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

MEXICO COUNTRY OUTLOOK 2023

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"Mexico Country Outlook 2023"

Executive Summary

The Mexico Country Outlook examines how key issues driving Mexico's politics, economy, border policies and more will likely play out in 2023. The report is designed to help businesses and investors make decisions related to their interests in Mexico and to help policymakers understand what they can expect to see next year. Drawing on their decades of study and analysis of Mexico, the experts of the Center for the U.S. and Mexico conclude that in 2023:

- Elections in the State of Mexico and Coahuila will be a litmus test for political coalitions and parties heading into the 2024 presidential election.
- Mexico's House of Representatives will appoint four new commissioners to the powerful National Electoral Institute (INE), giving President Andrés Manuel López Obrador a new opportunity to coopt this key organization.
- López Obrador will continue to give the military responsibilities traditionally carried out by civilians.
- Mexico's Supreme Court justices will elect a new chief justice from their ranks, setting up a more collaborative—or a more adversarial—relationship with the executive branch.
- Mexico's economy is expected to grow between 0.5% and 1.3%, which means the country's GDP will not return to 2018 levels until 2024.
- The financial demands of the president's pet projects and social programs, and the poor prospects for economic growth, will further pressure the federal budget.
- Inflation will come down slowly, with headline inflation reaching around 5% and core inflation 4.9% in 2023.
- The U.S. dollar-Mexican peso exchange rate will stand at around 21.1 on average. However, if the U.S. goes into recession, the peso may lose value well beyond that.
- Federal funds for health care will not be enough to compensate for Mexico's failing health infrastructure, and the fallout will affect millions.
- Low levels investment in education will continue. Electoral tensions caused by powerful teachers' unions will affect the education agenda.
- Violent conflicts between organized crime groups will likely escalate as they try to influence politics and get a firmer foothold in licit markets.
- The blatant use of regulatory tools to shield PEMEX and CFE market positions will not wane, but energy self-sufficiency will continue to be an elusive goal.
- The Biden administration may seek to designate a new ambassador to Mexico.
- U.S. will continue to pressure Mexico on the full implementation of the USMCA, immigration, and drug smuggling, particularly fentanyl.

- Mexico will likely accept more migrants from Cuba, Nicaragua, and Venezuela under the U.S. “Remain in Mexico Program.” Thousands of migrants will continue to amass at the U.S.-Mexico border.
- A water governance crisis in the river basins shared by Mexico and the United States will continue amid abnormally dry conditions.

I. Introduction

The U.S.-Mexico relationship is multi-faceted, with numerous issues and interests running through it. Despite expectations of a rough road when President Andrés Manuel López Obrador took office in 2018, the first four years of his administration did not produce a major crisis with the United States. Mexico’s nationalistic administration was a surprisingly good match for the Trump administration’s interests, despite Trump’s controversial stands on the North American Free Trade Agreement (NAFTA), immigration, and Mexico in general. Binational relations were tested, but not derailed. The Biden administration replaced Trump’s insults and threats with a focused and disciplined form of diplomacy. Even as its attention is diverted by other major foreign and domestic problems, the Biden White House keeps a close eye on Mexico’s myriad domestic issues, including its assault on democracy; problems with the rule of law; deterioration of human rights; increased militarization of the country’s public life; inaction on human smuggling and drug trafficking, particularly fentanyl; growth of organized crime and corruption; and Mexico City’s deference toward autocratic regimes in Latin American and cozier-than-warranted position toward Russia in particular. None of these issues will produce a major showdown in 2023, but there will be disagreements that will keep the U.S. and Mexico governments talking throughout the year.

The continued conversation especially applies to the countries’ economic ties, the brightest spot of the relationship. Cooperation will likely continue on its current path, though hampered by ongoing disputes about energy sector policies, which particularly interest López Obrador. The disagreements over the United States-Mexico-Canada Agreement’s (USMCA) coverage of the energy sector will continue well into 2023 and represent a relatively important and active obstacle to broader cooperation on other issues. Still, the economic, and especially the commercial, relationship will continue to be robust and grow on the basis of the USMCA framework. Mexico’s stance toward the U.S., moderated by continued dependence on access to U.S. markets and investment, will aim to avoid a major crisis with Washington. Similarly, Washington’s preoccupation with an increasingly complicated international scene and domestic political turmoil driving toward 2024 will lead it to avoid a diplomatic escalation with Mexico City. This situation means there will be no major breakthroughs on the strained status quo.

The turmoil expected in Mexico toward the end of 2023, when the country enters into a full transition toward the presidential race in summer 2024, will draw Washington's attention. Mexico's anti-Washington rhetoric is expected to play out during the country's election season, though the White House will likely respond conservatively, holding its basic line on disputed issues.

The following sections of this report break down by topic Mexico's outlook for 2023 and their impact on the binational relationship throughout the year.

II. A Shifting Political Landscape

High-stakes 2023 Elections

On June 4, 2023, the State of Mexico—the largest in the country—and the State of Coahuila will hold elections for governor and, in the case of the latter, for state legislators and mayors. The Institutional Revolutionary Party (PRI) has continuously governed both states since the 1920s, but the PRI's long run will probably end if a coalition is not formed to run against MORENA.

The 2023 elections will test coalitions, parties, and candidates heading into the 2024 presidential elections. In recent years, elections in the states of Mexico and Coahuila have been an election laboratory of sorts for political parties—and for organized crime in particular, which have tested illegal election financing schemes that could influence election outcomes the following year. This is expected to be the case again. Moreover, if the election results are close, they will be resolved in court, as often happens.

It is important to note that citizens of both states residing abroad with a valid voter registration card can vote by mail and, for the first time, in person at Mexico's consulates. Twelve million Mexicans living abroad were eligible to vote in Mexico's 2018 elections. Such numbers strengthen the interest of electoral authorities to involve Mexican citizens residing abroad in domestic politics.

All Eyes on the State of Mexico

The State of Mexico represents around 15% of the country's electorate. It is home to the PRI's powerful "*Grupo Atlacomulco*," which is believed to have ruled the State of Mexico for more than 70 years. Mexicans used to say that the party that wins the State of Mexico will win the presidential election a year later. However, this is not always true. President López Obrador's party, MORENA, insisted on Delfina Gómez as its State of Mexico gubernatorial candidate, although she lost in 2017 by three percentage points of votes against Alfredo del Mazo, the current governor. As a side note, in January 2022, Gómez—the former mayor of Texcoco, one of the State of Mexico's most important cities, and the former Secretary of Education—was found guilty of illegal electoral financing by Mexico's highest electoral court. Despite this, MORENA and President López Obrador have once again supported her candidacy. Without a doubt, she will again be MORENA's 2023 gubernatorial candidate in the State of Mexico.

The PRI and the other relevant opposition parties—PAN, PRD, and MC—have not yet decided to run as a coalition in the State of Mexico. The leaders in the race to be the candidate for the coalition, if there is one, are Alejandra del Moral, the State of Mexico's Secretary of Social Development, and Ana Lilia Herrera, the State of Mexico's senator. If the PRI, PAN, and PRD do not form a coalition, they will likely lose the gubernatorial election next year and MORENA will take the state.

Even if there is an opposition coalition, the race will nevertheless be close between MORENA and the coalition candidate. It is believed that the federal attorney general's (AG) office will likely pressure the current governor, Alfredo del Mazo, to work behind the scenes to defeat his own party; and that the AG will offer to not investigate him for corruption prior to and during his term in exchange for the governor's support of MORENA's candidate. This strategy has purportedly been successfully employed in the states of Sinaloa, Oaxaca, and Sonora, where former PRI governors have allegedly handed over their states to MORENA's candidates in exchange for impunity. Under this scenario, whether the governor decides to negotiate with MORENA or defend his state will decide the election's outcome.

Coahuila May Be Up for Grabs

One of the few PRI politicians who retains a good reputation and popularity in his state is Miguel Ánguel Riquelme, governor of Coahuila. Riquelme has publicly stated the need for a coalition to win the election, and he has apparently been dedicated to building one in recent months. For Riquelme, losing his state would be the end of his political career, and most importantly, the PRI would no longer be a relevant party in the state. There is still no clear PRI candidate to date, although Manolo Jiménez, Coahuila's Secretary of Development, could run as the coalition candidate. Ricardo Mejía, undersecretary of public safety, and Sen. Armando Guadiana are potential MORENA candidates. Coahuila will also elect state legislators.

We expect a tight race between MORENA and the coalition. However, the fact that Gov. Riquelme is a consummate political operator means that a coalition would be better positioned to win this election.

Unsettling Changes at the National Electoral Institute (INE)?

