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Commercial Pathways Forward for Mexico: 2024-2030

Edited by Ignacia Ulloa Peters, Martín Cassinelli, Charlene Aguilera, and María Fernanda Bozmoski

Foreword by Jason Marczak

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This report is a collaborative effort between experts within the Atlantic Council's network, including members of the Adrienne Arsht Latin America Center's Advisory Council, Nearshoring Working Group, and nonresident senior fellows.

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ABOUT AALAC

The Atlantic Council's nonpartisan Adrienne Arsht Latin America Center (AALAC) broadens understanding of regional transformations while demonstrating why Latin America and the Caribbean matter for the world. The center focuses on pressing political, economic, and social issues that will define the region's trajectory, proposing constructive, results-oriented solutions to inform public sector, business, and multilateral action based on a shared vision for a more prosperous, inclusive, and sustainable future.

AALAC – home to the premier Caribbean Initiative – builds consensus for action in advancing innovative policy perspectives within select lines of programming: US policy in the Western Hemisphere; US-Colombia ties; Venezuela's future; Central America's economic prosperity; Mexico's role in North America; China's next steps in the Americas; Brazil's trajectory; Caribbean development; regional economic development; commercial opportunities; and energy transitions. Jason Marczak serves as the center's vice president and senior director.

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FOREWORD

Countries representing half the world's population are voting in 2024. On June 2, just over five months before Election Day in the United States, Mexican voters will set a historic milestone with the election of the country's first female president. Over the course of her six-year term, Mexico's new president will face enormous challenges—internally and in the country's relationship with the United States. But, like never before, there is also a unique opportunity to strengthen the commercial and economic ties that bind the two countries and reimagine how our shared border could better serve our shared interests.

Although the United States and Mexico have long been economically intertwined, in 2023, Mexico became the United States' most important trading partner. Now more than ever, with great geopolitical headwinds, the commercial ties that bind our two countries will be increasingly critical to advancing US economic interests globally. Here, greater border efficiency will yield economic gains alongside improvements in our shared security.

The Atlantic Council's Adrienne Arsht Latin America Center, in partnership with internal and external colleagues and partners, sought to envision the future of two key aspects of the US-Mexico relationship: commercial flows and investment. With extensive feedback and numerous consultations with border stakeholders, including business owners, truck drivers, port operators, civilians, and local and federal elected officials, we sought out fresh perspectives and actionable recommendations. Our goal with this report is to spark dialogue among policymakers, business leaders, and civil society in both countries on the urgent need to address the immediate challenges of border efficiency and investment attraction over the next Mexican president's term while paving the way for a more prosperous and secure future in our countries.

The Rio Grande and its surrounding towns are more than a physical barrier separating the United States and Mexico. Rather, they are a vibrant artery of commerce, migration, and cultural exchange. Livelihoods depend on our border, but inefficiencies prevent us from maximizing the possible economic opportunities and achieving the necessary security gains. The pages that follow build on previous center findings and emphasize the need for a nuanced approach to foreign investment, infrastructure development, and security measures that prioritize efficiency and our national interests.

This publication also seeks to bring the human dimension to the forefront. Public policy, after all, should reflect how to improve everyday lives. We consolidate the stories of real people affected by the US-Mexico border daily. The combined stories we have gathered over the last two years remind us of the impact of policy decisions. That reminder is particularly poignant with the 2024 elections on both sides of the border. Indeed, we stand on the cusp of a new chapter in our shared history.

This report is a call to action for visionary leadership and bold, pragmatic solutions to the complex issues facing the United States and Mexico. We urge policymakers to embrace policies and strategies that address immediate challenges while laying the groundwork for both an even more inclusive and prosperous future. Let's seize this unique moment in time. .

Jason Marczak
Vice President and Senior Director
Atlantic Council's Adrienne Arsht Latin America Center

INTRODUCTION

Mexico's electoral landscape is critical for implementing cooperative economic and border enhancements. In 2023, Mexico became the United States' top trading partner, underscoring the need for strategic collaboration and policy alignment between the two nations to sustain and optimize the relationship. This will ensure that Mexico continues to gain commercial momentum with the United States and set the tone for the 2024 election year, emphasizing the importance of improved border efficiency and leveraging the nearshoring trend to attract foreign investment.

The presidential candidates—Xochitl Gálvez, Claudia Sheinbaum, and Jorge Álvarez Máynez—have each advanced a vision of working for the well-being of the Mexican people through increased economic opportunity. One option: increased foreign investment, particularly in strategic sectors like renewable energy and technology. Issues for the next administration include the promotion of increased trade and nearshoring through avenues such as opening state companies for foreign investment, expanding strategic infrastructure through conditional foreign investment, and transferring services and production back to national territory.

