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FROM THE U.S. TO MEXICO: FRIENDLY ADVICE ON ENDING THE FARM CRISIS

INTRODUCTION

Mexico has had the misfortune of having a geography and politics inhospitable to agriculture. This huge country of 85 million people has a hot and dry climate, poor soil, and little water for irrigating crops. Water flowing from the Mississippi River alone is greater than that of all Mexico's rivers combined. More than three-fourths of Mexico's territory is unsuitable for agriculture because of the arid climate and poor soil.

Adding to Mexico's natural problems are man-made ones. In no Western Hemisphere country does government policy do more harm to agriculture than in Mexico. State subsidies for food producers, distributors, and consumers waste billions of dollars a year and undermine farm productivity by rewarding inefficiency. Agricultural production has failed to keep pace with

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This is the fourteenth in a series of Heritage studies on Mexico. It was preceded by *Backgrounder* No. 723, "Improving U.S.-Mexican Economic Relations," (August 4, 1989); *Backgrounder* No. 700, "A 15-Point Program to Stem the Flow of Drugs from Mexico (April 12, 1989); *Backgrounder* No. 694, "U.S.-Mexican Economic Ties" (March 6, 1989); *Backgrounder* No. 688, "The Security Component of U.S.-Mexico Relations" (January 26, 1989); *Backgrounder* No. 679, "A Review of 150 Years of U.S.-Mexican Relations" (October 31, 1988); *Backgrounder* No. 638, "Evolution of Mexican Foreign Policy" (March 11, 1988); *Backgrounder* No. 611, "Privatization in Mexico: Robust Rhetoric, Anemic Reality" (October 22, 1987); *Backgrounder* No. 595, "Keys to Understanding Mexico: The PAN's Growth as a Real Opposition" (July 29, 1987); *Backgrounder* No. 588, "Deja Vu of Policy Failure: The New $14 Billion Mexican Debt Bailout" (June 25, 1987); *Backgrounder* No. 583, "For Mexico's Ailing Economy, Time Runs Short" (June 4, 1987); *Backgrounder* No. 581, "Mexico's Many Faces" (May 19, 1987); *Backgrounder* No. 575, "Mexico: The Key Players" (April 4, 1987); and *Backgrounder* No. 573, "Keys to Understanding Mexico: Challenges to the Ruling PRI" (April 7, 1987). Future papers will examine other aspects of Mexican policy and development.

population growth. Mexico's population grew 2.8 percent in 1988, while total crop production declined 4 percent. To fill the gap between consumer demand and crop shortages, Mexico spent a record $3.5 billion on food imports last year.

It was not always this way. From 1940 to 1965, Mexico's agriculture was the envy of the Third World, increasing crop output each year by 6.3 percent. But since 1965 agricultural production has dropped steadily, primarily because of the inefficiencies caused by increased state intervention in the agrarian economy.

Huge Debts. Mexico's depressed agricultural economy contributes enormously to the government's huge internal and external debts. State transfer payments to government-operated farm agencies totalled more than an estimated $2 billion last year, about one-half of the budget deficit of roughly $4.5 billion for the same period. Mexico's agricultural trade surplus before 1970 earned foreign exchange to finance state programs. But since 1970, Mexico's use of foreign loans to pay for money-losing government-owned enterprises and state subsidy programs, including agriculture, drove its foreign debt from $4.2 billion to more than $100 billion today.

Mexico's president, Carlos Salinas de Gortari, is building a solid foundation for Mexico's economic revival. He has privatized a few state-owned enterprises, deregulated parts of the economy, and removed barriers to foreign trade. But if he fails to introduce legal and economic reforms that fundamentally alter the role of the state in Mexico's farm sector, Mexico will be unable to feed its people or honor its domestic and international debt obligations. Because of this, as well as for reasons of neighborly concern, the state of Mexico's agriculture is of great importance to the United States. Washington thus should give Salinas friendly advice on how to end Mexico's agriculture crisis, Washington should suggest that Salinas:

♦ ♦ **Cease state ownership of land and turn it, with a clear title, over to peasants.** Mexican farmers do not own their land, but till it with the state's permission. Letting farmers own their land will give them the incentive enjoyed by farmers around the world, to farm more efficiently.

♦ ♦ **Privatize state-owned agricultural monopolies that produce fertilizer, processed foods, retail goods, and control storage and farm credit.** This will attract foreign investment to Mexico, eliminate costly subsidies to state enterprises, and make it easier for Mexico's government to pay its debts.

♦ ♦ **Lift state price controls on wholesale foods.** This will make Mexico's food producers and distributors more competitive with foreign producers, increase farm output, and reduce Mexico's dependency on expensive food subsidies and imports.

♦ ♦ **Remove legal restrictions on foreign investment in Mexico.** More foreign investment will attract desperately needed capital to agricultural development projects and increase confidence among domestic investors in Mexico's economy.

