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PROPERTY RIGHTS, OPEN TRADE, AND PROSPERITY: THE CASE OF MEXICO

CASE STUDY BY: **ATLAS NETWORK**

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"El respeto al derecho ajeno es la paz."[1]
—Benito Juárez, president of Mexico 1858–1872

1

INSTITUTIONAL FRAGILITY IN THE AMLO ADMINISTRATION

Mexico has experienced dramatic strides in structural transformations in the past quarter century. The pace of change developed a markedly different world from the crisis-ridden country that emerged in the aftermath of the generational cycles of debt, runaway inflation, and devaluation. The recognition of rapid technological disruption, and increasing competitiveness in attracting productive capital flows, led to a wave of pro-market economic reforms, with an emphasis on open borders in international trade and constitutional changes to allow competition and private investment in the energy regime. Mexico was ripe for a great leap forward in revamping a fragile system of rule of law and becoming a credible story of newfound prosperity.

This "paradigm shift" came to an abrupt halt with the administration of Andrés Manuel López Obrador (AMLO), the authoritarian populist who was sworn into office in 2018.[2] His performance in the past five years reflects an adherence to toxic policy proposals, a disdain for independent checks and balances, and a marked degree of intolerance of any view that is inconsistent with his preconceived belief of a society governed by autarky, *dirigisme*, and centralization of political economy decision-making. A salient victim of AMLO's self-proclaimed "Fourth Transformation" agenda has been the wanton disregard of property rights, alongside a list of ideological aims and claims for massive redistribution of wealth, broad-based expropriations to advance his wish-list of pet projects (such as the oil refinery in the port of Dos Bocas or the 1950s-inspired railway in the Mayan peninsula) and a full-scale onslaught against what he characterizes as Mexico's "long neo-liberal nightmare" during the period 1988 to 2018.

The fundamental problem facing the future of a free society in Mexico is that AMLO's extended popularity and the mantra of presumed moral infallibility give rise to the threat that he will wield the program of his Fourth Transformation to deconstruct many of the hard-won market reforms that took place in the past quarter century, including multi-lateral trade liberalization, the slow (if erratic) development of checks and balances, the climate of price stability, and crucially important achievements in energy opening.

The emergence of centralized decision-making is characterized by a mix of ignorance, intolerance, and resentment. AMLO has also decreed the (ab)use of sham popular consults or plebiscites to decide the outcome of major initiatives, such as halting the construction of a new airport in Mexico City or the development of an exceedingly costly oil refinery in his home state of Tabasco. This strategy has enabled AMLO

[1] "Respect for the rights of others is peace."

[2] For a summary of this development, see Salinas León, Roberto, "AMLO and the 'Fourth Transformation' in Mexico," *Cato Policy Report*, November-December 2019, Vol. XLI, No. 6.

to consolidate a powerful and effective link between his popularity and public policy decisions purportedly legitimized by the "wise and noble" peoples of Mexico. Nationalist zeal and the vanity of instant redemption represent a new criterion for policy action, taking precedence over cost-benefit analysis or the imperative to improve a long-term climate of productive investment. The ensuing damage has escalated to a growing list of violations of property ownership rights—in energy, mining, land titles, manufacturing concerns, and even global trade.

Notwithstanding the enthusiasm surrounding the advent of "near-shoring" (or "friend-shoring"), especially in northern states, there is little or no recognition of the role that a reliable system of well-defined property rights plays in the consolidation of an attractive and competitive investment regime. This failure effectively belies the promise of a new wave of productive investment, as companies and concerns seeking to relocate "close to home" within the North American region are forced to confront confidence-killers such as arbitrary expropriations, regulatory extorsion, or downside renegotiations of long-term existing contracts—despite the extraordinary increase in global trade since NAFTA (now USMCA) initiated in 1994.

Near-shoring is, in principle, a credible promise. Mexico's 30-year-old membership in North American regional trade and supply-chain integration has opened a reliable alternative to attract new investment, in the wake of the massive disruptions in supply chains occasioned by the Covid-19 pandemic, the mandated lockdowns across the globe, and the continued geoeconomic conflicts between the U.S. and China. Again, in principle, preliminary numbers suggest that the relocation of assorted projects could represent an inflow of almost $20 billion USD in productive investment, especially in manufacturing, infrastructure, tourism, and throughout the energy sector.[3] So far, however, the majority of productive capital has come in the form of reinvestment in established initiatives to increase production capacity, particularly in industrial parks in cities like Matamoros, Monterrey, Guanajuato, Querétaro, and Tijuana. The (vast?) majority of an otherwise remarkable window of opportunity for securing new investment is finding a safer haven across the southern belt of the U.S., especially states such as Arizona, Texas, and Mississippi.[4]

The obvious question is: why? Perhaps Acemoglu and Robinson are correct that the prevalence of extractive institutions over inclusive institutions (including respect for a well-defined legal structure of property rights) threatens to keep Mexico from generating a material difference in long-term prosperity.[5] The origin of the "uncertainty problem" facing the country goes beyond the highly counterproductive antics of AMLO's illiberal populism and "caudillo"-style way of doing business. Indeed, the fundamental source of uncertainty derives from the absence of a framework of sound property ownership rights and the institutional fragility embodied in the so-called economic chapter of the 1917 Constitution, which endows the federal government with a *de facto* blank check to limit, regulate, and seize property in the interests of "national sovereignty."

[3] Noguez, R. (2023, July 10). "Nearshoring: Parques industriales esperan la llegada de 453 empresas en 2024 y 2025." Forbes México; and Economía, (2023, May 21); "Más de 18 mil millones de dólares de Inversión Extranjera Directa de enero a marzo de 2023." Gobierno de México. Retrieved July 23, 2023, from https://www.gob.mx/se/prensa/mas-de-18-mil-millones-de-dolares-de-inversion-extranjera-directa-de-enero-a-marzo-de-2023.