The US-Mexico border is also a critical component of Mexico's capacity to increase commercial outcomes. Border reform, both in terms of commercial efficiency and security, stands out as an opportunity to foster increased economic cooperation with Mexico's top trade partner, the United States. Prioritizing the importance of balancing efficiency and security through updated border technologies and shared best practices that extend beyond the border will allow Mexico to improve economic opportunities for its citizens, create jobs, and ultimately reduce inequality.

This report combines stories and reporting collected over two years of engagements at the border to highlight how addressing these priorities will improve economic outcomes for citizens across Mexico and the United States. As Mexico approaches its 2024 election, the shared ideology between candidates on border reform and nearshoring underscores the common understanding of the significance of these issues. The decisions made by Mexican voters on June 2 will not only shape the nation's future but also impact the challenges and opportunities inherent in the US-Mexico relationship, emphasizing the imperative of continued cooperation on commercial strategies.

PRIORITY ONE

REIMAGINE A MORE EFFICIENT US-MEXICO BORDER

Our team spoke with many border operators and cargo drivers over the past two years. Through consultations and interviews, we have gathered stories and accounts describing the challenges and opportunities associated with the cross-border commercial industry. The allure of flexible work hours and good earnings draws many individuals from both sides of the border to the commercial trucking industry. While navigating through typical rush-hour traffic is a familiar challenge for drivers on domestic routes, embarking on cross-border journeys presents a distinct challenge. Drivers must be prepared to endure lengthy wait times, ranging from three to ten hours, depending on the day.

Truckers face multiple challenges during their trips. Temporary suspensions of ports of entry occur frequently, often due to the reassignment of US customs officers to manage the influx of migrants attempting to cross the southwest border. These closures compel drivers to reroute, aiming to steer clear of congested areas near the border where collisions are a constant risk. Unfortunately, alternative nearby commercial crossings is frequently overwhelmed, with hundreds of trucks queued for multiple hours, exacerbating delays and congestion.

After enduring hours of waiting, often in sweltering conditions, drivers finally reach the port of entry for processing, only to face additional delays during secondary inspections. Frequently, these inspections are prolonged due to malfunctions in noninvasive scanning technology, necessitating manual cargo inspections. By the time drivers clear the border, an additional twelve hours or more may have been added to their travel time. Such extensive delays translate into significant financial losses for the companies involved. The agricultural sector, in particular, bears the brunt of these delays, with commercial trucks transporting perishable goods like avocados and tomatoes often arriving with spoiled produce due to the extended wait times at the border.

Challenges include:

Challenge 1: Excessive wait times

Prolonged delays at US-Mexico ports of entry result from heightened inspections, outdated technologies, a lack of cross-agency communication, and growing security concerns. The need for rigorous inspections to counter illegal activities, such as the flow of weapons and drugs, is one factor contributing to these delays. A complex multistep process for commercial and noncommercial vehicles poses significant obstacles to efficient border crossings. The ongoing migrant crisis has resulted in border bridges being closed, further disrupting cross-border activity and creating up to fifteen-hour wait times.

The increased wait times along the US-Mexico land ports of entry create barriers to North American economic integration and advancement. An Atlantic Council report, written in partnership with the University of Texas at El Paso's Hunt Institute for Global Competitiveness and El Colegio de la Frontera Norte, and with support from the US Department of State's Bureau for International Narcotics and Law Enforcement Affairs, finds that a ten-minute reduction in wait times would create approximately eighteen thousand direct and indirect jobs in Mexico. At the same time, Mexico's six border states would see a 1.34 percent increase in gross domestic product (GDP), create three thousand direct jobs, and produce a $10.5 million increase in tax revenue. In the United States, the time reduction from enhancements to technology, architecture, and management practices would generate $312 million in additional value from increased commercial vehicle crossings annually.

Challenge 2: Outdated infrastructure and technology

Outdated infrastructure and technology obstruct the speedy processing of vehicles and travelers entering points of entry along the US-Mexico border. The current practice of processing commercial vehicles only once they have arrived at inspection booths, rather than throughout their route, contributes to prolonged wait times. Collaborative efforts are needed between the United States and Mexico to develop decentralized tools for swift and efficient inspections. Additionally, investing in smart infrastructure is critical to address operational issues stemming from outdated infrastructure on both sides of the border and to accommodate the increased volume of vehicles entering the points of entry.