SOWING THE SEEDS OF MEXICO'S FARM CRISIS

The causes of Mexico's agricultural crisis are rooted not only in the country's history, but in a series of policy decisions made by governments over the past quarter-century. They are: 1) attempts to use "agrarian reform" for political rather than economic purposes; 2) a forced investment of capital and public funds into industry rather than agriculture; and 3) a heavy-handed presence of the state in the production and distribution of agricultural goods.

Agrarian Reform

After Mexico's conquest by the Spanish in the 16th century, much of the nation's fertile land was owned by the Catholic Church, the descendants of Spanish gentry, and wealthy Europeans who established enormous feudal estates, or *haciendas*, some as large as several million acres. The lands owned by these wealthy *hacendados* were often left idle, but were the source of much prestige and political power. Another type of land holding, known as the *ejidos*, was held in common by small villages of Indians, who had the right to till, but not own, these tracts of land that averaged a few hundred acres in size.

Revolutionary Slogan. Over the next two centuries, Mexico's original Indian population became a

Mexico

Type of government - Federal Republic.

Area - 762,000 square miles; about one-fifth the size of the United States.

Population - 85 million.

Capital - Mexico City (population 18 million, est. 1985)

Ethnic Groups - Indian-Spanish (*mestizo*) - 60%, American Indian - 30%, Caucasian 9%.

Religion - Roman Catholic - 97%.

Work Force - about 25 million: Services - 32%, Agriculture - 26%, Commerce - 14%, Manufacturing - 13%.

Natural Resources - Oil (world's fourth largest producer), natural gas, iron ore, lead, zinc, and timber.

GDP per capita (1987) - $1,537

Agriculture - Major Exports: coffee, fresh vegetables and fruits, sugar, cotton.Major Imports: corn, wheat, soybeans, sorghum, dry milk, cattle.

U.S. Trade with Mexico:

Total Imports from Mexico (1988) - $23.5 billion
Agricultural Imports (1988) - $1.7 billion
Total Exports to Mexico (1988) - $20.6 billion
Agricultural Exports (1988) - $2 billion

Mexican Trade with the World:

Total Exports (1988) - $26.6 billion
Total Imports (1988) - $26.1 billion

Sources: Mexico Background Notes, U.S. Department of State, Bureau of Public Affairs, February 1988; Direction of Trade Statistics Yearbook 1989, International Monetary Fund; and U.S. Department of Agriculture, Foreign Agricultural Service, Annual Agricultural Report 1988 - Mexico.

Heritage DataChart

mass of destitute, landless laborers relying on landowners for credits, housing, and other necessities for survival. The concentration of land ownership in the hands of the few bred widespread discontent in the countryside. By the start of this century, roughly half of Mexico's farm land was controlled by fewer than 3,000 families.[1] Rural resentment of the economic system came to a head in the Mexican Revolution of 1910. Peasants eager to secure land ownership rallied around revolutionary leader Emilliano Zapata and his slogan: "the land belongs to those who work it." The Mexican Revolution toppled General Porfirio Diaz in large part because of peasant support.

One of the revolutionary government's first tasks was to change Mexico's agricultural system. The Agrarian Reform Act of 1915 gave the government the authority to expropriate portions of large estates and to distribute rights of land tenure to applicants from the peasantry. Because the old feudal landlords had been seen as "private" exploiters of the land, which the revolutionaries believed rightly belonged to the "people," the new system of land ownership was biased against private ownership and the free market. The old feudal system of land ownership was mistaken for capitalism and the system of private property. As a result, the revolutionary government concluded that the best safeguard against exploitation by "private" large landowners was for the state to own the land, and to divide it equally among the peasantry.

The land redistribution process was extremely slow. Once all available land had been redistributed, the state still retained the right to re-allocate land tenure rights until all claimants were satisfied. Roughly 6.3 percent of total farmland in Mexico, or 20.6 million acres, was distributed between 1917 and 1930 to state-run farms or *ejidos*.

Mandate for Intervention. The first wave of agrarian reform culminated in the Constitution of 1917. This revolutionary document provided the legal basis for land reform programs by granting the state the right to regulate and limit property rights, including the expropriation of private property. It also established the state as the "rector" of the Mexican economy and empowered it to establish organizations that protect its citizens from what it called "exploitation," thus providing a legal mandate for government intervention in all sectors of the Mexican economy, including agriculture.

