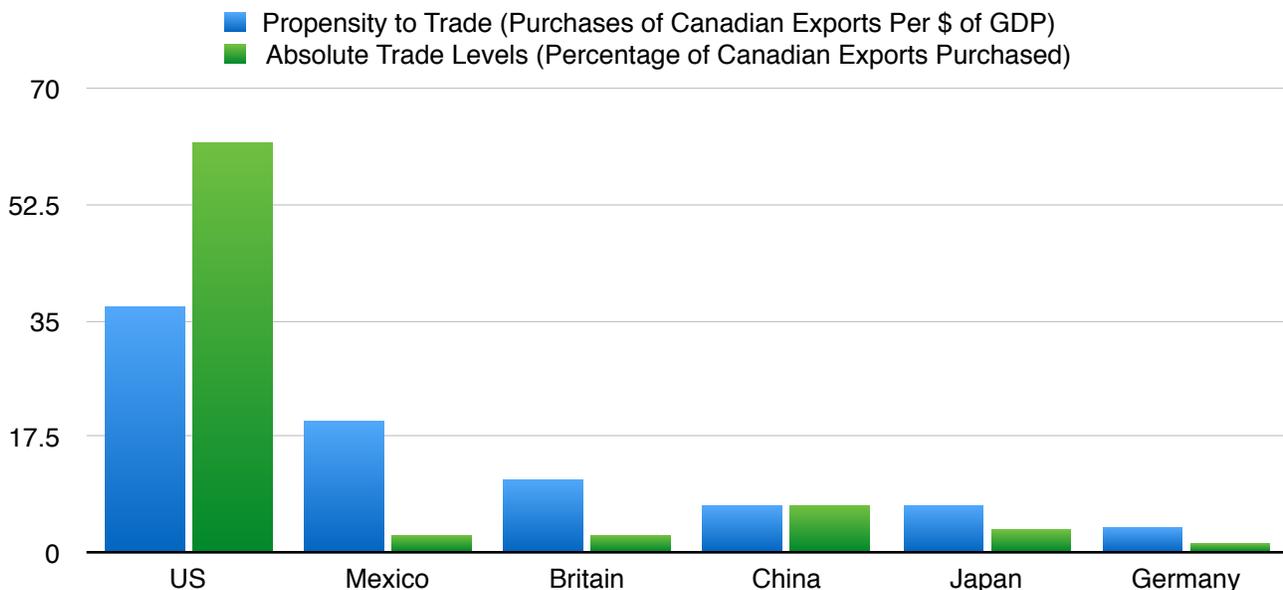
2. China —

In Canadian politics and business, it has become common in recent years to say that by exporting natural resources to China, Canada can finally reduce the near-monopoly that the US has on buying Canadian exports. This view, however, is based on a false extrapolation of a trend that is now nearing (or has already reached) its end: industrial growth in coastal Chinese cities.

As China now seeks to rebalance its economy, investing instead in service sectors (which are less resource-intensive than industrial ones) and interior cities (which have a lower propensity to engage in trans-Pacific trade than coastal ones), its demand for Canadian resources is unlikely to continue to surge. Most of the natural resources it does buy will probably continue to come from within its own borders — China only imports 15 percent of the energy it consumes, for example — or else from its "One Belt, One Road" partners in Asia.

Similarly, as Chinese growth moves away from the coastal industrial sector, the growth rate of outsourcing to China by countries like Canada is likely to decrease. For Canada, much of that future outsourcing of industry and much of that exporting of natural resources that has may instead go to Mexico rather than China, given the size and proximity of Mexico's labour force.

3. Immigration —

With a young population that is increasingly of Mexican or Hispanic descent, there has grown within the United States a political faction which is wary of further Mexican or Hispanic immigration, seeing it both as a threat to the singular position held by the English language in America and also as a threat to US employment levels. This faction includes many of those who voted for Trump in the Republican primaries, and thus it is not surprising to see that the US government has recently been trying to reduce both legal and illegal immigration to the country, while simultaneously prioritizing English-language proficiency (which Latin Americans mostly lack), rather than family reunification, as a factor in selecting immigrants.

