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Trade Deal Won't Rescue Mexico

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Mexican Finance Minister Arturo Herrera is worried about his country's sluggish economy. At the International Monetary Fund meetings in Washington in October, he urged Congress to pass the U.S.-Mexico-Canada Agreement to pull his country out of its slump: "It would clearly be an incredible stimulus."

Mr. Herrera rightly observed that uncertainty is a drag on the economy. But he's wrong that passing the USMCA—or even preserving the North American Free Trade Agreement—would cure Mexico's economic anemia. A resolution of the rules for North American trade is a necessary but insufficient condition for spurring Mexican growth.

Mexico is unlikely to recover absent greater investor trust, both foreign and domestic, in President Andrés Manuel López Obrador's government.

Since taking office a year ago, AMLO, as the president is known, has undermined confidence by steadily eroding the independence of the country's democratic institutions and the rule of law. He is politicizing the Supreme Court, regulatory agencies and the independent electoral authority, and he has used his power to rewrite contracts. The AMLO message is that the law is whatever he says it is.

Mr. López Obrador is an old-fashioned corporatist who longs for the Mexico of the 1970s, when there was one-party rule and extensive state ownership of the economy. So it seems to be the mother of all ironies that he is endorsing the renegotiated trade pact. But in fact, the USMCA—or even preserving Nafta—would allow Mr. López Obrador to maintain a dual-standard economy: one set of rights for international investors, a more limited set for Mexicans.

The USMCA hit a snag last week when Democrats tried to insert into the agreement new enforcement provisions for labor regulations. The new phrasing reportedly would allow for unilateral cross-border inspections by the U.S. when there are allegations of labor violations in Mexico. This wasn't in the USMCA agreement signed in November 2018 by all three countries.

"We said no. That is, inspectors no," Mr. López Obrador said. "But yes to resolving disputes through the creation of what are called panels involving specialists proposed by the countries under equal conditions."

A compromise remains possible, as Mr. López Obrador is well aware of the damage Donald Trump can inflict on the Mexican economy if the U.S. president decides Mexico isn't falling in line.

Yet while not getting the deal done can hurt Mexico, passage alone won't reverse faltering investment and growth. Even for foreign investors, the new agreement is suboptimal. It says that Mexico must compensate foreigners if it expropriates their property. But if Mexico engages in an indirect expropriation equivalent to a taking, only five "sectors"—oil and gas, power, transportation, telecommunications and highway infrastructure—are protected. Any other investment, notably manufacturing, is out of luck.

Mexican investors get even less protection. When they are subject to a taking, in any industry, they must litigate in a Mexican court. And there's the rub.

Writing on Dec. 2 in the Cato Policy Report, Roberto Salinas-León laid out AMLO's first-year record of wielding discretionary power. One of the more chilling developments is a new law that "categorizes fiscal evasion and noncompliance as organized crime." This allows the government "to seize assets of a presumed guilty party, freeze bank accounts, assign an immediate jail term and sell forfeited assets and property at any price."

The ratio of direct investment to Mexican gross domestic product is only around 22%, too low for a country that hopes to grow out of poverty. What is more, only about 3 percentage points of that come from foreigners. More than half of it comes from households and mom-and-pop enterprises, and from domestic companies other than the 60 largest. In other words, Mexicans are crucial suppliers of investment. Yet Mr. López Obrador's arbitrary decisions are damaging their confidence.

AMLO's capriciousness against business exacerbates a longstanding problem that Mexican economist Luis de la Calle calls the extortion economy. From the guy you have to pay not to vandalize your car when you park on the street to the terror of organized crime, Mexicans regularly face extortion.

The biggest extortionist is the government, Mr. de la Calle writes in a forthcoming book, "Extortionomics." Big business has the resources to defend itself from the state. Small and medium-size businesses instead "opt for not reaching their full potential given that they become more vulnerable to extortion when they achieve a certain level of success."

Mr. López Obrador and Mr. Trump may get a new trade pact. But on present course AMLO'S thirst for power makes him the Mexican economy's worst enemy.