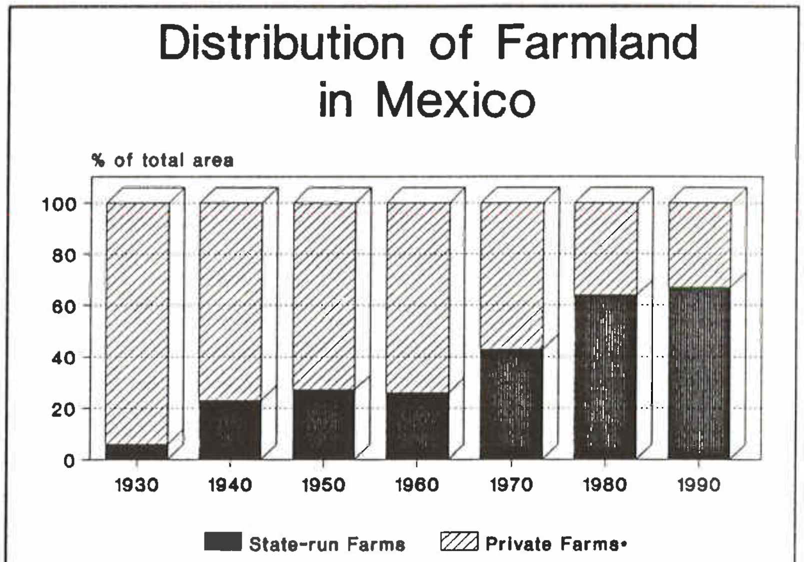
Out of these constitutional provisions and other agrarian reforms emerged a new system of land tenure. Land was distributed to peasants in two ways: 1) as small private plots, or *parcelas*, which exist mainly in the southern states of Hidalgo, Mexico, Oaxaca, Puebla, and Tlaxcala; and 2) as government-administered *ejidos*, or cooperative villages, which are found throughout Mexico. The *ejidos* could be farmed collectively, by individually assigned plots, or by a mixture of both.

1 H.B. Parkes, *A History of Mexico*, (Cambridge Massachusetts: Riverside Press, 1930), p. 306.

Lacking Legal Protection. Redistributed lands could not legally be bought or sold. But the government could "repossess" the land at any time, and tenants who left their assigned plots relinquished all rights to the land. In practice these *ejidos* were sometimes rented and sold outside the law, but with no legal protection for buyer or seller because only possession of rights to the land, not legal title, was transferred. Only the state held legal title of ownership to the land.

This system of land tenure survives until this day. It is the legal basis for the possession, and exchange of all *ejido* land in the Mexican countryside.

The next wave of agrarian reform came 25 years after the Mexican Revolution. It was pushed by Lazaro Cardenas del Rio, who was President from 1934 to 1940. He redistributed roughly 50 million acres during his term, taking the land mostly from large private estates, and organizing newly created *ejidos* in the form of Soviet-style collective farms. Between 1930 and 1940 the portion of Mexican farmland under *ejido* management rose from 6.3 percent to 22.5 percent.[2] As in the Soviet Union, it was thought that state-run collective farm managers could exploit modern farm machinery like tractors better than individual farmers on small plots of land.



* Including Indian community farms representing roughly five percent of total farmland in Mexico.
Sources: American Embassy, Mexico City, Foreign Agricultural Service data; P. L. Yates, *Mexico's Agricultural Dilemma*; Alan Riding, *Distant Neighbors*. Heritage InfoChart

Despite this collectivization, Mexico's agrarian economy developed at an unparalleled pace during the two decades after World War II. The Mexican economy grew at an average annual rate of 6 percent between 1945 and 1970, with agricultural output growing an average of 6.3 percent annually from 1950 to 1965.[3]

2 Paul L. Yates, *Mexico's Agricultural Dilemma* (Tucson, Arizona: University of Arizona Press, 1981), p. 155.
3 *Ibid*. p. 19.

This "Mexican miracle" in agriculture was rooted in the country's advantages following World War II. Mexico obtained capital investment for agricultural development through the sale of such raw materials as food and basic metals to the U.S. and the other allied forces during the war. Ambitious irrigation programs and the introduction of new high-yield corn, wheat, and other crops fueled Mexico's success in the countryside. Better irrigation boosted production and more high-yield crops lifted farm exports.

Flexible Private Farms. Important too was that private farms still outnumbered the *ejidos*. Between 1950 and 1960 the amount of land allotted to *ejidos*, roughly 27 percent of total farmland, remained unchanged. The best performers from the end of World War II to the mid-1960s were these private farms, whose output per acre during this time was nearly five times greater than that of the *ejidos*.[4] Private producers were more successful for several reasons. First, unlike the collective farms, which were locked into farm managers' production plans, private farmers could respond flexibly to new consumer demands, plant more profitable crops, and exploit modern machinery and farming techniques more efficiently. Second, large and medium-sized private farms could produce more crops, and therefore more profits than could *ejidos*.

Mexico's golden age of agriculture came to an end in the mid-1960s. Mexico's population growth, which averaged 3.4 percent in the 1960s, created millions of new people wanting land. Yet new sources of arable land, developed through both irrigation and deforestation, were exhausted by the mid-1960s. The state met the greater demand for farmland by expropriating the property of private farmers. Moreover, the *ejidos* shrank in size, making them less productive. Population growth on the cooperative *ejidos* farms resulted in the subdivision of plots among family members, making them after the mid-1960s smaller than the state-run collectives established earlier. Fewer than half of all *ejidos* plots exceeded ten acres by 1970, and the average income of cooperative farmers holding less than ten acres was less than half that of those who had larger plots of ten to 25 acres.