[4] Casanova, R. (2022, December 14). "The CHIPS Act Has Already Sparked $200 Billion in Private Investments for U.S. Semiconductor Production." Semiconductor Industry Association.

2

PROPERTY RIGHTS AND MEXICO'S PROSPERITY CONUNDRUM

Despite Mexico's success with pro-market structural reforms in the period 1988–2018, and despite visible macroeconomic accomplishments in the same period, the country remains a conspicuous under-performer in overall growth and in income per capita. There is a robust discussion in public discourse on the causes and consequences of this "prosperity conundrum." According to the *International Property Rights Index of 2022* published by the Property Rights Alliance, Mexico ranks 77 out of 129 countries. This marks a decline from its previous ranking of 73, with a score of 4.6 on a scale of zero to ten, as compared to the prior score of 5.3.[6]

As Manuel Sánchez explains, Mexico's per capita income performance during the past 40 years reflects, at best, a "modest" development—an annual increase, in constant terms, or merely 0.5% per annum.[7] A more adequate characterization would be "mediocre." This is a very disappointing datum in light of the high expectations for future progress and prosperity that had emerged in the wake of reforms designed to transform the economy into a pro-growth economy with a storyline of how free markets and free trade lead to episodes of greater enrichment.

There are myriad hypotheses that have been advanced to explain the chronic weakness in Mexico's indicators of overall prosperity. One seemingly plausible account is that the nation has experienced a sharp division between territories tightly linked to the competitiveness demands of international trade (for example, Nuevo León, Queretaro, and Aguascalientes, among others) versus territories that have remained isolated from the potential benefits of open trade with the rest of the world (for instance, Chiapas, Guerrero, even the strategically crucial state of Veracruz).[8] Another popu-

[5] Acemoglu, D., and Robinson, J. A. (2012). *Why nations fail: The origins of power, prosperity, and poverty.* Crown Publishers.

[6] Property Rights Alliance (2023). *Mexico. International Property Rights Index*. Retrieved August 18, 2023, from https://internationalpropertyrightsindex.org/country/mexico.

[7] Sánchez, Manuel (2023). "El modesto progreso económico de México." El Financiero, July 12, 2023. As the author notes, simple calculations reveal that, if the mentioned rate of growth continues, it would take Mexico a total of 142 years to double the real level of average income of 1982. In contrast, their respective rates of progress have allowed the United States to double its GDP per capita in 39 years, practically the period contemplated, while Korea has achieved it every 14 years, almost three times during that period.

lar claim suggests that low productivity in labor markets, occasioned by visible education deficiencies, the growing prevalence of extra-legal markets, and widespread corruption, lies behind the meager results in progress and prosperity.[9] Yet other views express a need for greater state intervention in the form of a revamped industrial policy, in order to "nudge" investment concerns in sectors and regions in need of greater "development."[10]

All of these explanations, however, either beg the question of the origins of the wealth of nations or fail to address key underlying institutional factors. None of them mention the uncertainty that runs throughout the structure of property rights, even less Mexico's need to embark on long-term changes to revamp its system of rule of law in order to support the sustainable growth needed to increase productivity and absorb an expanding labor force. Everardo Elizondo, former vice governor of the Bank of Mexico, and one of Mexico's most distinguished policy commentators, encapsulates the main challenges in a compelling explanation of Mexico's subpar performance in the past quarter century. As he states, "the real causes of low growth" in the Mexican economy are threefold: (1) insufficient investment in human capital and physical capital; (2) a corresponding slowness in the absorption of modern technologies; and (3) ***"the truly critical factor: an inadequate institutional structure, that imposes high transaction costs on economic agents, impeding them from fully realizing their productive potential."***[11]

Nations with higher productivity rates tend to produce higher per capita income. The secular trend in labor productivity reveals a discouraging scenario, which has magnified during the course of the AMLO regime: in the past two decades, the levels of productivity exhibit a falling tendency, despite isolated upward adjustments. The structural decline in productivity is, according to this analysis, the result of "higher transaction costs" that ensue from deficiencies in the institutional framework. In particular, contract enforcement, property rights protection, and monopoly privileges in key sectors have exerted a significant drag on productivity, and ultimately on potential prosperity. The finance sector, for instance, is hampered by issues with contract enforceability and systematically poor response to nonperforming loans. The fundamental source of the credit problems in the financial system is of extra-financial origin: the lack of trustworthy judicial underpinnings for contract enforceability. The difficulty surrounding the seizure of assets on defaulting debtors is notorious—a structural flaw stemming from delays in the adjudication of commercial disputes, corruption, and biased enforcement of decisions.

As demonstrated below, these problems and "high transaction costs" stem from the institutional weaknesses of an ill-defined system of property ownership rights, which empower the executive with the constitutional wherewithal to centralize all economic decision-making, and, alas, do as the ruling polity wishes. This has been dramatically confirmed by a set of unfortunate misadventures during the AMLO presidency.

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[8] Rubio, L., and Remes, J. (2014, April 1). "The Two Mexicos." McKinsey.

[9] *The Economist*, "Why are Latin American workers so strikingly unproductive?," June 8, 2023.

[10] Rodrick, Dani. "Focus on Productivity, not Technology." *Project Syndicate*, July 7, 2023.

[11] Elizondo, E., and Garza, J. G. (2023, May 29). "Tres notas y una errata." EGADE. Retrieved July 17, 2023, from https://egade.tec.mx/es/egade-ideas/opinion/tres-notas-y-una-errata.

3

"ADIOS" TO AN OPEN SOCIETY?

AMLO's assault on Mexico's checks and balances reflects a creed in a uni-personal project, where reality must adapt to the prevailing imperial will. To this end, from the very outset, AMLO's government set out a deconstruction of Mexico's evolution toward an open society—in the name of autarky and national sovereignty. This has entailed a major setback for addressing "inadequate institutional structures" that significantly hinder the productive potential of economic agents.