Challenge 3: Lack of cross-agency communication

The challenge of extended wait times at the US-Mexico border is exacerbated by the historical absence of real-time data and information sharing between agencies on both sides of the border. As of 2020, most Mexican border cities lacked traffic management centers to oversee transportation systems, including border crossings. Outdated communication systems worsen the problem by hindering swift and effective collaboration. This lack of seamless interaction impedes the timely verification of paperwork, inspection procedures, and overall decision-making at the border.

Challenge 4: Security and illicit trade

Strict security measures to curb the illegal flow of weapons, drugs, contraband, and people call for thorough border inspections. While crucial for maintaining security, these inspections add unnecessary time to processing commercial and noncommercial vehicles at the border. The heightened security measures often trigger secondary inspections, further extending wait times. Creating a comprehensive strategy to continue to enforce security measures while facilitating the smooth flow of commercial and noncommercial vehicles must be a top priority.

The issues cross-border truck drivers raise are endured across the whole commercial landscape. In an era of accelerating commerce and global connectivity, working to resolve these challenges and reimagine the US-Mexico border is more critical than ever. A safer and more efficient US-Mexico border has the power to shape our shared future and harness the untapped potential of the bilateral relationship. A border overseen by innovative technologies and more effective systems and processes can boost economic, labor, and security outcomes for Mexico, expanding opportunities for exporters and producers across the country.

The 2024 elections—the largest in Mexico's history with more than twenty thousand local and federal positions up for grabs—offer Mexico and the United States a unique opportunity to join forces to tackle shared challenges and chart a trajectory toward longer-term border prosperity. What pathways should Mexico's next administration prioritize regarding border issues? The following recommendations seek to address the root causes of the persistent delays, alleviate the economic strain on businesses, and strengthen the security framework governing cross-border commercial activities.

Pathways forward

Develop and deploy a strategic and binational plan to increase the use of noninvasive screening technologies at and beyond the US-Mexico border

Prioritizing noninvasive technology—such as X-rays and gamma-ray imaging—at the US-Mexico border is a strategic practice for both the United States and Mexico. Adopting advanced scanning methods offers a powerful solution for enhancing security measures while expediting the movement of authorized goods and people and streamlining commercial processes. By leveraging noninvasive technology, the United States and Mexico can bolster their collaborative efforts to fortify cross-border trade. Increased technological resources along the US-Mexico border will also allow US Customs and Border Protection (CBP) and Agencia Nacional de Aduanas de México (ANAM) personnel to limit the amount of time they spend manually inspecting commercial and noncommercial crossings, instead allocating resources to opening additional lanes and increasing throughput.

While advanced screening technologies at border ports of entry dramatically enhance efficiencies and resource allocation, implementing these technologies across checkpoints beyond the border offers two additional benefits. First, conducting inspections farther from the congested borders gives customs officials more time to perform meticulous inspections without the constraints of bottleneck pressures. Second, transmitting images from these devices to customs officers at the border before cargo arrival enables timely analysis and comparison with cargo manifest information. This proactive approach ensures that customs officers have more time and notice to assess the information compared to the limited window they are currently afforded.

The adoption of noninvasive technology reflects a commitment to transparency and trust building. Reducing reliance on physical inspections minimizes potential sources of tension and strengthens the foundation for a cooperative and resilient bilateral partnership. This approach promises a secure, efficient, and economically vibrant cross-border region, fostering sustained growth and collaboration between the United States and Mexico.

Incorporate best practices from model ports of entry for the construction of joint and technologically advanced ports of entry

Model ports of entry play a pivotal role in shaping border policies and are often known for their efficient processes, robust security measures, advanced technological integration, and streamlined infrastructure. Identifying best practices from successful model ports of entry that have grappled with operational challenges is crucial, as it would provide a blueprint for enhancing efficiency that should be systematically incorporated. The success of border enhancements depends heavily on political commitment and advancements in software, hardware, and infrastructure on both sides. Any process improvements must be coordinated and undertaken jointly to ensure comprehensive and seamless implementation across the border.

Expanding the number of ports of entry modeled after successful crossing points could translate into substantial reductions in wait times for both commercial and noncommercial vehicles. Additional model ports of entry will increase throughput and allow new technology and infrastructure proposals to be tested, refined, and incorporated into the broader border system.

