THE NEXT PRESIDENT OF THE UNITED STATES

CHALLENGES AND RECOMMENDATIONS FOR THE US-MEXICO RELATIONSHIP

Edited and Foreword by: Lila Abed

Essays by: Vanda Felbab-Brown | Ambassador Anthony Wayne and Diego Marroquín | Ernesto Castañeda and Julia G. Young | David L. Goldwyn and Lourdes Melgar | Rosario Sanchez and Gabriel Eckstein | Miguel Ángel Lara Otaola

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The Mexico Institute seeks to improve understanding, communication, and cooperation between Mexico and the United States by promoting original research, encouraging public discussion, and proposing policy options for enhancing the bilateral relationship. A binational Advisory Board, chaired by Luis Téllez and Earl Anthony Wayne, oversees the work of the Mexico Institute.

Ambassador Mark A. Green, President & CEO, Wilson Center

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Contents

Foreword

Lila Abed

The bilateral relationship between the United States and Mexico is broad and deep, bound by geographical, historical, cultural, and commercial ties that span over 200 years of diplomatic relations. Every twelve years the presidential elections in the United States and Mexico coincide and provide an opportunity to analyze past and current efforts and propose public policy options to the new governments to enhance the bilateral relationship.

The US-Mexico relationship touches the lives of millions of US citizens daily, more so than any other country in the world, with more than 1 million border crossings registered each day and one million dollars' worth of bilateral trade every minute.[1] In addition to sharing a nearly 2,000-mile border, the countries share mutual challenges, interests, and opportunities. Increasing cooperation on vital issues of the bilateral agenda- including security, trade, and migration- is crucial for ensuring the prosperity and safety of both nations.

With the onset of the Covid-19 pandemic, the Ukraine war, and rising competition with China, geopolitical trends have shifted from globalization towards regionalization. The disruptions to global supply chains caused by international crises paved the way for *nearshoring* to minimize the impacts on supply chains by moving production facilities closer to home markets or within regional markets. The *nearshoring* phenomenon reinvigorated North America, especially with the entry into force of the United-States-Mexico-Canada (USMCA) on July 1, 2020. USMCA, which replaced the 1994 North American Free Trade Agreement (NAFTA), included key new chapters and provisions that boosted North America's competitiveness, certainty, and trade vis-à-vis other trading blocs.

Since USMCA came into force, investment in the region soared 136%, and trade in goods and services increased by 50%.[2] Trade between the US, Mexico, and Canada reached 1.57 trillion dollars each year. In 2023, Mexico became the US' top trading partner, surpassing China and Canada, with two-way trade totaling just shy of 800 billion dollars.[3] An estimated 5 million US jobs depend on trade and investment ties with Mexico,[4] and up to 12 million US jobs rely on trade with its North American partners. Ahead of the 2026 USMCA review, the three nations must work together to resolve pending concerns and trade disputes and develop actionable recommendations to continue strengthening USMCA and deepening North American integration in a way that benefits each nation.

The incoming US administration should use this opportunity to rebuild mutual trust among security agencies on both sides of the border and increase cooperation on shared challenges ranging from reducing illicit activity and transborder crime, combatting transnational criminal organizations and their production and distribution of synthetic opioids, disrupting illicit arms trafficking and financiers, to dismantling human smuggling networks and combatting cybercrime. Despite the recent deterioration of US-Mexico security cooperation under Mexico's previous administration, Mexican President Claudia Sheinbaum's security strategy presents the opportunity for more robust intelligence and information sharing with US counterparts to identify and pursue criminal networks.

In recent years, the US government has witnessed unprecedented levels of cooperation with Mexico to help stem the flow of migrants from reaching the US southern border. Heightened apprehensions in Mexico through efforts, such as busing and flying migrants to the southern part of the country[5] and the Mexican National Guard's involvement in migration enforcement,[6] have contributed to a steady decrease of detentions at the US-Mexico border this year compared to 2023.[7]

Migrants from different regions are entering Mexico's southern border, hoping to reach the United States. Ensuring legal, safe, and orderly migration is essential and requires working with Mexican and regional authorities. The US should prioritize control and security of its borders while safeguarding migrants' human rights. With record numbers of migrants seeking asylum at the US-Mexico border, the US government should continue to implement policies that allow for timely processing of asylum claims to address the backlog of more than 2 million asylum applications. The US can simultaneously open legal pathways, such as temporary visas, while bolstering border security and enforcement.

The US-Mexico border region is a vital source of commercial and cultural activity. In 2023, US land borders with Canada and Mexico produced over 1.5 trillion dollars in cross-border trade. The US should enhance border security by adopting new technologies at its ports of entry and modernizing its infrastructure to ensure the legal, safe, and efficient flow of goods. Cross-border cooperation on issues such as water management, public health, and public safety requires strong coordination and collaboration with authorities on both sides of the border. Investing and building a more robust US-Mexico border region will allow the US to reap significant economic benefits and ensure a more competitive and innovative North America capable of countering China.

The US-Mexico relationship is vast. While the leaders of both nations need to establish clear objectives on the bilateral agenda, US-Mexico relations must be strengthened at all levels. The US Congress should engage more with its Mexican counterparts by reinstating the US-Mexico Inter-Parliamentary Group to discuss critical issues on the bilateral agenda. State-to-state engagement between the two countries should deepen, as Mexico remains the top trading partner and export destination for many US states.[8]

The US and Mexico have various institutional mechanisms for communication and engagement. The North American Leaders' Summit (NALS)[9] provides the three countries a platform to address shared challenges, promote investment, and reinforce the competitiveness and resilience of the region. The High-Level Economic Dialogue (HLED)[10] involves annual cabinet-level exchanges to advance mutually beneficial economic and social priorities. In 2021, the United States and Mexico agreed to a new security cooperation approach based on partnership and shared responsibility, known as the Bicentennial Framework for Security, Public Health, and Safe Communities.[11] Developing indicators to measure results and achieve the proposed deliverables for these mechanisms is needed. The US and Mexico- and Canada- should work on implementing the agreed-upon binational and trilateral actions.

At such a critical juncture in US-Mexico relations, the Wilson Center's Mexico Institute prepared this booklet to delve deeper into fundamental issues on the bilateral agenda and propose recommendations to the next US president on ways to better engage with Mexico. The booklet includes sections on security, USMCA implementation and the upcoming 2026 review, migration, energy, cross-border water management, and democracy.

In December 2023, the Mexico Institute published a similar booklet[12] geared towards Mexico's incoming president with recommendations on how to strengthen its relationship with the United States. Both booklets offer an overview of the topics, followed by recommendations at the end of each section. These are highly complex topics, but the objective is to provide a concise analysis, which means that some aspects or elements of the selected sections could not be covered.

Given the evolving political landscape in the US and Mexico, the authors will have the ability to periodically update their sections on the electronic version of this booklet. For brevity, multiple issues on the bilateral agenda were not included despite their importance. The Mexico Institute will explore these and other matters throughout its ongoing programming.

The **security** section provides an overview of the security strategy implemented by former Mexican President Andrés Manuel López Obrador (AMLO) and the security plan of the Sheinbaum administration. The author describes the wide range of illicit activities that Mexican criminal groups are involved in and their impact on US national security interests and Mexican society. This section analyzes the opportunities that Sheinbaum's security strategy presents and offers recommendations on how to strengthen US-Mexico counternarcotics and security cooperation.

The **USMCA** section focuses on the significant progress made in the last four years of the agreement, noting the expansion of trade, investment, and job creation in the region. Despite these successes, the authors delve into some of the USMCA's shortcomings, including the limited application of the Rapid Response Labor Mechanism (RRLM). The authors address multiple challenges ahead of the 2026 review, such as compliance issues, China's growing economic influence in Mexico, broadening USMCA, and sustaining North American cooperation.

The **migration** section addresses the need for the US to both protect its borders and develop policies that reflect evolving migration trends. Understanding the changing patterns of US-bound irregular migration is critical for implementing appropriate immigration policies and enhancing security at the US' southern border. Migrants will continue to reach the US-Mexico border if the root causes that push migrants to leave their countries of origin remain unresolved. The US should work with its regional partners to dismantle and prosecute human trafficking and migrant smuggling networks that have become increasingly more complex and dangerous. Sealing the US-Mexico border to protect national security interests is paramount, though it should be coupled with legal pathways (including temporary visas) to reduce unauthorized migration pressures.

The **energy** section highlights the need to boost Mexico's domestic energy supply and clean power to achieve sound economic growth. Ahead of the 2026 USMCA review, the authors stress the repercussions of Mexico's recently approved constitutional reforms [13] on US companies and investment. The potential of Western investors detracting from Mexico could deepen China and Russia's growing influence along the US border. The authors urge the next US administration to revive bilateral and multilateral energy policy engagement with Mexico through NALS and private avenues to express concern about the risks that specific energy policies pose for the future of both countries.

The **water** section discusses the borderland shared between the US and Mexico. Climate change, unpredictable precipitation patterns, intense wildfires, and other extreme weather events seriously threaten the shared water systems between both countries. Changing conditions could cause widespread health effects, impacting communities in the US-Mexico border region. The International Boundary and Water Commission (IBWC), a binational organization managing water along the border, requires additional resources to boost its capacity to implement the 1944 Water Treaty. The authors discuss issues such as the management of the Colorado and Rio Grande Rivers, groundwater under the border, the growing vulnerability of water quality, and offer recommendations on how to address ongoing challenges.

Diverse international reports have recently signaled a decline in Mexico's **democracy.** This section describes the objectives set forth by AMLO's Fourth Transformation and the onset of a possible new regime type in Mexico. It analyzes certain decisions and developments taken by AMLO's government that, according to reports and the author, may undermine the country's institutions and democratic principles. Though democratic governance has received little attention in past years, a stable and democratic Mexico is fundamental to US interests and the bilateral relationship.

We do not expect all of the recommendations in this booklet to be adopted as written. We do hope, however, that the next US president and administration, as well as others interested in US public policy and the US-Mexico bilateral relationship, will find them worthy of consideration and further exploration as they develop their policies and recommendations in the years to come. The Mexico Institute stands ready to continue supporting key policy discussions that will lead to a safer, more secure, and prosperous bilateral relationship.