THE CANCELLATION OF THE NEW AIRPORT

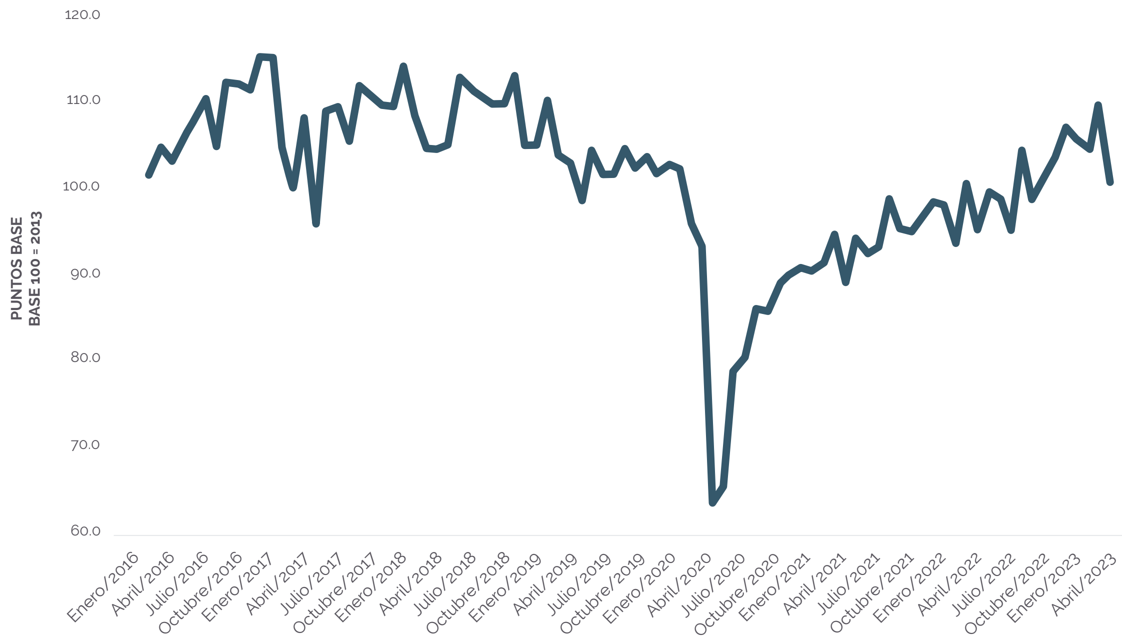
The leading example of AMLO's assault on any rudimentary notion of individual property rights involves the unbelievable decision to cancel the construction of the new international airport in Mexico City—a $13 billion USD project that was expected to compete with the most important airfields in the world, rivaling Miami or Panama in terms of global logistics and connectivity.

The project was initiated by the Peña Nieto administration and was supposed to conclude in 2021. The financial architecture was based on a public-private partnership, where financing would be secured through private bond placements, issued via a national REIT-like trust, that used the country's investment grade sovereign rating to underwrite the global placement of the medium- and long-term paper in financial markets.

In October 2018, still as president-elect, AMLO held the first of his capricious referendums—and the final vote was, unsurprisingly, to halt construction of the new airport in Texcoco; and, to opt instead for the development of a new strip in the military base of Santa Lucía, some 25 miles away. Already, $5 billion USD had been poured into construction and development, and while delays had ensued, the project was around 35% complete. AMLO had been approached by a group of private parties prior to the fateful consult, who had manifested a willingness to absorb the full weight of all termination costs and outstanding commitments. Such proposals were met with deaf ears—"Let's see first what the people have to say."

AMLO had inveighed against the new airport as an example of corruption and crony capitalism, a monument to ostentation and the injustices of "neo-liberalism."[12] The hope was that, if elected, he would cease and desist the nonsensical pledges to ditch the Texcoco project and choose to start anew in the Santa Lucía base. After the decision was taken, and well before formally assuming office, AMLO forewarned that the country should assimilate the modus operandi of the incoming government and become accustomed to a "new normal" of direct consultation with "the people" (even if all such consults to date have been based on, alas, 1% of the relevant demographics). A rattled investor community became understandably wary, questioning whether this could apply to constitutional changes to allow for everything and anything (a la Hugo Chavez), or an open license to expropriate private investment in the energy sector, or whatever the new imperial ruler deemed at any given moment.

The following graph dramatically exhibits the damaging effect of the presidential whim to cancel such an important initiative—namely, the collapse of confidence in the investment regime, derived from the discretionary and willful expropriation of property titles. The arbitrary violation of pre-existing contracts, based on a self-serving referendum, generated a signifi-



Monthly Indicator of the Formation of Fixed Gross Capital (01/2016 – 04/2023)[13]

[12] Groot, M. (2022, March 17). "The long road toward building a new airport for Mexico City." Airport History. Retrieved July 28, 2023, from https://www.airporthistory.org/mexico-city-new-airport-history-en.html.

[13] Own elaboration with information from INEGI. (2013). *Inversión Fija Bruta*, Base 2013. Retrieved July 28, 2023, from https://www.inegi.org.mx/temas/ifb/#Tabulados.

cant contraction in the formation of fixed gross investment. New construction projects and capital markets experienced a sudden stop, with an immediate spike in premiums. The climate of investment is still shaken by remembrances of things past, which has thwarted the ability to capture greater levels of productive capital flows, even despite the positive historical opportunity represented by near-shoring shifts in the global geoeconomic map.