In the technology space, such proposals include centralized digital infrastructure and cloud-based solutions that overcome challenges related to the frequent collapse of existing technological systems. These could enhance efficiency by supporting data-sharing platforms for cargo imagery, threat identification, and manifest processing, allowing border agencies to reduce redundancies and freeing up critical border resources to be used elsewhere. While joint initiatives such as Unified Cargo Processing have been successful in select land ports, they have yet to be extended to all ports of entry and service only a limited number of vehicles per day.

In terms of infrastructure, efficiency proposals include establishing a shared processing facility instead of having separate buildings on each side of the border. A centralized approach would foster collaboration among customs officers working together in the same building, streamline operations, facilitate information sharing, and promote a unified and coordinated response at the border. This approach promises a more responsive and streamlined cross-border trade landscape that capitalizes on proven methodologies while remaining adaptable to the dynamic nature of border operations.

Further separate commercial and noncommercial crossings to reduce congestion, streamline traffic, and minimize collisions

On an average day, hundreds of trucks and private vehicles cross the US-Mexico border through ports of entry located within urban centers, many of which are ill-equipped to accommodate large commercial vehicles which then find themselves stuck in city traffic. While most ports of entry process commercial and noncommercial vehicles separately, the approach to processing booths tends to be congested with an assortment of private vehicles and multi-axle cargo vehicles. Sharing the roads leading to ports of entry frequently results in collisions between cars and trucks and damage to road infrastructure, including potholes, curb corrosion, cracks, fissures, and so on. Construction, debris removal, and other necessary repairs cause additional delays and congestion. Diverting commercial vehicles away from urban centers and strategically directing future ports of entry to be constructed solely for commercial or noncommercial vehicles would alleviate this problem.

Another step toward enhancing border efficiencies can be achieved by incorporating trusted traveler programs such as Secure Electronic Network for Travelers Rapid Inspection (SENTRI) and collaborating with businesses through initiatives like Customs-Trade Partnership Against Terrorism (CTPAT). SENTRI, designed for preapproved, low-risk travelers, can expedite the processing of private vehicles, reducing overall congestion. CTPAT promotes smoother movement of commercial vehicles by engaging the private sector to enhance the security of the international supply chain. In addition to generating economic gains, a strategic combination of infrastructure development and trusted traveler programs will also improve health outcomes by reducing emissions along ports of entry.

Establishing a bilateral framework that effectively addresses the coexistence of commercial and noncommercial crossings is crucial, ensuring a clear and distinct separation between these two entry points. This will prevent disruptions in cross-border activities caused by unexpected circumstances, such as migrant caravans, temporary inspection requirements, or security concerns along border cities.

Address staffing shortages by investing in targeted recruitment, training, and retention programs

Effective reduction of commercial wait times at the US-Mexico border hinges on the presence of well-equipped and trained CBP and ANAM personnel. Adequate staffing is essential for expediting inspections and meeting the demands of commercial activities, thereby minimizing delays and optimizing overall border management efficiency. Binationally delivered training programs for customs personnel contribute to this efficiency by fostering a shared understanding of both countries' legal frameworks that will help streamline the crossing process.

While legislatures in Mexico and the United States have attempted to address staffing shortages at ports of entry, the issue has not yet been resolved. In 2022, ANAM called for two thousand additional inspection officers to help with detection efforts. Paired with joint inspection initiatives, the United States and Mexico could devise dynamic staffing plans that respond to processing needs without requiring a cessation of services.

A heightened CBP and ANAM presence would also serve as a deterrent to illicit activities, reinforcing security measures without compromising the flow of legitimate trade. By bolstering the workforce, the US-Mexico border can balance security imperatives and the expeditious movement of goods, contributing to a more resilient and responsive border environment. In tandem with this initiative, enhanced binational cooperation and coordination, with a specific focus on security measures, will ensure adequate staffing and equipment and empower authorities to proactively combat emerging threats at the border, fostering a safer and more secure cross-border landscape.

Increase bilateral collaboration by restarting the US-Mexico Border Governors Conference

The US-Mexico Border Governors Conference was an annual meeting between the governors of California, Arizona, New Mexico, Texas, Baja California, Sonora, Chihuahua, Coahuila, Nuevo León, and Tamaulipas that focused on tackling challenges and seizing opportunities affecting the border, including immigration, trade, and security. Because this conference has not been held since 2011, opportunities for collaboration and joint dialogue among the border states have been significantly reduced.

Revitalizing the US-Mexico Border Governors Conference, including targeted agendas, constituent consultations, and a robust information campaign, would promote advances on trade, migration, water usage, tourism, and security topics. It would serve as a testament to the commitment of both nations to foster regional cooperation and address shared challenges proactively. It would provide leaders an invaluable opportunity to build relationships, share expertise, and collectively work toward sustainable solutions. The model has proven successful for the United States and Canada through forums such as the Pacific Northwest Economic Region Annual Summit, designed to discuss economic best practices and trade concerns.