Fearing their land could be taken from them, farmers naturally failed to make long-term investments in their operations. The predictable result was lower productivity. Average annual crop production, for example, fell from 6.3 percent between 1945 and 1965 to 2.9 percent between 1965 and 1980.

New Cooperatives. The largest land expropriation occurred during the presidency of Luis Echeverria Alvarez, who held office from 1970 to 1976. Echeverria expropriated 30 million acres of land from private farmers and redistributed 16 million acres to the peasants. Roughly 14 million acres remained in the hands of the state or was transferred to political cronies within the ruling political party, known as the *Partido Revolucionario In-*

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4 *Ibid*. p. 161.

stitucional (PRI). Echeverria established hundreds of new cooperative *ejidos* managed by state agricultural specialists, or *technicos*, who were little more than government bureaucrats with a technical background in agriculture. State-run cooperative *ejidos* accounted for roughly two-thirds of Mexico's arable land by 1976.[5] These cooperative farms undermined farm productivity in several ways. Farmers lacked personal and economic incentives to produce because they generally received the same wages regardless of output. Furthermore, farm managers, not the farmers themselves, made all the important decisions, such as what crops to plant, what equipment to buy, and what farming methods to use. Unproductive *ejidos* farmers could not sell their plots without losing all of their belongings, and skilled farmers could not capitalize on their superior talents by expanding the size of their plots.

Political Constituency. Although the *ejido* system was originally envisioned as a mechanism to break up large farm estates and prevent a future concentration of land ownership, it never made the peasants real landowners. Government officials from the ruling PRI party instead exploited the land tenure system to gain favor with the more than 2 million applicants for farmland. For example, Echeverria's successor, President Jose Lopez Portillo, declared in 1978 that there was no more land to be distributed. He then seized and redistributed 40 million acres to 300,000 peasants. The pressures to please his political constituency among newly created farmers was greater than his desire to keep his promise not to confiscate and redistribute land.

Says Mexican economist Luis Pazos: "Between 1915 and 1988 the government redistributed more than six times the arable land. [Yet] there is no security of property ownership. The majority of the rural population have no title to their land; nor are they able to establish clearly the boundaries of their plots."[6] The bitter harvest of these ill-conceived policies has been low productivity, insecurity of land holdings, and low capital investment in agriculture.

Favoring Industry over Agriculture

One of the biggest problems facing Mexico is the diversion of scarce capital resources from agricultural production to develop such industrial sectors of the economy as steel, petroleum, and mining. The Mexican government in the mid-1950s adopted a strategy called "stabilizing development," which used Mexico's agricultural export revenues to finance rapid industrialization. The proportion of total food output devoted to exports jumped from 9 percent in 1950 to 14.7 percent in 1960, as agricultural export revenues were used to finance the construction of steel plants, oil refineries, and other state-owned industrial enterprises. Agricultural export revenues were raided throughout the 1960s by the government to build industry, while tariff barriers were established to shield newly-formed industries from foreign competition.

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5 Alan Riding, *Distant Neighbors: A Portrait of the Mexicans* (New York: A. Knopf, Inc., 1985), p. 187.

6 Luis Pazos, *Hace Donde Va Salinas* (Mexico City: Editorial Diana, 1989), p. 139.

By the mid-1960s and 1970s, state-sponsored industrialization began to undermine capital investment in Mexican agriculture. Deficit spending and foreign borrowing used to finance inefficient state-run industries drained capital that otherwise could have been used to clear land, irrigate crops, and buy fertilizers, pesticides, and farm machinery. Roughly 40 percent of public spending between 1960 and 1976 went to build Mexico's industrial plant, while less than 14 percent went to agriculture. Agriculture's share of total capital investment in Mexico fell from 14 percent in 1960 to 4.5 percent by 1970.[7] Capital was made scarce, too, by the flight of money abroad by investors who feared Echeverria's open hostility toward the private sector as well as Mexico's rising inflation rate, which reached 27 percent in 1976. Echeverria had spurred inflation by relying on deficit spending and foreign borrowing to finance more than 650 new state-owned industries.[8] The peso, which had been fixed at a constant exchange rate since 1954, became critically overvalued as the result of inflation. When these inflationary pressures forced Echeverria to devalue the peso by one-half in 1976, Mexican investors responded by sending over $4 billion abroad. The "flight" of Mexican capital to the U.S. and elsewhere deprived farmers and other investors of badly needed capital.