This, in turn, has exacerbated the country's prosperity conundrum and ruled out the possibility of transforming the Mexican economy into one of the most competitive strategic hubs for trade and investment in the world. There are no assurances, beyond a crony capitalism relationship with the ruling elites, that property rights will be respected. In turn, this has aggravated the predicament of attaining higher levels of growth, especially as countries struggle to find a more secure footing in the post-pandemic recovery period.[14]

The formidable cost of the cancellation goes beyond the $5 billion that had already been channeled during the previous administration. As the bondholders had a long-term pledge at stake, the new government could not formally terminate the development or halt construction *until all bondholders were redeemed* (at par, plus expected return). The total bill for the latter was superior to the executed investment—over $7 billion USD. In addition, 42,000 direct jobs were literally handed a pink slip. Finally, an additional payable had to be allocated to undertake the development of a refurbished airport in the Santa Lucía military base—a signature "white elephant" that now operates at around 20% capacity and at a loss absorbed by taxpayer receipts, called Aeropuerto Felipe Angeles.

But the unseen costs significantly surpass visible losses. In other words, an opportunity to develop productive supply chains across several sectors (education, retail, food and beverage, hotel and lodging, real estate, transport, and much more), associated with a newly functioning airport, was foregone overnight.[15] The long-term revenue stream from airport user duties defies commentary—some $145 billion USD in foregone gross fiscal income in net present value terms.

The obvious question still remains: why make such an irrational decision? The prevailing theory is that the immense cost of the ideological whimsy to cancel the new airport was a way of sending a powerful signal that the so-called Fourth Transformation constitutes an irreversible paradigm shift.

In sum, this disastrous episode raised eyebrows worldwide regarding the credibility of the AMLO administration to honor contractual commitments and acknowledge property ownership rights. A replica of the same maneuver was instrumented a year later, in the industrial city of Mexicali across the Rio Grande border, with the sudden and shocking cancellation of a $1.9 billion USD beer manufacturing establishment developed by Constellation Brands, where over 50% of the planned investment had already

[14]For an extensive account of the policy challenges in the post-pandemic recovery period in Latin America, see collection of essays in Atlas Network's "El Balance de la Pandemia Covid 19 en América Latina y los Desafíos a Futuro," ed. Salinas León, Roberto and Schwarz, Gonzalo, Center for Latin America, May 18, 2023. Retreived from https://www.atlasnetwork.org/articles/covid-19-essays.

[15]Grey, E. (2017, September 10). "Airport economics: how much value does a hub really hold?" *Airport Technology*.

been assumed. The formula was, again, another sham popular consult. The "voice of the people" took precedence over property rights.

THE MAYA TRAIN

Another project submitted to a manipulated popular consult was the approval of the construction of a multi-state train in the Riviera Maya, stretching across Yucatán, Quintana Roo, and Campeche. No cost-benefit analysis or corresponding environmental impact assessments were required. This enterprise turned out to be yet another instance of what has been labeled as the "despotism of occurrences." Yet AMLO has stated, axiomatically, as with other projects: "va, porque va" (it goes because it goes.). This reflects the deeply authoritarian dimension of AMLO's statist populism and the fatal conceit of presuming to know, *ex ante*, what is best for all citizens of the country. Feasibility studies, cost-benefit analysis, and technical assessments were summarily dismissed as pillars of a "neo-liberal" *ancien regime*, mere smokescreens of corporate special interests.

The Maya train embodies a clash between the facile romance of political nostalgia versus the hard facts about the independent costs and benefits of such an "occurrence." Over 100 expropriations of personal land[16] have been engineered, without due process (including willfully ignoring a number of judicial injunctions to cease and desist), in the name of the public interest.

The Mexican Institute of Competitiveness, or IMCO, unveiled a feasibility diagnostic of the Maya train, where the findings reflect the aforementioned clash—namely, a projected cost of four to ten times the amounts estimated by the government.[17]

In the end, landowners and the taxpaying community will shoulder the final bill, whatever the cost, even while AMLO's justification for taking away people's territory and investing other people's money in one of his ideological pet projects is that, well, it goes … because it goes.

AN OIL REFINERY IN DOS BOCAS

Yet another example of this self-serving form of governance is the decision to develop a new oil refinery in the port of Dos Bocas, in AMLO's southern home state of Tabasco. The project was also submitted to a "yes or no" direct referendum, in a predictably biased questionnaire—without the benefit of a feasibility study or the support of a specialized cost-benefit analysis. No open auction was put forth, and only four companies were invited to submit bids in a restricted tender. All four companies subsequently retired bids, as the time and financial requirements imposed by AMLO were deemed unreachable.

The government originally estimated that the new refinery would cost around $8 billion USD and would be completed over three years. The basis of the decision is still repeated ad

[16] *Animal Político*. (2023, August 8). "Nuevas expropiaciones para el Tren Maya: Ahora fueron 150 hectáreas en Quintana Roo y Campeche."

[17] Martínez Palacios, A. T. (2019, March 19). "Nota Técnica—Proyecto del Tren Maya." IMCO.

nauseum: that Mexico requires self-sufficiency in refined products, especially gasoline, and should seek to increase output in this part of the productive chain. This optimism constitutes wishful thinking. The current bill ascends to well over $16 billion USD, and there is no realistic timeline in sight of when this refinery will begin to, well, generate refined output.

Once again, the opportunity cost is astronomical. The extraction of crude oil by the state-run enterprise Petróleos Mexicanos (Pemex) has plummeted from 3.3 million barrels per day in 2004 to 1.5 million today. Yet, despite this manifest inefficiency (over 50% decline), crude extraction continues to enjoy a higher profit margin than the processing of refined products. It would have made far better sense to allocate scarce resources in re-capitalizing efforts to increase crude output than to waste billions of taxpayer currency on the construction of a project whose sole benefit is fulfilling misplaced ideological conceit.

After all, it is senseless to pretend to refine crude when the production curve is suffering a decline. This was the reasoning behind the energy reform of the Peña Nieto administration, particularly the emphasis on so-called *farm-outs*, where private capital investment was openly invited to bid on unexplored fields for new exploration and extraction, particularly in deep and ultra-deep waters. This activity has now been suspended indefinitely.