However, binational engagement should extend beyond annual events. The US-Mexico Border Governors Conference should establish regular working-group-level dialogues to provide a consistent and secure platform for addressing shared challenges—such as regulatory uncertainty, which can impede the flow of trucks and trains in transit and force rapid adaptations to suddenly changing norms.

Reviving the US-Mexico Border Governors Conference aligns with the evolving dynamics of the border region. It reinforces the importance of sustained engagement and collaboration to navigate complex issues and capitalize on opportunities that transcend political boundaries.

PRIORITY TWO

UNLOCK MORE TRADE & INVESTMENT

Over the past year, our team has focused on the challenges to nearshoring—the practice of moving company operations closer to company headquarters; it's the opposite of the perhaps more familiar "offshoring"—launching a working group in December 2023. Through dozens of consultations and strategy sessions with and beyond the Adrienne Arsht Latin America Center's Nearshoring Working Group, we have consolidated accounts of some of the most pressing challenges and avenues forward for nearshoring in Mexico. With rising tensions between the United States and China, nearshoring has become increasingly urgent. One common scenario we heard about often in our conversations is manufacturers looking to move their assembly, testing, and packaging (ATP) plants from China to Mexico. With Mexico being a member of the United States-Mexico-Canada Agreement (USMCA, the successor to the North American Free Trade Agreement, or NAFTA) and offering a cost-competitive advantage as a border country, it presents an opportunity for the country to be a potential candidate for companies' ATP plants.

Despite indicators of Mexico's potential as a location for "nearshoring" investment, companies have hesitated in the absence of an assurance of a high return on investment. An announcement by the Mexican government in October 2023 to give fiscal incentives to companies investing in fixed assets in sectors including semiconductors, electronic components, batteries, motors, fertilizers, and pharmaceuticals presents the opportunity for companies to assess the possibility of market entry in Mexico. Many companies are looking to understand the regulatory context, assess whether Mexican utilities could meet a typical ATP plant's water and energy demands, find sufficient employees, and evaluate the logistics and telecommunications infrastructure to ensure efficient supply chain and production processes. While there are benefits to relocating supply chains to Mexico, several challenges remain.

Challenge 1: Legal uncertainty

An important challenge facing companies moving into the Mexican market is the legal uncertainty around setting up operations in Mexico. Instances of cancelled projects, contracts, and concessions between companies and the Mexican government are a primary source of concern—examples are found in the government's involvement in large mergers and acquisitions transactions, a mining concession, a brewery plant, and the seizure of a railroad. These actions, among others, resulted in at least two dozen active or planned investor disputes against Mexico.

To ease concerns, the USMCA includes provisions that protect foreign investment and intellectual property and, through rule-of-origin provisions, incentivize investment in Mexico. However, while the USMCA sets out the legal framework and protections, implementing USMCA provisions is key. Concerns regarding the enforcement of these provisions are significant, in part because certain federal policies in Mexico would directly conflict with the USMCA's stipulations—for example, the preferential treatment of state-owned Pemex and CFE in the energy sector. Similar concerns surround Mexico's labor laws and inadequate enforcement of internationally recognized rights—including the formation of unions, competitive wages, and safe working conditions—that could result in targeted tariffs, if not complete bans on noncompliant companies' goods entering the US market. Mexico's record of weak enforcement of labor conditions adds to the legal uncertainty faced by companies entering the market. These concerns are worth considering for any company looking to move its operations to Mexico. Finally, some companies have noted the USMCA's built-in sixteen-year expiration clause (also known as the sunset clause), according to which the parties meet every six years (with the first checkup in 2026) to discuss potential changes. While having an avenue to update the agreement is a positive feature, the uncertainty that attaches to potential change could create uneasiness for investors.

Challenge 2: Limited access to clean energy supply

The second challenge relates to Mexico's unreliable and fossil-fuel-based energy supply. Mexico depends on natural gas to produce energy and fuel its industry. In the summer of 2023, the country's electricity grids were declared in a state of emergency, with rampant apagones (blackouts) reported as supply failed to keep up with demand and grids became saturated. After a decade of declining natural gas production, Mexico is highly dependent on US imports of natural gas and the pipelines that connect both countries. However, the availability of natural gas is limited to Mexico's northern industrial corridors created after NAFTA, which have become saturated by demand. The south of Mexico has sparse natural gas infrastructure, with only one pipeline supplying the states of Campeche and Yucatán. In contrast, no pipeline reaches the state of Quintana Roo (one is being planned). As a result, the cost of energy is higher in the south of Mexico. Private investments in renewable energy have been stalled by regulatory burdens, threatening to extend the timeline to achieve Mexico's energy transition goals. With limited available energy resources and an expected increase in demand, the unreliability of energy and its resulting higher cost could affect the bottom line while a fossil-fuel-dependent energy matrix presents a risk to the company's environmental, social, and governance compliance.