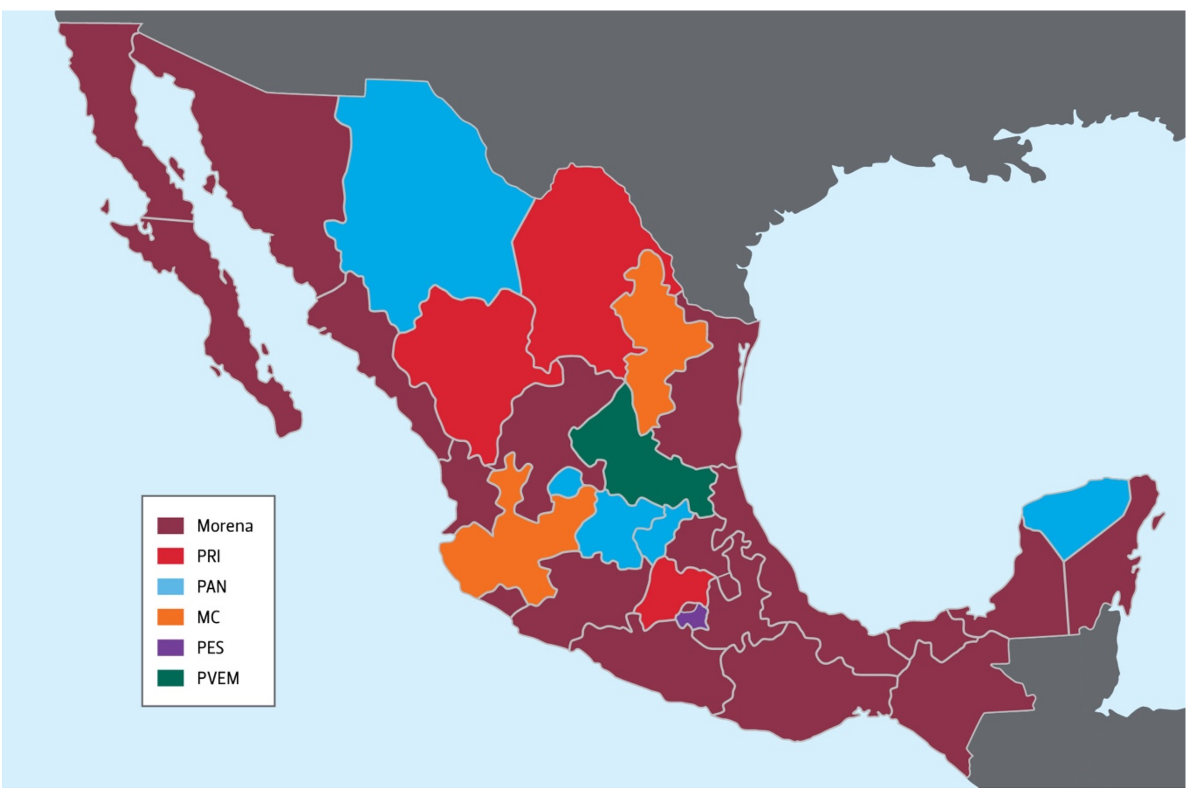
In April 2023, four of the 11 National Electoral Institute commissioners, including the chair, Lorenzo Córdova Vianello, will conclude their terms. Córdova has been a gatekeeper of Mexico's democracy. Unlike other heads of independent institutions, Córdova has been very vocal about his objections to MORENA's attempts to change the rules of the electoral game. Next year, when the House of Representatives appoints the four new commissioners, MORENA and its allies will have the majority in the House. Thus, we expect that MORENA will try to capture the INE, just as it has done with other independent regulatory agencies and institutions, such as the Energy Regulatory Commission (CRE) and the National Commission of Hydrocarbons (CNH). If—in spite of powerful citizens groups and opposition parties that will strongly defend the INE's independence—MORENA manages to take the INE, Mexico's democratic institutions will be weaker in 2023.

Urban Voters Could Spoil a MORENA Sweep

Since López Obrador took office in 2018, the president's party, MORENA, and its allies, PES and PVEM, have won 22 out of 32 governorships. MORENA holds the largest number of congressional seats and the majority in most state legislatures. This has reconfigured Mexico's political map. If MORENA remains organized and disciplined, it will be in great shape for the 2024 presidential election. However, 2022 has revealed that MORENA is strongly divided. Infighting will become more virulent in 2023, but López Obrador is nevertheless likely to hand-pick his successor. What the potential MORENA presidential candidates who don't make the cut do next will matter in 2024.

Despite its consolidation across Mexico, MORENA faces a clear urban-rural divide that could work against its interests. Most of the large cities are governed by opposition parties, including in Monterrey, Guadalajara, León, Querétaro, and Mérida. The population concentrated in these cities and the economic power they represent for Mexico's economy could reduce the impact of MORENA's electoral advances at the state and federal level.

Figure 1. Breakdown of Governors by Political Party



Source: Authors.

Rise and Fall of Key Political Figures

In Mexico, as is true everywhere, fortunes rise and fall. Under the López Obrador administration, some political figures have seen their stars rise, others have settled into their positions, while still others may have had difficulty maintaining their influence. López Obrador has opened the race for his successor early, so we recommend watching closely the following people in 2023:

Political Party	Up	Stable	Down
Morena	Claudia Sheinbaum Marcelo Ebrard Ricardo Monreal Adán Augusto	Mario Delgado	Rocío Nahle Cuitláhuac García
PAN	Mauricio Kuri María Eugenia Campos Mauricio Vila		Ricardo Anaya Marko Cortez
PRI	Miguel Angel Riquelme		Alejandro Moreno
MC	Luis Donaldo Colosio Samuel García Dante Delgado	Enrique Alfaro	
Other	Lorenzo Córdova (National Electoral Institute)	Arturo Zaldívar (Supreme Court)	Alejandro Gertz (Attorney General's Office)

III. A Complex Legislative and Regulatory Environment

This section covers legislative initiatives passed in 2022 that extend into 2023, new legislative changes proposed by MORENA and the López Obrador administration, and critical issues before Mexico's Supreme Court of Justice.

Legislation Passed in 2022 with Impacts in 2023 and Beyond

<u>Mexico's Growing Militarization</u>

In October 2022, Mexico's Congress approved a constitutional amendment allowing the armed forces to continue performing public security duties through 2028—effectively ruling out the possibility of a civilian police force at the federal level under the current administration. President López Obrador has granted the military more responsibility than any other Mexican president in the last few decades. In addition to policing, the army is now also responsible for building the Tulum airport; constructing 2,700 branch offices of the Banco del Bienestar; guarding Mexico's borders to the north and south to control migration; managing all maritime ports, airports, and land ports of entry; and many other activities. All of these duties come with large budgets. This situation is not desirable, as

Mexico's military is well known for its human rights abuses and lack of accountability, and such problems will likely deepen in 2023. The greatest risks will be to Mexico's democracy and to the development and growth of effective civilian institutions.

López Obrador will continue to favor the military because it does not question his decisions. It simply follows his orders. Even so, time is running out for Mexico's president, as 2023 is his last full year in office. His continuing reliance on the armed forces reflects his failure to develop both the public policies that address Mexico's problems and the civilian institutions that support them. Further, López Obrador still needs to complete some of his pet projects, such as the Dos Bocas Refinery and the Mayan Train—but he is unlikely to see them up and running during his term.

López Obrador's focus on the military could be a major mistake with consequences for many years to come. His tactics have already prevented Mexico from building strong governance institutions and led to more human rights violations. In the past eight years, the National Human Rights Commission (CNDH) has received at least 6,661 complaints of human rights violations committed by the army; under current conditions, the numbers are sure to grow. A continued shift to the armed forces will weaken democracy in Mexico, as it will be tough to remove the military from power and reduce the large budgets it enjoyed during this administration.

<u>A Multilateral Convention to Implement Tax Treaty-Related Measures to Prevent Base Erosion and Profit Shifting (MLI)</u>
In 2017, the Organization for Economic Cooperation and Development (OECD) proposed a multilateral instrument that will swiftly implement a series of tax treaty measures to update international tax rules and reduce the opportunity for tax avoidance by multinational enterprises. On October 12, 2022, Mexico's Senate approved the treaty. After approval, the MLI must be published in the *Diario Oficial de la Federación* (Mexico's official gazette), and the ratification instrument must be sent to the OECD. Three months after that, the accord will enter into force. This process will be concluded in early 2023. Several tax implications for multinational companies may arise once Mexico implements the instrument. Multinational corporations that do business with Mexico should pay particular attention to the provisions regarding the principal purpose test (PPT) and mandatory binding arbitration. Companies should ensure that their offshore operation have a business purpose beyond a tax benefit and be ready to resolve the cross-border tax disputes through arbitration. It is important to note that the United States has not signed this multilateral instrument, so the tax treaties between Mexico and the United States will not be affected.

Legislative Bills Expected in 2023

<u>Will the National Electoral Institute (INE) and Electoral Courts Survive?</u>
During his time in office, López Obrador has tried to weaken the authority of electoral entities, including the INE and electoral courts. Opposition parties and organized citizen groups have blocked previous bills that would undermine the INE. But López Obrador is nothing but persistent. The upcoming departure of INE Chief Commissioner Lorenzo

Córdova seems to give López Obrador and MORENA the opening to capture a majority in the INE, coopting that key agency, and a new opportunity to pass his anti-democratic electoral reforms.

Already MORENA and López Obrador have introduced two bills that seek to change the country's political landscape by:

1. Reducing the number of legislators in Congress;
2. Reducing public funding for political parties and eliminating the 32 state electoral institutes and electoral courts;
3. Selecting new electoral judges and magistrates by popular vote instead of a process supervised by the judicial branch;
4. Eliminating the INE altogether and creating a centralized federal commission to oversee all federal and local elections from within the government; and
5. Reducing the number of INE commissioners from 11 to seven.

Such changes, among others, are seen by some as strategic moves that would tilt the playing field against political opponents and return Mexico to a time when elections were run by partisan, centrally controlled government appointees. This is a step back for democracy. There will be new attempts continue such tactics in 2023.