Moreover, there are six existing refineries in the country that operate at highly sub-optimal levels, mostly due to operational inefficiency and the lack of capital investment. Pemex is already the most indebted petrol company in the world, with over $106 billion in outstanding liabilities. In addition, the location of a new refinery in the state of Tabasco makes no strategic sense, neither in terms of logistical access to the product nor transportation to assorted supply centers. As observers have pointed out, the fantasy of Dos Bocas could turn into the absurd nightmare of having to import crude oil in order to service the nationalist whimsy of becoming self-sufficient in refined product development.[18]

The plea to re-open energy reform is construed as surrendering sovereignty, as another example of "neo-liberal" conspiracy—even though suspension of farm-outs in upstream energy represents an opportunity cost of approximately $200 billion USD in foregone productive investment over the next several years.

OTHER MISADVENTURES IN ENERGY POLICY

The cases of toxic public policy may defy commonsense economics; yet, these are merely a handful of an escalating list of misadventures. The suspension of deep water oil exploration tenders was quickly followed by a halt of auctions in electricity capacity—and with it, the loss of multi-billion sources of productive investments in renewable energy projects for electricity generation (in excess of $20 billion

[18] Cárdenas, C. (2019, March 5). "Petróleo: prioridades." La Jornada. In this article, Cárdenas the son of revered General Lazaro Cardenas, who expropriated oil interests in 1938 and ushered in the culture of energy nationalism in Mexico, published an article in La Jornada newspaper as a response to the cancelation of auctions of oil fields, wherein he offers a diagnosis of Pemex's recent failures. Cárdenas recommends the need for large capital investment in the energy sector and says that "all of the required investment *does not need to come from Pemex, but from private investment*." Moreover, he says that investment should be concentrated in extraction of crude, not in refining.

in new capital opportunities). Another significant setback ensued, namely, the decree to halt electricity reform, which entails the re-emergence of the state-owned Federal Electricity Commission (CFE) as the sole monopoly player in the electricity sector—generation, distribution, and sales. The opening of electricity generation to private participation had enhanced the quantity and the quality of supply and was beginning to help industrial ventures to lower costs. These gains reflected a real cost reduction and a structural improvement in competitiveness. The 2014 reform sought to encourage competition among suppliers and thereby promote an efficient framework for such an important economic input. In particular, the federal government has scheduled a series of auctions for long-term investments, including renewable energy projects, thereby enabling companies to amortize large capital requirements of such ventures over reasonable time frames.

This set of misadventures in energy policy form the outcome of old-style nationalism, where the priority is not to make progress possible but to attain so-called "self-sufficiency." The paradigm of the Fourth Transformation suggests that the "authentic" role of government is to distribute federal resources to targeted social groups, not to improve the conditions for sustainable wealth creation and long-term prosperity.[19] ***In this surreal utopia, everyone has a right to everything, whereas no one has an individual obligation to do anything.***

[19] For a possible way out, see our case study on the adoption of a ctitizens' fund in energy, Salinas, R., Rodríguez, M., and Navarro C., (2023). *The 2022 IPRI. International Property Rights Index.*

4

CONSTITUTIONAL "ORIGINAL SIN"

The toxic combination of intolerance, ignorance, and resentment in the matrix of policy decision-making suggests that the AMLO regime is unlikely to re-think the unfortunate policy choices that have undermined confidence. Isabel Turret has warned that the country should remain wary of the concentration of power in a highly authoritarian figure seeking to impose, come what may, a program that is "statist, protectionist, of a central planning type, against the law of supply and demand, or the law of comparative advantage—a model that has never worked, anywhere, at any time."[20]

The sound and fury of the nationalist narrative of the Fourth Transformation begs the question on the key role that well-defined property rights perform in the evolution of an growing market economy. Mexico will not be able to reap the benefits of an open economy unless it substantially revises constitutional provisions governing rights to property ownership.

The fundamental determinants of sound property rights are as follows: they must be well-defined, they must be transferable, and they must be enforceable in an impartial court system. There are widespread anomalies in the economic chapter of the Constitution (articles 25 to 28) that are inconsistent with one, or all, of these features. For instance, the text prohibits the existence of monopolies but established a highly arbitrary criterion for deciding what qualifies as a "strategic" enterprise.[21] If the ruling polity decides, say, that sector S is "strategic," then the government not only has the constitutional basis to expropriate all interests involved in S but also has the mandate to exclusively operate the entire productive chain of S. Yet, by constitutional fiat, this would not qualify as a monopoly! This is precisely the argument that the AMLO administration has wielded to "prove" that the electricity state-owned enterprise is, *de jure*, not a monopoly.[22]

As Isaac Katz and others warned over 25 years ago, the paradoxes (even absurdities) embodied in the concept of "national ownership" in Mexico's constitutional framework is a result of the "original sin" of viewing the nation-state (as representative of the social pact between governed and governor) as the originator and guarantor of property. So, the aforementioned laundry list of toxic episodes during the AMLO presidency can be genuinely construed as a constitutional crisis waiting to happen. After

[20]Turrent, I. (2018, August 5). "Las caras de López Obrador." *Reforma*.

[21]Williams, A., Dempsey, H., and Stott, M. (2023, June 4). "Mexican mining industry under threat from sweeping new regulations." *Financial Times*. Recent regulatory changes and government actions in Mexico have led to concerns among mining companies regarding property rights, legal challenges, and political stability. These factors are influencing mining companies' decisions about whether to continue investing in the Mexican mining industry.

[22]Katz, Isaac. "Protección jurídica de la propiedad privada." *El Economista*, May 21, 2023. Article 28 states, incredibly: "The functions of the State that are undertaken in exclusive fashion will not constitute monopolies, in the following strategic areas: mail, telegraphs, radioactive minerals and nuclear power generation, planning and control of the national electric system, exploration and exploitation of oil and other hydrocarbons, as well as the activities expressly signaled out by the laws enacted by Congress."

all, the economic chapter of the constitutional text all but institutionalizes the "planning of all economic activity in the name of public interest"—whatever that means.