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Security

Vanda Felbab-Brown

The start of the Claudia Sheinbaum administration in Mexico provides an opportunity for strengthened US-Mexico counternarcotics and security cooperation. Although a close protégée of the former Mexican president Andrés Manuel López Obrador (whose security policies were deleterious to both Mexico and the United States), Sheinbaum unveiled a surprisingly comprehensive anti-crime plan in October 2024. During the López Obrador administration, criminality in Mexico reached unprecedented levels while Mexico's law enforcement cooperation with the United States plummeted. Far from quelling violence, López Obrador's hands-off approach toward organized crime groups facilitated growth in their power and functional reach in Mexico and their expansion around the globe. These developments profoundly threaten US national interests as well as the Mexican state and society. It is increasingly likely that Mexico could turn into a narcostate, even if a stable one, unless substantial changes in policies in Mexico take place.

Although the structural legacies and legal and policy frameworks that López Obrador handed over to his successor hamper the implementation of more effective anti-crime policies in Mexico, the United States can embrace the various positive elements of Sheinbaum's security plan. It should broaden its counternarcotics policies vis-à-vis Mexico to tackle the entire spectrum of criminal activities of Mexican criminal groups beyond fentanyl trafficking. Countering fentanyl trafficking itself, a key priority for the United States, will be enhanced by a broader and smarter approach. The United States also needs to strengthen its anti-crime policies at home and look beyond relying on Mexico to counter migration to the United States.

Criminal Activities in Mexico and their Impact on US Interests

Mexican criminal groups have not only diversified into a wide range of illegal activities, such as extortion, human smuggling and trafficking, illegal logging and fishing, wildlife trafficking, and cyberscams, but they are also taking over legal economies in Mexico.[1] While Mexican criminal groups do not engage in extensive violence in the United States as they do in Mexico, their criminal activities in Mexico pose serious threats to US public health, security, economic, and geostrategic interests.

Mexican criminal groups—particularly the Sinaloa Cartel and Cártel de Jalisco Nueva Generación (CJNG) — are the principal suppliers of fentanyl, methamphetamine, cocaine, and other illicit drugs to the United States. The lethal fentanyl is increasingly mixed into all kinds of drugs in the United States, killing tens of thousands of people per year. The purest and most potent in the world, Mexican methamphetamine has also become increasingly deadly. Like fentanyl, it is largely produced from non-scheduled chemical precursors with limited government regulations that the Mexican cartels import from China and India.[2]

Beyond smuggling drugs directly into the United States, Mexican drug trafficking groups also sell fentanyl and methamphetamine through pharmacies that operate in Mexico's major tourist areas and cater to US customers. For decades, US citizens have bought their regular medication in Mexico since they struggle to cover the high costs of medications in the United States.[3] As I saw during my June 2023 fieldwork in various parts of Mexico, the cartel-supplied pharmacies openly advertise drugs such as antibiotics, anabolic steroids, and prescription opiates but sell them illegally without prescription. Furthermore, these pharmacies do not inform their international customers that Mexican cartels mix fentanyl and methamphetamine into drugs such as oxycontin and Adderall to supply the illegal market and get new victims hooked. The pharmacies thus pose enormous life-threatening public health hazards and serve as vectors of international drug trafficking.

As a result of investigative work by *Los Angeles Times* and *Vice* and the subsequent US government pressure, the Mexican government finally shut down tens of these cartel-linked pharmacies between March 2023 and December 2023.[4] Hundreds more, however, remain. Moreover, the López Obrador government did not appear to mount any investigation into which cartels or illicit drug networks were supplying the fentanyl- and methamphetamine-laced drugs to the pharmacies, even though a handful of pharmacy managers and shop assistants selling the illegal drugs were arrested.[5]

These pharmacies and this form of illicit drug supply continue to pose a high threat to the safety of US citizens. The adulteration of fake medications with fentanyl and methamphetamine is not the sole problem. The retail of any controlled medication without a prescription can pose significant harm. For example, the unauthorized sale of antibiotics intensifies the spread of drug-resistant bacteria—a grave global public health, economic, and security threat.

Although Mexican criminal groups are more cautious of inflicting harm on US citizens than on Mexicans for fear of US law enforcement,[6] US and other foreign citizens living or traveling in Mexico can find themselves subject to extortion, murder, or kidnapping, whether on purpose or as a result of cartel hits gone awry.[7]

No terrorist attack against the United States has ever originated across the US southern border, with both the Mexican government and Mexican cartels themselves understanding the high costs of failing to counter any terrorist activity in Mexico.[8] But as the Sinaloa Cartel and CJNG have become far more involved in human smuggling—charging extortion fees to human smugglers, fostering logistical chains for human smuggling, and recruiting migrants from as far away as West Africa—their level of control and screening over migrant flows may have been reduced. The intensity of risk from migration nonetheless remains relatively low because, as in all cases, the vast majority of migrants are escaping political oppression and economic misery and do not seek to perpetrate crime.

Similarly, the increased volume of Russian-speaking migrants coming to Mexico and crossing the US-Mexico border could augment the risk of Russian criminal actors entering the United States illegally or setting up shop in Mexico. The greater risk is that Russian intelligence agents in Mexico could recruit assets among Mexican criminal groups. Yet, despite US objections, the López Obrador administration tolerated a significant increase in the presence of Russian intelligence agents in Mexico, even as European countries began expelling them.[9]

Mexican criminal groups also pose a variety of economic threats to the United States and US citizens. Not only do Mexican products taxed by the narcos head from Mexico to the United States and contribute to the coffers of Mexican criminal groups, but the criminal violence and theft in Mexico, such as truck-hijacking and narco-blockades of legal ports of entry, jeopardize the safety of US-Mexico supply chains. The increasing economic reach of Mexican criminal groups into legal economies in Mexico[10] also imposes economic costs on the United States and the economic growth enabled by the United States-Mexico-Canada Agreement (USMCA).[11] The criminal infiltration into legal economies could jeopardize US geostrategic objectives of de-risking from China through nearshoring to Mexico as well as expose US businesses and individuals to grave legal liabilities.

Increasingly, the Mexican cartels, most prominently CJNG, harm US citizens through cyberscams, such as timeshare scams. Such scams and other cybercrime activities have cost US citizens hundreds of millions of dollars, often destroying the entire savings of US families.[12] Timeshares are also a money laundering tool for the cartels, as are investments in construction, including hotels and resorts, and hospitality services in areas of high tourism.[13] Overall, Mexican criminal groups use a wide range of money laundering methods, including cryptocurrencies.

A particularly problematic form of illicit value transfer is the increasing payments for fentanyl and meth precursors with Mexican wildlife products, coveted in China for Traditional Chinese Medicine, aphrodisiacs, and other forms of consumption. Instead of paying Chinese suppliers of precursor chemicals with cash, Mexican cartels pay them in wildlife.[14] This value-transfer method engenders multiple serious threats to public health and safety, economic sustainability, food security, and global biodiversity. It can devastate Mexico's unique and valuable biodiversity and the transmission of dangerous zoonotic diseases, thus also posing a threat to national security.

Increasingly, Mexican criminal groups also utilize Chinese money laundering networks. In fact, Chinese money laundering networks have become the go-to money launderers for Mexican cartels. Since various Chinese criminal groups also provide a variety of services to the Chinese government and intelligence agencies, such as developing networks of influence and corruption abroad and monitoring and repressing Chinese diaspora communities,[15] the intensified interactions among Mexican and Chinese criminal groups could also pose an intelligence and national security problem. These strong criminal relations could bring Mexican criminal groups to closer proximity with Chinese espionage agents.

In sum, the existing level of criminal takeover of Mexico and the possibility that it could be exploited by hostile powers pose extensive and multifaceted threats to the United States. Few international relationships are as directly consequential to the United States as the US-Mexico bilateral relationship.

★ RECOMMENDATIONS ★

- **Elevate Mexico to a level of priority in US interests on par with China and Russia.** The importance of US interests regarding Mexico and the severity of the criminal challenge that Mexico faces require that the United States expands and strengthens its policy toolbox for dealing with Mexico. A sotto voce approach has failed to induce adequate cooperation from Mexico on a wide range of core issues, including countering fentanyl trafficking and the takeover of Mexico by criminal actors. The bilateral agenda needs to go beyond a narrow focus on migration as the dominant issue.

- **Take a holistic approach to countering the panorama of operations Mexican criminal groups engage in rather than narrowly focusing on drug trafficking in isolation.** Countering their fentanyl trafficking is essential but not sufficient since fentanyl trafficking is facilitated by parallel crime operations.
- **Strongly support and incentivize actions by the Mexican government to start purging Mexican criminal groups from Mexico's legal economies and government institutions.** The United States should support the Mexican government in moving beyond the sporadic hits and window-dressing operations against criminal groups that characterized the López Obrador administration and toward mounting a sustained and comprehensive effort to roll back the criminal takeover of the Mexican state and society.
- **Offer Mexico assistance with building the intelligence and investigative structures and capacities the Sheinbaum administration seeks to establish, conditioned upon the implementation of anti-corruption measures.** Purging out the extensive corruption and criminal networks from Mexican institutions must be an indispensable twin element of US assistance provision. Expanded US access will once again fall flat if Mexican rule-of-law institutions remain corrupt.
- **Expand the presence of US law enforcement agents in Mexico.** The United States should no longer allow itself to be placated with Mexico's questionable reports of labs busted and the amounts of drugs and precursors seized without such numbers being verified by the ride-along US law enforcement agents. The United States should work with Mexico to build out busts and seizures into the dismantling of Mexican criminal networks.

- **Disincentivize the cooperation of Mexican criminal groups with anti-US state actors who may seek to recruit them.** Communicate to criminal groups that if they cooperate with anti-US espionage, sabotage, and other clandestine operations of other governments, they will become as much a US priority target as groups trafficking to the United States highly lethal drugs such as fentanyl.
- **Collaborate in anti-money laundering efforts and financial intelligence build-up against Mexican criminal groups in Mexico and the United States.** Within the panoply of anti-money laundering measures, the United States should particularly encourage Mexico to focus on countering the role of Chinese money-laundering operations servicing Mexican cartels and on the value transfer among illegal economies, such as logging and wildlife trafficking, increasingly utilized by the cartels to evade banking sector controls.
- **Enhance cooperation in the public health domain to respond to expanding drug use in Mexico.** Encourage the adoption of robust wastewater monitoring to detect drug use and its evolving patterns in both countries. Other concrete measures include expanding naloxone availability in Mexico to reverse opioid overdoses as well as methadone maintenance and other medication-based treatment of those suffering from opioid use disorder.