That said, these bills are not likely to pass. The INE has international prestige and solid support among the general public. Many Mexican citizens have contributed to INE's success because under the INE's guidance, citizens organize and supervise elections. Opposition parties and civil society will continue to defend the INE's independence.

Scrambling for a Budget Solution

The López Obrador administration is running out of money. It will be difficult for the administration to cover short-term budget gaps, continue financing its cash-transfer social programs, and fund major public infrastructure projects (Dos Bocas Refinery, the Mayan Train, and the AIFA Airport). MORENA's lawmakers constantly present initiatives to collect more money for the administration. For instance, in 2020, they passed legislation to seize about $3.2 billion from 109 public trusts. These trusts had been used to finance medical research, disaster response efforts, film production, the protection of journalists, and more. The administration diverted the money to fund its priorities, such as PEMEX and the major infrastructure projects mentioned above. More recently, Congressman Ignacio Mier, MORENA's leader in the House, introduced a bill that amends the Financial Institution Law to require that banks transfer money and accrued interest from accounts that have been inactive for at least three years to the government. These funds would be used to finance federal and local public security activities as well as charities and nonprofit organizations.

The bill is likely to pass. Approval requires a simple majority in both chambers, and MORENA and its allies have the votes. However, the bill itself is a sign that, without economic growth, a tax hike, increased foreign debt (which the government is pursuing), and additional sources of income, the government is now nearly bankrupt. Some experts believe the government's precarious financial situation will lead to a fiscal and financial crisis at the end of 2023.

Relevant Supreme Court Rulings Expected in 2023

On January 2, 2023, Mexico's Supreme Court justices will elect its next chief justice. Seven out of the 11 Supreme Court justices are running for the position, including four justices appointed by López Obrador. Mexico's judicial branch has been an effective check on other government powers, notably those of the executive branch. Despite the odds that one of López Obrador's picks will be chosen, we expect the next chief justice to respect the court's independence and avoid meddling in politics. Most of the candidates running for the position have demonstrated their independence through multiple rulings. The court's role in this regard is vital for the country's democracy.

<u>Militarization Cases</u>
Opposition parties have challenged most of the legislation introduced by López Obrador and his coalition, and the militarization of Mexico is no exception. Legislation passed by Congress and executive actions that expand the military's role have brought numerous lawsuits. Most are awaiting rulings by the Supreme Court. The current chief justice, Arturo Zaldívar, has been criticized for having been too complacent with López Obrador and for delaying the resolution of these cases. Zaldívar has been careful not to clash with the president—an approach that has generated many complaints about his tenure, which concludes on January 2, 2023. We expect rulings on these cases next year under a new chief justice.

IV. Another Year of Economic Uncertainty

Mexico's economic performance has been lackluster for decades, with an average growth rate of 2% per annum. However, economic indicators have deteriorated further since López Obrador took office in December 2018. Between 2019 and 2022, the growth rate of the Mexican economy shrunk by an average of -0.4%. In 2023, the economy is expected to grow between 0.5% and 1.3% (Figure 2). This means that Mexico will not return to its pre-pandemic GDP until well into 2024.

Figure 2. GDP Growth Rates in the United States and Mexico (1985-2023)

Sources: World Bank. 2022 and 2023 rates are authors' estimates.

The COVID-19 pandemic partially explains this dismal performance. However, the main issue is uncertainty in the investment and business environment that the administration introduced by making economic policy decisions on ideological rather than practical grounds. For instance, it cancelled public infrastructure projects; coopted regulatory agencies; slashed budgets and public goods and services and the general bureaucracy; and relied on the military to build and manage new projects and handle public safety and security. All of this has weakened the country's infrastructure; compromised a level playing field for economic actors; affected the quantity and quality of public services, such as health and education; and undermined the rule of law. These key decisions will continue to affect Mexico's business and investment landscape into 2023.

A slowdown in global economic activity in 2023 will exacerbate conditions in Mexico and have a major impact on its economy—especially if economic growth slows in the U.S., Mexico's main trading partner. If the U.S. economy enters a recession, Mexico will probably follow suit.

In 2023, Mexico's economy will continue underperforming and could even face stagflation. The factors that will support the economy are remittances—money sent by Mexican migrants abroad, particularly in the U.S.; manufacturing exports to the U.S.; and foreign direct investment (FDI), which is still a viable source of income, as long as there is no recession in the U.S. next year.

Factors Influencing Mexico's Economic Performance in 2023

Mexico's economic performance in 2023 will be affected by the following factors:

a) The government of Mexico's (GOM) political and electoral calculations will continue to drive economic decisions that affect Mexico's prior commitments to international trade and investment through numerous commercial accords.
b) The GOM will not raise taxes but will maintain fiscal discipline. This will put pressure on the federal budget, which has been battered by spending on the president's major projects and broad social programs. As noted below, this situation will continue.
c) The GOM is likely to increase real spending by 13% in FY2023 compared to FY2022, but most new spending will go toward the president's infrastructure projects and social programs—for example, the Mayan Train (with an increase of 115.5%) and cash transfer social programs (with an increase of 34%). These initiatives run without clear operating rules or accountability mechanisms. Much of the increase in spending will be financed through additional debt of some $1.2 billion pesos (14.5% of total estimated revenue).
d) Aggressive tax collection efforts by the GOM will continue, but since many are one-time revenue sources that have already been realized, the GOM will not reach its planned revenue goals. It will resort to borrowing in international markets to fill the budget gap.
e) The regulatory environment will remain uncertain due to the president's ongoing conflict with the judiciary, independent regulatory commissions, the private sector, and civil society.
f) The GOM will continue efforts to reestablish a government-led economy, primarily in the energy sector, and to grant costly and unproductive subsidies to the two state energy monopolies—oil company PEMEX and the electric utility CFE.
g) The GOM will not propose any new initiatives that address the problem of higher pension outlays, which already represent 20.4% of the federal budget.
h) The GOM's inaction regarding some serious social problems, including the high rate of femicide or the unsolved disappearance of 43 students in Ayotzinapa, could generate more social unrest in Mexico that could weaken confidence in Mexico's economy. This could translate into lower investment flows to Mexico.
i) The GOM will likely continue to respect the autonomy of the Central Bank (Banxico) and monetary policy.

These factors, in general, will generate uncertainty in the business environment, translating into lower economic growth affecting millions of Mexicans, particularly those living in poverty.

Key Economic Health Indicators in 2023

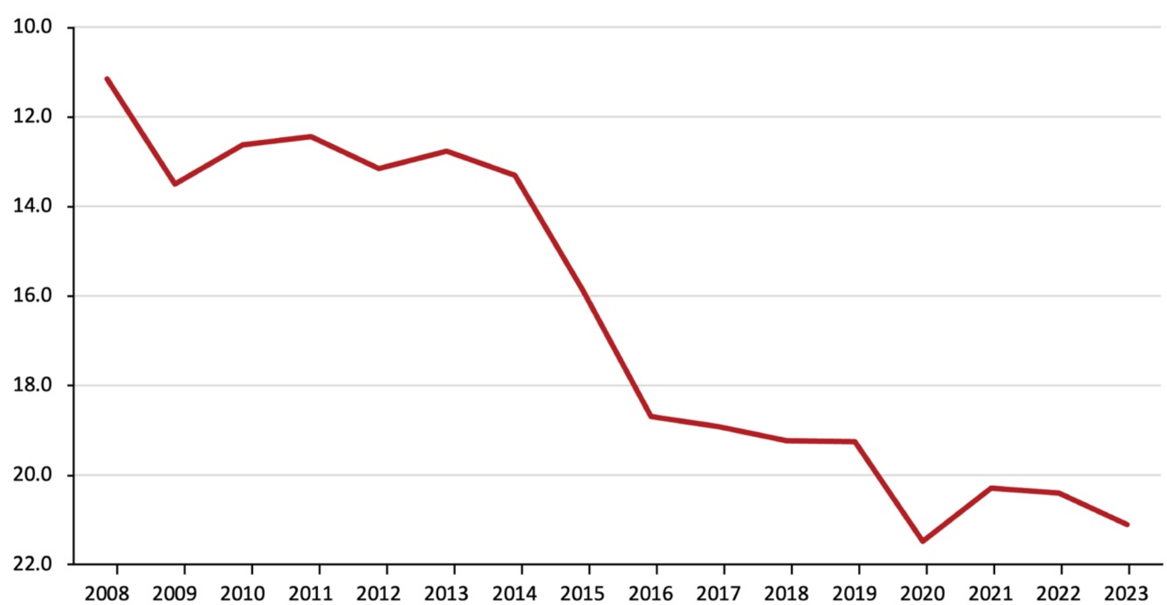
Will Inflation Finally Ease?

Inflation in 2022 has been a major concern globally due to several factors, including a series of supply shocks driven by the pandemic and its end, as well as the Russian invasion of Ukraine, which caused food and energy prices to spike. Mexico was no exception; its inflation in 2022 has hovered around 8.5%. Inflation will come down slowly in 2023, with headline inflation reaching around 5.0% and core inflation 4.9%. As inflation will be high at the start of 2023 and above Banxico's target of 3%, the bank will continue to use a tighter monetary policy, as do other countries. We expect inflation to recede gradually by 2023, in part because of the tighter policy and slower global growth. This will cause inflation in Mexico to continue to be a problem for low-income households in particular.