> *Article 25. [...] The State shall plan, conduct, coordinate, and orient national economic activity, and will implement the required regulation and foment all activities that are in the general public interest, consistent with the liberties granted by Constitution. [...]*
>
> *Article 26. The State will organize a democratic planning system for national development that gives solidity, dynamism, permanence, and equity to the growth of the economy for the independence and political, social, and cultural democratization of the nation [...]*

This is precisely one of the flaws that Elizondo alludes to when he inveighs against the "inadequate institutions" that inhibit the realization of an individual's "productive potential." In the absence of proper safeguards and established procedural protocols, the government can expropriate property (as several land plots were seized, literally, to make way for the Maya train) by simply appealing to the "public interest." This constitutes a violation of individual rights and undermines the rule of law. The ambiguity of these provisions impedes the creation of a thriving entrepreneurial society.[23] The institutional fragilities in the constitutional provisions governing property ownership rights are arguably the source of widespread corruption at the level of administrative bureaucracy and the inefficiency of judicial performance. The failure to hold accountable violations of property rights represents a negative signal to the investment community and erodes trust in the legal system. Consequently, they act as a deterrent for risk-taking, innovation, and securing long-term prosperity. In addition, corruption in the legal system imposes significant transaction costs. Our claim is that these problems originate from constitutional "original sin" and the

[23]Galiani, Sebastian, et al. "Property Rights and Economic Growth: Evidence from a Natural Experiment." *The Economic Journal*, vol. 115, no. 505, 2005, pp. 505-517.

failure to establish a well-defined criterion for property ownership.

In general, the Constitution of 1917 represents a culmination of modern Mexico's peculiar notion of property rights. The framework endows the nation-state with broad powers as the *originator of property*, and the sole decision-maker as to who gets what and in what fashion (or "modality"). The (in)famous article 27 is a direct result of this version of open "original sin," where property of soil, sub-soil, and waters is decreed to belong to the Nation, which, through its political representation, assigns a specific "modality" for uses of said (nationally owned) property to entities or individuals. So seen, the ruling government cum nation-state can, literally, do whatever it wishes.

> *Article 27. The ownership of lands and waters within the limits of the national territory corresponds to the Nation, which has the right to transfer ownership to individuals, constituting private property.*
>
> *This may not be expropriated except for reasons of public interest and through compensation.*
>
> *The Nation will have the right to impose the modalities of the public interest to private property, as well as to regulate the use of natural resources susceptible to appropriation, to make an equitable distribution of public wealth, and to take care of its conservation. [...]*

There are numerous risks that emerge from the ambiguities in this text (including the lack of well-defined specifications for determining the value of "compensations"). The key failing is that private property is left in a precarious position, with no certainty of who owns what, perpetually exposed to the mercy of those who allegedly represent the public interest and the national will. Mexico's famous jurist, Emilio Rabasa, detected these deficiencies in the early 1930s, and forewarned about the dangers of broad confiscatory powers embodied in this clause, especially as pertains to the indefinite number of interpretations of what is (and what is not) deemed "public utility." Under this criterion, anything goes: it constitutes a platform for the ruling power to expropriate whatever it considers proper.[24]

[24]As Rabasa states: article 27 "destroys the basis of property," which is "confidence" over its reliability as an individual right, alongside rights to life and liberty. as a result of article 27, "it can be said that property of lands has ceased to exist in Mexico." Rabasa Estebanell, Emilio. *El derecho de propiedad y la Constitución mexicana de 1917*. Ed. José Antonio Aguilar Rivera.

4

IMPLICATIONS FOR ECONOMIC FREEDOM AND NORTH AMERICAN INTEGRATION

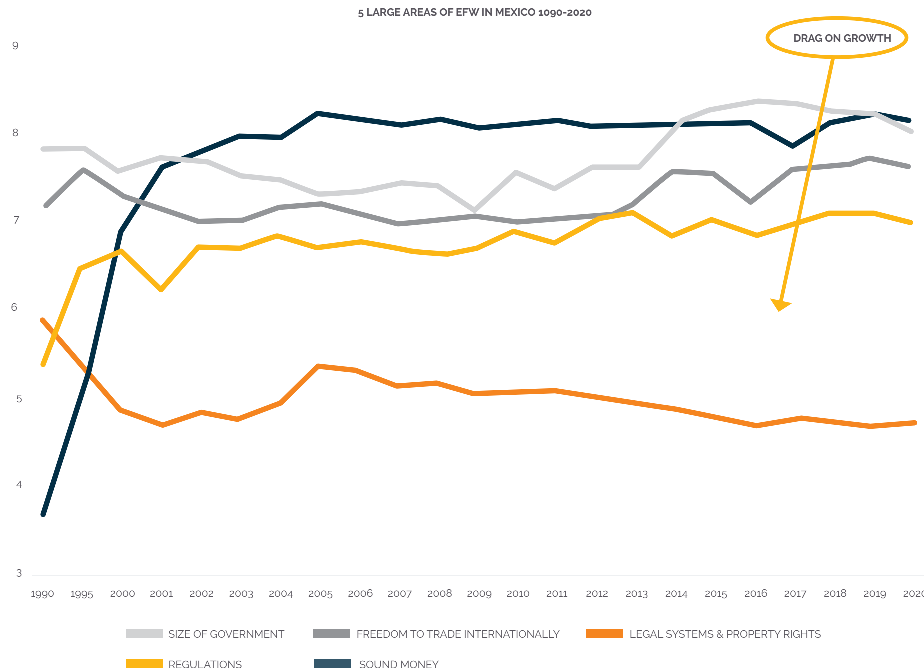
Mexico has the (enormous) advantage that its economic performance does not wholly depend on a single resource or commodity. Its principal economic engine is foreign trade, which has generated tightly integrated supply chains after 30 years of a multilateral approach to open trade on all borders.