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USMCA

Ambassador Anthony Wayne
and Diego Marroquín

Introduction

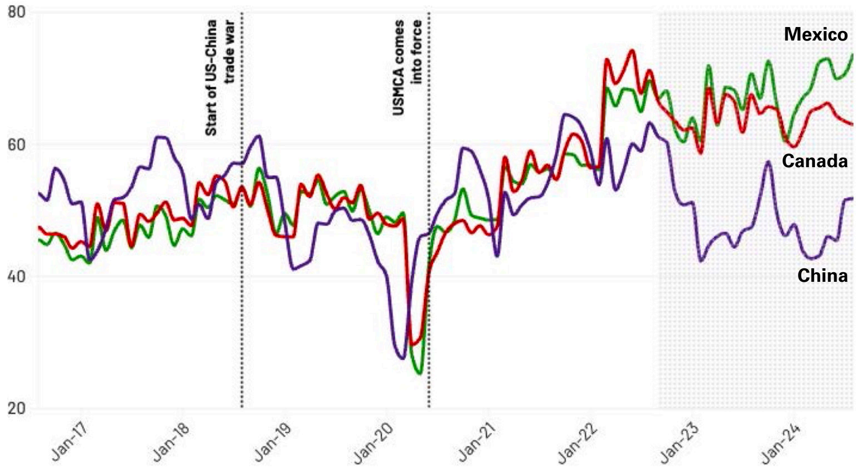
Since coming into force on July 1, 2020, the United States-Mexico-Canada Agreement (USMCA) has delivered remarkable results. Despite challenges which included the COVID-19 pandemic, rising competition with China, and Russia's invasion of Ukraine, trade in goods and services within North America has surged by 50% and investment in expanded and new ventures has increased by 136%.[1]

In its early years, the agreement enhanced economic integration across all three countries, boosted investment, eliminated supply chain bottlenecks, and funneled unresolved issues into agreed-upon dispute resolution channels. However, much work remains to fulfill the commitments and opportunities built into USMCA, as major disputes are still unresolved, and substantial challenges lie ahead to develop to potential growth many see as possible.

USMCA has strengthened the partnership between Mexico, Canada, and the US, boosting North America's resilience and competitiveness against global powerhouses like China and the European Union. The region is also positioned as a global leader in standard-setting. With new leadership in the US and Mexico, and potential elections in Canada, the three countries should capitalize on this moment to build on USMCA's

Figure 1: Mexico Becomes the US's Largest Trade Partner

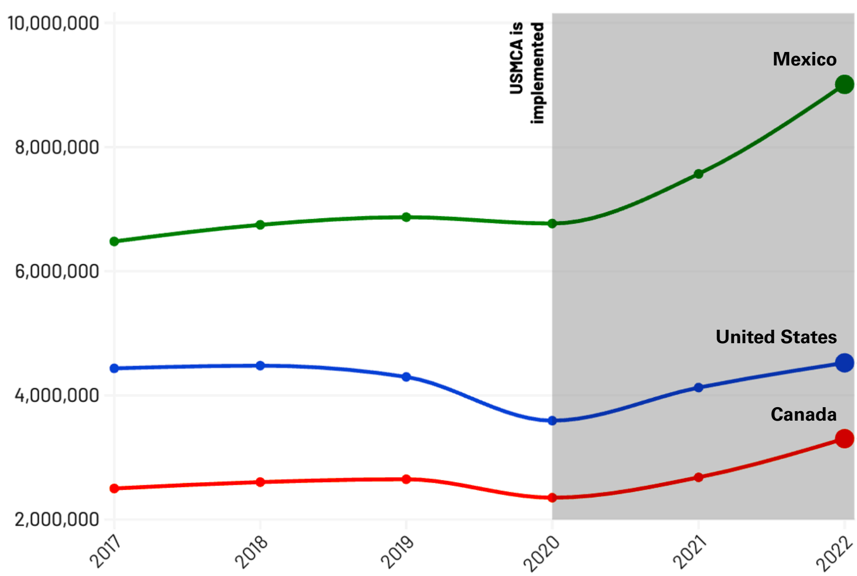
Total goods trade in billions of US dollars; August 2016 through August 2024



Source: US Census Bureau Total trade (imports+exports). Dollars on a nominal. basis, not seasonally adjusted. Author: Diego Marroquin Bitar (@DiegoTMEC)

Figure 2: USMCA Fuels Job Growth, Adding 931K U.S. Jobs Through Trade

Number of jobs supported by intrarregional goods and services trade, 2017–2022



Source: Author's own calculations using Brookings USMCA Tracker. Author: Diego Marroquín Bitar (@DiegoTMEC) momentum. By making potential adjustments to their trade integration and building more effective engagement by stakeholders, the three nations can see significant benefits of trade integration and ensure the agreement's continued success.

Key Figures Behind USMCA's Success: Trade, Jobs, Investment, and Workers' Rights

The last four years have shown significant progress in expanding trade, investment, and job creation. In 2023, the total value of trade within North America exceeded $1.88 trillion—equivalent to $3.6 million exchanged per minute—driven by double-digit growth since USMCA replaced NAFTA in 2020. This remarkable growth positioned Mexico as both the US' top supplier and export destination for the first time since 2002, with merchandise trade volumes 54% larger than US-China trade during the first half of 2024.[2] Additionally, 35 U.S. states had Canada as their top export destination in 2023, while China held this position for only three states—Louisiana, Alaska, and Washington.

USMCA has also fueled job creation in North America, with intra-regional trade in goods and services supporting nearly 17 million jobs in 2022—a 32% increase compared to 2020 (Brookings USMCA Tracker). This trade boom contributed to 4.1 million new jobs in Mexico, 950,000 in Canada, and 931,000 in the U.S.

Similarly, since the implementation of USMCA, investment has surged, with the US and Canada emerging as the top global destinations for foreign direct investment (FDI) in 2023, attracting $311 and $50 billion, respectively. However, Mexico has lagged, securing only $37 billion in FDI, with nearly half coming from North American partners. This figure also falls short compared to other major Latin American economies; for instance, Brazil attracted $66 billion during the same period. Still, all three countries have benefited relatively to China as a source of manufacturing production during this period, showing the importance of US-Mexican and US-Canadian trade as a source of growth for the region.

When it comes to workers' rights, substantial progress is evident with the introduction of USMCA's Rapid Response Labor Mechanism (RRM). From May 12, 2021, to September 16, 2024, 30 labor complaints were filed under the RRM, leading to 25 prompt and positive resolutions that resulted in improved wages and better working conditions for thousands of workers. Notably, all complaints were related to Mexican facilities, with 66% of the cases involving Mexico's automotive sector.

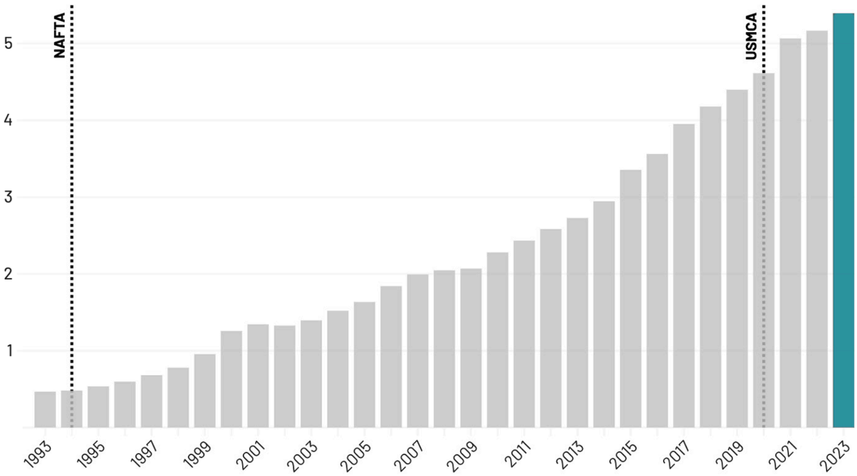
Despite these successes, the RRM's application remains limited. USMCA restricts its use for US and Canadian facilities, allowing Mexico to invoke the mechanism only for facilities that are already subject to orders issued by specific domestic enforcement agencies. Furthermore, only two cases have reached the panel stage, leaving important elements of the RRM untested. The Mexican government may seek to address this imbalance during the upcoming USMCA review, potentially aiming to broaden the mechanism's scope to ensure more equitable enforcement across all three countries.

The Importance of a Successful Review of USMCA in 2026

The USMCA was approved for an initial 16-year term, lasting until July 1, 2036, with the option for extension and a mandated review at the six-year mark (Article 34.7). This provision allows the agreement to address emerging issues without triggering a full renegotiation, ensuring it re-

Figure 3: FDI in the U.S. Reaches New Peak on a Historical-Cost Basis

Foreign Direct Investment Position in trillions of dollars, 1993-2023



Source: U.S. Bureau of Economic Analysis Figures not adjusted for inflation
Author: Diego Marroquín Bitar (@DiegoTMEC)

mains relevant and adaptable to changing economic and geopolitical landscapes. However, it also introduces significant risks. For instance, the uncertainty surrounding the review clause is a major concern for businesses and entrepreneurs in the region, whose long-term investment decisions require years to yield returns.

Per the agreement, the governments of Mexico, Canada, and the United States will convene in 2026 to assess USMCA's effectiveness, consider recommendations from any of the parties, and decide on appropriate actions. Each country can gather input from stakeholders, including businesses, unions, NGOs, legislators, and local authorities involved in USMCA. Since the next U.S. president will not have Trade Promotion Authority, Congress will play a more prominent role in the review process (unless Congress agrees to somehow forgo that authority).[3]

An effective approach to the review would use this moment as a chance to pursue improvements that ensure both USMCA's credibility and longevity. Jointly addressing issues of common concern—such as countering unfair trade practices from China, eliminating forced labor from supply chains, expanding digital trade and opportunities brought about artificial intelligence, and enhancing regulatory cooperation—will be crucial. While disagreements should be addressed during this process, they must be resolved within the broader context of promoting USMCA's benefits for all three countries. Failure to conduct a successful review would introduce significant risks and costs, particularly to the investments necessary for ensuring North America's long-term security and competitiveness.