Mexico's Peso Faces Headwinds

Mexico's peso will be under pressure next year due to uncertainty around the country's domestic and international policies and high inflation. The peso is not yet at its pre-pandemic level and averaged 20.4 pesos per dollar in 2022. Banxico's monetary policy has boosted the currency despite stagnation in Mexico's economy. However, next year this policy will not have that desired effect and since the peso has not reflected the country's weak economic outlook, the U.S. dollar-Mexican peso exchange rate will stand at around 21.1 on average (Figure 3).

Figure 3. Mexican Peso Exchange Rate (2008–2023)



Source: Banxico, 2022. Authors' estimates, 2023.
Note: MXN per USD average annually (inverted axis).

Will Banxico Stop Raising Rates?

Given the high levels of inflation in Mexico in 2022, its central bank has been forced to accelerate interest rate hikes. Banxico has followed the U.S. Federal Reserve's interest rate hikes this year, with no impact on lowering inflation. As inflation has remained well above Banxico's 3% target, the bank is likely to continue to raise its benchmark interest rate, which will likely reach 10.25% by the end of 2022. Inflation will ease gradually in 2023, but the central bank will take time to reduce the reference interest rate; it will be at about 9.75% at the end of next year. Still, inflationary pressures will negatively affect investment and private consumption, causing a decrease in aggregate demand during this process. This will impact economic growth next year.

Remittances To the Rescue

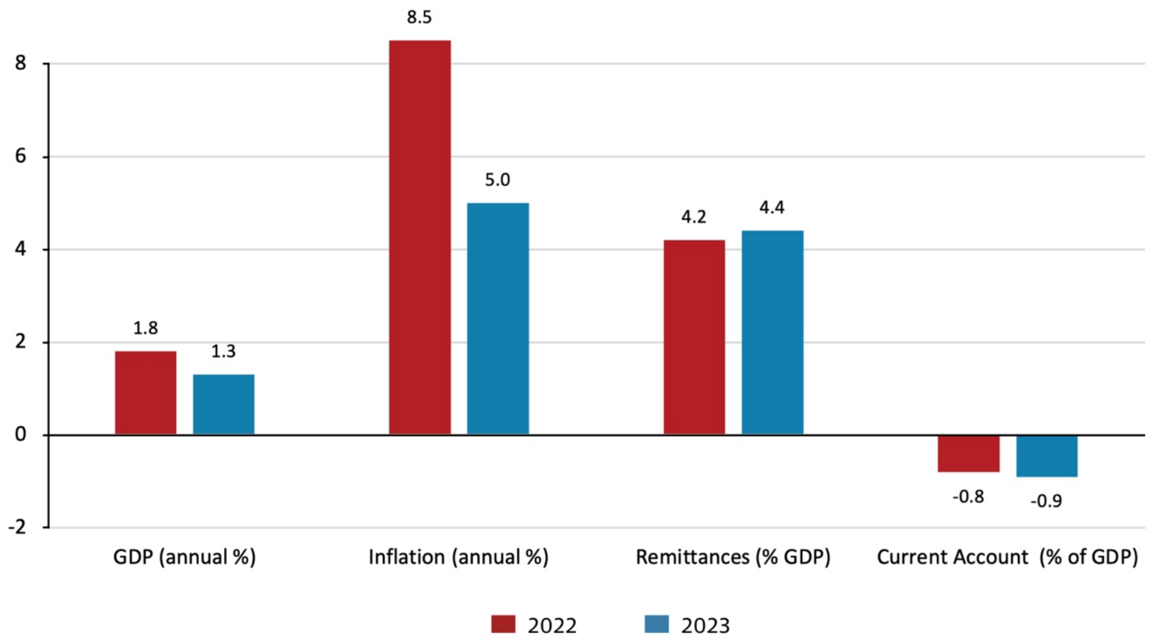
The current account balance as a percentage of GDP indicates a country's level of international competitiveness. In Mexico, this figure is likely to be -0.8% (a deficit) in 2022; given the slowdown of the economies of the U.S. and Mexico next year, we estimate Mexico's current account will be at the same general level in 2023, around -0.9%. This deficit could be higher, but the flow of remittances will continue to help achieve a lower deficit next year.

Remittances will continue to be a main driver of Mexico's economy. This resource has grown exponentially since 2013 and become one of the most important sources of currency and income in Mexico—the second largest behind manufacturing. Remittances reached $58 billion in 2022, a historic high, and could hit $60 billion in 2023. Remittance income as a percentage of Mexico's GDP will be more than 4.2% in 2023.

Fiscal Austerity

Mexico's government will continue to practice fiscal discipline in 2023. Austerity has been a central feature of the López Obrador administration. However, there will be greater fiscal pressures in 2023 due to increases in social expenditures, particularly for pensions and cash transfers, and the president's priority infrastructure projects. Public debt as a percentage of GDP has increased in recent years due to the primary deficit and the dynamics of the debt. Next year, the primary deficit will be around 0.2% of GDP and Mexico's gross general government debt as a percentage of GDP will be above 50% of the GDP—still healthy but growing.

Figure 4. Primary 2022 Economic Indicators and 2023 estimates



Sources: Banxico and BBVA, 2022. Authors' estimates for 2023.

V. USMCA Disputes Persist

Two-and-a-half years after the USMCA entered into force, major areas of conflict have not changed and are likely to continue in 2023.

USMCA dispute settlement proceedings under Chapter 31 brought by Canada and Mexico against the United States challenging the U.S. interpretation of automotive rules of origin ("rollup" provisions) will likely continue into 2023, unless the panel rules before that time. If Mexico and Canada prevail, Mexican auto and parts manufacturers will gain additional flexibility in meeting the USMCA regional content rules (75% compared to 63.5% under NAFTA). If not, the gradual shift of automotive manufacturing from Mexico and Canada to the United States will continue and adjustments (e.g., to reduced industry employment) in Mexico will begin.

U.S.-Mexican ongoing consultations over Mexico's energy policies, which the U.S. (and Canada) believe are a violation of Mexico's USMCA obligations to maintain foreign investor access to the energy sector under Article 32.11 (treatment equal to that provided to Mexico's CPTPP partners) will result in panel proceedings. When the panel rules in 2023 it will likely confirm the U.S. and Canadian interpretation of the USMCA. President López Obrador will not change his policies, further poisoning the investment climate in Mexico, but any trade sanctions would not likely be imposed during 2023 pending further negotiations. Investment disputes will be a major irritant in U.S.-Mexico relations throughout 2023 (and 2024). Private investors will likely bring multiple investor-state claims against Mexico under NAFTA (until June 30, 2023), the USMCA, or under investment contracts with binding arbitration provisions.

Multiple disputes over the USMCA's environment provisions, in addition to Mexico's failure to meet Paris Agreement criteria, its illegal fishing in the Caribbean, and its failure to protect endangered dolphins in the Gulf of California, will continue throughout 2023 and beyond. Lack of business access to clean, reliable electrical energy will discourage some new foreign investment in 2023 and thereafter.

Mexico's refusal to authorize certain genetically modified corn traits developed in the U.S. to be sold in Mexico will continue. White corn is a culturally sensitive product in Mexico, and because of the interests of small farmers, López Obrador's populism apparently views GMO corn as yet another affront to Mexico's sovereignty. Bilateral discussions over the issue will continue into 2023 without resolution and could discourage support for Mexico among members of Congress from states that are major agricultural exporters to Mexico. Meanwhile, Florida interests are pushing the United States Trade Representative to open a Section 301 investigation of an "export targeting scheme" by Mexico to force Florida agricultural producers of seasonal fruits and vegetables out of business. Such action is unlikely on the part of the Biden administration but cannot be ruled out.

VI. A Further Weakening of the Education and Health Sectors?

Health Overview

Health spending by Mexico's federal government is low and increases slowly. Spending by all economic agents in Mexico grew from 5.67% in 2012 to 6.24% in 2020, just over a half percentage point in eight years. This uptick in spending did not approach the amount allocated by Mexico's peers, who averaged 7.18% of their GDP on health care in 2019. At 3.3% of GDP in 2020, public spending on health care in Mexico is almost one point of GDP less than the cluster average of its peers, 4.24% in 2019. As a result, the people of Mexico had the second highest out-of-pocket health care expenditures among countries with similar economic conditions in 2020—2.42% of GDP or 38.8% of total health expenditures.

Systematically low investments in public health care have limited Mexico's human and physical capital compared to similarly situated countries. Mexico's ratio of 1.21 nurses per doctor remained the same from 2012 to 2020, but was always lower than its peers' average of 1.63 nurses per doctor in 2012 and 1.67 in 2020. The gap in care equipment is more dramatic: Mexico had 0.99 hospital beds per 100,000 inhabitants in 2020 (3% less than in 2010), but a cluster of similarly situated countries had far more, 5.1 hospital beds per 100,000 inhabitants.

Even before the pandemic, some key health indicators began faltering. Mexico reported 13.8 deaths per 1,000 births in 2020, 3.9 more than the peer average. Furthermore, preventable deaths increased: Mexico was below the peer country average in 2012 (225 vs.

242 preventable deaths, respectively), but exceeded the average in 2019 (220 in Mexico vs. 182 for its peers). The percentage of children in Mexico under the age of one who completed the recommended vaccination schedule began to drop in 2016, when it fell to almost 93%, but it plummeted to 27.5% in 2021.

