center for the
united states
and Mexico
Rice University's Baker Institute for Public Policy

MEXICO COUNTRY OUTLOOK 2021

December 2020

"Mexico Country Outlook 2021"

Introduction

Four factors are likely to drive Mexico's outlook for 2021. The first is the government of Mexico's (GOM) current path regarding politics and policy. Politically, we expect the GOM to continue to 1) centralize power in the presidency and 2) weaken institutions that provide checks and balances on the government. From a policy standpoint, we expect the GOM to 1) disincentivize private and foreign investment in favor of state monopolies and 2) prioritize policies that seek wealth and income redistribution over the creation of conditions for economic growth. In the short term, these actions will send a clear signal to investors and companies about the government's behavior, but over time they will also introduce a higher degree of risk as government decision-making becomes more politically centralized and arbitrary and more punitive toward private investment. Consequently, the GOM's approach in the medium term will have important impacts on private and public investment, fiscal policy, social polarization and unrest, and the state of the country's institutions in general, from political parties to regulatory agencies.

The government's inaction will also be a crucial factor in 2021. For example, conditions are not likely to improve in the area of public safety and security due to the administration's reluctance to confront crime and violence or engage justice demands head-on. And the government's unwillingness to craft an effective financial package to aid businesses and families struggling through the COVID-19 pandemic will make the post-pandemic recovery slower and more difficult.

The second factor driving Mexico's 2021 outlook is the cumulative effect of COVID-19. The pandemic has delivered an enormous shock to the Mexican economy. The full impact is not yet known, but it is likely to be worse than in most countries—especially because policymakers in Mexico did not react swiftly to soften the blow to the economy and the job market. On the contrary, current policy has caused a steeper economic fall in Mexico than elsewhere, and the recovery to recede further into the horizon. So far, Mexico seems to have bet on herd immunity as an unspoken strategy against the pandemic. This approach will cause much death and pain. The early months of 2021 are shaping up to be devastating for Mexico's public health and economy.

A third factor is the midterm election scheduled for June 2021. These elections will be decisive, defining Mexico's political and policy landscape through at least 2024. In the lead-up to Election Day, there is likely to be some degree of election interference by the government in favor of MORENA, President Andrés Manuel López Obrador's party. At the same time, the opposition is still largely in disarray. Although there are now signs of reorganization, its efforts to present a united front may not be enough, or have been initiated in time, to keep the president from retaining control of Mexico's Congress.

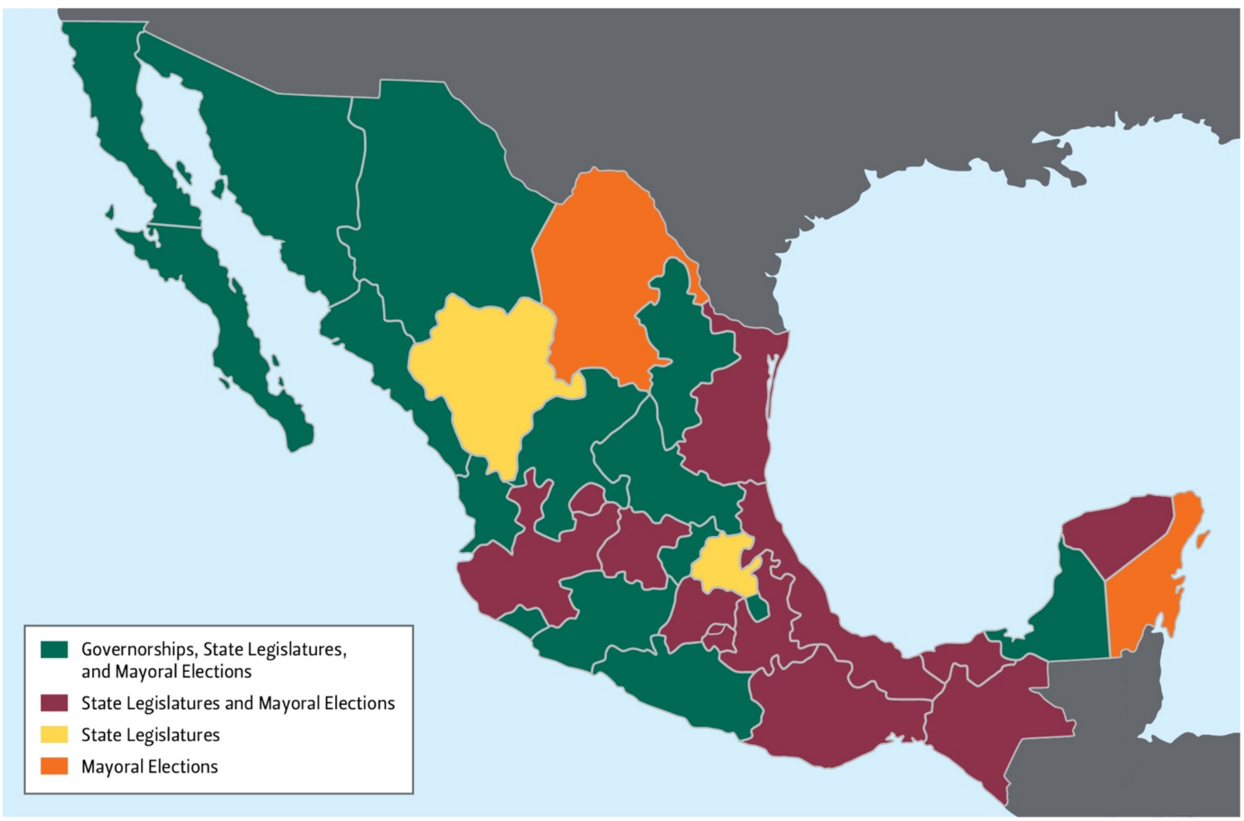
Finally, although the U.S. elections are not a domestic issue for Mexico, they will impact the binational relationship and the GOM's ability to maneuver in the public policy arena. This will be particularly true in 2021 because, with President Trump out of office, the López Obrador administration will lose an important pillar of support for its approach to the country's political economy. In addition, a Biden administration will seek to enforce Mexico's commitments to the United States-Mexico-Canada Agreement (USMCA) and press for cooperation on security and immigration matters in ways that the López Obrador administration may not find palatable.

This Mexico Country Outlook examines these and other issues to watch for in 2021. It lays out possible scenarios based on the four broad variables above, emphasizing areas of concern for business and investors.

Political Atmosphere

2021 will be an important year in Mexico's political history. The country will hold elections in June to renew the entire lower house of Congress (500 members); 15 governors (out of 32); 30 state legislatures (out of 32); some 1,900 mayoral elections (out of over 2,500); and thousands of other municipal-level offices. A total of 21,368 elected positions will appear on the ballot—making the election the largest in Mexico's history, due in part to the country's consolidation of the electoral calendar into two tranches, every third and sixth year.

Figure 1. Breakdown of the Electoral Stakes in Mexico



Source: Authors

Several factors will affect the outcome of these elections, which will in turn determine if President López Obrador pushes through his agenda or the country returns to a government system of checks and balances. These factors are:

a. **The state of the president's political party, MORENA.** The party has maintained a lead in the polls, with about 36% support among likely voters. But the results of the 2019 and 2020 elections show that MORENA may not be invincible, as opposition parties scored important victories. Moreover, MORENA is under-institutionalized and fragmented. It took fierce infighting and all of 2020 to elect the leadership that will carry the party through to the 2021 elections. Even so, considering the electoral rules in Mexico, if other party candidates spread the opposition vote, which represents about 64% of the total, MORENA could be victorious, giving the president a virtual mandate to continue pursuing his agenda.

b. **The state of the opposition**. The likelihood of an alliance between the leading opposition parties—the National Action Party (PAN) and the Institutional Revolutionary Party (PRI)—is low given their history, although surprisingly, they seem willing to form a coalition against MORENA in several states. But if the PAN, PRI, and others fail to craft a multiparty coalition, they may split the anti-government vote, allowing MORENA to sweep on a mere plurality. No other major political parties are likely to strongly emerge in 2021.

c. **The government's interference in the elections**. Mexico has strict rules and penalties against interference by government actors in elections; the use of public funds for campaigns, open statements by elected officials about candidate preferences, etc., are prohibited. But López Obrador has shown that he is willing to sidestep these rules and openly criticize opposition leaders, parties, and electoral authorities. Given his political strength, he may seek to put his thumb on the scale; it is unlikely that he or his party will be penalized for flouting the law.

d. **The broader policy environment**. Although most Mexicans continue to give the president the benefit of the doubt, as evidenced by his approval ratings (~55%), there is growing fatigue with the government's handling of key issues—the failure to effectively deal with the pandemic, the poor performance of Mexico's economy, and the continued public safety and security crisis, among others. These crises are likely to be in the voters' minds and could affect the election results.