Challenges

USMCA Compliance Issues

USMCA's dispute resolution mechanisms have successfully reduced the risk to trade and investment across North America. Nine state-to-state disputes have been initiated so far, covering issues like automotive rules of origin, oil and gas, solar panels, digital services tax, and agricultural trade. However, several significant cases remain unresolved, including those involving Mexico's approach to genetically modified corn and energy policies, Canada's dairy trade policies, and the US' calculation of automotive rules of origin. Notably, it has been nearly two years since a panel ruled that the U.S. position on automotive rules of origin was inconsistent with USMCA, yet no further action or announcements have been made, raising concerns about enforcement.

Additionally, after a decisive electoral victory, Mexican President Claudia Sheinbaum and the governing party's (Morena) coalition are using their absolute majorities in Congress to approve a series of constitutional reforms that threaten to weaken Mexico's economic regulatory framework, degrade its investment climate, and jeopardize USMCA compliance.[4] More critically, if passed, these reforms would not only risk billions of US and Canadian investments in Mexico but could also complicate the 2026 USMCA review and increase the likelihood of the agreement expiring in 2036, endangering the long-term stability and economic benefits the trade agreement has brought to the region.[5]

For the next US president, addressing Mexico's reforms through constructive dialogue will be crucial. Ensuring that all parties adhere to panel rulings, even when they are contrary to national interests or interpretations, is essential for maintaining the credibility of USMCA's dispute resolution system and safeguarding the foundational principles of the agreement. Continuing to address Canada's proposed Digital Services Tax through USMCA's dispute process is also critical.[6]

China's Growing Economic Influence

China's growing global economic influence and North America's reliance on Chinese inputs have spurred bipartisan concerns in the United States. Rather than using a unilateral approach, the US should foster dialogue with Mexico and Canada. By adopting a coordinated approach to maintain and grow North American production in sectors vital to national security—such as border infrastructure, electric vehicles, semiconductors, critical minerals, and medical devices—the region can safeguard its competitiveness and boost supply chain resilience in North America. Jointly defining "red lines" on Chinese investments and trade and reinforcing the region's production chains will help the three nations maintain USMCA's benefits and counter China's rising influence.

As North America moves into a new era of global competition, the future agenda must focus on boosting competitiveness in critical sectors. This will involve balancing the integration of European, Japanese, and Korean production within North America, while addressing competition from China and other global players. Such efforts will occur within USMCA and other North American fora, requiring strategic dialogue to ensure the region retains its competitive edge without fragmenting production within North America.

Sustaining North American cooperation Beyond USMCA

While USMCA has bolstered North American integration, momentum must be added to bilateral and trilateral cooperation outside the agreement to enhance trade and investment. Regulatory harmonization, infrastructure development, and labor mobility are key areas where greater cooperation could make all three economies more globally competitive. Expanding collaboration beyond USMCA will maximize the agreement's benefits and better equip North America to manage emerging geopolitical risks.

Broadening USMCA

Some US lawmakers have advocated to expand USMCA to include new countries from the Americas (see Americas Act)[7]. While deeper trade, investment, and production ties with countries like Costa Rica and Uruguay are attractive, it is unclear if the upcoming 2026 USMCA review is the best venue for pursuing this expansion. Adding new members could complicate negotiations among current USMCA partners and necessitate renegotiating concessions to accommodate new entrants.

★ RECOMMENDATIONS ★

- **Leverage the 2026 USMCA review to reinforce the agreement and enhance North America's competitiveness.** Any weakening of North American cooperation could provide opportunities for adversaries, such as China, to exploit gaps in the region's trade framework.
- **Lead by example through full US compliance with USMCA commitments.** Ensure that USMCA's dispute resolution mechanisms remain a cornerstone of North American trade by insisting on compliance with panel rulings, particularly regarding unresolved disputes like automotive rules of origin and Mexico's stance on genetically modified corn and energy policies. Firmly addressing non-compliance will preserve the credibility of USMCA.
- **Bolster Regulatory Harmonization:** Promote deeper regulatory cooperation between the US, Mexico, and Canada to minimize trade barriers and streamline supply chains. The next president of the United States should push for more integrated standards in crucial sectors, such as electric vehicles, semiconductors, critical minerals, and energy, enhancing North America's global competitiveness.
- **Address Mexico's Constitutional Reforms.** Proactively engage Mexico on its proposed constitutional reforms[8] that may undermine USMCA's long-term benefits. Open diplomatic channels to negotiate any changes that threaten regional investment climates or trade stability, ensuring that any reforms are aligned with USMCA commitments.
- **Develop a unified approach to address China's growing influence.** Strengthen trilateral cooperation to counter the economic and geopolitical risks posed by China's trade practices and influence. A coordinated strategy for critical

industries like semiconductors, electric vehicles, and critical minerals would safeguard North American supply chains and national security interests.

- **Broaden the scope of USMCA's Rapid Response Labor Mechanism (RRM).** Consider extending the Rapid Response Labor Mechanism (RRM) to include US and Canadian facilities, thereby ensuring fair enforcement and strengthening protections for workers throughout the region.
- **Support North American infrastructure development.** Invest in critical infrastructure, such as modernizing ports, roads, and digital networks across Mexico, the US, and Canada, to facilitate trade and improve supply chain efficiency. A unified infrastructure strategy would enhance nearshoring opportunities and boost regional competitiveness.

Notes

1 Wayne, Earl Anthony, Marroquin, Diego. Policy Brief. USMCA at Four. Measuring Success, Addressing China, and Working Towards the 2026 Review. Wilson Center., Canada Institute, Mexico Institute, July 2024, pp. 1, 4, 6, https://www.wilsoncenter.org/sites/default/files/media/uploads/documents/USMCAatFour.pdf

2 United States Census Bureau. Trade in Goods with Mexico. https://www.census.gov/foreign-trade/balance/c2010.html

3 Trade Promotion Authority (TPA) is a law that allows the US President to negotiate trade agreements and adjust tariff rates that Congress can then approve or reject, but not amend or filibuster. It speeds up the process of finalizing trade deals. The most recent TPA was enacted in 2015 (TPA-2015, P.L. 114-26) and expired in July 2021.

4 Marroquin, Diego, Turning Point: The Impact of AMLO's Reforms on USMCA and Nearshoring, August 21, 2024, https://www.wilsoncenter.org/article/turning-point-impact-amlos-reforms-usmca-and-nearshoring

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Migration

Ernesto Castañeda and Julia G. Young

Immigration remains one of the top priorities on the US-Mexico bilateral agenda. While the Mexican share of migrants crossing into the US has dropped in recent years,[1] migrant encounters at the border peaked to record highs in 2023 (though have decreased significantly in 2024).[2] Mexico is not only a transit country for migrants attempting to reach the US, but has also become a destination. Migrants unable to enter the United States seek to regularize their legal status in Mexico, creating a substantial increase in asylum applications in recent years[3].

A host of push and pull factors motivate people to leave their countries of origin, including lack of economic opportunities, a desire to reunite with family, limited access to basic services, violence and insecurity, environmental degradation, and natural disasters, among others. Safe and legal pathways to enter and obtain citizenship, asylum, or work permits in the United States remain difficult to attain. Therefore, migrants continue to seek irregular, dangerous channels to cross the US-Mexico border, making human smuggling a lucrative business endeavor for organized criminal groups.

While the next president of the United States has announced that mass deportations of unprecedented numbers of undocumented immigrants will take place under the incoming administration, this policy could produce economic, political, and social costs economic, political, and social costs. Instead, there are ways in which recent waves of migration can be harnessed to bolster the economy and shore up labor demands in key sectors. There are only 6.8 million unemployed workers in the US compared with nearly 8 million open jobs,[4] of which approximately 2.4 million are in the agricultural sector (a sector dominated by foreign workers).[5] Expanding temporary work visa programs such as H-2A could offset potential labor shortages, reduce barriers to employment, protect US jobs and wages, and ensure legal status for workers.

Immigration Policy and Labor in The United States

Immigration is not merely a contemporary issue pertinent to the US-Mexico relationship but has long been a topic of debate in American domestic politics. Restrictionist policies have been implemented in different combinations with varying degrees of success since the 1870s. To propose sound public policies to meet current labor shortages while reducing irregular migration from the southern border, the next US administration should consider historical approaches to immigration policy, while acknowledging the rapidly evolving demography of those attempting to cross the border.

Restriction and limitations 1925-1970

In 1921 and 1924, the US Congress passed laws creating numerical quotas based on nationality, drastically limiting the arrival of immigrants from Southern and Eastern Europe. As a result, immigration to the United States was effectively restricted, except for the Western Hemisphere. This restrictive immigration regime, in combination with external events such as the Great Depression and the Second World War, slowed worldwide immigration to the United States dramatically. From the mid-1920s onwards, the number of immigrants to the United States would continuously decline. By 1970, the US Census revealed that the immigrant share of the country's population had declined to a historical low of 4.7 percent.[6]

Despite this decline, migration, specifically from Mexico, played an important role in the US labor market. Since the 1921 and 1924 laws failed to place a quota on migration from the Western Hemisphere, and because there was a demand in the US economy for immigrant labor, Mexican migration—which had grown significantly after the mid-1920s—continued during the 1940-1970 period. In 1942, the United States and Mexico negotiated a bilateral agreement to contract Mexican workers, known as *braceros*, for short-term labor in the United States. Unfortunately, there was a greater demand for workers than the available number of permits. As a result, undocumented migration increased, as did concern about the security of the US-Mexico border. Public anxiety about unauthorized border crossers, known as 'wetbacks' (*mojados* in Spanish), prompted the Eisenhower administration to launch Operation Wetback, a series of workplace raids that led to the deportation of over one million Mexicans and the termination of the Bracero Program in 1964.[7]

Post-1965

One year after the end of the Bracero Program, and in the midst of the civil rights movement, the United States overhauled its immigration system significantly, discarding the national-origins restrictions from the 1921 and 1924 laws and instituted the 1965 Immigration and Nationality Act. The new law created a system based on family reunification and professional skills. It established equal numerical caps on migration across countries, creating a fairer system that did not discriminate based on region of birth. Over time, this system led to a significant rise in immigration from various regions, particularly from Asia, Latin America, and Africa.