Canada, however, unlike the United States, has an aging, Baby Boomer-dominated population, and prioritizes immigrants based not only on English proficiency but also French proficiency. It is much easier for a Spanish-speaker to learn French than English, and, indeed, Canada's French-speaking areas (Quebec and parts of New Brunswick) are have the oldest populations, which are most in need of immigration. Already, Trump's rhetoric has led to an increase in emigration of groups like Haitians and Salvadorans from the US to Quebec.

Canada's Mexican population may grow as well. Certainly it has plenty of room to: in spite of the fact that 21 percent of Canada's population is foreign-born—compared to 14 percent in

the US—only 0.3 percent of Canada's population is Mexican, compared to an estimated 11 percent of the population in the US. Even the state with the smallest share of its population being Mexican or Mexican-American — Maine — has a higher proportion, 0.4 percent, than Canada.

4. Canadian Demographics —

The aging population of Canada's Baby Boomers, and especially of Quebec's Baby Boomers, also indicates another area in which Canada-Mexico economic ties are likely to grow: tourism. Already today, Mexico is the largest destination for Canadian travellers apart from the US. (Plus,the areas of the US that Canadian snowbirds spend the most time — Florida, the Southwest) — are the very ones that Mexican-Americans (or in Florida's case, Hispanic-Americans in general) inhabit in large numbers. As Canadian Baby Boomers reach old age or retire in the years ahead, they are likely to spend more time in places like Mexico, in order to avoid the discomfort (even danger) of dark, icy Canadian winters. This will be most true of Quebec, given its older population, colder winters, and ability to learn basic Spanish.
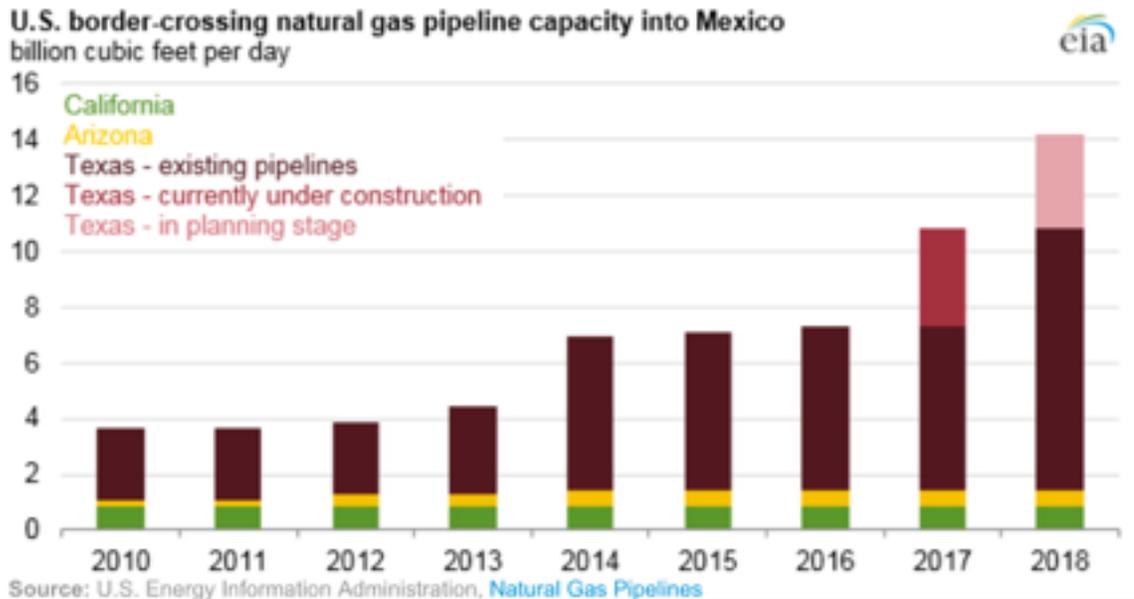
5. The Shale Boom —