The importance of the midterm elections cannot be overstated. If the president maintains a majority in Congress, he will feel vindicated, and he will pursue an even more aggressive change in Mexico's institutions in favor of an imperial presidency and double down on current policy. This will bring additional uncertainty to the business environment, as López Obrador has shown himself to be fundamentally hostile to the private sector, especially foreign capital. A MORENA majority will also create additional social and political conflict, partly because López Obrador has demonstrated no inclination to broaden his political coalition and reach out to the opposition.

After two years in office, it can be said that López Obrador does not fit well into any of the usual ideological categories. Still, his approach to governing has populist overtones. This is likely to continue, especially given that his polarizing political style has hardly changed at all throughout his public life or his years in office. It is now quite evident how López Obrador's policy preferences will play out in his remaining four years as president, should conditions remain the same. The following will prevail through at least September 2021, when a new Congress takes office—or beyond if his party is victorious in the June elections.

1. López Obrador will continue centralizing decision-making in his office. The Cabinet will remain relatively weak and act only upon his narrow direction.
2. López Obrador will continue weakening an already relatively fragile system of checks and balances built over three decades in Mexico. His severe downsizing of the state's administrative apparatus—including budget cuts, personnel reductions, office closings, etc.—illustrates the shift in power to the executive office and the vacuum left behind in Mexico's system of checks and balances.
3. López Obrador will likely continue his attacks on the free press, public intellectuals, independent government agencies, the judiciary, governors and mayors, and on his political opposition in general.
4. After criticizing the militarization of public safety and security in Mexico during his time as an opposition leader, President López Obrador has heavily relied on the use of the military for functions previously thought well outside the military's purview. He is likely to continue down a path of militarization of Mexico's public life.
5. López Obrador will continue to dominate public life in Mexico and advance his policy agenda, which, on the face of it, follows these principles:
    a. To transfer wealth from richer states to poorer states in the form of major public infrastructure projects.
    b. To transfer wealth from the rich to the poor through largely unregulated and unconditional cash transfers that come from an array of government programs.
    c. To pressure companies and businesses to pay their taxes (current and in arrears) in lieu of growing the economy. This is not *per se* undesirable, but his administration uses threats and other tactics to collect taxes, and channels the additional revenue to favored infrastructure projects that most experts agree will not yield the promised results. Moreover, collecting taxes from a stagnant tax base is an inadequate strategy to avail the government of additional resources. We should not expect López Obrador to increase revenue by stimulating private and public investment; instead, he will prioritize his reliance on heavy-handed tactics to collect taxes.

Finally, the administration has used the power of the pulpit to keep political opposition leaders at bay—generally by threatening to expose their alleged corruption. This will continue as it is a key tactic used by the administration to disable the opposition. Even so, there are people from both the president's political party and the opposition to keep an eye on, as they are the most likely to aid the president in the exercise of power or to serve as a check on it. These are:

Table 1. People to Watch in 2021

Political Party	Up	Stable	Down
MORENA	Marcelo Ebrard Claudia Sheinbaum Mario Delgado Ricardo Monreal Santiago Nieto	Porfirio Muñoz Ledo Alejandro Gertz Manero Alfonso Durazo	Rocío Nahle Olga Sánchez Cordero Cuauhtémoc Blanco Cuitláhuac García Miguel Barbosa Jorge Alcocer
PAN	Ricardo Anaya Mauricio Vila	Javier Corral Marko Cortés	
PRI	Ildefonso Guajardo Miguel Angel Riquelme	Miguel Angel Osorio Chong Alejandro Moreno	
MC		Enrique Alfaro	
Other	Lorenzo Córdova (National Electoral Institute)		Arturo Zaldívar (Supreme Court Chief Justice)

Source: Authors

Legislative and Regulatory Environment

MORENA majorities in Congress have helped López Obrador advance his agenda, and the legislation they passed will be felt in 2021. Most changes aim to: 1) strengthen the executive branch to the detriment of the states, independent regulatory agencies, and other institutions; 2) redistribute wealth by transferring resources from northern to southern states in the form of major public infrastructure projects and from the middle class to the poor in the form of largely unregulated cash transfer social programs; 3) pressure companies and businesses to pay taxes; and 3) support the military by providing funds for activities outside of their mandate.

Legislation Passed in 2020 with Impacts on 2021

<u>Public Trusts</u>
In October, Congress passed legislation to seize funds from 109 public trusts. These funds helped finance medical research, disaster response efforts, film production, the protection of journalists, climate change mitigation, and more. López Obrador and MORENA legislators stated that the abolition of the trusts would improve transparency and help end corruption. They also said the Ministry of Finance would guarantee funding for those that lost important financing, including organizations supporting the arts, science, human rights, and national sports. Opponents unsuccessfully argued that legislators did not offer

evidence of corruption and the reform will leave key projects vulnerable and without funding in the long-term.

López Obrador will likely divert the funds from the public trusts, some 68 billion pesos ($3.2 billion), to cover short-term budget gaps and to fund his major public infrastructure projects (Dos Bocas Refinery, the Mayan Train, and the Santa Lucia Airport). Cultural and academic institutions that lost their trust funding are unlikely to get line items in the federal budget that would guarantee their independence from the government and their long-term survival. This reform illustrates how the president centralizes power and cuts funding to organizations that operate autonomously, limit his control, or are a check on his influence. Most of the affected organizations did not previously require a special line item in the federal budget to receive funding. Now they do. Moreover, it is important to note that most of the president's major public infrastructure projects are in Mexico's poorer southern states, where he seeks to redistribute the country's wealth. He is not necessarily growing the economy, but is simply by transferring from those who have to those who do not.

Ports and Customs

In the summer of 2020, Congress passed legislation transferring control of seaport operations from civil authorities to the Mexican Navy; this law does not affect land ports. López Obrador argued that the legislation will help end corruption, tackle organized crime, and combat the massive smuggling of drugs and precursor chemicals through seaports. Opponents, including former Transport Minister Javier Jiménez Espriú—who resigned in protest—stated that there is no evidence the Navy can operate seaports better than civil authorities. For years, the government has invested in the development of human resources for these tasks; the new strategy could slow the movement of goods across international border, given the Navy's lack of experience. This move represents the latest new role for Mexico's armed forces. López Obrador has also involved the Army in activities that range from the construction of a new airport in Mexico City to the delivery of books to public schools. Critics warn that the growing concentration of power and public resources in the military could threaten the country's democracy. We expect that the nation's armed forces will continue to be used for tasks outside of their mandate due to López Obrador's distrust of both the private sector and the capacities of his own civil servants.

Tax Legislation

In FY2019—which ran from January 1 through December 31—Congress passed legislation that taxed digital platforms such as Amazon, Netflix, Uber, and Airbnb, effective June 2020. For FY2021, Congress approved an amendment that permits tax authorities to take down websites of nonresident digital companies that do not meet their tax obligations (i.e., they did not register in the federal taxpayer registry, designate a legal representative, obtain an electronic signature, or file information returns, among other requirements). This sanction is familiarly called the "kill switch." So, starting in 2021, nonresident digital providers that do not meet their tax obligations could lose their ability to provide services to customers in Mexico. We believe that it will be very difficult for tax authorities to enforce the "kill switch" due to a lack of institutional capacity; and if applied, litigation is sure to follow as this provision potentially violates Mexican laws and trade treaties, such as the USMCA.

In 2020, in part through threats to shut down businesses behind in their tax obligations, federal tax authorities collected 27.83 billion pesos ($1.3 billion). We expect the continuation of extreme tactics to pressure businesses to pay taxes, although they will eventually stop paying off as the primary means to increase revenue as the economy flounders and the government fails to expand the tax base. The 2021 budget bill passed by Congress aims to enhance the tax collection capabilities of the SAT (Mexico's IRS).

