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CEO’s Executive Summary

Despite the welcome sight of new U.S. President Joseph R. Biden extolling the virtues of the U.S.-Mexico relationship in his March 1 bilateral meeting with Mexican President Andrés Manuel López Obrador (AMLO), the business climate in Mexico continues to deteriorate, largely due to the AMLO administration’s continued efforts to centralize power, undermine independent regulatory institutions, and promote a nationalist agenda that looks backward, not to the future. And while the recently concluded bilateral meetings were cordial, they were largely perfunctory. The Biden administration appears to be gently easing into its relationship with AMLO, careful not to push too hard or move to fast. This stands in contrast to the warmth and ambition reflected in the U.S.-Canada bilats a week earlier. And much of the problem rests squarely with Mexico itself.

The recent winter storms that brought down Texas’s electrical grid highlight that there has never been a more important or urgent time for cooperation and integration between the U.S. and Mexico, yet forces in Mexico continue to move in the exact opposite direction. A new Electricity Law, for example, aims to shore up the Federal Electricity Commission (CFE) as the dominant player in Mexico’s electric power sector. The new law would damage the interests of private energy producers and weaken the country's capacity to meet its energy needs with low-cost, clean electricity. It also could be unconstitutional, and it appears to contravene provisions of several Mexican trade agreements, including the United States-Mexico-Canada Agreement (USMCA), opening the door to bilateral conflict.

U.S.-Mexico relations are also poised for conflict in security matters, where the fallout from the November 2020 arrest of Mexican General Salvador Cienfuegos has driven the security relationship to its lowest point since the 1980s. The USMCA's labor provisions could also be a point of bilateral contention.

Nevertheless, there is still a lot of room for bilateral collaboration and cooperation, as the March 1 summit meeting between AMLO and President Biden demonstrated. AMLO is not gunning for conflict with the United States but instead understands the importance of a good relationship with Mexico's powerful northern neighbor. This *will create* opportunities for cooperation on issues ranging from immigration to pandemic response to cross-border trade, but the depth and breadth of that cooperation is likely to be limited.

Meanwhile, pending legislation that would sharply constrain subcontracting in the Mexican labor sector and restrict the autonomy of the Bank of Mexico is adding to concerns about both the business climate and AMLO's continued efforts to undermine the autonomy of independent institutions. In politics, the June 6, 2021, mid-term elections in Mexico are fast approaching, while the Mexican economy continues to face strong headwinds.

I. The Electricity Law

On February 1, the first day of the new congressional session, AMLO introduced a preferential initiative proposing a new law governing the operations of the electricity sector. As a preferential initiative, this legislation had to be acted on by both houses of Congress within 60 days. Given Morena legislators' complete loyalty to AMLO, it was easily approved by the Chamber of Deputies without "changing a comma," as AMLO demanded, and is being rammed through Senate, where it should be approved no later than March 4.

This proposal reflects AMLO's desire to establish Mexican energy independence led by two state-owned energy firms–the Federal Electricity Commission in the generation and dispatch of electricity and Pemex in oil & gas production and refining. The proposed Electricity Law would change the order in which electricity is dispatched into the national grid. At present, the system favors low-marginal cost producers such as solar and wind farms, but under the new law it would prioritize electricity generated by CFE–regardless of cost–including fuel oil which is nearly five times more expensive and highly polluting.

The Electricity Law also eliminates the obligation to use auctions to identify and contract the least expensive electricity suppliers for residential consumers and small businesses. It seeks to scrap self-supply contracts and to renegotiate long-standing contracts under which privately generated electricity has been delivered to CFE for decades. And it undermines the capacity of the clean energy certificate program to promote new renewable investments by allowing pre-existing CFE-owned hydro-electric plants to qualify for these certificates, which will flood the certificate market, significantly depreciating their value and lowering their utility for renewable producers.

Designed to shore up CFE, the legislation hinders efforts to access sufficient supplies of clean, low-cost electricity. It will instead lead to higher electricity tariffs, which could be passed along to business users and harm Mexican competitiveness. Households, on the other hand, will be protected by AMLO's promise not to raise electricity rates, leading to higher government subsidies on electricity consumption, which will eat away at scarce fiscal resources.

At the same time, the legislation is based on questionable legal foundations. The core elements of the law are based on the government's electricity plan that was deemed unconstitutional by the Mexican Supreme Court on February 3. And its contents likely conflict with Mexico's trade agreements with the European Union and the Trans-Pacific region, as well as being at odds with key provisions of the USMCA, as a sharply worded statement from the U.S. Chamber of Commerce emphasized. The USMCA prohibits preferential treatment for domestic firms, whether publicly or privately owned, over their foreign counterparts, and it strengthens national regulators. It also protects investors from confiscatory government rules or regulations such as the forced renegotiation of contracts. The new energy dispatch system proposed in the Electricity Law runs contrary to these provisions.