Since 2014, the number of “care units” (or clinics) operating under the IMSS-Bienestar health care program has dropped; this has also been the case with care units operated by the Ministry of Health, which runs the most important network of public hospitals in the country. Just one year before the pandemic, in 2019, 65% of the budget for public health system infrastructure and equipment was not spent. Most of the unspent funds were earmarked for the expansion or remodeling of facilities and the acquisition of medical equipment for all public health systems operating in the country; the funds were not disbursed largely because the guidelines for doing so were unclear or nonexistent. Since 2017, all public health care systems have seen the effects of funding cuts, including shortages in everything from medicine to hospital beds, incubators, and operating rooms. Health infrastructure and equipment are outdated, and the numbers even show a decrease in the number of available hospitals and clinics.

In addition to the COVID-19 pandemic, the health sector in Mexico experienced other major challenges, such as institutional changes in health care programs, especially for people without formal access to federal assistance programs. The transition from Seguro Popular to Insabi occurred the same year as the pandemic, which worsened its impact. From the beginning, there was no expectation that Insabi would improve the benefits of Seguro Popular, since the new system did not have an operational design at the time of its implementation, nor did it develop it in subsequent years.

Some operating indicators have shown worrisome deterioration, such as medical visits for the uninsured population, which began to fall in 2018 but plummeted through 2020 and has since continued to drop. From January to August 2022, Insabi granted 10.5 million medical visits. This is 29% lower than the number of visits in the same period in 2021, and 79% lower than the number of visits in 2018—before López Obrador took office.

By type of care, appointments for healthy people have seen the greatest drop in numbers: 2.2 million medical appointments were scheduled for healthy individuals between January and August 2022. This represents a 35% drop, or 1.2 million fewer visits, compared to the same period in 2021, and an 85% drop in visits compared to the same period in 2018.

Another worrying drop in medical visits involves those with chronic or degenerative diseases such as cancer, diabetes, or HIV/AIDS. Between January and August 2022, 2.4 million visits were reported, a reduction of 35% (or 1.3 million medical appointments) compared to the same period in 2021; and a drop of 72%, or 6.3 million medical appointments, compared to the same period in 2018. This unfortunate situation is due to fewer resources for catastrophic illnesses and to poorly written laws that do not specify how much should be spent for various purposes. The upshot is, a patient’s average out-of-pocket expenses for health care increased by 40.5% in 2020.

The maternal mortality rate also exploded during the pandemic, but was aggravated by other factors, such as the structural limitations of Mexico's health care systems and institutional changes (i.e., the switch from Seguro Popular to Insabi and the financial weakening of Fonsabi). Before the pandemic, in 2019, rate stood at 31.1 maternal deaths per 100,000 births; during the coronavirus crisis, the rate increased to 53.1 maternal deaths per 100,000 births. One study reported that not all maternal deaths in Mexico were directly related to COVID-19; some were due to the limited availability of health care combined with the health of pregnant women at risk for serious complications.

Life expectancy dropped worldwide by an average of two years due to COVID-19. But life expectancy in Mexico dropped by 4.3 years, going from 72.2 years in 2019 to 67.9 years in 2021.

In 2022, the government announced the closure of the Insabi program and launched a transition toward IMSS-Bienestar. IMSS-Bienestar is a smaller-scale program that does not have the budget, infrastructure, and equipment to serve the tens of millions of people in need of its services. In addition, it does not have tertiary care services and options for highly specialized medical treatments. Before being named for the challenge, IMSS-Bienestar also exhibited a deterioration in the medical services it offers. In 2021, medical visits under this program totaled 15.9 million—26% (or 5.4 million) less than the average for IMSS-Bienestar during the previous six years.

Furthermore, the program lacks a detailed plan and strategy for expanding its capacity to care for patients; it is present in only 54% of the country's municipalities and in 19 out of 32 states. IMSS-Bienestar had had 80 hospitals since 2014; in 2020 it had 3,983 clinics, a lower number than in 2014.

In addition, in the last decade the number of doctors in the program has largely remained the same, while the number of beds and incubators has plummeted.

For 2023, the public health budget does not guarantee that progress can be made on the path to compensate for the deterioration. Officially, federal spending on health will be 3.9% higher than in 2022. However, the outlook is not so promising if resources whose destination is opaque or undefined (contributions to trusts or financial investments not yet specified) are subtracted. Aside from this ambiguous budget, resources that positively impact health will only grow 0.8% in 2023 (compared to an average growth of 14% between 2013 and 2018 under the previous administration). But for the institutions that provide health services for those without access to federal aid, budgets will fall by 10% in 2023. In addition, the GOM has asked the House of Representatives for authorization to liquidate during the second quarter of 2023 Fonsabi's final reserves, which are in a fund that covers tertiary care (high level, specialized care) for the uninsured population. If the reserves are liquidated, it is unclear how this population will access tertiary care.

There is little hope for a successful transition in health care systems under the 2023 budget proposal. The proposed joint budget for Insabi and IMSS-Bienestar will be around 127.8 billion pesos, 4% (5.5 billion pesos) less than in 2022 and 1.5% (1.3 billion pesos) less than in the previous administration, on average. The loss is more serious if we just count subsidies for the provision of health services. The proposed subsidies could reach 94.9 billion pesos or 4% (3.8 billion pesos) less than this year and 6.2% (6 billion pesos) less than the previous administration's average.

Mexico's human and physical capital in the health sector is inferior to that of other parts of the world. Unfortunately, the future does not look much better. Federal government health spending that truly benefits Mexicans is less than the official figures suggest. This means that, among other things, already poor sanitary conditions in hospitals and clinics will remain or worsen. Limitations in health care funding will limit the early detection of diseases and the prospects for recovery, and increase the cost of treatments. In the case of chronic diseases, late detection and lack of follow-up visits can increase deaths. Mexico's shortage of vaccines in general will cause a resurgence of preventable diseases, which in turn can trigger epidemics that were already controlled and increase suffering and death. Under current health care conditions in Mexico, there is a greater probability than in previous years of dying from an avoidable cause.

Education Overview

Education in Mexico is suffering from several crises that will have an important impact on the economy. Studies have found that learning shortages during the pandemic will likely have a negative impact on the affected students' incomes as adults; they could lose the equivalent of a year's worth of earnings. In addition, three out of four companies in Mexico are currently struggling to fill their vacancies. It is important to view education policy as one of the keys to solve the crisis to come, but is this what we are seeing in Mexico?

Several events that drew the media's attention in 2022 will continue to impact Mexico's education outlook in 2023. Throughout 2022, a current theme in the public debate has been the transition to the "Nueva Escuela Mexicana" (New Mexican School) curriculum. This curriculum takes a community-centered and interdisciplinary approach whereby students learn through a communitarian approach. It differs from the previous curriculum, which focused on an approach centered on students and the knowledge, skills and abilities to function in society. The position of Secretary of Education also has been part of the public discussion, as it is seen as a platform to advance the political careers of those who fill it. Regrettably, other more relevant issues like learning losses caused by the COVID-19 pandemic and significant but unjustified cutbacks to education spending are not getting equal attention.

Amid this concerning scenario, and the administration's prioritization of discourse over action, scholars across Mexico have tried to return to the spotlight, with increasing participation in conferences and forums on evidence-based public policy actions. Thus, the 2023 education outlook must be analyzed through two lenses: decisions by government officials that are based on their views of the road ahead and the on-the-ground reality of schools, teachers, and students facing a learning crisis and emotional upheaval caused by the isolation, uncertainty, and stress of school closures during the pandemic.

Given the severe impact of the pandemic on learning outcomes around the world, many international studies have estimated the effect of learning losses during school closures in Mexico. Scholars have found that Mexico's children have lost between 33% to 100% of one school year's worth of learning. Learning losses were highly unequal. The impact of school closures for students depended on parental educational attainment and economic resources available in the household. In the long run, students could lose the equivalent of up to two years of learning if recovery policies are ineffective.

Despite a clear education crisis in Mexico, it appears the government's only plan for 2023 is a pilot program of national strategies that seek to address high drop-out rates, to increase lifelong learning trajectories, to assist in post-pandemic socioemotional recovery, and to offer remedial education to minority groups. The National Commission for the Improvement of Education (or in Spanish, *Mejoredu*) has also announced a series of publications that profess to meet teacher training needs, with the objective of ensuring that students get a quality education at schools led by well-trained principals and teachers. Toward this end, *Mejoredu* has offered schools a voluntary standardized assessment so that strategies can be adapted to the needs of every community, and thus improve learning benchmarks.

In contrast, state governments—where opposition parties are in place—have developed different assessment strategies to compensate for learning losses. These strategies are expected to be a relevant part of their 2023 education agenda, highlighting a difference between state-level priorities and those of the federal government.

Mexico's education agenda will be impacted by electoral tensions that continue to grow as the 2024 presidential election nears. This is not because of popular interest in education public policy, but rather, because of the size and power of teacher unions in most Mexican regions; teachers are always a key feature ahead of Mexico's elections.

Teacher influence on Mexico's education policy can be seen in the federal budget: 26% of the federal education budget is allocated for scholarships while 61% goes toward administrative expenses that include principal and teacher salaries.