New Legislation Expected in 2021

We expect little legislative activity in the first half of the year because congressional members will be focused on their reelection campaigns rather than on legislative activities.

<u>Labor Legislation</u>
On November 12, 2020, López Obrador introduced a bill that eliminates most manufacturing and service outsourcing. While his stated reason for the law is to protect employee rights, it also has the effect of increasing tax revenues by forcing companies to pay employment taxes and social security fees for in-house workers. However, if enacted, the law would raise production costs because employers will pay more for worker benefits. We expect that Congress will pass the law with some relevant amendments, and it will go into effect in 2021.

<u>Drug Law Changes: Marijuana</u>
On November 19, 2020, Mexico's Senate approved legislation that legalizes the recreational use of marijuana. The bill is now awaiting approval by the lower house of Congress. If enacted, which is very likely, the new law would represent major shift in Mexico's public safety and security policy and would create the world's largest legal marijuana market in 2021.

Regulatory Changes

<u>Energy</u>
López Obrador has tried to reverse the energy reforms put into place by the previous administration, believing he is protecting the interests of state oil producer Petroleos Mexicanos (PEMEX) and electricity firm Comision Federal de Electricidad (CFE) for the good of the Mexican people. He first moved to control the two state energy monopolies and regulatory agencies, appointing political allies to lead them. In 2020, López Obrador pushed further, releasing a set of rules that benefit the CFE as the grid operator and that prioritize the dispatch of electricity through CFE for all generators, including wind and solar operators. Private renewable energy generators won an injunction that allowed them to operate until a final decision on the new rules, but the controversy is far from over. We expect these disputes to continue in 2021. The midterm election results will largely determine whether López Obrador continues his strong pursuit of a nationalistic energy agenda.

We expect the GOM to heavily favor PEMEX in rulemaking and funding in an attempt to restore the national oil company to its former glory. Earlier government moves have not yet led to violations of previously signed exploration and production contracts, but López Obrador has hinted at the possibility of further energy counter-reform measures. These would bring additional lawsuits against the government and a potential fight with U.S. investors and the U.S. government. The issue is likely to boil over in 2021.

<u>Monetary Policy</u>
Despite adverse economic conditions associated with the coronavirus pandemic, Mexico's Central Bank has so far adhered to a disciplined monetary policy. This is likely to remain the case through 2021. To contain inflation, Mexico's Central Bank lowered the overnight interbank interest rate by 3% in 2020, going from 7.25% in January to 4.25% at the end of the year.

Economic Outlook

In 2020, Mexico's economic performance, already poor, was further shaken by the pandemic. Although the economy was not growing before the pandemic hit, mainly due to uncertainty in the business environment created by the current administration, the country's GDP will have contracted by approximately 10% by the end of 2020. The GOM appears to be relying on exports to the U.S. to support a recovery in 2021. This will not be enough. Mexico needs foreign investment to foster economic growth, but because that is not likely to materialize, the outlook for the 2021 is bleak. We forecast a 2.9% growth rate in 2021. At this pace, it will be four to five years before Mexico returns to 2019 levels (Figure 2).

Figure 2. GDP Growth Rates for the United States and Mexico (1985-2021)

Sources: World Bank, 2020; 2021 figures are the authors' estimates

Mexico's economic recovery is likely to lag behind that of other countries when the pandemic is over. This is because, while most countries are using a combination of monetary and fiscal incentives to counter the havoc wreaked by the pandemic, Mexico has not provided similar support and modified its spending priorities. Instead, it chose to finance somewhat questionable infrastructure projects, such as the Dos Bocas Refinery, the Mayan Train, and the Santa Lucía Airport, as noted earlier. Mexico's economic rescue package for the pandemic is, in fact, one of the smallest in Latin America (1.1% of GDP). This strategy has left a great number of businesses on their own; many have closed and many workers have lost their jobs. If uncertainty about investments in Mexico is added to the mix, a long and difficult economic recovery appears to be ahead.

Overall, we do not foresee dramatic changes in the variables affecting economic growth in Mexico. We also expect the high degree of political and regulatory uncertainty to continue, dampening foreign investment, a key driver of the economy.

Factors Influencing Mexico's Economic Underperformance in 2021

Mexico's economic performance in 2021 will be affected by several factors. Some are related to specific decisions by the López Obrador administration, including:

a) The seizure of public trusts previously used to support science, education, technology, natural disasters, sports, the arts, security, catastrophic diseases, and human rights initiatives. The funds are being reallocated to primarily finance the president's favored construction projects and government social programs. Unfortunately, the now well-funded social programs were designed without measures to assess their impact.

b) The depletion of the Budget Revenue Stabilization Fund (FEIP). The FEIP, used primarily to make up for revenue shortages, held funds of approximately 280 billion pesos ($12.7 billion) at the end of December 2018. It will likely be completely drained by 2021.

c) A decrease in FY2021 transfers from the federal government to the states and municipalities. Transfers will be reduced by 5.5% compared to FY2020, with consequent underinvestment in police forces, public services, and local infrastructure, among other things, at the state and local levels.

d) Continued friction between the president and most other national institutions. The president will go from threats to seize them to cajoling them to comply with the executive branch. This will deeply affect the strength of the rule of law and create greater uncertainty among investors.

e) The absence of countercyclical fiscal and monetary policies to foster economic growth. The GOM will instead adhere to fiscal austerity and monetary discipline.

f) A de-emphasis on power generation through private investment in renewable energy projects and an emphasis on hefty subsidies for the two state energy monopolies—PEMEX and the electric utility CFE.

g) Placing the burden for increased hydrocarbon production on PEMEX—a strategy that we consider impractical and unprofitable—instead of relying on private investment.

h) Underinvestment in infrastructure, health, and education.

i) Lower investor confidence. Private investment as a percentage of GDP will decrease further in 2021.

j) A volatile regulatory environment, as rules and regulations continue to be disregarded or rapidly change.

k) Mismanagement of the pandemic. This will lead to a lengthy and difficult process for purchasing and distributing the COVID-19 vaccine when it becomes available.

Inadequate government policies to support businesses and workers during the public health and economic crises are driving high unemployment rates in Mexico. All job growth achieved in 2019, for example, was lost during the first five months of the pandemic. Thus, we expect the country's jobless rate to be about 5.0% in 2021. Furthermore, the pace of employment gains will be slow, and it will likely take years to reach pre-pandemic levels. Given the number of workers looking for jobs, we expect wages to remain stagnant or even decline, and unemployment among lower paid workers to rise considerably. Compared to recent years, this may lead to a higher number of Mexicans looking for work in the United States, Canada, and Europe—some migrating without authorization.

Given the absence of unemployment insurance programs, many of the jobless will continue to move to the informal sector, which includes domestic workers and unregistered vendors. In 2021, about 56.5% of employment in Mexico is expected to be in the informal sector. This sector is not part of the tax base and therefore tax collection may drop, leaving the government with even fewer resources to spend and invest.

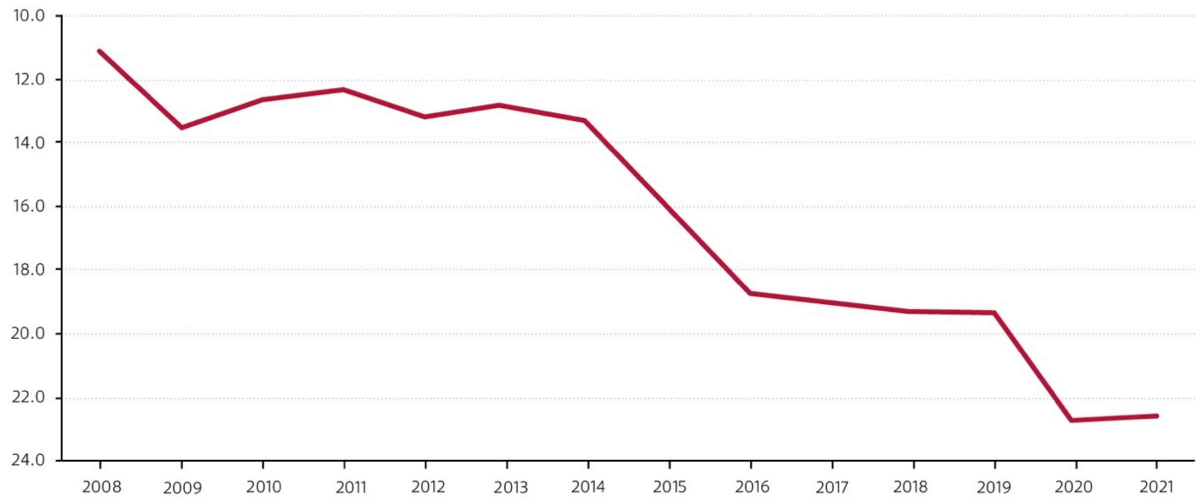
Inflation

Low economic growth in 2021 will cause demand for goods and services to drop, leading to lower prices that will eventually hold steady for the year. Even so, in the short term, higher inflation volatility associated with a strong rebound in energy prices and pressures on food prices is likely. This will decrease in the long term due to weak consumer demand. Our estimates show the consumer price index (CPI) will be 3.4% and CPI core inflation (excluding food and energy) will reach 3.3% in 2021. This level of inflation is within the Central Bank's inflation target of 3%, plus or minus one percentage point.