Government Intervention in Agriculture

Government agricultural policy is administered by two state bureaucracies: the Secretariat of Agriculture and Water Resources and the Secretariat of the Agrarian Reform. Branches of these agencies are based in urban areas, and they set planning and production goals for agriculture. Their more than 200,000 bureaucrats oversee over 40 state-owned agricultural enterprises that control production, distribution, subsidy, and farm credit programs. The largest state-run agricultural enterprises are the National Popular Subsistence Company (CONASUPO) which distributes all basic food products, the National Rural Credit Bank (BANRURAL) which dispenses farm loans, and the Mexican Fertilizer Company (FERTIMEX) which makes and distributes fertilizer.

The National Popular Subsistence Company (CONASUPO). CONASUPO is the primary agency for state intervention in Mexican agriculture. Formally

7 Daniel Levy and Gabriel Szekely, *Mexico, Paradoxes of Stability and Change* (Boulder, Colorado: Westview Press, 1987), p. 135; and, George Phillip, *Mexico's Internal Conflicts* (London: Institute for the Study of Conflict), p. 2-3.

8 In May 1973, Echeverria's Finance Minister, Hugo Margain announced that Mexico's Treasury lacked the resources to expand state spending programs. Echeverria fired Margain and promised to hire "someone who can find the money." The new Minister, Lopez Portillo, found the money for state-industrialization projects, such as the $1 billion Sicarsta steel project by borrowing abroad. Predictably, Mexico's foreign debt jumped from $4.2 billion in 1970 to $19.6 billion in 1976. [see Alan Riding, op. cit..pp. 205-6; Dale Story, *Industry, the State and Public Policy in Mexico* (Austin: University of Texas, 1986); and Michael Dziedzic, *Mexico: Converging Challenges* (London: IISS, Adelphi Papers, No. 242, Autumn 1989), pp. 10-12.

established in 1965, it allocates state funds to purchase and distribute agricultural goods throughout the country. CONASUPO spawned scores of new subsidiary state companies at the local level, which became involved in purchasing and processing corn and wheat, in retail food sales, and, in recent years, in importing grains and other commodities. CONASUPO's sprawling operations include 18,000 retail grocery stores, 32 manufacturing and food processing plants, and 70 percent of the country's food storage and silo capacity.[9]

CONASUPO subsidizes farmers by purchasing crops at fixed or "guaranteed" prices. By guaranteeing farmers a fixed price for their products, the state hopes not only to augment the farmers income, but to encourage production. In practice, it does not turn out this way. High inflation often means that the guaranteed prices for crops are below their true market value. CONASUPO's price-fixing offices cannot keep up with the fast pace of inflation. CONASUPO's price controls therefore produce not only food shortages when guaranteed prices are below market rates, but expensive food subsidies when food prices are held below producers' costs and the rate of inflation.

When farmers get below market prices for their goods, they cut back on production. This causes food shortages. Mexico's milk producers, for example, have been subject to artificially low guaranteed prices and rising production costs since the 1970s. Many have been driven out of business as a result. This has caused a tremendous shortage of domestically produced milk. Mexico now, in fact, is the single largest milk importer in the world, buying over $220 million of dry milk last year.

Core Electoral Base. Roughly one quarter of CONASUPO's budget, or nearly $500 million, is used to subsidize the purchase of foods by urban consumers. These subsidies are given to state-owned stores that sell food at below market prices. Retail food outlets, administered by CONASUPO bureaucrats and PRI officials, have been established in middle class suburbs as well as low-income urban areas primarily for political purposes. The success of the ruling PRI party seems to depend heavily on the continued backing of lower and middle income urban consumers accustomed to low food prices. CONASUPO's food subsidies and the resulting low food prices are seen by the PRI as a way maintaining the loyalty of this core constituency of urban-dwelling workers and bureaucrats. Over 7 million unionized workers in state companies and 3 million state bureaucrats represent the core electoral base for the PRI.

These subsidies and other wasteful economic practices have created huge financial losses for CONASUPO. Last year the Ministry of Finance was forced to bail out CONASUPO by transferring an estimated $950 million to its account, which is over one half of that agency's annual budget. Only the

9 Peter Young, "Privatization in Mexico: Robust Rhetoric, Anemic Reality," Heritage Foundation *Backgrounder* No. 611, October 22, 1987, p. 8.

Comision Federal de Electricidad (CFE), the state electricity commission, receives more state subsidies than CONASUPO.

National Rural Credit Bank (BANRURAL). Created originally to service the credit needs of poor farmers, this state-run farm credit bank has 38,000 employees operating in 600 branch offices across the country.[10] It is the main source of credit for the agricultural community in Mexico.