In recent years, tensions have increased between teacher unions and state governments because of delayed or missed salary payments. The federal government is beginning to take advantage of such tensions by saying it will regain control of the teachers' payroll. In 2023, it will be clear if the federal government honors promises to regularize high school teacher contracts in different states and to implement a salary increase. It is unlikely that federal authorities will be able to take over all teacher payrolls in primary and secondary schools, as the federal budget seems insufficient for this to happen. The authorities have already spent most of the extra funds the government had at the beginning of the López Obrador administration (i.e., savings that several previous administrations had accumulated for financial emergencies). As a result, the government has implemented a series of budget cuts—including to several education programs—to finance the president's main infrastructure programs, such as the Refinery in Dos Bocas, the new airport in Mexico City, and the Mayan Train.

The promise of a curriculum change may not be fulfilled in 2023. The educational crisis in schools caused by learning losses and economic grievances might make it impossible to deploy such a change, especially when schools must spend time deciding how to spend and keep resources from "*La Escuela es Nuestra*" (the government's school-based infrastructure and food program). However, this program will likely serve as a lever for the government to maintain presidential approval rates at regional and community levels.

An international event that could influence Mexico's educational outlook is the release of the results from PISA, the OECD's Program for International Student Assessment. Due to the pandemic and federal government inaction in Mexico, poor results are expected, and could mark 2023 as the year when local recovery strategies become an important part of the solution to the current learning and mental health crisis. In the last couple of years, some schools have organized their own initiatives to help students and teachers. Also, state authorities have developed alliances with the World Bank and Tecnológico de Monterrey, among others, to implement learning assessments and recovery strategies. The results of the assessments at the primary level in Guanajuato, and at the high school level in Nuevo León and Querétaro, helped schools develop specific measures that tackle learning losses and that most likely will have significant, positive results in the years to come.

VII. Escalating Violence Amid New Opportunities for Organized Crime

Drug Cartel Disputes Between Sinaloa and CJNG in 2023

The conflict between the Sinaloa Cartel and the Cártel de Jalisco Nueva Generación (CJNG) is the defining battle of Mexico's drug war. Two countervailing possibilities exist for the Sinaloa Cartel moving into 2023. In the first, factions within the Sinaloa Cartel could fragment and move into internal conflict. In the second, which we think is more likely, the Sinaloa Cartel will work diligently to counterbalance the CJNG. The Sinaloa Cartel does not have the luxury of fragmentation between groups such as the Chapitos- and Mayo Zambada-led factions. External pressures thus promote internal cohesion. We will see a continued expansion of the CJNG, limited only by internal fragmentation, and proxy Sinaloa Cartel forces (another driver of violence).

Violent Hotspots

We expect continued violence in the broader Tierra Caliente region comprising the State of Mexico, Michoacan, and Guerrero. We expect port cities such as Manzanillo, Colima, and the surrounding states to be hotly contested directly or by proxy between the Sinaloa Cartel and the CJNG. Ports are critically important to the synthetic drug trade, given the need for chemical precursors imported from China and increasingly, India. We further expect states along the border to see high levels of violence as this battle plays out in states such as Baja California and Sonora. High levels of violence will continue in Zacatecas and Guanajuato where oil pipelines and the roads to the border have made these states more valuable in an era of fentanyl trafficking and oil theft.

More High-impact Violence

Overall levels of violence will likely remain stable or tick up slightly to 27-30 homicides per 100,000 people, with increases in high-profile security incidents between cartels and the state. Violent responses to high-ranking cartel apprehensions have become the norm since the October 2019 release of Ovidio Guzmán following a siege by the Sinaloa Cartel in Culiacán. In response to the attempted arrest of two cartel operators in August 2022, the CJNG responded with large- scale violence in Baja California that included 30 burned vehicles. The mayor of San Miguel Totolapan, Guerrero was assassinated in the municipal president's office along with 17 others. The brazen attack that featured roadblocks and also targeted the mayor's home was claimed by the armed group Los Tequileros. There will likely be more high-impact incidents like this in 2023. These incidents are becoming so common they do not break through the news cycle anymore.

Organized Crime Expands Into Legal Markets, Elections

Mexican elections have been characterized by the meddling of organized crime, as happened in the past elections in Sinaloa, Sonora, Guerrero, and Nayarit. Unfortunately, we expect that these criminal groups will try to intervene and finance next year's elections in the State of Mexico and Coahuila to obtain benefits and act with impunity. Organized crime will continue to expand its tentacles into legal and licit markets. The mid-2000s saw a rise in the criminal diversification of activities by Mexican drug cartels into crimes like kidnapping and extortion. Extortion led to more contact with the licit world. In the 2010s, there was a growth in *Huachicol* or fuel theft mafias, who simply stole from a legal, regulated market and resold. Today with droughts and climate change we can expect to see a new phenomenon of water theft mafias or *Aguachicol*.

The Rise of Aguachicol

Mexican organized crime has long had extensive experience stealing water for drug cultivation. Given drought conditions in Northern Mexico, there will be a continued expansion of organized crime into water markets. Recent reporting has shown mafias providing water delivery to hotel chains and mafias diverting government water sources to resell in neighborhoods with limited access. The city of Monterrey, Nuevo León provides five hours of water per day to residents and some neighborhoods have no water. This situation has impacted social classes differently. The wealthy have cisterns and pumps allowing the storage of water throughout the day while the truly poor often have no access to water. This has created an increase in the value of water ripe for illicit market actors to profit. The *Aguachicol* issue increases the illicit/licit interface that normalizes criminal relationships across the state and society. This normalization will make law enforcement increasingly difficult. We can expect to see the rise of specialized water theft mafias in 2023 but also for *Aguachicol* to become a larger part of cartel criminal portfolios.

Militarization of Policing

2023 will see continued militarization of security in Mexico. The López Obrador administration has created a National Guard with about 100,000 troops. The term "troops" is intentional because this gendarmerie force is composed almost entirely of former soldiers or marines. Its chain of command has been formally put under the military (SEDENA). Further, the military will likely be legally authorized to continue its role in public safety until 2028. The military is also handling customs duties at maritime ports and ports of entry, and myriad other tasks. This has expanded the military's portfolio, but also increased its exposure to corrupting influences from organized crime. The long-term implications of increased militarization are bad for Mexican democracy.

Femicides Will Persist

2023 will likely see the continuation of the slow uptick of femicides as a percentage of overall homicides. While men are the vast majority of victims of the drug war, constituting roughly 88% of all homicide victims according to the Justice in Mexico project, there has been an increase in women's deaths. This trend will likely continue to tick upward.

Potential Drivers of Violence in 2023

- El Mencho arrest and severe CJNG fragmentation
- Sinaloa Cartel internal fragmentation
- Expansion of new fronts or battle zones in intercartel violence
- End of military restraint strategy

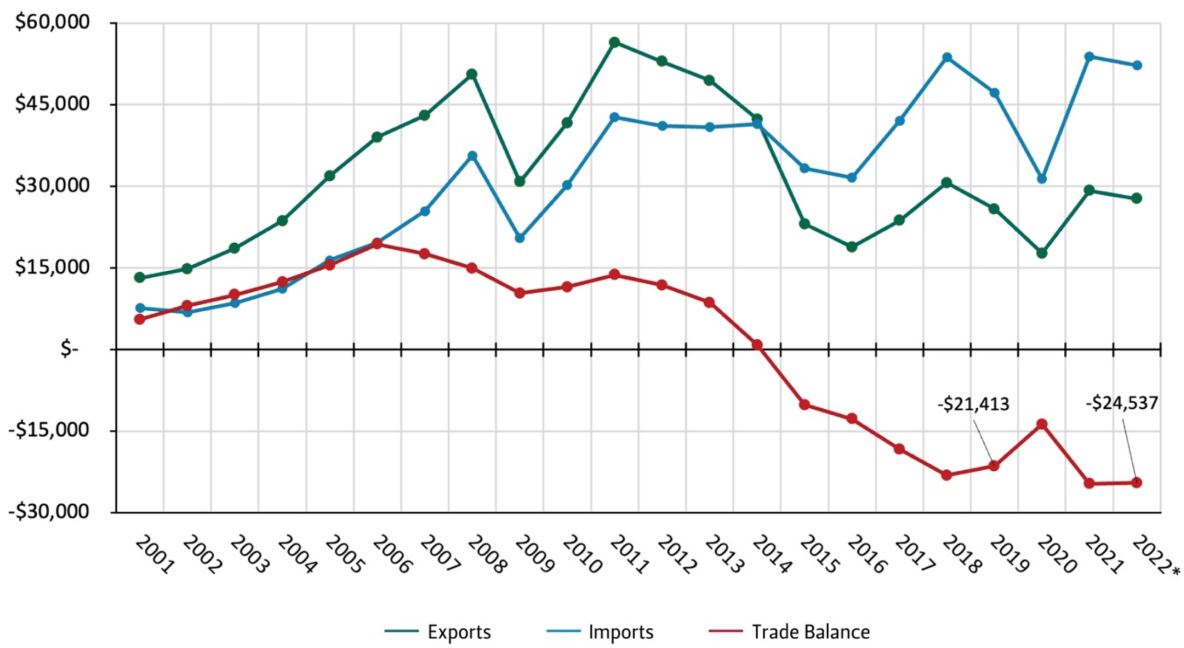
VIII. Mexico's Quest for Energy Self-Sufficiency

While the outcome of U.S.-requested dispute settlement consultations on Mexico's energy policy is not yet known, Mexico's challenging business and policy environment is poised to persist in 2023. The appointment of Raquel Buenrostro as head of the Secretariat of Economy suggests that the government is not willing to back down in its efforts to make the energy sector largely reflect Mexico and Mexicans—instead of the international investors who flocked to the country under its historic, and now weakened, energy reform. The nationalistic stance of López Obrador means that safeguarding both state-owned energy companies from competition will continue to be determinant in the process of decision-making during his penultimate year in office. A major aspect to ponder is that, with the 2024 presidential race in full swing, López Obrador cannot afford to change course and risk losing approval among his electoral base and supporters. The odds for his national political project to survive hinges upon selecting his successor, and in that regard, the energy sector is fundamental.