Currency

Mexico's currency has been under pressure due to uncertainty about the country's domestic and international policies in recent years. The floating exchange rate has played a leading role in helping Mexico's economy adjust to external shocks. During the pandemic, the Mexican peso depreciated much more than emerging market currencies on average. The peso has been more volatile since the beginning of the pandemic, but we expect it to steady in the coming year—although international oil prices and oil supply, new private investments and, foremost, the course of the pandemic could have negative effects. We expect the U.S. dollar–Mexican peso exchange rate to be 22.5 on average in 2021 (Figure 3).

Figure 3. Mexican Peso Exchange Rate (2008–2021)



Note: MXN per USD average annually (inverted axis)
Source: Banco de Mexico, 2020; authors' estimates, 2021

Interest Rates

The relative stability of the exchange rate and inflation forecast will allow the Central Bank (Banxico) to lower its benchmark interest rate. Furthermore, since Mexico has been suffering from a recession and rising unemployment, expansionary monetary policy can foster economic growth and thus increased employment. In this environment, Banxico will have incentives to lower its interest rate, which we expect to decrease to 4.0% by the end of 2020 and to 3.25% by the end of 2021.

An expansionary monetary policy in 2021 will allow Banxico to boost GDP growth in the short-term, while a lower interest rate can provide some protection against internal political risk and global economic risk. A lower interest rate will also stimulate investment and consumption spending, which will cause an increase in aggregate demand.

Fiscal Policy

Mexico's government will adhere to strong fiscal discipline in 2021. Austerity has been a central feature of the López Obrador administration. However, increased fiscal pressure in 2021 will make it necessary to set the public debt ratio on a downward path. The priority should be to raise non-oil tax revenues and provide certainty to markets in order to attract investment. But we expect that spending pressures will threaten the fiscal balance. Indeed, in 2021, Mexico's gross general government debt as a percentage of GDP will reach its highest in decades—even though the government has provided almost no fiscal support to businesses and households during the pandemic. This figure will be higher than 65% next year, and it will take a few years to lower it.

Current Account and Remittances

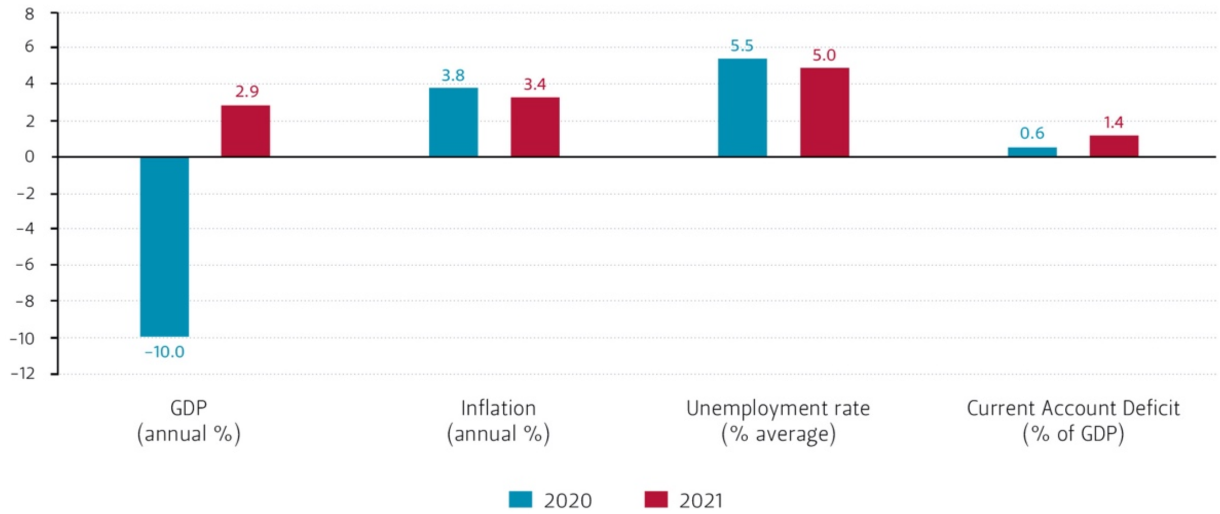
Low public and private investments and stable oil production will negatively affect Mexico's economy in 2021. The only factor that can help the economy is access to foreign markets. We expect the current account deficit to be around 1.4% of GDP by 2021. The expected deficit for next year can be financed with foreign direct investment (FDI) and remittances. However, a significant economic contraction in 2020 and weak economic growth in 2021—coupled with a public policy environment that is slowing public and private investment—will hamper the recovery of FDI despite the entry into force of the United States–Mexico–Canada Agreement (USMCA).

Despite the pandemic's negative impact on the world economy, remittances in Mexico have not been affected. On the contrary, remittances have been growing and by the end of 2020 will stand at a record $39.5 billion. Households use remittances to cover health-related expenses and other immediate needs. Given that the economy in the U.S.—the main country of origin for remittances to Mexico—should improve, the scenario for next year could mirror that of 2020. We expect remittances in 2021 to remain close to 2020 levels or slightly higher.

Poverty and Inequality

Uncertainty about the Mexican economy has affected new investments since 2018. Investors know there is a high risk of putting their money in Mexico. If the risk is high, the return on investment must also be high. One way to obtain a high return on capital is to reduce the salaries of workers. Hence, uncertainty and risk slows down investments and can lead to more poverty and inequality. If we also consider that many workers have lost their jobs during the pandemic, we can safely predict that poverty and inequality will rise. By the end of 2020, the income of around 49.5% of Mexicans will fall below the poverty line, while 17.4% will live in extreme poverty. These figures will be slightly higher in 2021. Regarding inequality, the Gini coefficient will increase next year to around 0.55. As a result of increased poverty and inequality, social unrest may also grow in Mexico next year.

Figure 4. 2020 Economic Indicators and 2021 Estimates



Sources: Banco de Mexico, 2020; Authors' estimates, 2021

Public Health

Mexico, with a population of 130 million people, is facing major public health problems—from a high prevalence of chronic diseases and obesity to health challenges associated with a rapidly aging population. Moreover, the COVID-19 pandemic has put an unprecedented burden on Mexico's economy and people. In 2021, health issues will continue to challenge the country.

The five leading causes of mortality in Mexico are heart disease, diabetes mellitus, malignant tumors, liver diseases, and homicide. Influenza, pneumonia, and chronic obstructive pulmonary disease are among the top 10 causes of death in Mexico, and all underlie conditions that increase the risk of severe illness from COVID-19. We foresee that the COVID-19 virus will be among the principal causes of death in Mexico in 2021. Here is why.

As noted above, one of the biggest health challenges in Mexico is the high number of people who are overweight or obese. In fact, 73% of the Mexican population is overweight, and one in three adults is obese. Child obesity is a grave concern: one-third of Mexican children and adolescents are overweight or obese. Nutrition and lifestyle choices, such as the consumption of ultra-processed food and beverages in Mexico, have played a large role in rising obesity levels. These factors also increase the risk of developing serious health problems such as hypertension, cardiovascular disease, and metabolic disorders. The Mexican government has sought to combat the obesity crisis through different public health strategies, such as an initiative in 2014 to tax sugar-sweetened beverages. Just this year, Mexico's government also started requiring new front-of-package labelling to indicate if a product contains excessive amounts of sugar, sodium, saturated fats, trans-fats, or is highly caloric. This is a start, as a critical component of addressing major health problems is improved health literacy—but it often takes generations for the public to adopt new behaviors.