The advent of North American free trade under a regional agreement of rules (NAFTA, now USMCA) held the promise of importing the rule of law and first-world property rights in all of the sectors of Mexico's economy linked to international trade. Indeed, the political logic of the agreement was to "lock in" regional trade liberalization, as well as to provide a mechanism of institutional credibility in the investment regime. The game-theoretic rationale was that regional rules would trump notoriously malleable national rules, especially in times of a statist polity, such as the current one. Luis Rubio suggests that the ultimate value of the trade treaty was the formal acknowledgment of "the incapacity of existing institutions to give investors" the certainty they require for long-term growth."[25]

This does not entail that the "golden straight jacket" theory is true (it is not), but rather that there is often an underestimated institutional dimension to the North American open trade framework, one which has been a fundamental driver in supply chain integration from the northernmost regions of Alaska to the southernmost tips of Chiapas. For instance, the agricultural boom in the ensuing period following the implementation of three-way free trade in North America is more a product of the institutional credibility of establishing regional rules of the game, rather than of fine-tuning local legislation. In addition, the huge expansion of industries such as autos and auto parts or aerospace manufacturing has led to a remarkable rise of a culture of competitiveness, in the wake of the massive increase of regional trade. Mexico now exports the equivalent of more than ***one billion dollars of manufacturing goods, per day***. Open trade has enabled Mexico to radically diversify its external sector: whereas oil and oil derivatives represented almost 80% of total exports, now it is a large gamut of manufactured products and parts that make up this percentage. In turn, while tradable goods remain tied to the North American business cycle, the diversification of exports has significantly reduced the ghost of a resource curse and hence the complacency of other commodity-based economies in assuming that, when prices are high, good times are forever.

[25] Rubio, L. *A Mexican Utopia: The Rule of Law Is Possible*, monograph published by the Woodrow Wilson International Center for Scholars, Washington, D.C., January 27, 2015, p. 59.

LEGAL SYSTEM AND PROPERTY RIGHTS (SCORE 1-10)	4.4
JUDICIAL INDEPENDENCE	3.9
IMPARTIAL COURTS	3.9
PROTECTION OF PROPERTY RIGHTS	5.2
MILITARY INTERFERENCE	5.8
INTERGRITY OF THE LEGAL SYSTEM	2.5
ENFORCEMENT OF CONTRACTS	5.5
RESTRICTIONS ON PROPERTY	6.8
RELIABILITY OF POLICE	3.2
BUSINESS COSTS OF CRIME	2.9



Mexico's Profile in Economic Freedom of the World (1990–2020)[27]

This is, unquestionably, a positive outcome. However, this important claim about the institutional impact of North American integration failed to anticipate a downside effect that is now beginning to materialize—namely, how "bad economics" and negative policy decision-making south of the Rio Grande border seeps into the core of all geoeconomic relationships across North America, in the form of a functional "septic shock." This is especially true with large-scale capital investment commitments in energy and the electricity sector, where AMLO's nationalist mishaps had led to the need to appeal to a dispute-resolution mechanism in order to arbitrate a wave of conflicts and concerns that arose after the suspension of the rules governing private participation in energy, which were enacted in 2013. A notable example was how unilateral changes to benefit the CFE electricity monopoly over private competitors in electricity generation (giving the former priority over dispatch of electric outputs) violated "level playing field" rules in the market.[26] In addition, AMLO loyalists in the relevant regulatory bodies have systematically failed to recognize existing investment commitments, and in several instances, permanently delayed scheduled authorizations, especially in the renewable energy sector. Some companies cut their losses, vowing never to return to Mexico; others had to hire legal counsel to attempt a renegotiation, while others have appealed to a dispute resolution panel at a regional level. In all cases, companies have had to either realize losses or incur new transaction costs.

The end result, despite the institutional protection of the regional treaties, remains the same: a high degree of uncertainty with respect to property ownership rights.

[26]Patiño Alcalá, V. (2022, June). "La responsabilidad corporativa de CFE a prueba." *México Evalúa*.

[27]Author's own creation with information of the Fraser Institute's *Economic Freedom of the World Annual Report 2022*. The latest available data in this report is 2020, which is why the profile reads 1990-2020.

It is no surprise, therefore, that Mexico continues to lag significantly behind in economic freedom.

This is a genuine paradox: despite the aggressive wave of pro-market reforms since the early 1990s, Mexico continues to disappoint in the annual rankings of economic freedom. The reason is wholly institutional: the fragilities in its system of rule of law, and especially in property ownership rights. Hence, despite visible progress during the past quarter century in areas like sound money, open competition, and international trade, formidable challenges remain in the very core of its system of rule of law.

As the following graph suggests, the main driver behind Mexico's problems lies in the (very) poor quality of its institutional framework: poorly defined property rights, unreliability of contract enforcement, regulatory affixation, lack of police protection, as well as a host of high transaction costs imposed by rent-seeking, regulatory extortion, and a complex web of rules and regulations for everyday business.

The country's legal system and property rights performance has been systematically poor, far lower than other general areas in the measure of economic freedom. ***This is the principal cause of the drag on growth and hence the reason for the country's prosperity conundrum.*** The complexities imposed by regulatory burdens fuel an enterprise of "rent-seeking" activities, particularly affecting small and medium-sized enterprises. Unfortunately, Mexico's counterparts north of the border are now feeling the economic pain of the lack of institutional reliability and protection of well-defined property rights.

[28]For a detailed account of the time-tax involved in burdensome bureaucratic regulations, see *México Evalúa*. (2022, December 1). *Índice de Burocracia en América Latina 2022–México Evalúa*. México Evalúa. Retrieved August 18, 2023, from https://www.mexicoevalua.org/indice-de-burocracia-en-america-latina-2022.