Agrarian reforms have transferred of more than two-thirds of Mexico's arable land from the private sector to state-run *ejidos*. Since farmers on these state-run cooperative farms cannot offer their land as collateral for loans, they must rely instead on PRI officials and BANRURAL bureaucrats for government credit. BANRURAL and other credit agencies, such as the National Farm and Livestock Insurance Agency (ANAGSA), have been criticized by Salinas for their "lack of organization, inefficiency and even of corruption."[11]

BANRURAL officials frequently favor political rather than commercially prudent objectives by lending to marginal producers or issuing "living expenses" to cash-strapped farmers. This honors what PRI politicians call a "social duty" to an important constituency. This also, however, diverts financial resources from successful producers and assigns the administration of what essentially is a welfare program to a credit agency. Most BANRURAL credit is issued in short-term loans that contribute little to long-term investment in farm productivity. Money is lent on a short-term basis primarily because BANRURAL wants to recover its loans quickly, calling in the loan when the borrower sells his crops.

Mexican Fertilizer Company (FERTIMEX). FERTIMEX is the state monopoly for producing seed, fertilizers, pesticides and insecticides. This agency provides subsidized credit and irrigation to producers and sells fertilizers to farmers at artificially low prices. Mexico is well endowed with such mineral resources as potassium, urea, and ammonium sulphate, which are necessary for manufacturing fertilizers. FERTIMEX was thus able to produce and sell 5.1. million metric tons of fertilizer last year.

Like most state industries in Mexico, FERTIMEX has been extremely inefficient. A 1982 World Bank study noted that the price charged by FERTIMEX for its fertilizers was 26 percent below the cost of production. The PRI-dominated government subsidized FERTIMEX to keep control over distribution and pricing of agricultural goods. Ranking third after the electricity monopoly (CFE) and CONASUPO, state subsidies to FERTIMEX last year totalled more than $500 million.[12]

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10 Riding, *op. cit.*, p. 190

11 President Carlos Salinas de Gortari, *First State of the Union Address*, November 1, 1989, p. 35.

12 Reliable official data on state transfer payments to state agricultural monopolies, including FERTIMEX, are not available. Unofficial statements from Mexican government officials and American Embassy officials in Mexico City indicate that FERTIMEX subsidies exceeded $500 million in 1989.

STATE-CONTROLLED AGRICULTURE: MEXICO'S BITTER HARVEST

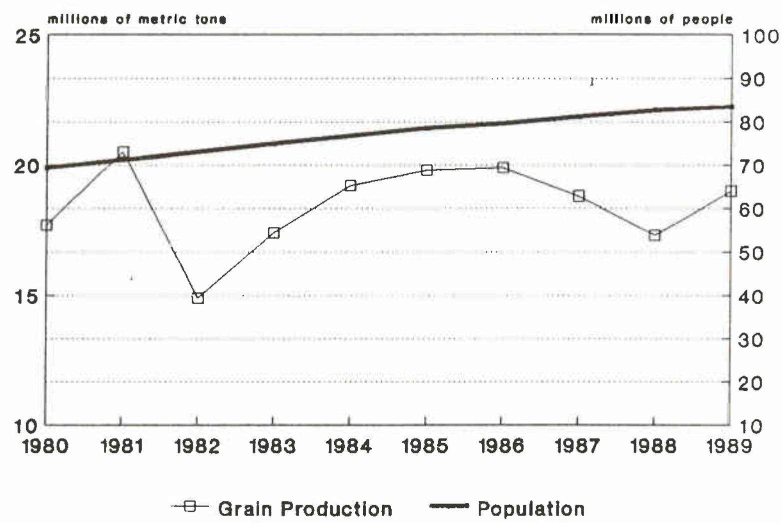
More than seven decades of state intervention in Mexican agriculture have yielded a predictably bitter harvest. Mexican government statistics indicate that from 1965 to 1982 agricultural growth declined sharply from an annual rate of 6.3 percent to 2.9 percent. Average annual agricultural production has grown only 1.46 percent since 1982, far below the population growth of an average of 2.5 percent over the same period.[13] The social and economic costs of government control over agricultural production and distribution continue to rise. Examples:

♦ ♦ Since 1967 Mexico has depended increasingly on imports to feed its rapidly growing population. In 1975 the country imported only 10 percent of the grain consumed, but by 1983 the figure jumped to nearly 40 percent, where it now remains. According to the Bank of Mexico, crop production shrank 4.5 percent in 1988.[14]

♦ ♦ Mexico spent a record-high $3.5 billion or roughly five percent of net government spending, on food imports in 1988. Agricultural exports from the U.S. to Mexico last year totalled $2.7 billion, one-half the total of U.S. agricultural exports to all of Latin America.

♦ ♦ Roughly half of Mexico's imports are financed by subsidies from such U.S. export promotion agencies as the Commodity Credit Corporation and the Export-Import Bank. These agencies finance U.S. exports by providing commercial credit guarantees, direct loans, and loan insurance to countries purchasing goods from the

Grain Production* and Population Growth



* includes wheat, corn barley, sorghum, rice
Source: U.S. Department of Agriculture, Foreign Agricultural Serivce, Mexico City; and 1989 estimates from government data confirmed by private sources in Mexico City. Heritage InfoChart

13 Population Reference Bureau, Washington, D.C.
14 Telephone interviews with U.S. Department of Agriculture and American Embassy officials in Mexico City.