Mental health issues in Mexico are also a top concern, with the stigma of anxiety, depression, or mental illness a major barrier to seeking treatment. Mexico's suicide rates have grown every year for the past decade. Fifteen out of every 100 individuals suffer from depression in Mexico, though this figure is likely higher due to underreporting. There is also a shortage of mental health professionals. Currently, Mexico has approximately 4,600 psychiatrists, but estimates show that over 12,000 mental health practitioners are needed to handle the number of patients who need treatment. The pandemic's full impact on mental health is not yet known. Improved mental health services should be a priority in 2021, but the issue is unlikely to capture the attention of the government, which is already fighting battles on multiple fronts—a collapsing economy, an ongoing public security crisis, and multiple vulnerabilities in its health care system.

Mexico's Health Care System

Mexico's health care system has undergone major restructuring under the López Obrador administration. The *Seguro Popular de Salud* (SPS), which since 2003 provided public health insurance to those without coverage, was disbanded. The government argued that after 15 years, the SPS was plagued by too much corruption and other problems to keep it funded. The problems included too few doctors and other medical professionals, a lack of medicine and basic supplies, prolonged patient wait times, and the fact that 20 million Mexicans were still without health insurance. Its replacement, the *Instituto de Salud para el Bienestar* (INSABI), a decentralized insurance program, began operations on January 1, 2020. INSABI, however, has so far been a failure—it is underfunded, understaffed, and has no clear rules of operation. Before the pandemic, Mexico's health care system was fragile, but COVID-19 has made it worse. Conditions are expected to further decline in 2021, when the government is expected to reduce funding for health services, despite predictions that COVID-19 cases will increase in early 2021.

The COVID-19 Pandemic and Worsening Public Health Crisis

Mexico failed to implement an aggressive and timely response to the COVID-19 pandemic. As of December 15, 2020, the country has recorded over one million confirmed cases of COVID-19 and over 100,000 related deaths, although the true number for both categories is significantly higher. In early May, for instance, when Mexico's Ministry of Health estimated that more than 100,000 people were infected, the number of officially reported cases was a little over 23,000.

Among the many factors contributing Mexico's worsening public health crisis are poor communication and inconsistent messaging about the virus, including contradictory safety guidelines and measures to reduce the risk of infection. Another major contributor is Mexico's use of a sentinel surveillance system to count and report cases from a limited network of reporting sites (rather than, for instance, implementing a mass testing strategy). And when it comes to COVID-19 testing, Mexico significantly lags behind other countries. Even when testing is done, the samples have been improperly handled. For example, some samples have been inappropriately stored or subject to long delays in processing, further contributing to a significant undercount of cases. Limited government funding for a pandemic response is compounding the crisis, causing conflicts between federal and state governments and leading to uneven responses across the country. Together, these factors have fueled widespread confusion, uncertainty, and insecurity among the general population, not to mention a growing mistrust toward government and health authorities that predated the pandemic. In a recent report comparing government responses to the COVID-19 pandemic in 36 countries, Mexico ranked near the bottom, in 34th place.

Another alarming development is the effect of the pandemic on Mexico's health care workforce. COVID-19 is killing higher numbers of health care workers in Mexico than in other countries. The risk of dying from the virus, primarily among nurses and doctors, is four times higher in Mexico than in the United States and eight times higher than in Brazil—two countries with the highest number of COVID-19 related deaths in the world. Other factors that increase the risk of infection among Mexican health care workers include delays in receiving information about safety measures; scarce or inadequate supplies of personal protective equipment; and low health care spending by the government, which often forces health care professionals to supplement their wages by working at multiple hospitals, thereby increasing the risk of spreading or contracting the virus.

An already crumbling health care system, limited resources, and a weakened health care workforce have contributed to a devastating public health crisis in Mexico. Unfortunately, this situation will continue to worsen if immediate action is not taken.

Public Health Outlook: 2021

The enormous challenges facing Mexico's public health system threaten the physical and mental well-being of the country's population. We do not foresee additional government funding for quality health care, including for prevention and treatment services. Funding to address some of the social and economic factors that impact health will also be absent. This situation will lead to needless suffering and death.

In the next year, we do not expect Mexico to develop a strategy for rapid and convenient access to COVID-19 testing; to implement and enforce preventive measures against COVID-19; or to develop and distribute valid sources of health information tailored to the needs of different sectors of the population. Such efforts would require collaboration between government institutions and non-traditional sources of service delivery, such as community nonprofit or faith-based organizations. The work of these organizations has become increasingly hobbled as the GOM cuts their funding. Unfortunately, this type of collaboration will be key to the effective dissemination of COVID-19 vaccines when they are available.

López Obrador has stated that a COVID-19 vaccine would arrive in early 2021, and that he plans to make it "universal and free" to the Mexican people. However, the logistics of production and distribution do not seem to put Mexico at the top of the global chain of recipients. Mexicans are probably on their own until at least the second half of the year. Finally, given previous and expected budget cuts to the health care sector, we do not expect the government to invest in additional infrastructure, technology, or personnel to deal with most health problems, including COVID-19. Mexico appears to be relying on the herd immunity model, an approach likely to increase suffering and death throughout the country well into 2021.

Public Safety and Security

When López Obrador took office in December 2018, he proposed a new approach to public safety that avoids open confrontation between law enforcement and organized crime, and that instead focuses on the root causes of crime. However, this public safety approach has been more rhetorical than real. Initially, most open confrontations with organized crime groups did stop, as the president called for "*abrazos, no balazos*" ("hugs, not bullets"). More recently, however, confrontations have been inevitable as crime and violence have continued unabated.

López Obrador is also attempting to fight corruption to prevent law enforcement and other bureaucrats from collaborating with organized crime groups on human smuggling, natural resource theft, drug trafficking, etc. However, Mexico's fight against corruption is failing, and nothing in current policy points to improvements in 2021. Organized crime groups have proven adaptable and resilient in their interactions with the government, employing anything from hefty bribes to threats and murder to get their way. A recent report estimates that about 20% of the country's territory is in one form or another controlled by organized criminals.

Even as old problems remain, new ones emerge. These include homicides (up by 7.9% between 2018 and 2019), "femicides" (the intentional killing of females because they are females), increasing reports of missing persons, relentless natural resource theft (in mines, pipelines, forests, etc.), extortion of businesses (up by 12.7% between 2018 and 2019), and the all but unhindered ability of criminal groups to challenge state and local authorities. Recently, even roads and toll booths have been taken over by organized criminals.

Figure 5. Homicides in Mexico by Month and a Projection for 2021

Sources: Observatorio Nacional Ciudadano; Author projection, 2021 using the 2020 average through September

The president seems convinced that poverty and inequality must be addressed to fight crime and violence. He has also urged criminals to “behave.” This two-pronged strategy is not working—at least not in the short term—as the statistics show. The pandemic and the economic collapse that followed are likely to complicate efforts to further implement this unconventional approach. The current strategy is not expected to effectively deal with any of the old or new challenges.

Capacity to Enforce Law and Order

Mexico created a National Guard or *Guardia Nacional*, a militarized police force, to replace the role of the Mexican Army, Navy, and the federal police in the battle against cartels, organized crime, and the violence they bring. The *Guardia Nacional* has approximately 97,000 troops and plans 248 bases in 2021. Insofar as the National Guard is an attempt to forge a new crime-fighting force, it is still the same old police: it is composed of former members of the military, former police officers, and some new recruits.