Thus, in 2023 López Obrador's rhetoric outlining the rewards of his energy policies, the quest for self-sufficiency in motor fuels, as well as the political handling of regulatory tools to shield PEMEX and CFE market position will not wane.

Contrary to the official discourse, the evidence demonstrates that, when measured by the value of trade flows, the country´s energy self-sufficiency has weakened since the beginning of the present government. Banxico reported that the energy trade deficit grew from $21.4 billion in 2019 to $24.6 billion in 2021 (Figure 5). The most recent estimates, which encompass only the first eight months of 2022, are even more upsetting as the negative trade balance during that period amounted to $24.5 billion, a figure that is equivalent to the entire value of the previous year. In 2023, Mexico could be confronted with a global and local context where the gap between the value of imports (gasoline, diesel, natural gas, and petrochemicals) and exports (crude oil) is greater than past years.

Figure 5. Mexico's Trade Balance of Hydrocarbons and Petroleum Products, 2001-2022, in US$ millions



Source: Banxico, 2022.
* January to August

As López Obrador approaches the end of his term, it becomes more important than ever to meet the production targets of refined products such as gasoline and diesel, which until now has not taken off as intended. Based on the level of capital expenditures allocated to the country´s operating refineries from 2019 to 2021, which were on average half of what the past government spent, we anticipate that, even if the GOM boosts investment, PEMEX refineries will continue to register relatively low levels of production. In general, Mexico will not experience a substantial increase in the production of petroleum products in 2023, mostly because the construction of the Olmeca refinery at Dos Bocas and the two coking units at the refineries of Tula and Salina Cruz are not expected to be completed in the short term. Imports will keep filling the gap.

The green credentials of Mexico will be put into question once again. As the goal is to boost the role of fossil fuels in the economy, bureaucratic barriers are expected to prevent the country´s deployment of renewables. Also, financial stress at PEMEX will leave little leeway for reducing natural gas flaring, a practice that contributes to climate change and that, in Mexico´s case, has risen significantly since 2018.

IX. Testing the Limits of Binational Relations

The Biden administration's posture toward Mexico aims to deprive López Obrador of a nationalistic card to play with his base and during Mexico's 2024 election campaign. This commitment means that the White House pressures in private but maintains a conciliatory discourse in public. The approach is expected to prevail in 2023, as a number of international crises and an ever-more-complicated landscape on Capitol Hill continue to occupy the Biden administration.

Among other issues, Washington will likely maintain pressure on Mexico to cooperate with the U.S. on the implementation of the USMC, on immigration as the flow of refugees and asylum seekers continues; and on drug smuggling, especially fentanyl, where there is little cooperation from Mexico but a surging crisis in the United States. The USMCA, immigration, and drug smuggling are in fact the three main issues affecting the binational relationship between Mexico City and Washington, D.C.

In 2023, no one should expect Washington to press Mexico on its relations with other countries—including its tolerance toward Cuba, Venezuela, and Nicaragua and hesitancy to criticize Russia on its invasion of Ukraine. But Washington will pay increasing attention to Russian activities in Mexico, in addition to its ongoing attention to China's activities in Mexico.

The tenure of U.S. Ambassador Ken Salazar in Mexico City has been mired in controversy, with some accusing him of having been too complacent with certain nationalistic positions of the López Obrador administration that counter a commitment to protect all investors under the USMCA. It is possible that in 2023, the Biden administration will seek to designate a new ambassador to Mexico—one who pursues Washington's interests more aggressively. This is not assured, but Washington is well aware of the growing questions about Salazar's ambassadorship.

Still, as noted earlier, the U.S. is not expected trigger a major showdown in 2023, despite pressure from Mexico's critics and some congressional members. At this stage, the Biden administration is likely to quietly tolerate Mexico's actions. Militarization, however, will be a particular source of frustration in Washington, as the Mexican Ministry of Defense (SEDENA) is well known for its anti-American sentiments and is increasingly in charge of more of the country's public policy actions, not least security.

The López Obrador administration's quiet aversion to Washington's interests will remain, but it will also be pragmatic, as Mexico depends on access to the U.S. market for manufactured and agricultural goods, on FDI flows from the U.S., on remittances from migrants, and on a degree of U.S. tolerance for Mexico's democratic backsliding. Relations are not likely to improve in 2023 but will stay on the current path of mutual accommodation. No clear breakthroughs should be expected in the High-Level Economic Dialogue or the High-Level Security Dialogue—or the Bicentennial Framework launched as part of the latter. These are initiatives that have produced lesser levels of cooperation than those that existed prior to the López Obrador administration. The dialogues are probably meant to maintain open channels of communication and to put moderate levels of pressure on Mexico, and not operate as effective mechanisms that produce increased collaboration.

X. Brewing Crises at the U.S. -Mexico Border

Managing Migrant Flows

The issue of migration in Mexico is complex and multidimensional, consisting of various types of human mobility: migration from countries of origin on its southern and northern border, Mexico as a transit or destination country, and return migration to Mexico. Each requires policy approaches and practices that are safe, orderly, and humane. Mexico has a key role to play in migration issues, but migration management has been a significant challenge for Mexico and will continue to be in 2023, as the nation lacks a long-term vision and sustainable efforts to strengthen its institutions and provide adequate funding.

Mexico will end 2022 with its second-largest year for asylum requests: as of August 2022 there were 77,786 requests, with Hondurans, Cubans, and Haitians making up top three requesting countries. 2021 marked the largest year: asylum requests made before Mexican authorities surpassed 130,000––the third-highest number of asylum applicants globally. An insufficient budget for the refugee authority, the Mexican Commission for Refugee Assistance (COMAR), has not kept pace with the unprecedented growth in migrant numbers. Mexico has heightened its security efforts and continues to rely on National Guard troops, who have been criticized for numerous human rights violations and abuses against migrants. There are currently an estimated 46,000 armed forces and National Guard troops directly involved in migration control activities. Efforts to stem unauthorized migration have been heavily influenced by the United States.

The Biden administration sought to end the Trump-era Migrant Protection Protocols (MPP), also known as the "Remain in Mexico" policy, which required asylum seekers to wait in Mexico while their applications were adjudicated. Several states challenged the administration's actions, but in August 2022 a U.S. District Court's decision, following a Supreme Court ruling in June, lifted an injunction that had blocked the Biden administration's termination of the policy and ordered its reimplementation. The U.S. Department of Homeland Security is no longer enrolling individuals into MPP. In May 2022, the Biden administration also attempted to end a controversial and restrictive pandemic-era policy known as Title 42, which allows U.S. border officials to quickly expel migrants and asylum-seekers on public health grounds. However, a court ruling has kept it in place indefinitely and the Biden administration has continued to use it. Title 42 has led to significant increases in repeat crossings at the border. By far the most commonly expelled individuals from the U.S. under Title 42 are single adults (88% of those expelled between April 2020-March 2022) and people from Mexico (60%).

The U.S. will close the year with over 2.1 million enforcement encounters at the U.S.-Mexico border. In a shift from the recent past, when migrants were predominantly from Mexico and Central America's Northern Triangle (Guatemala, Honduras, and El Salvador), 2022 has seen an increase of migrants from countries like Venezuela, Nicaragua, and Cuba that are driving a new wave of migration across the Western Hemisphere. Growing violence and deteriorating economic conditions will cause the exodus to continue in 2023, leaving Mexico as a key transit or destination country.

The United States will continue to pressure Mexico on migration issues in 2023. It is likely that Mexico will accept more migrants from Cuba, Nicaragua, and Venezuela under Title 42. Transit and irregular migration through Mexico and at the U.S.-Mexico border will remain at high levels next year. Stronger enforcement by Mexico and the United States has caused and will cause migrants to take new and dangerous routes. Along the U.S.-Mexico border, 2022 has become the deadliest year on record for migrant deaths. Many migrants also go missing in Mexico, although inaccurate and incomplete government data from Mexico's National Registry of Disappeared Missing Persons (*Registro Nacional de Personas Desaparecidas y No Localizadas*) only reports 73 missing migrants from 1964 to 2022; other organizations estimate the number to be from 72,000 to upwards of 120,000 migrant disappearances in Mexico from 2006 to 2016. Mexico is not a safe country for transit migrants, who are especially vulnerable to crime. 2023 is unlikely to be a year in which migration issues improve.

Climate Change and Elaborate Water-sharing Agreements

Water governance arrangements in the Colorado River and Rio Grande/Río Bravo—the two river basins shared by Mexico and the United States—have come under intense pressure in recent years. International and domestic institutions on both sides of the border are struggling under the strain of climate change impacts, population growth, and the attendant impacts to water supply and demand in the region. Stakeholders in the region are working to find solutions but the challenges they face are unlikely to abate anytime soon.