Yet, the 1965 law also contained a provision that led to a massive wave of undocumented migration. It placed a numerical cap on migration from the Western Hemisphere, which was not included in the 1921 and 1924 laws. As a result, Mexico was subject to the same caps on migration as any other country, even though Mexico shares a border with the United States. At the same time, the demand in the United States for Mexican labor did not decline; nor did the supply of willing Mexican laborers. In consequence, undocumented migration from Mexico rose steadily between 1965 and 2008.[8]

The rise in undocumented immigration provoked a new wave of public anxiety around immigration, and unauthorized migration became an ever more visible issue in the US media and public sphere. Politicians and the public debated whether "new" immigrants represented an economic, cultural, and criminal threat to the native-born population. Increasingly, pundits, politicians, and voters began to demand that immigration—especially irregular immigration along the US-Mexico border—be controlled through the enactment of stricter laws and increased border security.

Throughout multiple presidential administrations since the 1970s, the US government has attempted to stop illegal immigration by directing resources into efforts to police and control the border, specifically by increasing funding to US Customs and Border Protection (CBP), building barriers along the border, and targeting immigrant communities for detention and mass deportation. In the wake of the terrorist attacks of September 11, President George W. Bush brought immigration control under the jurisdiction of the Department of Homeland Security (DHS), explicitly tying the issue of immigration to concerns over national security. In response to undocumented immigration after 2008, the Obama administration increasingly targeted immigrants for deportation. Fears over the growing undocumented immigrant population continue today, and meaningful reform to immigration policy remains elusive.

Border management and the immigration landscape has become more complicated as the demographics of those seeking to cross the US-Mexico border has shifted drastically over the past several years. For over a decade, migration of Mexican nationals to the US has significantly decreased,[9] even as migration levels have steadily risen. Increasingly, migrants attempting to cross into the United States come from countries experiencing insecurity or economic malaise in Central America, the Caribbean, South America, and other regions around the globe.

In recent years, major airports such as Sao Paolo, Brazil and Bogota, Colombia have become hubs for migrants from the Middle East, Africa, and Asia who hope to make the journey northward to the United States.[10] Along the perilous journey, migrants are often stopped in third countries and may seek the support of smuggling operations. Human trafficking and migrant smuggling has become a profitable business for organized crime groups, causing humanitarian and security concern for the US and neighboring countries.

Rapidly changing migration patterns to the US border require comprehensive immigration reform to address national security concerns, enhance border security, meet labor market demands, and provide legal pathways to migrants that seek employment and citizenship. Responding to larger numbers of migrants will require a regional and global response, with increased coordination between the US, Mexico, and other transit and destination countries.

Looking forward

An effective approach to national security and irregular immigration should be accompanied by immigration reform that incorporates legal migration pathways for high- and low-skilled workers whose activities and capabilities are essential for the US economy. A substantial increase in the number of temporary visas for unskilled workers would be a positive step forward, but additional actions are needed—such as regularizing the status of the current undocumented population, a comprehensive expansion of the asylum system to evaluate petitions, and rational operational control of the border, among other measures. The limitations of the US immigration system can be solved through the passage of a bipartisan comprehensive immigration reform.

On a global scale, the United States could provide support through the US Agency for International Development (USAID), the Interamerican Development Bank (IDB), as well as other international organizations to Mexico and other countries in the region to provide migrants with opportunities to acquire temporary work visas and citizenship, while ensuring protection of their human rights. The US, Mexico, and countries in Central and South America should negotiate new guest worker programs that benefit all nations. These programs could result in a decrease in the number of foreign-born people in the United States and would reduce the number of arrivals at its southern border.

★ RECOMMENDATIONS ★

- **Increase cooperation with regional governments to limit the arrival of migrants at the US-Mexico border.** The US government should seek collaborative efforts with regional and global partners to mitigate the root causes of migration and, over time, decrease migration flows. Heightened coordination will also enable the region to better detect, understand, and dismantle migrant smuggling networks and improve ineffective national and regional asylum systems.
- **Collaborate with countries in the Western Hemisphere to provide migrants with safe and economically viable alternatives to crossing the US-Mexico border.** Alternative destination countries for migrants in the region will require financial assistance to facilitate the integration of immigrants into their workforce. Simplifying working permit processes to fill labor shortages and creating legal pathways to citizenship in these alternative destination countries is crucial.
- **Expand access to temporary work visas for cooperating countries in sectors with high labor demand.** Temporary workers in the US should be paid the minimum wage or wages comparable to local workers to prevent unfair competition. The number of temporary visas should increase gradually and be determined by labor demands and the ability to accommodate guest workers. Migrants who contribute through their labor and taxes to the US economy should have an opportunity to apply for permanent residency and, ultimately, citizenship. This would reduce a growing undocumented population in the US, protect their

human rights, ensure proper working conditions, reduce the incentive to cross illegally at the US-Mexico border, and prevent unfair competition for local workers.

- **Utilize deportation orders to remove individuals with criminal convictions who remain in the country illegally.** This measure should be used with restraint. Deporting the millions of undocumented migrants who have no criminal backgrounds would have significant economic and social costs. If mass deportations are enacted against the entire undocumented population, the GDP of the United States could suffer a decline between 4.2% and 8%.[11]
- **Comprehensive bipartisan immigration reform.**

  Approve a bipartisan comprehensive immigration reform that increases border security, improves border infrastructure and technology, includes stricter requirements to attain asylum, increases the number of judges handling asylum cases, and provides safe and sanitary conditions for asylum seekers. In addition, the reform should expand legal pathways to citizenship, particularly for Deferred Action for Childhood Arrivals (DACA) recipients. The Trump administration will be in a strong position to update the bipartisan, bicameral reform signed into law by President Ronald Reagan in 1986.

- **Enable foreign-born students that attend US universities to obtain a green card upon graduating.** The US should integrate highly educated and highly skilled immigrants into its workforce, especially in STEM, healthcare, computer programming, and other key labor sectors with high demand.

Notes

1 https://www.migrationpolicy.org/article/mexican-immigrants-united-states
2 https://www.pewresearch.org/short-reads/2024/10/01/migrant-encounters-at-u-s-mexico-border-have-fallen-sharply-in-2024/
3 Article: Mexico at a Crossroads Once More: Emigrat.. | migrationpolicy.org
4 https://www.uschamber.com/workforce/understanding-americas-labor-shortage
5 https://www.newsweek.com/us-farming-crisis-h2a-visa-reform-labor-shortage-1878530
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7 https://www.vox.com/2015/11/11/9714842/operation-wetback
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Energy

David L. Goldwyn and Lourdes Melgar

Summary

The trajectory of President Sheinbaum's energy policy, combined with the erosion in its investment climate from recently passed judicial and controversial constitutional reforms, poses risks for Mexico's economy. Without adequate access to reliable and affordable clean power, Mexico will squander the opportunity to host companies seeking to foster a North American supply chain and embrace a nearshoring strategy. If this pathway reduces future growth, then high debt levels and social unrest will increase migration pressure. The reshaping of Mexico's geopolitical alliances could further expand a growing Chinese and Russian influence in Mexico's socio-political and economic life, creating a significant challenge to the terms of engagement between USMCA partners. The need to boost Mexico's economic growth to fulfill her electoral commitments may provide the opportunity to steer President Sheinbaum toward a more pragmatic and constructive posture. The relationship between the two administrations will require forceful quiet diplomacy and leveraging the 2026 USMCA review to carve out an expanded rule of law protection for foreign investment and a friendlier environment to boost bilateral and trilateral cooperation in the energy and climate realm.

US interests in Mexico's energy sector

The US has multiple interests in Mexico's energy sector. A prosperous Mexico, achieving sufficient economic growth for domestic employment and fiscal stability, will reduce migration pressure on the US and be able to host companies interested in supplying the US market, which is essential to US national and economic security objectives. That prosperity depends on an adequate domestic energy supply and clean power for most companies seeking to meet their net-zero targets.

The US is also a primary exporter of natural gas and petroleum products to Mexico. Natural gas exports undergird Mexico's power system are the leading source of decarbonization of its power grid as Mexico reduces its dependence on fuel oil. Years of subsidizing petroleum products and underinvestment in maintenance have eroded Mexico's refining system, leaving the country largely dependent on the US for refined fuels despite the construction of the Dos Bocas refinery and the acquisition of the Deer Park refinery in Texas. The US imports heavy oil from Mexico for Gulf Coast refiners, although declining oil production in Mexico has reduced imports over time. Likewise, the US has interests in Mexico meeting its climate change targets by expanding its supply of renewable energy generation, given the need to supply its industrial base and the potential to trade clean power with Texas and California. If Mexico is to take advantage of near-shoring opportunities, it will need to increase significantly both power generation and transmission capacity. If it cannot, the failure to attract investment will undermine economic growth, negatively impacting domestic employment and national development and boosting illegal migration.

A Lost Opportunity

Mexico's long-standing nationalistic stance on its energy industry led to significant underinvestment in oil and gas production and power generation; it also resulted in a technological setback that curtailed the national oil company and electricity utility from modernizing and fully developing Mexico's energy wealth. The 2013 Energy Reform under President Peña Nieto aimed to reverse declining hydrocarbon production, strengthen Pemex and CFE by allowing them to operate as public companies, promote competitive electricity and refined product sales through the creation of energy markets, and unleash the country's renewables potential. The reform brought billions of new investments into Mexico's energy sector, from oil and gas exploration and production to new natural gas pipelines, gas stations, and highly successful auctions for renewable energy, which would have supplied Mexico with low-cost wind and solar power and would allow CFE to attract investment in the transmission lines.

Alas, despite the reform's initial success in attracting foreign investment, the Lopez Obrador administration blocked its implementation throughout its tenure, systematically seeking to undo the energy reforms by legislation and executive fiat. These efforts failed because the reforms were codified at the constitutional level and Mexico's courts repeatedly overturned AMLO's efforts through injunctions (or *amparos*). The impact of his administration on energy investment was still chilling. The government's refusal to give the winners of renewable energy auctions the guaranteed priority in dispatch destroyed the economics of those projects. Moreover, the government refused to hold additional auctions for renewable energy or for oil contracts, essentially capping investment in both sectors. Disputes over the contractual agreements of the natural gas pipelines from the US to Mexico were resolved through renegotiation of their terms, but no additional pipelines have been built. Permits for import of lubricants and other products from the US were not forthcoming, leading many investors to exit or consider exiting the Mexican market. Many of these actions also violated the USMCA. In July 2022, the United States (joined by Canada) activated the USMCA's dispute settlement mechanism with regards to President AMLO's proposed energy sector reforms; this case remains in the consultation phase.