The mission of the National Guard is multipronged: to prevent and combat crime, to preserve public safety, and to restore national peace and tranquility. Members of the National Guard are trained in law enforcement procedures and practices, judicial rights, human rights, first aid, and emergency operations management, such as disaster relief and assistance. Yet the guard has done little to chart a specific course for implementing public safety and anti-violence policies. It has suffered from what is referred to as “mission creep,” often straying from their original mission to assume other duties and functions. These include serving as security guards for fruit orchards in Guerrero, working as border patrol agents in Chiapas, guarding municipal facilities, breaking up protests at water reservoirs in Chihuahua, removing protesters who took over federal highway toll booth stations in over 18 states, and performing other functions not envisioned in their core mission. At the same time, they have left the work of combatting organized crime and other hot button issues virtually untouched. As these issues worsen in 2021, the National Guard will likely continue to be distracted from fighting crime.

The national public safety and security strategy also lacks coordination between state and local police forces. This situation is expected worsen in 2021, as antagonism grows between opposition governors and the president.

Meanwhile, Mexico’s armed forces have “returned to their barracks.” Many members of the Army have been reassigned to duties that are slowly transforming soldiers into carpenters, construction workers, civil engineers or other craftsmen wielding hammers and saws. The Army is almost more of a job corps than a military fighting force. Their functions include the construction of several large-scale infrastructure projects, such as portions of a new rail line known as the Mayan Train; an international airport that will service Mexico City; another international airport in the tourist-rich Yucatan peninsula; and approximately 2,700 state-owned branch banks called “Banks of Well-Being,” which are intended to provide banking resources for the nation’s poorest citizens.

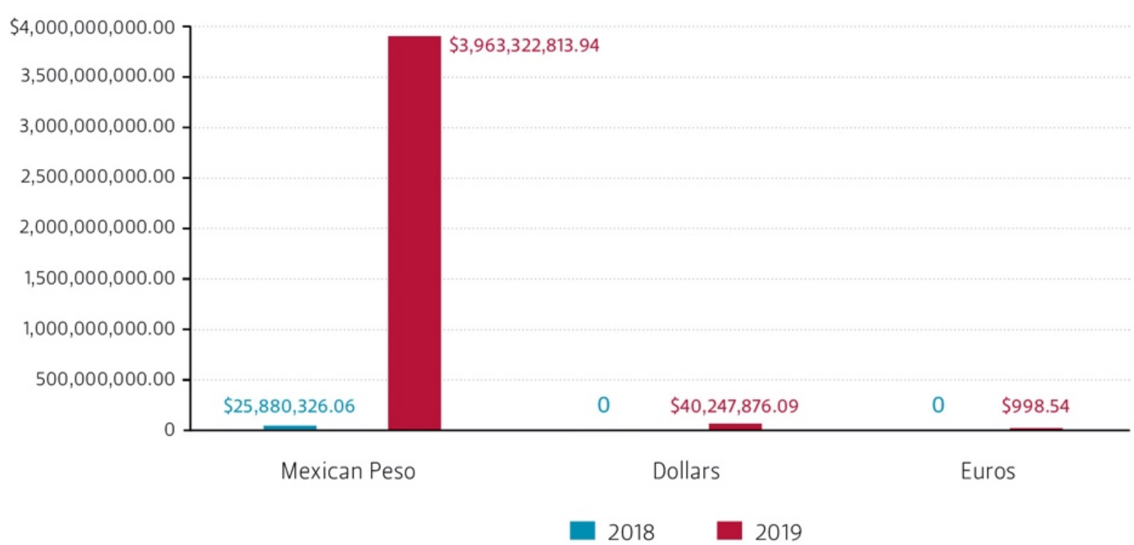
However, the Army and the Navy do protect National Guard troops during sensitive operations that involve the arrest and capture of high-value targets. They will likely continue to be called upon to carry out law enforcement operations through 2021 when the National Guard requires assistance.

Corruption and Impunity

According to the 2019 Corruption Perceptions Index (CPI), the most widely used indicator of corruption worldwide, Mexico scored 29 out of 100 on a scale where zero is a highly corrupt country and 100 is a very clean nation.

López Obrador has always acknowledged that Mexico suffers from endemic corruption and has taken steps to combat fraudulent practices, especially in government. The president says that his policies to fight corruption and implement austerity measures have saved the government at least 560,000 million pesos ($28 million) that would have otherwise been lost to illicit activities. The validity of this figure is difficult to assess, however. And while fighting corruption in the government is laudable, it nevertheless continues throughout society and the economy, and there is currently no strategy to address corruption outside the administration's hallways. Moreover, there are signs that the president's own political party has engaged in graft by illegally using public resources. We expect this situation to worsen in 2021, as MORENA may try to buy votes throughout the country.

Figure 6. Funds Frozen or Seized by the Financial Intelligence Unit



Source: Department of Treasury, Mexico (Hacienda)

The *Unidad de Inteligencia Financiera* (the Financial Intelligence Unit or UIF) in Mexico's Treasury Department has become the "pointy end of the spear," responsible for conducting public corruption investigations under the López Obrador administration. The UIF, however, also appears to have become a major instrument for punishing and intimidating opposition leaders, critics, and individuals who dare criticize the government. We expect it to continue playing this double role—fighting corruption, but also serving as a "sword of Damocles" over government critics. Even so, the UIF has recovered some ill-gotten resources for the government and will remain the main anti-corruption instrument for the government in the foreseeable future.

Challenges, Trends, and Tendencies: 2021

For the past two years, the López Obrador administration has failed to put into place a clear strategy for Mexico's future; to develop institutional capacity (laws, regulations, and processes); to increase the number of law enforcement personnel and provide more equipment and facilities; or to build the public consensus needed to face down crime and violence, resorting instead to exhortations for criminals to "behave" and to rhetorical assurances to the citizenry that all is well. These exhortations and assurances are disconnected from reality and the government's own statistics. Public safety and security challenges are, in fact, getting worse, even if homicides and other crimes are now increasing at a decreasing rate.

In addition, the López Obrador administration has not found a way to coordinate its strategy or actions with Mexico's governors and mayors. The 2021 midterm elections are likely to create even more animosity between the federal government and local officials, further hampering their ability to cooperate on public safety and security. For at least the first six months of the year, they are likely to play "the blame game."

Organized crime groups have also achieved control of new territories, expanding their ability to extract natural resources—such as petroleum and water—for revenue. These groups have also continued illegal drug production and trafficking operations. Instead of attempting to bring down these criminal groups, the López Obrador administration has faltered. It addresses the public safety problem from a social and behavioral perspective rather than one that treats organized crime as a threat to the peace and stability of the nation. The administration has exhibited an aversion to direct action or confrontation, and instead has taken a very long view that, in the end, gives criminals ample opportunity to advance. As a result, some larger criminal groups—like the *Cartel Jalisco Nueva Generación* (CJNG)—continue to consolidate their stranglehold in various territories, while smaller groups continue to victimize local populations. They have become so brazen that they felt comfortable ambushing Mexico City's secretary of public security, Omar García Harfuch, in June 2020. Members of a cartel known for its extreme violence shot García Harfuch several times. He survived, but two bodyguards and a passerby were killed in the attack.

There is nothing in President López Obrador's approach so far to signal that he has the political will to crack down on crime and violence. The prospects for a proactive government response are poor and, consequently, current trends are unlikely to improve over the next year.

U.S.–Mexico Security Cooperation

The Trump administration largely allowed López Obrador to pursue his own approach to security. Top levels of the Trump administration have in fact not paid much attention to Mexico's deteriorating public safety and security environment. At the lower echelons of the bureaucracy, however, U.S. law enforcement agencies have been very active, initiating activities that target not only criminals but also former Mexican officials who may have aided and abetted crime and corruption. Under the Biden administration, the situation will likely draw greater attention from top law enforcement levels in Washington, who will pressure the López Obrador administration to address major public safety and security concerns, especially those that affect the United States.

However, new approaches and frameworks to facilitate cross-border cooperation on public safety and security are unlikely in 2021, as the Biden administration will be grappling with with domestic issues in the United States. The Merida Initiative (MI), signed into law in 2008, is nearly defunct, despite a history of achievement that includes a new architecture for bilateral security cooperation—but it will probably be revived to continue providing Mexico's security and judicial institutions with equipment and training and to galvanize U.S. efforts to curb the flow of weapons and money and the demand for drugs. The Trump administration's FY2021 budget asks for $63.8 million for Mexico, without specifying that the funds be used to address migration-related issues. The GOM, however, can be expected to resist reviving the Merida Initiative, as it is often associated with López Obrador's political archenemy, former president Felipe Calderón. Despite this, the MI is still alive on paper and will continue.