U.S. Mexico last year received $2.3 billion in loan guarantees from the U.S. Commodity Credit Corporation to purchase such basic agricultural goods as corn, wheat, and soybeans.[15]

♦ ♦ Mexico imported 35 percent of its corn, 25 percent of its wheat, and 40 to 50 percent of its soybeans and oilseeds last year. Wheat imports are expected to reach 1.2 million tons (up 69 percent from last year), soybeans, 1.4 million tons (up 44 percent), and rice, 150,000 tons (up 150 percent).[16]

AGRICULTURAL REFORM UNDER SALINAS

Salinas's academic and political experience should allow him to understand the causes of Mexico's declining agricultural productivity. Salinas served in 1981 under President Jose Lopez Portillo as director of the Institute for Political, Economic and Social Studies of the PRI, and in 1982 as economic policy director in President Miguel de la Madrid's Secretariat of Planning and Budgeting. He has seen, first-hand, the costs of state intervention in the Mexican economy. It is this, perhaps that has prompted Salinas to do what his predecessors have not: lay the blame for Mexico's economic crisis at the doorstep of state intervention in the economy.

In his State of the Union address last November 1, Salinas condemned what he calls "state gigantism" for suffocating social and economic initiative. He declined that he does not associate "statism with progress," as his predecessors did. That, he said, "only defends the privileges of the old guard that clings to the status quo." Agricultural decline, he noted, represents "the greatest challenge to economic modernization."

Forcing Competitiveness. Following these brave words, Salinas has started taking steps to halt further decline in Mexico's agricultural production. He has encouraged private investment in Mexico's large agricultural processing, packing, and freezing plants and in the so-called "agro-industrial corridors," or road networks that link farmland with food processing and distribution centers. His new foreign investment regulations, announced last May, ease restrictions and expand opportunities for wholly-owned foreign investments in Mexico. What is very important, by reducing Mexico's maximum tariffs on agricultural and other imports to 20 percent, Salinas is forcing Mexico's agricultural sector to become more competitive.

At a ceremony in Veracruz on January 6, 1990, commemorating the Agrarian Reform Act of 1915, Salinas announced an agricultural modernization program aimed at creating a "new Green Revolution" in the Mexican countryside. The plan is intended to:

15 Christopher Whalen, *The Times of the Americas*, November 29, 1989, p. 12.
16 World Agricultural Production, U.S. Department of Agriculture WAP-1-89, July 1989.

1)Provide farmers with security of land tenure through what Salinas calls "consensus and decentralization" of agricultural decision-making.

By this he means that farmers will be allowed to participate more in government land distribution and farm management policies, particularly at the local level. This is a welcome step. He backed away, however, from what would be a much more important step: privatizing the *ejidos*. Thus, state cooperative farms will retain control over roughly three-quarters of Mexico's farmland. A government-appointed arbitrator will be assigned to resolve land tenure disputes, but this is no substitute for land ownership.

2) Decentralize state-run agricultural businesses and government farm agencies.

State-owned farm credit agencies ANAGSA and BANRURAL "gradually" are to be decentralized to give regional branches a greater voice in making loans. Financial resources, now controlled by the federal Secretariat of Agriculture and Water Resources, will be transferred to local state agencies, beginning with northern areas such as Sinaloa, Tamaulipas and Aguascalientes.[17]

3) Boost government investment in the agricultural infrastructure.

As in past proposals, more money is pledged to be used to build irrigation works, technical research facilities, and roads that link cultivated areas to shipping ports and food processing centers.

4) Raise government prices for farm produce.

Mexico's farmers have been discouraged from planting crops because government-guaranteed crop prices often have failed to keep pace with inflation or world prices. Salinas believes that crop price increases would encourage greater food production and reduce Mexico's dependence on costly food imports.

5) Sell unprofitable and inefficient state-run companies.

Most of the 36 state-owned agricultural enterprises will face what Salinas calls "selective privatization." Exempted, however, are the largest agricultural bureaucracies, BANRURAL, CONASUPO, and FERTIMEX. Some processing plants and retail outlets owned by CONASUPO will be sold to farm cooperatives or the private sector and guaranteed prices for some food commodities will be lifted.

17 Telephone interviews with Giullermo Ramos, Agricultural Counselor, Mexican Embassy in Washington, D.C.; and Ana Vila-Freyer, "Promises to Reactivate the Countryside," *El Norte*, Monterrey, Mexico, January 7, 1990, p. 1.

Looming Disaster

Salinas's economic reforms have been modestly successful. Mexico's GNP last year grew 3 percent, export earnings jumped nearly 15 percent, and over $3 billion of money deposited abroad (called "flight capital") has returned to Mexico as investors have regained confidence in their country.