Economic journalists frequently focus on direct trade relationships (country A's trade with country B) but ignore indirect trade relationships (country A and B's joint trade with country C). Canada and Mexico already have the largest, second-degree indirect trade relationship in the world; as the graph below shows, Canada's trade with the US plus Mexico's trade with the US is greater than even China-US trade plus China-Japan trade, which is the next largest:
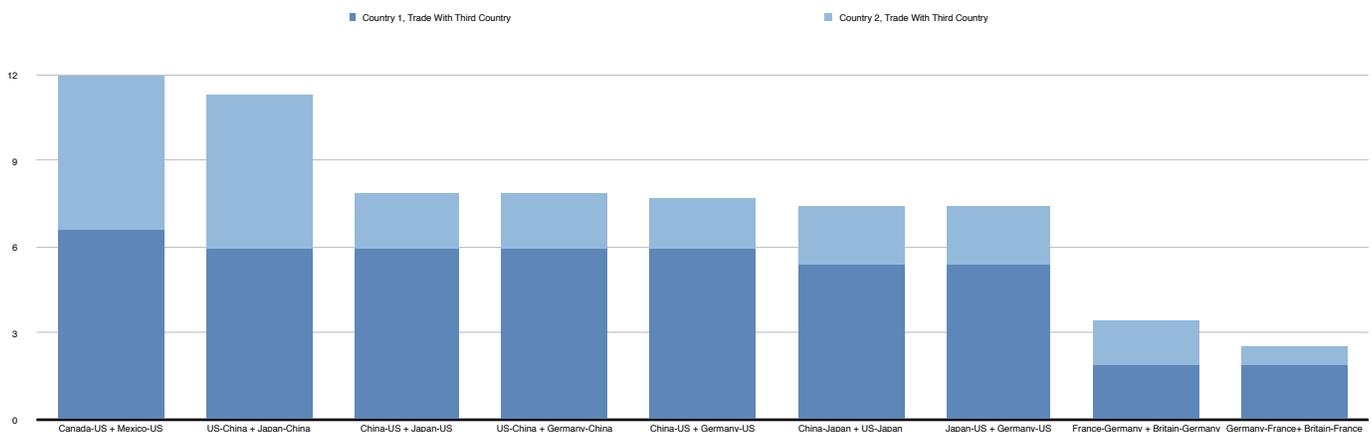
The massive, ongoing shale gas boom in the US is causing Canada and Mexico's indirect trade relationship to grow even more. Canada, which is the world's fourth largest producer as well as exporter of natural gas, had previously exported nearly all of its surplus gas to the US, in order to avoid the high expense of building LNG facilities and pipelines across the Rockies. Now, however, the shale boom has caused US gas prices to plummet, and the US has actually become a huge exporter of gas to Mexico, helping to fuel Mexico's

manufacturing boom. In other words, Canada is now indirectly exporting gas to Mexico, via the US. This relationship may be likely to continue growing, given the Republican commitment to fossil fuel growth, US export growth, and an "energy independent" North America.

U.S. border-crossing natural gas pipeline capacity into Mexico
billion cubic feet per day

Source: U.S. Energy Information Administration, Natural Gas Pipelines

6. US Demographics —

Canada and Mexico's indirect economic relationship is also likely to grow because their shared major trade partner, the United States, in the process of a demographic shift that will likely make it closer (in spite of current US politics) to Mexico. US Baby Boomers will in the years and decades ahead be giving way to the large US Millenial and post-Millenial generations, in which Mexican-Americans and Hispanic-Americans both are greater in numbers than they are in the Baby Boomer generation. According to Pew, the number of Hispanic-Americans is likely to increase from around 50 million today to around 80 million by 2030.