As already stated, U.S.-Mexico cooperation on public safety and security has not gone well in the recent past and is not expected to improve much in 2021. Even so, the U.S. will likely continue high-profile arrests of Mexican criminals, often without coordinating with Mexico, something that has irked the Mexican government in the past and represents the United States' fundamental distrust of Mexico's public safety and security efforts.

Nothing indicates that the United States government (USG) will increase its coordination with the GOM through Mexico's National Guard or armed forces. Mutual distrust will be an important determinant of security cooperation in 2021. U.S. agencies will continue their law enforcement and intelligence operations, with or without the Mexican government's authorization. And with a new administration in Washington, Mexico will experience increased pressure to revise its security strategy, given the abysmal results of the first two years under López Obrador. This, in turn, will likely inject more friction in the binational relationship.

Energy

The López Obrador administration has stepped up its efforts to make PEMEX and CFE the center of the country's energy sector and, with the help of regulators, protect both from competition in their respective markets. Thus, as López Obrador's nationalistic agenda is expected to continue in 2021, investors' confidence will deteriorate further. Moreover, due to financial constraints, among other factors, production of hydrocarbons and fuels is expected to miss official targets for the year.

The Role of Regulators

The 2013-2014 energy reforms introduced asymmetric regulations to boost competition in relevant markets and curtail the dominant character of PEMEX and CFE. López Obrador has implemented a process to weaken and/or reverse the application of regulations, although it became more noticeable in 2020 as permits for existing firms to expand operations faced delays. In 2021, we foresee that the independent character of regulators will be under greater pressure and that the GOM will not back off in its bid to support state-owned firms to protect their market share.

In that vein, there is another scenario for 2021 that must not be ruled out. If current regulations and regulators fail to safeguard PEMEX and CFE from competition, López Obrador may seek to adjust energy laws. At that point, resource nationalism—the idea that the natural resources of a country, such as oil, are best administered by the central government through parastatal companies—will go from a purely rhetorical stand to actual legislation, reversing the 2014-2015 energy reform.

With Mexico as the United States' second largest energy trading partner, we anticipate that López Obrador's position on energy regulatory issues will become a source of concern for U.S.-based firms, policymakers, and industry associations. This in turn will introduce greater friction in the binational relationship through 2021.

Energy Sovereignty

Energy sovereignty, through greater state control of energy sources, continues to be one of the most important goals of the López Obrador's administration. Despite this, production levels of crude and gasoline—commodities that are key to the government's policy—have yet to reach the volumes promised by the López Obrador administration. Average crude production during the first nine months of 2020 was 8% lower than in 2018, while gasoline production registered a drop of 6.3%. Both are likely to be lower in 2021, as financial constraints as well as operating setbacks at PEMEX are likely to take a toll on official production prospects.

Financial Issues at PEMEX

PEMEX is fighting several battles simultaneously. In addition to dropping production, financial obligations are poised to influence the company's outlook. Total consolidated financial debt increased from $99.627 billion in September 2019 to $110.259 billion in September 2020, of which $18.349 billion is short term. In U.S. dollar terms, these figures represent a jump of 10.6%, but when measured in Mexican pesos, PEMEX's debt increased by 26.5% during the same period, principally due to market volatility affecting exchange rates. Liabilities continue to pile up when employee benefits and outstanding debt with suppliers are added. As of September 2020, these amounted to $67.029 billion and $7.499 billion, respectively. Overall, PEMEX's liabilities stand at $197.644 billion.

Financial obligations will not be the only burden for PEMEX in 2021. Greater domestic competition from private players in key markets, such as commercialization of fuels, and an uncertain economic environment are likely to hit the company's operating and financial indicators.

Binational Relationship

The year 2021 will be the first full year of the implementation of the USMCA by Mexico and its two partners, the United States and Canada, and the first year in the past four where uncertainties about whether NAFTA would be terminated or the USMCA approved are no longer present. Effective implementation by Mexico, which will mean increased investment, job creation, the protection of new labor rights, and exports, will be critical for Mexico. As an earlier section of the report indicates, we expect Mexico in 2021 to remain in the throes of a deep recession, with high unemployment and the risks of the coronavirus hurting most parts of the country. The USMCA is not a panacea for economy recovery, but a variety of factors, such as the increase in regional value content required for autos to qualify for duty-free treatment, should result in increased investment in Mexico, if investors are convinced that they can successfully deal with an anti-business investment climate along with continuing corruption and drug violence.

Investment in Mexico in 2021 will also be affected by other factors, such as the decoupling of U.S. and Chinese supply chains, particularly in areas relating to personal protective equipment and other medical supplies and with regard to high-tech products and technology (such as 5G communications equipment), which the U.S. government believes raise national security risks if supplied by Chinese enterprises such as Huawei. Mexico reasonably stands to benefit from the decoupling, entirely apart from the advantages of the USMCA, by producing these sensitive products or, more likely, some of the parts and components. There is also increasing pressure to shorten long supply chains because of a potentially reduced risk of disruption and because of environmental benefits from shorter shipping distances.

Changes in automotive rules of origin under the USMCA are potentially both helpful and harmful to Mexico. Under the new agreement, 40% of the production cost of autos and 45% of light trucks must be attributable to workers earning at least $16 per hour, which with the exception of a few R&D and supervisory workers in Mexico, means production in the United States and Canada. On the positive side, the regional value content for vehicles traded duty-free increases from 63.5% to 75%, to be phased in over three years. Presumably, this means that 12.5% of content now being produced in China or elsewhere in Asia will gravitate toward the United States; since such components are likely to have a high labor content, Mexico is the logical place to produce many of them assuming that production could not be fully automated, in which case the United States or Canada could be a viable option. Mexican parts production could also benefit initially from lower steel and aluminum costs, given that 25% and 10% duties apply to steel and aluminum imports into the United States from most sources other than the Mexico and Canada. While this advantage may be reduced after seven years, when under the USMCA 70% of the steel used in auto production must be "melted and poured" in North America, it will not have much impact in 2021.

Significant opportunities and risks also exist with regard to the conversion of the global and North American auto industries to focusing on electric vehicles. Even though it is probably unlikely that within the next five years electric vehicle sales in the United States will represent more than 5% to 6% of the market (they are currently about 3%), the industry has little choice but to prepare. The USMCA rules of origin strongly favor production of the critical components of electric vehicles, the electric motors, the battery, and the electronic controllers, in North America. For example, in most cases the battery must demonstrate that the regional value content is 75% or 85% depending on the methodology used. Also, electric vehicles may be considered by the United States to present national security risks from China spying or hacking if certain subassemblies are imported from China. With Tesla automobiles, for example, a central computer system is in constant contact with each vehicle's own sophisticated computer to monitor performance and regularly update the vehicle's software. One does not have to be paranoid to be concerned that such monitoring systems could be a platform for foreign spying (in addition to raising other privacy concerns). This suggests that the vehicle computers will be manufactured in the United States or Canada, but some of the parts and components could well be produced in Mexico, even if the full impact will not be felt for at least several years.

A more difficult matter to assess is the impact of the increased costs in producing autos in North America because of stricter rules of origin and steel/aluminum requirements. Eventually, these rules may increase vehicle prices sufficiently to reduce consumer demand for autos in the USMCA countries and reduce competitiveness for exports of vehicles from North America to third countries. The full impact of the new rules is more than three years away, but the continuing threat of Section 232 "national security" tariffs of an additional 25% on auto parts imported from Japan—parts that are used by many producers all over North America—in theory remains. Auto sales in the U.S. for the full year 2020 are by most estimates running only about 0.253% below 2019. The minor decrease is probably due to the lingering effects of the pandemic, which has resulted in increased unemployment in both the

U.S. and Mexico and some consumer reluctance to purchase high-ticket items. Some of the decrease, however, has been offset by increased demand for automotive vehicles by persons who fear commuting by crowded public transportation.