The complexity of the Colorado River treaty regime is well known. The interstate compacts and state laws that govern it are on a collision course with the realities of climate change and human development in that basin. In August 2021, the U.S. Bureau of Reclamation ("Reclamation") declared an unprecedented shortage at Lake Mead, triggering the first-ever water cuts to Colorado River stakeholders, including Mexico. A year later Reclamation declared a Tier 2 shortage and called for even more shared cuts, diminishing the amount of water sent to Mexico by 7%. Because most of the Colorado River basin is in the United States, discussions over drought response have largely involved the U.S. states and other stakeholders in the upper and lower basins, but Mexico is cooperating under the terms of Minute 323, an agreement signed by the International Boundary and Water Commission (IBWC) in 2017, to share the pain of shortages. Mexico is accepting the agreed-upon delivery reductions, participating in conservation discussions, and protecting its own interests against potential upstream management decisions that could harm it. In addition to planned supply restrictions, Minute 323 seeks to facilitate funding and development of water conservation projects in Mexico to boost storage across the greater system. Though the situation on the Colorado River is extremely serious, Minute 323 and its predecessor, Minute 319, have established a firm foundation for trust and collaboration among stakeholders on the Colorado, and ongoing negotiations have the potential to create future solutions for the benefit of all.

Perhaps of more immediate concern to Mexico is the status of the Rio Grande River and its tributaries. The Rio Grande, which has long suffered heavy withdrawals for irrigation and other uses on both sides of the border, is increasingly showing ill effects as rising temperatures and an unprecedented drought—likely driven by climate change—are drying the river and devastating ecosystems. In summer 2022, the Rio Grande went dry in places where it had never gone dry before. Just as the 1944 Treaty on the Utilization of Waters of the Colorado and Tijuana Rivers and of the Rio Grande requires the United States to deliver 1.5 million acre-feet of Colorado River water to Mexico annually, it obligates Mexico to deliver to the U.S. from tributaries named in the treaty an annual average of 350,000 acre-feet of water across five-year cycles. In the last few decades, conditions in the basin have made Mexico's obligation increasingly difficult to meet.

By the second half of 2020, concerns were mounting over whether Mexico would be able to fulfill its delivery requirements for the end of the five-year cycle concluding in October of that year. Tensions were especially heightened because Mexico had already deferred its delivery for the preceding cycle as allowed by the treaty. Minute 325, signed on October 21, 2020—just three days before Mexico would have violated its treaty obligations—provided the necessary resolution: Mexico met its obligations by transferring enough of its water in the two major international reservoirs, Falcon International Reservoir and Amistad Reservoir, to the U.S. to cover any shortfall. Provisions were included in the minute to provide Mexico with temporary use of U.S. water in the event Mexico's storage volume reached zero or was insufficient to cover one month of municipal needs for urban use in Mexico. The minute resolved a long-standing disagreement over whether the treaty permitted Mexico to end two back-to-back cycles in a deficiency, making it clear that Mexico could not do so. It also tasked two pre-existing working groups—the Rio Grande Hydrology Work Group and the Rio Grande Policy Work Group—with developing a new minute by December 2023 to provide "increased reliability and predictability in Rio Grande water deliveries to water users in the United States and Mexico." By fall 2021, less than a year after ending the previous cycle, Mexico had accumulated a significant water debt and was poised to begin a third five-year cycle with a shortfall. A very hot and dry summer 2022 brought about extremely low water levels in the Falcon and Amistad reservoirs, even as Mexico restricted irrigation and reduced water rights for Mexican farmers and ranchers in northern Mexican states. Rains in late summer and early fall helped the Rio Grande somewhat, but water availability remains a concern of water managers in the region as drought persists. As of October 1, 2022, nearly two full years into the current five-year cycle, Mexico has delivered around 38% of its expected minimum delivery during that time.

Minute 325 resolved the issue for the cycle ending in 2020, but Mexico's struggle to meet its obligations under the 1944 treaty appears likely to be perennial as the effects of climate change become more severe. The new minute contemplated by Minute 325 is a positive step, evidencing a binational pledge to develop reliable mechanisms to improve the predictability and reliability of Rio Grande water deliveries by 2023, the year that will encompass the halfway point of the current five-year cycle. IBWC has been sounding the alarm over conditions in the basin, arguing that it needs additional climate management studies and better long-term planning, as well as a huge influx of infrastructure funding. In a year that has seen historic amounts of spending allocated by the U.S. Congress for repair and expansion of infrastructure, including to address problems in the Colorado River Basin, little to nothing has been provided for the Rio Grande's needs.

In addition to ongoing concerns over Mexico's ability to meet its treaty obligations on the Rio Grande, there are additional issues of concern over groundwater and groundwater-surface water interactions and the related practical and policy implications for the Mexico-U.S. region, as well as strained relations between the two treaty parties and with local and regional stakeholders.

Groundwater has long been neglected by the Mexico-U.S. transboundary water regime. Groundwater plays a significant role in agricultural production and other economic development activities in the region; it constitutes an essential water source for millions of people on both sides of the border. Groundwater supplies are not included in the existing treaty regime and are managed independently via the domestic legal regime in each country (which often manage groundwater as though it were separate from the rest of the water cycle). Both Mexico and the U.S. would benefit from joint efforts to inventory and analyze existing information on groundwater-surface water relationships in the basin, expand data and information sharing initiatives to include groundwater resources, and fund new research to fill knowledge gap.

IBWC's work in the basin involves relatively limited stakeholder involvement, a fact that has been criticized as more integrated and inclusive management approaches have proliferated elsewhere around the world. Stakeholder participation and transparency in Mexico are lacking largely due to the country's centralized approach to water management, which entrusts the vast majority of water management decisions to the National Water Commission (CONAGUA), the federal water agency. Local communities in Mexico have little to no real opportunity to be involved in meaningful decision-making about their water resources. The eventual effects of these enduring conditions became apparent in the summer and fall of 2020 when Mexican farmers in the state of Chihuahua—having suffered huge cuts in their water allocations for irrigation—protested water deliveries from the Río Conchos to the Rio Grande and seized control of three dams in an effort to derail the Mexican federal government's release of water supplies to meet Mexico's treaty obligations.

That governance crisis continues to have implications for water in Mexico, as abnormally dry conditions in Northern Mexico have been exacerbated by exceedingly poor management to create dire and inequitable shortages in that region. Water policies that privilege powerful people and industries and frequent failures to enforce what restrictions do exist often leave ordinary citizens and communities in the region with dry sources or polluted supplies. Some Mexicans are pointing their fingers at government officials and at the country's failure to create laws and policies that support the constitutional right to water that was added to the Mexican Constitution in 2012. As the effects of climate change intensify in Mexico, finding solutions to boost social and environmental resilience under different scenarios will be essential, but fixing governance of the resource will be a key first step toward that objective.

XI. Conclusion

Forecasting the future is always difficult. But in the case of Mexico, the López Obrador presidency and its preferences are key determinants and allow a simpler path to prediction. The key issues, based on this line of argument, for the year 2023 are a major effort by the López Obrador administration and his political party, MORENA, to capture the elections in the State of Mexico and the State of Coahuila; to continue consolidating political power in his and the party's hands; and to prepare to roll out the electoral machine to win the 2024 elections. López Obrador will insist on pushing for changes to the constitution, federal laws, and government agencies to concentrate power in the executive branch. And he will continue to polarize Mexicans and use state agencies to attack critics, intimidate opposition leaders, and advance his preferred policies, particularly in the energy sector.

Still, fiscal and financial pressure on the government will increase, as Mexico's liabilities will rise considerably with no additional funding sources to cover them. This could lead to a serious economic crisis, especially if there is a global slump in growth and Mexico is dragged along with it. This also indicates that Mexico's goods and services—infrastructure, education, health, and general welfare—will continue to deteriorate throughout 2023, with no end in sight unless the major policies of the López Obrador administration are reversed.

The economy will hold up, barely, but primarily on the basis of strong exports and remittances that will help employment and consumption—but nothing can be expected to ease the financial strain more than it already has.

No major crisis in the U.S.-Mexico relationship is expected, but Washington is likely to continue to put pressure, quietly but steadily, on the López Obrador administration to prioritize some key issues, including immigration, drug trafficking, and the implementation of the USMCA. Mexico City will continue to drag its feet, but we do not expect Washington to create a crisis out of this.

Finally, the main problem will be the legacy of the López Obrador administration in Mexico's governance institutions. These institutions will further weaken in 2023, as López Obrador likely pushes for major changes to concentrate power in the executive branch. He will also continue to militarize public life at the expense of democracy and human rights; and he will continue to polarize society politically, stretching the patience of governors and mayors, who are now left to deal with major problems and few resources. To this, one more concerning observation is warranted: organized crime is expected to advance its political interests and actively engage in elections in 2023 and 2024, favoring the president, his party MORENA, and its candidates, as they appear to be the least likely to confront cartel activities, territorial control, and increased firepower.
In all, 2023 does not appear to be the year that Mexico turns things around. Instead, the president will double down on his agenda, leading Mexico on a path of slow economic and democratic deterioration, leaving behind serious issues that the next administration will have to confront.

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