While AMLO could not overturn the 2013 reforms for most of his term, when Claudia Sheinbaum won the election in a landslide Morena party also secured a near super majority in Mexico's legislature. The new Congress pushed forward AMLO's so-called Plan C, which includes a series of constitutional reforms that will profoundly redefine the legal and institutional landscape of Mexico. Thus far, judicial reform has been at the forefront of the national debate, bringing the country to the brink of a constitutional crisis, raising serious concerns over the future of Mexico's fragile democracy, the rule of law, and the deterioration of its investment climate.

In October, with the control of Congress, President Sheinbaum proclaimed a constitutional reform on energy, setting back the sector several decades. The reform will significantly limit the potential for private investment, complicating the future of USMCA, and hampering Mexico's energy securityand capacity to reach its climate goals.

President Sheinbaum Doubles Down

In her first month in office, President Sheinbaum swiftly accelerated the deconstruction of the 2013 energy reforms. She has proposed reestablishing government control over Pemex and CFE, eliminating their operational and managerial flexibility, requiring their alignment with government policy, and granting them priority over other market participants. Independent regulators are subjected anew to the political supervision of the energy ministry (SENER), including those regulators in charge of hydrocarbons upstream activities, together with the oversight of petroleum contracts (CNH), energy markets (CRE), and gas transportation (CENAGAS), and eliminates the independent nature of the ISO (CENACE), further dismantling the electricity market and the possibility of financing the expansion of the transmission lines through private investments. The lack of investment in transmission lines over the past 14 years is a significant bottleneck to electricity supply, putting the system's reliability at risk.

Yet, President Sheinbaum has announced an ambitious energy program, calling for major investment in renewable power, nuclear power, electric mobility, and energy efficiency. However, the dire fiscal predicament of the Mexican government in general—and Pemex and CFE in particular—makes it unlikely that these plans can come to fruition without private investment. Pemex remains the world's most indebted oil company, requiring the government to transfer US$56 billion, the equivalent of 6.1% of Mexico's GDP in capital during the AMLO administration. CFE is deeply undercapitalized, and the Sheinbaum government has set in the constitution that it will retain at least 54% of all power generation. The combination of a hostile climate for energy investment and the highly constrained domestic fiscal situation makes the prospects for new energy investment quite dim. Sheinbaum's first national budget will be published in November 2024, previewing how she will raise capital without raising taxes.

The Impact of the Sheinbaum Energy Framework

The major impact of the new energy policy is that Mexico will face severe challenges in meeting electricity demand for residential use and new industrial demand. Any new data center, factory, auto plant, or industrial park will require high-quality, low-cost, clean power. With the power grid already stressed, Mexico may be unable to meet this demand and will lose out on nearshoring opportunities.

With no new gas pipelines likely to be built, competition for existing natural gas supply may intensify. Gas intended to supply LNG export plants on Mexico's East and West coasts may be at risk if gas supplies for domestic power or industrial needs compete with gas for export or if the US imposes new or onerous restrictions on non-free trade agreement exports of U.S. gas to Mexico for reexport. The withdrawal of investors supplying the Mexican market with petroleum products will negatively impact industrial consumers and the lack of electricity will constrain electric mobility.

The direct impacts on the US of these conditions, such as a plateau in gas and petroleum products exported by pipeline to Mexico, are manageable. If US natural gas demand grows due to increasing electricity demand, this could also be a positive outcome for domestic natural gas prices in the US. However, the negative macroeconomic impacts from its government's policies on Mexico's economy will dampen US investment, lower trade balances, and chill the prospects for more reliable supply chains based in Mexico.

An Opening for China and Russia?

Little attention has been paid to the growing influence of China and Russia in Mexico. Chinese investment is rising in Mexico and BYD's location of auto plants will be a focus of the USMCA review no matter who wins the US Presidential election. RT, Russia's propaganda arm, sponsors public news feeds in the Mexico City transportation system and is very active in social media. One risk of US and other Western investors shying away from Mexico is that geopolitically minded investors like China and Russia may fill the void, hoping political alliances will overcome any commercial risks. It will be complicated for the US to both oppose Chinese investment in Mexico and seek for the first time to change rule of origin restrictions from *place* of origin to *investor* of origin while US investors shy away from the country. The geopolitical realignment of Mexico's foreign policy will likely affect the renegotiation environment of the USMCA. The challenge for the US and Canada will be to propose an agenda that will entice President Sheinbaum's interest in the USMCA's success and spur an interest in strengthening her ties with her North American partners.

Conclusion

As we prepared this essay, the Sheinbaum administration was in the process of redefining the legal framework of Mexico's energy sector, including the rules for private sector participation. Even from the trendlines we see today, we believe there is a better pathway for Mexico's approach to energy development if President Sheinbaum chooses to pursue it. With creative ways to provide a secure environment for investment in power, natural gas and transmission, Mexico can increase its own prosperity, reduce migration, pressure to the US, and help enhance the resilience of both the US and Mexican economies. For the sake of US national security interests, a revived high-level engagement is essential and should commence as soon as possible.

★ RECOMMENDATIONS ★

- **Adopt a Focused US Strategy for US-Mexican Energy Relations.**
  - The US should encourage Mexico to consider more constructive energy policies to reduce migration pressure from Mexico. The US should seek to revive bilateral and multilateral energy policy engagement with Mexico. The AMLO government was distinctly uninterested in bilateral engagement with the US and the trilateral North American Energy Leaders' Summit (NALS) also went dormant.
  - The US needs to privately raise with Mexico the severe risks the current pathway poses for all investment in Mexico and for the USMCA review. The importance of independent regulation, effective rule of law, and respect for existing contracts should be raised at the head of state level, as well with agency counterparts.
- **Revive Bilateral Engagement on Energy.** The US should suggest a revived energy dialogue, separate from USMCA discussions, where the US and Mexico can collaborate on important but less controversial issues like electric mobility, nuclear power, energy efficiency, critical minerals, industrial safety, and cross border infrastructure.
- **Resurrect the NALS Process.** A revived NALS process can bring Canada to the table and, with support from the Departments of State and Commerce, expand discussions of the conditions for attracting investment and technology deployment.

- **Encourage President Sheinbaum to Take a More Pragmatic and Flexible Approach to Foreign Investment.** A USMCA carve out for investment protection, resolution of existing disputes, reconsidering independent regulation, and effective platforms for public and private sector dialogues could revive the concept of North America as a secure, innovative, and competitive energy powerhouse.
- **Approve outstanding applications to export US gas through Mexico.** Developers have requested non-free trade agreement, export licenses to export US gas through Mexico. These projects are both a positive for the United States in terms of export revenue but also support Mexico's access to gas for domestic purposes, and LNG for the global market.
- **Exempt trade in oil, gas, electricity, energy trade in oil, gas, electricity, and energy services from tariffs.** Whatever the outcome of the USMCA review, trade in energy is an essential component of energy security and reliability for both the US and Mexico; it should be protected from tariff treatment by both countries.

Water

Rosario Sanchez and Gabriel Eckstein

Context of the US-Mexico Border Water

The borderland shared between the US and Mexico is mostly arid, threatened by climate change, and subject to erratic precipitation patterns. Population centers, as well as agricultural and industrial development, have concentrated along the naturally, and therefore, arbitrarily distributed flows of the transboundary rivers and aquifer basins that traverse the frontier. Since the early 1990s, however, the natural limits of these shared water systems have shown clear signs of extreme stress due to growing demand and persistent droughts.

The most noteworthy transboundary river basins in the border region are the Colorado River and the Rio Grande. The Colorado River provides water to more than 44 million people in the United States and Mexico, seven American and two Mexican states, 29 Indian tribes, and 5.5 million acres of farmland.[1] The Rio Grande provides water to an estimated 15 million people between the two countries, 22 Indian tribes, three states in the US and four in Mexico, and around 3 million acres of farmland.[2] Both transboundary basins are two of the most water stressed systems in the world,[3] and both are currently experiencing their lowest flow levels of the last one hundred years. Dams and reservoirs in both basins have significantly altered natural flows causing serious impacts to downstream users, habitats, and ecosystems. Moreover, persistent drought conditions are putting pressure on limited water resources and constraining both countries' ability to comply with existing international obligations.

In addition, transboundary aquifers in the region are poorly understood. Information on shared groundwater reserves, both their volumes and quality, is limited. Meanwhile, the border communities' reliance on these shared subsurface resources is growing as surface water supplies decline. Recent research confirms the presence of at least 28 transboundary aquifers in the border region, half of which possess good aquifer potential and good-to-moderate water quality.[4] Overexploitation and contamination concerns have been reported for at least half of them.[5]

Projected climate scenarios for the border region are very concerning: higher temperatures, decreased and more variable precipitation, increased evaporation, less replenishment of groundwater resources, more frequent and intense wildfires, and more extreme weather events.[6] Changing conditions are expected to have widespread health effects including new diseases and growing heat-related illnesses and deaths. The most impacted communities in the border region will be poor urban and rural residents, Tribal peoples, and other vulnerable groups, including "*colonias*" in Texas that are estimated to hold around 300,000 people.

Water supplies and climate change related to rivers and aquifers, however, are not the only water-related challenges on the US-Mexico frontier. More frequent and severe flooding events, as well as worsening contamination of transboundary waters, are threatening critical border water infrastructure and heightening sanitation and public health concerns. Salinity concentrations from agricultural drains are a major water quality concern for both the Colorado River and Rio Grande. Contaminants of emerging concern are also found in both river systems, including pharmaceuticals, industrial chemicals, household cleaning products, household and agricultural pesticides, microplastics and others.[7] The Rio Grande also suffers from significant nutrient and fecal coliform bacteria contamination from untreated wastewater discharges.[8] At least 35% of the daily runoff entering the Lower Rio Grande constitutes untreated surface flows from agriculture lands and municipalities, as well as raw sewage.[9] Of the 55 water treatment plants located on both sides of the border, 80% report deficiencies in infrastructure maintenance, capacity, and operations.[10]

Continued drought conditions throughout the border region are generating both domestic and bilateral tensions as competing water users in both nations struggle to meet their needs. By 2050, water demand for municipal and industrial use is expected to increase by 100 and 40 percent, respectively. As a result, there is a tremendous need for policy action that will improve management and cooperation of shared surface water and groundwater resources on the border.