7. Commodity Prices —

The last decade saw migration to the US fall, as a result of Latin America's strong economic growth. Now, however, with commodity prices down since mid-2015, large countries in Latin America — notably Venezuela and Brazil — are in trouble, and an exodus' of migrants to the US and Canada may occur, making Canada more Hispanic in its economic orientation. This also brings us to the next topic, Cuba, a country which has seen all of its historic allies (Russia, Venezuela, Ecuador, Bolivia, Russia, Angola, etc.) weakened by the commodity crash:

8. Cuba —

Travel by Canadians to foreign countries, top 15 countries visited (2015)

	2015		
	Overnight visits		
	Visits	Nights	Spending in country
	thousands		C$ millions
Country visited			
United States	20,707	216,628	19,929
Mexico	1,926	25,690	2,306
United Kingdom	1,193	16,688	1,714
France	1,140	15,041	1,549
Cuba	800	8,716	708
Germany	574	5,523	542
Dominican Republic	487	6,871	561
China	480	10,042	1,009
Italy	459	5,871	583
Spain	399	4,993	382
Ireland, Republic Of	254	3,510	291
Australia	245	5,138	664
Hong Kong	243	3,246	319
Netherlands	240	2,117	187
Jamaica	231	3,333	234

Source: Statistics Canada, Tourism and the Centre for Education Statistics.
Last modified: 2016-11-01.

As the chart above implies, the US reconciliation with Cuba may also lead Canadians to spend more time in Mexico. During the past generation, the US rivalry with Cuba has given Canadians a near lock on the Cuban market. Canadians account for an estimated forty percent of all visitors to Cuba, and Cuba accounts for a disproportionately large destination (given Cuba's *relatively* small size) for Canadian tourists. As the US allows its own population to go to Cuba, however, Canadian snowbirds will lose the advantage of having such a cheap, warm country all to itself. Many of them will likely re-route to other Caribbean beaches.

A similar situation may exist for Canadian investment. If the US begins outsourcing to or investing in Cuba, redirecting some investment that would have otherwise gone to Mexico, it may leave more room for Canadians to find opportunities for investing in the large Mexican economy.

9. Climate —

The relationship may not even remain one-way only: Mexicans may begin to visit Canada more often too. Today Mexicans do not go to Canada much, because they lack the disposable income to do so. If and as Mexicans become wealthier, however, they may look to Canada as a place to go in the summer; a place where the summer weather is not too hot, the major metropolises are not too crowded, and a cottage by a northern lake may be rented at an affordable rate.

Climate change could, sadly, also play a role in this equation. Mexico — and also the Southwestern US, in which tens of millions of Mexican-Americans live, and in which millions of Mexican seasonal workers labour in industries like agriculture — has a dangerously arid climate, whereas Canada is in possession of an abundance of renewable, surface-level freshwater.

10. The Internet —

Another important pull factor for Canadian snowbirds will be "e-commuting". The ability for young Canadians to spend time in a cheap, warm country like Mexico in the winter is likely to increase dramatically as a result of the modern Internet. Again, this is particularly true for Quebec. The Internet is increasingly allowing people to "outsource themselves" to foreign countries.

Conclusion

Obviously, given current US politics, Canada and Mexico have more of an interest than ever in showing that they can trade with one another regardless of what Washington intends to say or do about NAFTA. An economic relationship between Canada and Mexico could, however, turn out to be far more significant than being just a knee-jerk response to Trump's America-First position. As we have discussed, Canada and Mexico are in fact complimentary nations. They may not be *too* close to one another physically—Mexico City is 3000 km from any major Canadian city—but there are other factors that may help to unite them: competitive advantage (Canada has capital, Mexico has labour), climate (Canada is cool and wet, Mexico hot and dry) and even communication (both are Romance countries). These trillion dollar economies have a bright future together within NAFTA, no matter how often any of its members try to renegotiate it.