5

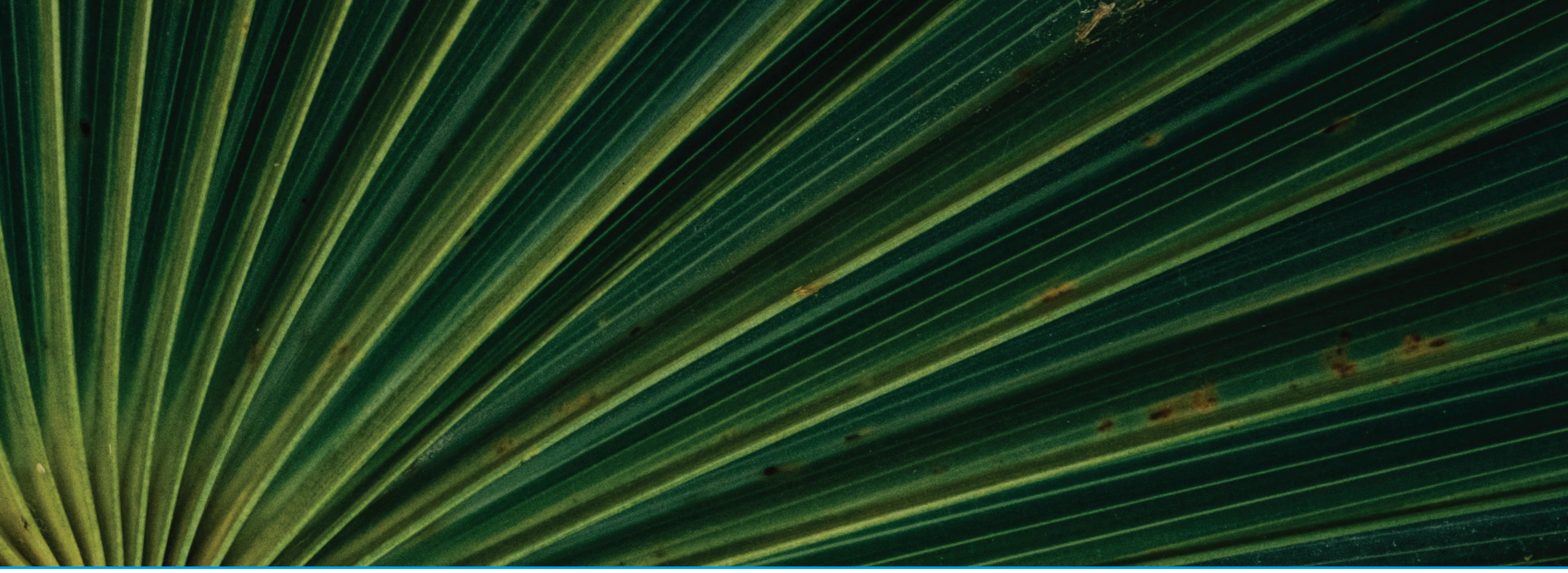
CONCLUSION

Mexico will hold a presidential election in mid-2024. As the public debate progresses on prospects and proposals for positive change, it would be welcome to include the need for sweeping reform of the property rights regime as a priority in the agenda of change. For the AMLO administration and would-be successor, this would necessitate a more open and flexible stance, a willingness to listen, and a tolerance to criticism. If contracts and commitments can be undone as a result of a whimsical policy decision, new potential investment will demand far more stringent conditions to compensate for the downward adjustment in the risk-reward equation, or flee. After all, as Benito Juárez's celebrated lemma says: *"El respeto al derecho ajeno es la paz."*

Perhaps historian Enrique Krauze was not exaggerating when he first characterized AMLO as a "tropical Messiah."[29] The hubris exhibited in his government's policy decision-making also breeds intolerance and confrontation—and thus, an unavoidable case of authoritarian fatal conceit. The manifest lack of humility and the refusal to learn from trial and error suggests that if factual reality is different from the expectation of stated objectives, so much the worse for reality. It, too, must adapt to the Fourth Transformation.

One such fact, however, is that open competition is now widely regarded as an everyday economic reality, regardless of politics or ideological confrontations. But so is the continued prevalence of organized crime, widespread corruption, and fragile judicial institutions. The reform agenda will need to address all these to enhance the level of competitiveness of domestic firms *via the reduction of high transaction costs*

[29] Krauze, E. (2006, June 30). "El mesías tropical." *Letras Libres*.



to enable everyday agents to realize their "full productive potential." To this end, a system that protects possessions is essential in fostering wealth creation and a robust culture of entrepreneurship. Mexico's legal framework needs wholesale structural reform, especially at the constitutional level, to capitalize on the great opportunity that has emerged with nearshoring; and policy proposals on all fronts should prioritize individual property rights over "national interest."[30]

As Ludwig von Mises stated, in a marvelous lecture entitled "Mexico's Economic Problems," delivered in Mexico City in 1943, "a policy indifferent about tomorrow … which sacrifices the future, is not progressive but parasitic."[31] In this text, Mises elaborates a general diagnostic of the risks and challenges facing modern Mexico, one that is remarkably relevant to the current state of affairs; and, especially as it pertains to property rights. Where would Mexico stand now had the country adopted some (or all) of the policy prescriptions advanced by Mises in 1943?

This is not a mere counterfactual. Mises is very clear on the fundamental need for an institutional structure of well-defined property rights and advocates that Mexico's policymakers should all but eliminate article 27 of the Constitution. This can be construed as a mere flight of fancy in light of a highly divisive political climate. Still, as we reflect on the opportunities facing Mexico in matters of progress and prosperity, Mises's claims remain as visionary and challenging in this brave new world of radical uncertainty … as they were in the early 1940s.

[30]See our case study for a detailed proposal on how to develop a market-oriented way out of the nationalism dilemma, via individualized property titles, Salinas, R., Rodríguez, M., and Navarro C. (2023). The 2022 IPRI. *International Property Rights Index*.

[31]Mises, Ludwig von. *Selected Writings of Ludwig von Mises*, Volume 3. Indianapolis: Liberty Fund, Inc., 2000. "Mexico's Economic Problems."

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