AMLO's personal promotion of this legislation means he is unlikely to back down even in the face of the coming legal challenges and potentially expensive international arbitration. As a result, the confiscatory character of the law will further undermine private investment in the energy sector (already sharply reduced by government action that has stalled over 200 energy projects), and have a chilling effect on private investment in Mexico more broadly.

II. U.S.-Mexico Relations

Beyond potential legal challenges surrounding the Electricity Law, the bilateral relationship will experience other areas of conflict in the months and years ahead, but they will be coupled with room for real cooperation and collaboration.

Several recent events seemed to suggest that AMLO desired open confrontation with the Biden adminstration. He delayed recognition of Biden's election victory until after the Electoral College vote, one of only three world leaders to do so. And the congratulatory note he ultimately sent to Biden was decidedly lukewarm. AMLO also offered political asylum to Julian Assange, the WikiLeaks founder who faces felony charges in the United States for publishing classified documents.

More troubling was Mexico's handling of the case against General Salvador Cienfuegos, the country's former defense minister who was arrested in the United States on drug charges and later allowed to return to Mexico. The Mexican government exonerated General Cienfuegos quickly and with little investigative effort despite promises to the contrary. It then publicly released the DEA evidence against the general that had been provided confidentially by the U.S. government and which Mexico insisted was insufficient to prove his guilt. Potentially most damaging, AMLO accused the United States of fabricating the evidence against the general. While there is no doubt that these developments have driven security cooperation to their lowest point since the 1980s, this does not translate into a desire on Mexico's part for bilateral conflict.

In fact, AMLO understands quite well the importance of a cooperative relationship with its powerful northern neighbor. What he fears is that the Biden administration might meddle in Mexican domestic affairs and obstruct elements of his "Fourth Transformation" suite of policies. He is particularly concerned about Biden's interest in placing climate change at the center of his Latin American policy agenda at a time when Mexico is doubling down on fossil fuels as the foundation for energy independence.

The Biden administration, for its part, is trying to avoid additional conflict with Mexico given its full domestic and foreign policy agenda. That being said, energy and security policy are apt to be points of dispute in the bilateral relationship. Indeed, Mexico's reliance on imports from the U.S. for 70% of its natural gas needs became a point of contention during the mid-February cold weather-induced energy crisis in Texas. The same natural gas pipelines whose flow was dramatically reduced by the freeze cut the fuel supply for both Texas and Northern Mexico. The ensuing decision by Texas Governor Greg Abbott to halt all natural gas exports to Mexico created a bilateral crisis that was quickly resolved in Washington, but not before the action was used by AMLO to reinforce his determination to achieve Mexican energy independence.

A Mexican delay in implementing the labor provisions of the USMCA could be another point of contention. Any indication of Mexican foot-draging will produce loud complaints and calls for action from U.S. labor unions and their democratic supporters in the U.S. Congress.

While the relationship between Mexico City and Washington could be characterized as pragmatic and cordial, its tone stands in sharp contrast to the warmth and genuine enthusiasm recently witnessed when President Biden and Canadian Prime Minister Justin Trudeau held their first, albeit virtual, summit. Apart from the evident personal charisma and warmth the two share despite their significant age difference, Biden and Trudeau also announced a new *Roadmap for a Renewed U.S.-Canada Partnership*. The Roadmap sets forth an ambitious agenda for cross-border collaboration across a range of Biden's most important policy priorities, from COVID-19, to economic recovery, to a renewed alliance tackling shared global priorities like climate change.

The outcome of the first Biden-AMLO summit meeting on March 1 was much different. Both sides entered the meeting with low asiprations—for Biden to reassure Mexico and to establish the foundations for cooperation on immigration and COVID, and for Mexico to assert and protect its sovereignty from potential U.S. intervention—and both achieved their goals. As a result, while the joint declaration calls for a restart of the High Level Economic Dialogue—something the U.S. and Mexican private sectors greatly welcome—and discusses areas where the two countries can collaborate, it was short on specifics and ambition. It pointedly made no mention of areas of potential conflict, including security and energy, and instead focused on issues where a collaborative foundation with a prickly partner could be established. It made plain that the U.S. and Mexico no longer share a common vision for the future.

We can only hope that Mexico is not left, with its nose pressed against the glass, a missing partner in what should be a trilateral effort among the so-called "Three Amigos." Much of this will depend squarely on Mexico, however. There are clearly no shortage of opportunities for bilateral collaboration starting with immigration. AMLO continues to use the National Guard and presidential rhetoric to limit the flow of Central Americans migrating to the United States through Mexico, and he strongly supports the Biden administration's plans for a Central American development program that might mitigate the motivation to migrate. There is also room for pandemic-related collaboration including reopening the U.S.-Mexico border post-pandemic and working to reduce the kind of supply chain disruptions binational producers experienced last spring. But the agenda is, admittedly, narrow and uninspired.