Management of the Colorado and Rio Grande Rivers

The International Boundary and Water Commission (IBWC) is a binational organization, with Mexican and United States sections, charged with managing all water issues along the border. According to the 1944 Water Treaty,[11] the IBWC is responsible for: 1) all joint boundary and waterworks activities, including international dams and reservoirs, hydroelectric power plants, and stream-gauging stations; 2) measures to improve flood management, border sanitation and other water quality problems, and preserve the Colorado River and Rio Grande as the international boundaries; and 3) resolving disputes between the two countries regarding interpretation or application of the 1944 Water Treaty.[12] Although the IBWC historically has served as an effective institution for addressing shared water issues on the border, climatic changes over the past three decades have significantly strained the Commission's existing authority and capacity in unprecedented ways in the organization's extensive history.

Until the 2010s, the 1.5 million acre-feet of Colorado River water allocated to Mexico under the 1944 Water Treaty had been delivered successfully due to adequate flows and cooperation between the two nations. Recent climatic conditions, however, have required a new water management sharing scheme in which the seven US states within the Colorado River basin and Mexico have had to cooperatively reduce water allocations in accordance with the Colorado Basin Drought Contingency Plan. These reductions were substantial and challenging to negotiate. By 2025, the US is expected to reduce its water use in the lower Colorado

River basin by more than 1 million acre-feet as compared to prior years.[13] At the same time, delivery reductions to Mexico are expected to reach nearly 300,000 acre-feet, approximately 20% of Mexico's original allocation under the 1944 Water Treaty. This latter reduction is comparable to the combined annual water consumption of around 3.5 million people.[14]

Water allocations on the Lower Rio Grande have been even more contentious. Since the Rio Grande forms a 1,250-mile border between Mexico and the United States, both nations have delivery obligations under the 1944 Water Treaty. However, only Mexico has a fixed volumetric delivery requirement. Since the early 1990s, Mexico's deliveries, which Texas users heavily depend on, have been chronically irregular due to extraordinary drought conditions. As a result, since 1992, Mexico has not met its Rio Grande delivery obligations in three 5-year cycles (1997, 2002 and 2015), although these water debts were repaid in a subsequent cycle. Nevertheless, Mexico's shortfalls have twice led to last-minute, large-scale water transfers (2007, 2020), impeding proper planning and causing conflicts and uncertainty among downstream users. Moreover, for the first time since the Rio Grande Water Master Program was established on the US side in the early 1970s, a negative allocation was applied in 2022 to safeguard reservoir operational supplies.[15] In addition, Mexico's deficient deliveries have twice in the past 20-years forced that country to use its own storage from the two shared reservoirs on the Rio Grande (Amistad and Falcon) to comply with its delivery obligations to the US, provoking domestic tension and social unrest in downstream irrigation districts on the Mexican side.

Given the challenges with application of the 1944 Water Treaty in the Lower Rio Grande basin, there have been some calls to revisit how its provisions, particularly Mexico's use of the "extraordinary drought" criteria to delay water deliveries to the US, are applied to the river. Moreover, suggestions have been made to consider the relevance of mechanisms applied in the Colorado River basin, where collaborative water reductions have resulted in more predictable and reliable flows for both nations to the Lower Rio Grande basin.[16] These proposals are intended to stabilize and improve the consistency of water deliveries from Mexico to downstream users on the United States side of the river.

In parallel, the IBWC has set a precedent for involving local stakeholders in the Colorado River basin, including governmental, non-governmental, and private sector organizations, in meaningful policy-making processes. An example of this inclusive approach was the establishment of the Binational Core Group and the four Binational Work Groups to explore and evaluate opportunity areas for water conservation, storage, supply augmentation, and environmental protection in the context of the Colorado River Joint Cooperative Process.[17] Likewise, a Binational Core Group comprising community leaders was also established to oversee the work of three binational working groups to address transboundary issues in the Tijuana River Basin under Minute 320 (one of the recent supplementary agreements adopted under the 1944 Water Treaty).[18] Membership in these groups included federal and state representatives, along with nongovernmental organizations, tribal nations, and universities from both sides of the border. Regrettably, a similar integrative experience of stakeholder participation and contributions has not yet been developed for the Rio Grande.

It is noteworthy that research, data generation, and monitoring to plan and manage Colorado River water allocation among the US states and between both countries has received greater financial support from federal and state governments on the US side, largely because 97% of that river basin lies within US territory. In contrast, and due in part to the fact that only 33% of the Rio Grande basin is located in the US, significantly less funding from US federal and state budgets have been allocated for research, data gathering, and monitoring efforts in that basin. As a result, reliance on Mexican institutions and data to support management of the Rio Grande has created significant vulnerabilities for the US and, in particular, the state of Texas.

Groundwater Under the Border

As surface water systems have experienced increasing stress due to growing demand and dwindling supplies, unregulated transboundary groundwater systems in the border region have become both a strategic resource as well as an additional source of growing tension. Eighty percent of groundwater used in the border region is used for agriculture, while industry and domestic users account for the rest. It is estimated that over 7 million people in the border region rely on groundwater for domestic use, including 3 million on the US side[19]. This number, however, does not reflect recurring drought conditions when groundwater becomes the only source of water for many border communities, resulting in absolute dependence on the resource.[20]

Over-extraction of transboundary groundwater resources is documented around cities such as San Diego and the Imperial Valley in California; Tucson, Nogales, and Douglas in Arizona; Columbus, Deming, and Las Cruces in New Mexico; and El Paso and the Lower Rio Grande region in Texas. Also of concern are increasing levels of groundwater contamination from irrigation seepage in large agricultural areas, such as Imperial Valley and the Lower Rio Grande Valley, as well as naturally occurring arsenic concentrations, particularly along the New Mexico-Mexico border.

Yet, groundwater in the border region has received limited attention binationally. Apart from Minute 242 from 1973 (another supplementary agreement adopted under the 1944 Water Treaty), which mentions groundwater as a pending issue that should be added to the bilateral water agenda, neither of the two chief legal instruments applicable to the rivers traversing the frontier (1906 Convention[21] or 1944 Water Treaty) address the use or management of shared groundwater resources. This has complicated the IBWC's ability to administer groundwater as an alternative source of freshwater as well as to develop integrated surface water-groundwater approaches. Additionally, little funding has been allocated for research, data gathering, and monitoring of aquifers on the border, creating significant knowledge gaps and increasing the region's vulnerability to water scarcity. With groundwater being left out of water resource management strategies at the binational level, opportunities to improve efficiency across the water cycle remain significantly constrained.

The Growing Vulnerability with Water Quality

Even though water quantity and allocations command significant attention in binational discussions, water quality is a growing vulnerability for the region. As water supplies decline due to climate change, growing demand, and overexploitation, reduced water supplies increase pollution concentrations in both surface water and groundwater systems. Public health risks associated with exposure to contaminated sources, polluted soils, and aridification due to increases in evapotranspiration, as well as ecosystem impairment resulting from an increase in contaminant concentrations and habitat degradation, now lead the list of water concerns among scientists, nongovernmental organizations, and border community leaders. Unregulated water access—particularly by disadvantaged communities that often are unconnected to municipal systems and therefore not protected by federal US laws or any state regulations—is a significant growing threat to the region's public and environmental health and border security.

★ RECOMMENDATIONS ★

- **Apply lessons learned from the Colorado basin to the Lower Rio Grande basin,** such as stakeholder participation and allocation mechanisms that support research, monitoring, and data generation from a basin perspective.
- **Explore how interpretation of the "extraordinary drought" provision in the 1944 Water Treaty, as applied to the Colorado River, may be relevant to the Lower Rio Grande** to improve the two countries' ability to address growing demand and worsening climatic conditions, while also enhance reliability and predictability of water deliveries to downstream users.[22]
- **Recognize shared habitats and environmental and health threats** by investing in integrative approaches that prioritize clear environmental, social, and economic outcomes for border communities.[23]
- **Facilitate the development of holistic and integrated approaches** that improve resiliency of hydrologically-linked surface and groundwater systems.

- **Evaluate the need for a framework Minute** on transboundary groundwater resources and its potential implementation at an aquifer or local scale.[24, 25]
- **Enhance cooperative research, data and monitoring at the binational scale,** in particular in the Lower Rio Grande basin, to reduce overdependence and vulnerability.
- **Strengthen the IBWC's existing roles** by facilitating funding and allocation mechanisms to enhance its institutional and technical capacities.[26]
- **Facilitate the participation of local, regional, state, and federal authorities** as stakeholders in the decision-making processes related to all transboundary water resources.[27]

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Democracy

Miguel Ángel Lara Otaola

History of Democracy in Mexico

In the 2024 elections, 59.7% of voters (only 61.04% of registered citizens voted)[1] cast a ballot for Claudia Sheinbaum to become Mexico's first female president. Sheinbaum, one of the founders of the governing party, the National Regeneration Movement (Morena), was handpicked by Andrés Manuel López Obrador (AMLO) to become his successor.

The 71-year rule of the once dominant Institutional Revolutionary Party (PRI), started to break down in 1997 when it lost its majority in the Chamber of Deputies for the first time in decades. Since then, Mexico has been classified as an electoral democracy (Figure 1). In the mid-nineties, the country created an autonomous electoral authority (the Federal Electoral Institute-IFE, now National Electoral Institute-INE), which ensured free and fair elections and the peaceful transfer of power.

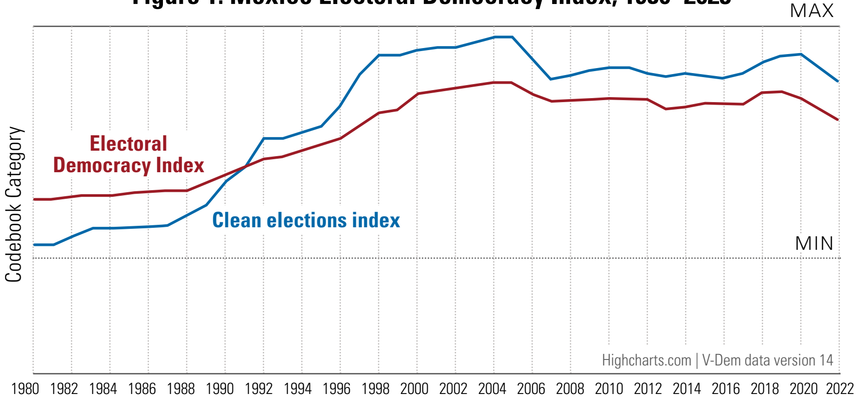
In recent years, several democratic indicators have positioned Mexico in a "grey zone"[2] or as a "hybrid regime"[3], between a democracy and an autocracy. Other countries that share this classification include Albania, Bolivia, Bosnia Herzegovina, Guatemala, Honduras, Indonesia, Kenya, and Zambia[4]. This decline reflects decisions made by Mexico's former president, ranging from capturing control of independent institutions and agencies to antagonizing the media, journalists, academics, and civil society organizations. Specifically, the democracy indicators that show the most decline since 2019 include: freedom of expression, academic freedom, institutional autonomy, and judicial independence (Figure 2).