It is difficult to predict how foreign investment will be affected in 2021 (and through 2024) by López Obrador's protectionist and anti-business policies. In the hydrocarbons sector, the answer is clear: López Obrador has banned new oil leases until 2021, thus limiting upfront lease fees as well as additional investment in this sector in 2021. In addition, in mid-2020, Mexico significantly changed the operating environment for enterprises (American-owned and also some from Spain and Italy) that had invested in solar and windmill energy production facilities. In the past, clean energy produced by those enterprises was welcomed by the Mexican government and "wheeled" (transported) by Mexico's monopoly electrical entity CFE power grid at generally favorable transmission rates. Those rates have been abruptly changed, apparently because López Obrador wants CFE to maintain a monopoly over electrical power generation, even though CFE has neither the funds nor the expertise to install additional clean energy production facilities. (It also seems clear that López Obrador does not consider such climate change measures a priority.) The new transmission regulations have been challenged in multiple lawsuits within Mexico by the foreign investors. If they do not prevail in Mexico they will probably seek international arbitration against Mexico under NAFTA's Chapter 11, which remains available to them for three years after July 1, 2020. The impact of such actions on Mexico's investment climate beyond the energy sector is difficult to estimate. In some sectors such as autos and auto parts and in most other manufacturing sectors, there have been few significant disputes between investors and the Mexican government, so additional investment there may not be affected, but a decision to invest in steel production in Mexico to meet the USMCA melted and poured requirements could be affected.

Another risk for Mexico under López Obrador is that antibusiness policies may affect the decision by companies serving U.S. customers, even for relatively labor-intensive products, whether to enjoy lower labor costs in Mexico or absorb higher production costs in the United States or Canada. Many enterprises that are relocating their production from China to North America (where the supply lines are shorter and thus more secure against interruptions and more environmentally friendly than with Asia), will ultimately need to decide whether to increase investment in the United States or Mexico (or both). With the United States, higher labor costs are a serious deterrent, although with highly sophisticated production Mexico may simply not have the properly trained workers. In less critical sectors, the trade-off will be between lower labor costs in Mexico and U.S. facilities that extensively use more technology, including robots, to offset higher wage costs. This equation may be different among different industrial sectors. In each instance, the potential investor in new or increased North American production will weigh such factors as labor costs, convenience of location, and access to third-country markets through Mexico's many free trade agreements against endemic corruption, drug violence, the lingering effects of the pandemic, and an anti-business investment climate. Mexico has significant advantages in labor costs and, for many parts of the United States, in location (near the U.S. interstate highway system, which means that most states are no more than two days' travel for a truck). Mexico also has the protection of the USMCA and a situation where unlike with China, the United States has the ability to put great pressure on Mexico to comply with the agreement (since Mexico is still dependent on the United States to take over 75% of its total exports). The USMCA also has an improved state-to-state dispute settlement system. It is unfortunate that some of these potential investors might be turned off by the risks that López Obrador has created in the past two years.

With regard to potential problem areas in 2021, the most significant is probably the new labor rights provisions in the USMCA, Mexico's 2019 labor legislation, and in the United States' USMCA Implementation Act (December 2019). Under the new rules, Mexican workers are for the first time ever encouraged to form independent labor unions and engage in effective collective bargaining for better wages and better working conditions. These new rules can be enforced *inter alia* against individual Mexican enterprises (many of which are owned by U.S. companies) through a "rapid response" arbitration mechanism that may target specific enterprises that are accused of failing to meet the requirements of the new obligations. Continued violations can be punished by restricting exports from those enterprises to the United States. (A similar mechanism exists for Mexico-Canada trade.) The United States is actively engaged in monitoring compliance through five labor attachés located in Mexico City and other major Mexican cities. However, beginning in July 2020, Democratic members of Congress were complaining that the funding provided for labor monitoring and enforcement was not being used by the administration as intended. U.S. labor unions have announced their intention to support enforcement actions before the end of 2020, and such actions are likely to continue into 2021.

While there is some risk that overactive enforcement by the United States (or demands from U.S. labor unions) would go beyond good faith efforts, it is undeniable that the changes in the present system—whereby union leaders have worked with business managers to suppress any effective collective bargaining, limit worker rights, and keep wages low—are long overdue. Over time, effective enforcement may gradually result in increases in Mexican hourly wages, but probably not enough to erode significantly the approximately 5:1 ratio that currently exists. Failure by the López Obrador administration to effectively implement the new rules thus could be a significant issue in U.S.-Mexico relations in 2021, potentially interrupting duty-free trade for some businesses and sectors, and particularly with Biden as president.

Other areas of potential trade friction between the United States and Mexico also exist as of the end of 2020. Under the USMCA, Mexico and Canada are required to raise the threshold for permitting low cost shipments to enter free of duty and other fees. (It is $800 per package for entry into the United States, and about $112 for duties and $30 for national sales taxes under the USMCA.) For Mexico, an exemption from customs duties applies to shipments valued under $177 and for value added taxes, $50, with simplified entry procedures. Reports suggest that Mexico is not yet complying with these requirements, violations that directly affect companies such as Amazon seeking to have purchases delivered to Mexico. (Since many of Amazon's goods are produced in China or elsewhere outside of North America, they do not meet the USMCA rules of origin.) Also, as noted in the taxation section, above, a potential dispute over taxation of internet services and data localization is possible.

Some senators and members of Congress have complained that Mexican authorities have unreasonably delayed approval of applications submitted by U.S. producers for certain biotech products to be imported into and used in Mexico, effectively denying access to a potentially lucrative market. Others have complained about the ban—predating the USMCA—of an agricultural chemical, glyphosate, that applies in Mexico (and many other countries) even though the chemical is still approved for use in the United States. These differences have been subject to ongoing negotiations between the two governments but the Office of the U.S. Trade Representative (USTR) has threatened to seek arbitration under USMCA's Chapter 31 if necessary to resolve the biotech approval delays.

Tomato and other fresh fruit and vegetable exports from Mexico to the United States (e.g., blueberries) remain subject to new trade restrictions, although the dispute over alleged Mexican dumping of tomatoes is of some 30 years' duration. Mexico successfully defeated efforts by the United States to include in the USMCA new restrictions on tomatoes exported to the United States. However, the U.S. Department of Commerce, with pressure from Senator Marco Rubio and the Florida and Georgia congressional delegations, succeeded in imposing further restrictions on such "winter vegetable" exports through a new dumping suspension agreement concluded in 2019. Under that agreement, inspections of incoming tomatoes increased from spot-checks to screening of 90% of the shipments. This is seen by observers as a blatant attempt to restrict tomato imports because delays in inspection by U.S. authorities, reported in many cases, cause the tomatoes to spoil, making them worthless.

The USTR Robert Lighthizer promised members of the U.S. Congress that he would provide a new plan to limit imports of Mexican fruits and vegetables by August 30, 2020 and issued a plan for such actions on September 1, 2020. USTR also announced plans to open negotiations with Mexico over the ensuing 90 days, although it is unclear whether such negotiations have taken place. USTR also requested the U.S. International Trade Commission to initiate expedited safeguards under Section 201 of the 1974 Trade Act targeting Mexican and other imported blueberries. Mexico has threatened to initiate state-to-state dispute settlement if the U.S. attempts to impose further restrictions, on grounds that such actions violate provisions of the USMCA that address eligibility to bring trade actions against another party. Mexico successfully challenged U.S. safeguard tariffs against corn brooms under NAFTA rules in 1995. While the immediate pressure from Florida was reduced after the November 2020 election, it is reasonable to assume that efforts by U.S. interests to restrict fruit and vegetable imports from Mexico will continue.

Conclusion

In general, 2021 will be a complicated year for Mexico—more so than 2020 was. The primary factors affecting conditions on the ground are the pursuit of policies that harken back to Mexico's state-led model of the mid-20th century; the midterm elections, which can either give the president a mandate to pursue his public policy agenda or introduce a check on his political power; the pandemic, which is likely to intensify during at least the first half of the year; the continued economic crisis, made worse by the GOM's refusal to abandon its draconian austerity measures and engage in countercyclical spending; the persistent crisis of public safety and security, for which there is no articulated public policy beyond "addressing its long-term causes." In addition, the U.S.-Mexico relationship is likely to deteriorate somewhat in 2021, particularly due to trade and investment issues and the lack of coordination on public safety and security. Binational relations will also be affected by the departure of Trump, whom López Obrador favored and considered an ally. As a result, the business environment will continue to be mired in uncertainty and most investors investors will likely think twice before seriously engaging with Mexico in at least the first half of 2021.