III. Mexican Politics: Congressional Actions

The Mexican Congress is tasked with addressing a wide range of legislative proposals before the current session ends on April 30. These include reduced funding for political parties, a requirement that no government employee earns more than the president, and elimination of autonomous institutions essential to democratic practices but considered expensive and superfuluous by AMLO. But the top issues, beyond the Electricity Law, include two matters left pending at the end of the last congressional session in December: limitations on outsourcing (labor subcontracting) and the Bank of Mexico Law.

As we noted in our November newsletter, a government proposal to sharply curtail the use of subcontracting in the Mexican economy produced a chorus of opposition from the private sector, giving rise to a formal negotiation process to modify the proposed legislation. The outcome of these nogotiations and the proposal itself remain up in the air. In a Bloomberg interview, Ricardo Monreal, the Morena leader in the Senate, commented that it seemed unlikely that Congress would have time to address this legislation in the current session since most of its time will be devoted to the Electricity Law. Less than a week later, however, the leader of Morena in the Chamber of Deputies pointed to this legislation as a priority item. We will keep close watch to see how this develops.

In the same interview, Monreal expressed his continued support for the proposed Bank of Mexico Law that would force the central bank to purchase dollars with no questions asked. As we noted in our December newsletter, this legal change would limit the constitutional autonomy of Banxico. In addition, independent analysts and the Bank fear this could contaminate Mexico's foreign reserves with illegally obtained dollars putting the banking system at risk of violating global norms around anti-money laundering. Banxico and the Finance Ministry proposed a solution whereby remittance receivers could sell their dollars to the government-owned Banco del Bienestar, and Banxico would lend money to banks that are unable to repatriate surplus dollars. Monreal, however, deemed this an "insufficient solution," but said he would wait to see how the Senate-approved legislation advances in the Chamber of Deputies. Given AMLO's stated concerns with the legislation, it appears that this "insufficient solution" could emerge as the agreed upon path forward.

IV. Politics and the Economy

In Mexican domestic politics, AMLO's approval ratings remain in the low 60s, but support for his Morena party is much lower. This creates an opportunity for the opposition to deprive Morena of its majority in the lower house in the June 6, 2021, mid-term elections when all seats in the Chamber of Deputies are up for grabs as well as 15 of 32 governorships. An agreement by the three main opposition parties (PRI, PAN, and PRD) to form an electoral alliance in most congressional districts and states will significantly increase the opposition's electoral strength. Nevertheless, the absence of appealing leaders and new policy ideas from the opposition continues to undermine their electoral appeal. Analysts estimate that Morena could win as many as nine governorships, and will retain its control of the Chamber of Deputies thanks to a rule that guarantees a majority to any party or alliance that wins at least 42% of the vote. Morena has again formed an alliance with the Green and Labor parties, PVEM and PT, respectively.

On January 10, 2021, the new Secretary of the Economy, Tatiana Clouthier, announced an economic recovery plan. Unsurprisingly given AMLO's emphasis on fiscal rectitude and the need for another massive bailout of Pemex, the plan did not offer much in the way of a government stimulus. Private investors, meanwhile, remain discouraged both by the COVID-induced depression (the economy shrank 8.5% in 2020) and by unfriendly government policies. Absent any stimulus, economic recovery in Mexico will depend on application of the COVID vaccine throughout the country and recovery in the U.S. economy. Indeed, the IMF estimates that the Mexican economy will grow just 4.3% this year, driven mostly by exports reflecting what they anticipate will be a strong U.S. recovery. The Bank of Mexico, meanwhile, estimates growth could rise to 5.3% with effective COVID-19 vaccine distribution, a huge caveat given the challenges Mexico has faced thus far in vaccinating its population.

The deteriorating business climate in Mexico continues to be of concern to most Mexican watchers, and the Mexican private sector continues to feel beset not only by bad public policy but also by a concerning lack of vision for how Mexico can and should position itself for the future. A recent decision by JPMorgan Chase to pull its private banking operations from Mexico may be understood as an alignment with the bank's overall hemispheric strategy and not a reflection of its view of Mexico specifically. But that's cold comfort for the reality it reflects: at a time when the United States, Canada, and the majority of western economies are set to emerge from the COVID-19 pandemic, with the anticipated growth that will attend it, while also a moment when the U.S. is developing a renewed strategy to confront the challenge of how best to compete with and respond to Beijing, Mexico seems off on its own, dithering in an isolationist mode that seems intent on moving backward, not forward. Time is short, and as big champions of Mexico, we can only hope things start to change soon.

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