Several incidents are responsible for the democratic decline in Mexico, including the lack of checks and balances. Many autonomous agencies have been eliminated. Presidential decrees and legal changes have led to the disappearance of institutions such as INDESOL (National Institute for Social Development), which provided technical assistance, funding and training to civil society, and INEE (National Institute for Educational Evaluation), which monitored and evaluated the performance of Mexico's education system.

Other autonomous institutions, especially those directly related to democracy building, have been weakened by political or budgetary constraints. One of the most alarming examples is Mexico's National Electoral Institute (INE), which is responsible for organizing elections at the federal level. Since the onset of AMLO's government, the INE suffered yearly budget cuts, in addition to constant attacks from the former president labeling it as a partial body that poses a threat to democracy.[5] Most of Mexico's 32 local electoral authorities (OPLEs) have experienced significant budget cuts, hampering their capacity to staff and conduct local elections. The OPLEs in the states of Guerrero and San Luis Potosí had their budgets slashed by more than 60% in 2024.[6]

The judiciary branch and electoral tribunals have also been greatly

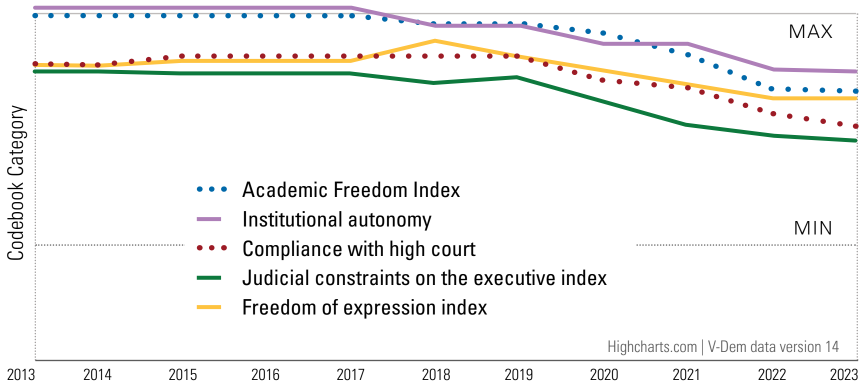
Figure 1: Mexico Electoral Democracy Index, 1980–2023



Source: V-DEM, Varieties of Democracy dataset, 2023 affected. Mexico's Supreme Court has suffered budget cuts and became a target of the president, who called it a "rotten power."[7] Moreover, many experts have raised concerned about the recently approved judicial reform, indicating that it severely undermines judicial independence.

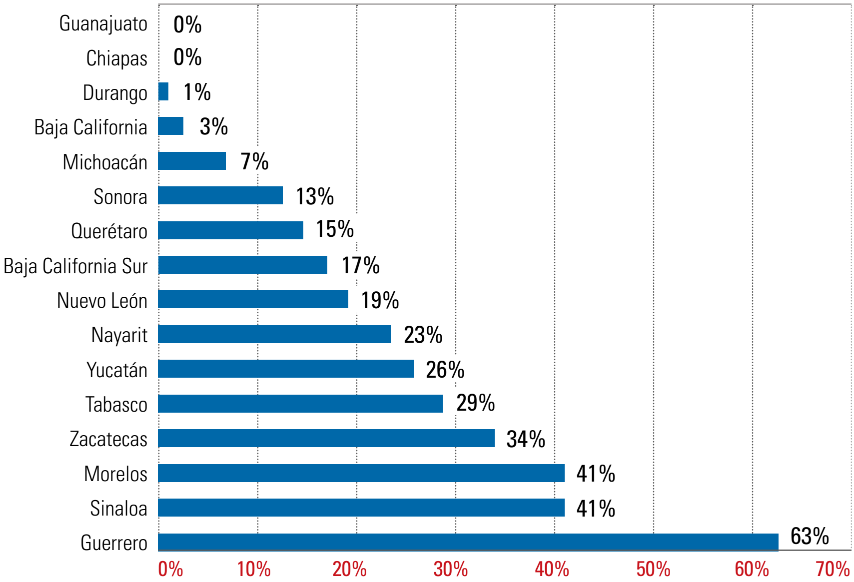
Mexico's judicial reform calls for all judges, including Supreme Court justices, to be elected by popular vote. The reform runs the risk of politiciz-

Figure 2. Mexico, Specific Democracy Indicators, 2013–2023



Source: V-DEM, Varieties of Democracy dataset, 2023

Figure 3: Budget Cuts to Mexico's Local Election Management Bodies (2024)



ing Mexico's judicial branch by placing pre-selected candidates on the ballot that are most likely aligned to the governing party's interests. Candidates will only need a law degree, decent grades, five years of undefined "judicial area experience," and letters of recommendation to run for some judgeships. The Federal Judiciary Council (CJF) will be replaced by two new bodies: the Judicial Administration Body and the Court of Judicial Discipline.

The latter is more alarming as it will consist of 5 politically pre-selected members elected by popular vote that will be able to rule not just on the judicial misconduct of judges but could also open investigations into judges for their legal reasoning. Other concerns include low voter turnout, inadequate resources to carry out the elections, the possible participation of organized crime, and low name recognition of the candidates. Many experts agree that the judicial reform represents a direct threat to democracy and rule of law in Mexico. More concretely, it could have significant implications for the country's competitiveness, as it reduces legal certainty for foreign investors and could complicate the 2026 review of the United States-Mexico-Canada Agreement (USMCA).

Tribunals responsible for electoral justice have been severely impacted with the blockage of key appointments by the ruling party in the Senate. One third of the magistrates of the Electoral Tribunal of the Federal Judiciary (TEPJF) and of state electoral courts are vacant. Even further, the electoral tribunals in five states are operating with only one judge instead of three. These bodies are more susceptible to external pressures and political capture, compromising their independence.

Continuous attacks towards the media, civil society organizations, environmental activists, feminists' groups, and opposition leaders have contributed to Mexico's democratic decline. Freedom House's latest Freedom in the World report, which rates 195 countries, has characterized Mexico as "partly free," noting a deterioration in basic freedoms since 2017. The report flags concerns with organized crime and violence, corruption, lack of government transparency, poor rule of law, and civil liberties more broadly. Similarly, the World Justice Project's Rule of Law Index finds that Mexico's rule of law scores declined substantially between 2018 and 2023, with particularly bad ratings on corruption, security, and criminal justice performance.

In short, the above indicators and examples highlight how democratic institutions, civil society, the judicial system, and the media have been weakened. Democracy reports indicate that civic space, access to information, transparency, and basic freedoms are diminishing in Mexico.[8]

Looking Ahead

September was a critical month for Mexico. It represented a significant moment of transition. While President-elect Claudia Sheinbaum was set to be sworn in on October 1, new members of Congress (Chamber of Deputies and Senate) began their official duties on September 1. During his last month in office, AMLO used the commanding legislative majorities that Morena and its allies obtained—after judiciary ruling expanded its June elections margin of victory—to approve various constitutional reforms. It is important to note that making constitutional changes or using a majority to fast-track the approval of reforms is not necessarily undemocratic. Many democracies in the world have (or had) legislative or parliamentary qualified majorities and yet do not enact bills that negatively impact a country's democracy or its institutions.

Whether the approved reforms and the actions of the next administration can be considered undemocratic will depend on the political agenda and self-restraint of the ruling party. It is yet to be known whether the Executive, Congress, and the governing party will engage with experts, opposition leaders, and civil society groups that may have contrary views to the government. Morena's coalition in Congress will be responsible for enacting bills and proposing constitutional reforms that can strengthen or weaken the country's democratic system.

The future of Mexico's democracy will have serious and wide-ranging regional implications, impacting how Mexico and the US interact economically and diplomatically, and how they approach shared interests pertaining to security and migration. Many of the proposed constitutional reforms, from the elimination of key regulatory agencies to the implementation of the judicial reform could violate and undermine USMCA. By modifying institutions and processes, many of the reforms could weaken the rule of law in Mexico, thus eroding legal certainty for American investors and multinational businesses.

Therefore, the incoming administration in the United States should encourage practices and policies that strengthen the rule of law and democracy, while respecting Mexico's sovereignty and the governing party's mandate. An open, cooperative approach by the next US administration may help to ensure that future constitutional reforms do not undermine US interests and the future of North America.

★ RECOMMENDATIONS ★

- **Leverage the 2026 USMCA review to advocate the importance of the rule of law, judicial independence, and legal certainty as a key asset for US investments.** The current Mexican administration will rely heavily on the promise of nearshoring for the health of its economy going forward. US policymakers could use the 2026 USMCA review to express the importance of upholding democratic practices and legal certainty as a pillar for attracting foreign direct investment.
- **Emphasize the importance of independent election management bodies, with sufficient staff and resources, to ensure free and fair elections.** This includes both the National Electoral Institute (INE) and the 32 local election bodies (OPLEs).
- **Promote mechanisms that can enhance the current judicial reform by retaining the talent and experience of current judges.** The merit-based Japanese model of judicial appointment could be used as a reference point.
- Predicate investment, future development assistance, and/or security cooperation on the wellbeing and **independence of the country's remaining autonomous agencies** to ensure that access to information, free competition, and anti-trust measures are not eliminated.

- **Allocate resources to key democratic institutions, including public agencies, civil society, media, universities, and journalists.**
- **Expand dialogue with federal and state governments and legislators for inclusive decision making that takes into consideration experts, academics and other views and experiences that can enhance public policy and legislation.** This is especially important for the appointment of key positions in democratic institutions such as INE, where consensus is needed.
- **Provide assistance and constructive guidance** through diplomatic channels, prioritizing **respectful dialogue** over imposed solutions. Recognizing the sensitivity around perceived interference, the US should engage with Mexican leaders in a way that leverages **shared interests** to encourage democratic reforms, while respecting Mexico's sovereignty.

Notes

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