Challenge 3: Lagging transport infrastructure and uncompetitive digital economy

A third challenge is Mexico's lagging transport and telecommunications infrastructure, which is critical to seamless supply-chain integration and increased efficiencies at a potential ATP plant. The country has inadequate transport infrastructure, from congested ports to meager railway and road infrastructure. According to the World Bank's Logistics Performance Index, Mexico scored 2.9 in 2022 on a scale of one to five, placing it seventy-first out of 139 countries, significantly trailing China (nineteenth). The Manzanillo, Lázaro Cárdenas, and Altamira ports—among Mexico's busiest—all encountered significant delays in 2023, reaching up to fifteen-day delays in processing imports and exports.

The productivity of companies' plants will also hinge on their capacity to seamlessly interact with local suppliers through the digital economy. However, in 2023, Mexico fell to fifty-fourth out of sixty-four countries in a digital competitiveness ranking by the International Institute for Management Development. While it is true that Mexico has been unable to deploy broadband connectivity and 5G infrastructure at a rate to keep up with companies' demands, the 2013 information and communications technology reform improved broadband connectivity by enabling a more competitive market, and 5G usage has been gaining ground in the last few years. Nonetheless, high spectrum fees severely limit the competitiveness of telecommunications providers and their ability to further telecommunications infrastructure deployment across the country. As a result, Internet access in Mexico is one of the most expensive in Latin America. What's more, the growth of digital services providers (be it in e-commerce or mobile banking) in Mexico has trailed that of its Latin American counterparts—in large part due to a complex regulatory framework. Digital service providers are subject to many regulators—IFT (Federal Telecommunications Institute; Instituto Federal de Telecomunicaciones), COFECE (Federal Economic Competition Commission; Comisión Federal de Competencia Económica), PROFECO (Office of the Federal Prosecutor for the Consumer; Procuraduría Federal del Consumidor)—which translates to high transaction costs to operate in the Mexican market.

Challenge 4: Shortage of skilled labor

Companies often paint a sobering picture of staffing capabilities for their potential plant, presenting a fourth challenge to market entry: human capital. As many as 65 percent of companies in Mexico, particularly in the technology sector, report difficulty finding employees with the necessary skills to fill vacancies. The causes behind the shortage of skilled labor are, on the one hand, a mismatch between skills acquired by students in higher-level institutions and the demands of companies, and a sheer lack of qualified labor. Regarding skills mismatches, 30 percent of science, technology, engineering, and mathematics (STEM) graduates remain unemployed, indicating that a degree in STEM is not necessarily required for employment. Moreover, while in the northwest 10.4 percent of employees hold STEM degrees, only 2.8 percent of employees hold similar degrees in Mexico's southern states, pointing to a pronounced lack of skilled labor in that region. Moreover, in the Organisation for Economic Co-operation and Development, Mexico has the lowest share of young adults (twenty-five to thirty-five years old) with vocational education and training—also called technical education. To produce its semiconductors, many US-based companies require a force of skilled laborers, from engineers managing the plant to employees supervising the manufacturing processes.

Challenge 5: Unreliable water supply

The large amount of water companies would require running their production plants leads to the next challenge: Mexico's water stress. Unfortunately, the situation has only become more acute due to climate change, uncontrolled urban growth, and lagging infrastructure. In March 2023, Mexico's water agency, CONAGUA, warned that nearly half of Mexico's municipalities were experiencing drought. Also in 2023, President Andrés Manuel López Obrador's government canceled contracts of companies trying to move their water-intensive plants to the north, adding a layer of political risk to an already fraught set of circumstances. Southern Mexico, less prone to drought, saw its water infrastructure damaged by heavy rainfall in 2023. Companies must be advised to work with the regional government and municipalities to guarantee a stable water supply.

