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Mexico Takes a Bad Brazilian Turn

A protectionist breakout threatens Peña Nieto's economic reform agenda

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Less than a month after Mexican President Enrique Peña Nieto took office on Dec. 1, 2012, his government suspended for one year scheduled tariff reductions on shoes imported from China. A year later the tariff cuts were suspended again. Twelve days ago, Finance Minister Luis Videgaray announced that there will be no reduction of the 25%-30% Chinese shoe duties during the Peña Nieto government.

On a trip to Leon, the shoemaking capital of Mexico in the state of Guanajuato, Mr. Videgaray also announced that the government would assign a minimum import value to all shoes from China and give new subsidies to local footwear manufacturers. In other words, he has raised taxes on low-income consumers and agreed to channel scarce resources to politically powerful special interests.

Within a few days, textile producers and apple growers began asking for their own handouts.

To his credit, Mr. Peña Nieto has spent significant political capital to reform the constitution to allow private investment in Mexico's energy sector, promote competition in telecom, and introduce accountability in public education. So it's tempting to dismiss the shoe duties as a venial sin committed by an otherwise virtuous, reform-minded administration.

Enrique Peña Nieto *Getty Images*

But structural reforms in a few key sectors will not have their desired effect if economic freedom is not more broadly promoted. On that score the Peña Nieto government is coming up short. From fiscal policy to trade and regulation, the evidence is mounting that the first PRI government in 12 years seeks to restore the centralization and bureaucracy that made the party so powerful in the 1980s and also made Mexico so poor.

Brazil illustrates the dangers. It deregulated telecom and energy more than a decade ago. That brought a lot of foreign capital to the country but did not transform the economy.

It may even have slowed things down. The Brazilian political class saw no reason to incur the costs of further liberalization when the world was pouring dollars into new deep-water oil concessions. It ignored the pain inflicted on entrepreneurs by a suffocating tax and regulatory framework, subsidies and protection for uncompetitive domestic manufacturers, and the wholly politicized development

bank, even while it trumpeted a new phase of development. The so-called Brazilian breakthrough quickly turned into the Brazilian bust.

Mexico has free-trade agreements with 44 countries, including the North American Free Trade Agreement with the U.S. and Canada. This puts it light-years ahead of Brazil in opening. But it is still a long way from becoming a vigorous free-market economy. Mr. Peña Nieto has raised expectations by talking about the aim of faster growth. But he's not always walking the walk.

No one doubts that, warts and all, the new laws governing energy could bring tens of billions of dollars in fresh capital to Mexico. Yet elsewhere and below the headlines *el diablo* lurks. A truly free market in telecom would imply putting the 700 megahertz spectrum—crucial for mobile broadband—on the auction block without any restrictions in technology and service usage. Instead the government has set it aside for "public-private partnerships," which in countries with a weak rule of law can also be known as "taking care of my friends."

It's true that Mr. Peña Nieto has had to do some horse trading with special interests to get his large structural reforms through. But that cannot explain bad decisions that were not part of the bargaining and are certain to undermine growth.

In 2013, Mr. Videgaray engineered a fiscal reform that imposed new taxes on capital and dividends and progressively higher income-tax rates for anyone earning more than $38,000. The heavier tax burden came with new entitlement spending and a return to fiscal deficit.

The finance minister is promoting government credit allocation, always a bad idea, by expanding the role of the largest "development" bank. Earlier this year a Videgaray-inspired antitrust law gave the government the broad power to punish companies for the crime of being more successful than their competitors.

The stellar Mexican economic reform of the past 20 years is trade opening. Beyond its many free-trade agreements, the country had been unilaterally lowering trade barriers, signaling that the intellectual case for giving consumers choice through competition had been won. Trade policy was moving in the direction of Chile and away from protectionist Brazil.

Now the government is messing with that too, as shown by its decision to extend protection to the shoe industry. Backing off scheduled tariff cuts suggests that the industry is flagging, but in fact the ministry of finance reports that from 2009 to 2012 the number of shoe and leather jobs grew by almost 8,000 to 125,464.

Mr. Videgaray's decision is capricious and political. Guanajuato has been a stronghold of the opposition PAN for many years and the PRI would like to win it back. I get that. But at what cost to Mr. Peña Nieto's legacy as the man who changed Mexico?

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