These challenges, derived from consultations with business leaders and policy experts, are faced by hundreds of companies seeking to relocate their supply chains to Mexico. The relocation of plants would create thousands of well-paid jobs across Mexico. Large investments like these also have ripple effects that spur social development across communities and offer opportunities, for example, to the seamstress who supplies a company's work attire or the entrepreneur who opens a restaurant in front of the new plant. Investment in Mexico's southern states also has the potential to lessen regional disparities and offer more prosperous conditions for Mexicans living outside of the industrial corridors. However, for a new Mexican administration to be able to attract and channel investment, understanding the practical challenges facing interested companies is the first step toward crafting appropriate policies and programs that should be implemented. Unlocking the willing, if hesitant, sources of investment will boost Mexico's economic growth and social development while also benefitting North America writ large.

Pathways forward

Provide legal certainty for economic actors

The USMCA provides the necessary framework to attract investment to Mexico. For instance, its labor rules give investors more certainty about what standards will be expected when entering the market. However, for rules to provide the legal certainty they intend, actors must abide by them.

The next administration could take concrete steps to strengthen regulatory certainty and boost enforcement capacity. To achieve the former, the Mexican government should implement predictable regulations for the energy sector, minimizing discretionary interventions and policy changes that create uncertainty for investors. This would enhance trust and encourage long-term investment in transportation and energy infrastructure projects. To the extent possible, attempting to harmonize regulatory frameworks with the United States and Canada is important. To achieve the latter, it is imperative to invest in strengthening the capacity of regulatory agencies to enforce regulations and ensure compliance with USMCA provisions effectively. Boosting and appropriately allocating resources to regulatory agencies would help address concerns about unfair practices—especially around labor laws—and create a more stable investment environment.

Finally, promoting a high-level, regional dialogue on gradually tweaking and revising the USMCA would provide an opening for reform ahead of the 2026 sunset clause—and avoid the likelihood of a "blanket" overhaul of the agreement. Fostering dialogue and collaboration with the United States and Canada on potential updates to the USMCA and building consensus on changes that enhance the agreement's overall effectiveness and attractiveness for investors would provide that opening—and the recently resurrected North American Leaders' Summit is a good platform for doing so. As part of this dialogue, the expansion of USMCA via the inclusion of additional Central American countries should be considered.

Modernize the electricity grid and increase competition in the energy sector

Overcoming electricity shortages is imperative to attract new production plants to Mexico. To relieve an overburdened electricity grid, it is necessary to expand and modernize the grid, empower the competent authorities—CENACE (National Center for Energy Control; Centro Nacional de Control de Energía) and its subsidiary production company, CFE Transmission—and add more storage capacity. A good start would be a joint definition of the annual modernization program for the national transmission grid between CENACE, which exercises control over the national electric system or SEN (Sistema Eléctrico Nacional), and CFE Transmission, whose task is to carry out the necessary activities to transport electricity from the places where it is generated to consumption centers.

Mexico also needs to improve its natural gas infrastructure to increase energy reliability. Natural gas is widely recognized as a transition fuel necessary to achieve the energy transition, as it produces less emissions than coal or oil. To that end, investment in pipelines and implementing a natural gas storage policy will be crucial to achieving a reliable supply of energy. Introducing an energy and natural gas storage regulatory framework to encourage private companies to invest in energy storage would, for example, permit these companies to remove the burden from the electricity and natural gas grid. Regulatory uncertainty around storage has resulted in an insufficient investment in energy storage projects.

Lastly, to enhance investment in renewable energy, the federal government must increase competition in the energy space by addressing regulatory and bureaucratic burdens on private renewable projects. A reassessment of the CFE's (Federal Electricity Commission; Comisión Federal de Electricidad) importance in investing in new power plants (as warranted by the 2021 Electric Industry Law) and empowerment of the CRE (Energy Regulatory Commission; Comisión Reguladora de Energía) to clear the backlog of companies trying to obtain power-generation permits would be a good starting point. These regulatory and bureaucratic burdens have slowed private investment in large-scale renewable energy projects.

Improve public-private collaboration on transport infrastructure and increase competitiveness of the digital economy

While the current government has prioritized transport infrastructure and has started many such mega projects, filling the critical logistics infrastructure gaps will necessitate better collaboration with the private sector to complement state-led development. Such collaboration would allow the country to reach its financing goals for infrastructure and warrant an efficient selection of infrastructure projects while alleviating the government's fiscal balance. But first, investment in infrastructure must be an attractive proposition. A private company entering an infrastructure process faces a high economic and organizational cost, and preparing the bids is complex. There is a lack of information regarding infrastructure projects: no public feasibility studies or comprehensive databases indicating which projects are being prepared, their general characteristics, or the amounts and terms of the bidding process. Improving access to relevant information and streamlining the bidding process to reduce costs for private bidders would certainly have a positive impact.

To attract outside companies, Mexico must offer a competitive digital economy. On the one hand, this means delivering competitive broadband and 5G connectivity. In line with the 2013 telecommunications reforms, the Mexican government should prioritize updating its regulatory framework to align with the technological demands of companies entering the market. This should include revisiting and refining regulations on spectrum fees to ensure an even playing field for all telecom providers. Beyond that, it is imperative to strengthen the regulatory authority of the IFT, which has been a key factor in making the market more competitive and lowering the cost of telecommunications for Mexicans. On the other hand, Mexico must offer a streamlined regulatory framework for digital service providers. To do so, a federal digital strategy should be considered, according to which the various agencies that regulate digital service providers are given clear jurisdiction and regulatory roles, and overlapping regulatory responsibilities are avoided.

Improve access to and design of vocational education programs

Mexico suffers from a shortage of skilled labor, especially in the south, and it is imperative to align the skills taught to students with the demands of businesses. A positive example of the latter is the 2023 agreement from the High-Level Economic Dialogue between Arizona State University and the Mexican Secretariat of Foreign Relations on establishing an alliance between US and Mexican universities and semiconductor manufacturers to train workers.

In addition, Mexico must strengthen its vocational education programs and lifelong learning programs for mid-career professionals as an alternative to academic degrees. Vocational programs provide the ability to respond fast and flexibly to labor market needs. They are proven to have high graduation rates and labor market outcomes across the Latin America and Caribbean region. Mexico's next administration would be advised to increase subsidized vocational education programs in public and private institutions and provide financial aid to students in critical fields (e.g., technology manufacturing). Mexico currently provides little to no financial aid for vocational training. It would also be smart to reframe the regulation of these programs, so the curriculum is designed to improve labor market outcomes by tailoring it to companies' needs, rather than ex ante regulation of program inputs. Close collaboration with private companies on curriculum development is essential to the process.

Centralize water regulation and improve the financial stability of water operators

Water shortages have been exacerbated by climate change, but Mexico's water shortages result from its inefficient water infrastructure, distribution, and treatment systems. For example, faulty water distribution in metropolitan areas leads to 45 percent of the water being wasted via leaks. The country's dams, aquifers, and water treatment plants are outdated and need an overhaul. Of the three thousand nine hundred and sixty wastewater treatment plants, nearly a third (over one thousand three hundred and thirty) are not operational, as municipal authorities do not have the resources to pay for the energy required to run them. In fact, 99 percent of operators charged with water distribution services in Mexico operate under technical and financial bankruptcy. This is shocking, but also not surprising, considering that municipalities—chronically underfunded in Mexico—are tasked with the water distribution service.

Consequently, increasing the budget for water projects at the federal level should be made a priority. The federal government should strive to meet the United Nations' recommendation that at least 1 percent of the national GDP be directed toward water-related issues. Mexico currently invests approximately 0.3 percent of its GDP in water projects.

Yet another challenge is that with thousands of individual operators and in the absence of a federal water regulator (CONAGUA is responsible only for water concessions), no coordination or benchmarking mechanism applies to the entire country. The future administration should therefore consider creating coordinating entities at the federal or state level—for example, by centralizing water regulation, information gathering, and goal setting for water operators, such as passing the Ley General de Aguas (General Water Law).

CONCLUSION

With the 2024 elections and a new administration to take office in October, Mexico is in the global spotlight. New presidential terms are prime opportunities for governments to reassess long-term growth strategies and adjust policies and programs to improve the prosperity of their citizens. Moreover, Mexico is in a privileged position to leverage its border with the United States and deep commercial integration with the rest of North America, as warranted by the USMCA. The US-Mexico relationship is crucial for the livelihoods of millions of individuals on both sides of the border. The pathways forward presented in this report have the potential to improve border efficiencies and unlock meaningful new investment in Mexico.

Beyond improving border efficiency, these recommendations can potentially reduce costs for companies operating on the border and create new jobs in Mexico. Successfully addressing the investment challenges can spur social development across communities and possibly even lessen regional disparities by offering greater prosperity for Mexicans outside of the industrial corridors. Ultimately, the pathways forward should be seen as tools a new Mexican administration could use to pursue its broader social and economic goals.

Mexico being in the global spotlight in 2024 represents an opportunity to address the country's longstanding challenges, and the new administration will be tasked with meeting the moment. This report offers actionable steps for an incoming administration to hit the ground running.

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