As positive as these signs are, they mask a deeper problem. Since 1982, federal deficit spending has been financed largely by increasing the domestic debt. Interest payments on the estimated $60 billion in domestic debt last year absorbed roughly 45 percent of Mexico's public spending. State intervention in agriculture has contributed to this budget crisis by increasing federal spending on food price support programs while discouraging domestic food production. Agricultural subsidies for producers and consumers and Mexico's $3.5 billion food import bill for 1989 dwarf the estimated $1 billion in annual savings from the highly-publicized debt reduction agreement Mexico reached with foreign commercial banks last year.

Discouraged Farmers. Moreover, Mexico's inflationary fiscal and monetary policies since 1970 have driven interest rates above the reach of many credit-starved farmers. Farm credit rates, currently over 40 percent, increase farm operating costs and discourage farmers from planting crops when production costs exceed guaranteed crop prices. Interest rates may soar even higher when a "Solidarity Pact" between key government, labor, and business leaders, which has controlled wages, prices, and exchange rates since December 1987, is lifted. (Salinas last month extended the Pact to July.) The amount of idle farmland in Mexico will increase unless guaranteed crop prices are lifted to allow farmers to contend with the cost of farm credit.

Salinas could also reduce the burden of state agriculture on Mexico's budget by lifting price controls on agricultural products for urban consumers. But the political cost of doing this could damage the PRI as it faces in the 1991 mid-term congressional elections. The beneficiary could be the leftist Party of the Democratic Revolution (PRD), led by the fiery populist Cuauhtemoc Cardenas. Rising consumer prices later this year will erode the PRI's political support among powerful steel, mining, and teachers unions who oppose Salinas' privatization programs and wage controls. The consequence could be a shift of these traditional pro-PRI unions toward the far left and a boost for the PRD at the polls.

WHAT SHOULD BE DONE

Salinas so far has avoided the most dramatic and politically painful steps necessary for Mexico's agricultural reform. His farm reform package of January 6 is a good start, but only that. If he is serious about increasing Mexico's food production and ending dependence on foreign imports and food subsidies, he must propose fundamental changes in the Mexican countryside that would privatize food production. The U.S. should urge Salinas to:

♦ ♦ **Secure rural property rights for farmers.**

History, with evidence from around the globe, teaches that property rights are the cornerstone of political and economic development. The central failure of agrarian reform since 1917 has been the PRI's unwillingness to honor revolutionary hero Zapata's pledge that the land belongs to those who till it. Salinas should fulfill Zapata's promise by transferring rights of land ownership to rural peasants laboring on small *ejido* plots throughout Mexico. By providing farmers with property rights Salinas would eliminate politically motivated land redistribution and ease economic uncertainty within the farm community. Cash-starved farmers could use their land as security to obtain bank loans or sell it. Either way, investment would flow toward profitable and productive enterprises.

Salinas should work to revoke the government's right, under Articles 27 and 28 of the Mexican Constitution, to exclusive ownership of "strategic and primary" sectors of the economy. Article 25 also should be revoked; it establishes state planning of the economy as a constitutional right of government. These provisions undermine investor confidence in Mexico's economy and restrict the flow of private capital to the agricultural sector. Until these constitutional provisions are eliminated, institutional reform of Mexican agriculture is impossible.

The Mexican government should grant peasants full title to the land they work. Fewer than one-fourth of Mexico's farmers now have such a legally secure land tenure. The others thus are vulnerable to rival land claims by other farmers and PRI officials. Only when farmers really own their land will politically motivated land transfers come to an end and investment in agriculture expand. Without clear title to their land, farmers have no incentive to modernize or improve their operations

♦ ♦ **Privatize state-owned agricultural firms.**

The continued operation of BANRURAL, CONASUPO, and FERTIMEX as government monopolies on banking, food distribution, and fertilizer production virtually ensures the continuation of Mexico's agricultural crisis. State subsidies of these inefficient agricultural monopolies contribute to the public debt and reduce farm output by discouraging commercial risk and long-term investment.

BANRURAL should be restructured as part of an overall de-nationalization of the banking system. It could be either sold, perhaps to private farmers, farm communities, or liquidated entirely. Mexican economist Luis Pazos proposes that shares in BANRURAL be sold to private Mexican and foreign investors holding Mexican government bonds and other debt securities. These investors would "exchange" the Mexican debt that they hold for BANRURAL shares. This would reduce Mexico's $60 billion domestic debt. Mexico's Finance Minister, Pedro Apse, endorsed this concept last year, but powerful domestic political opposition has stalled movement on this.

FERTIMEX, the state-subsidized seed and fertilizer monopoly serves no commercially valuable role in Mexico. Fertilizer produced abroad is already available to Mexican farmers at prices below those of FERTIMEX. This money-losing state enterprise should be sold to private investors or local farm cooperatives.

♦ ♦ **Lift price controls on agricultural goods.**

The Mexican government currently guarantees a farmer a specific price for his crops. These prices, because of inflation and other factors, frequently are below the crops' market value. Guaranteed crop prices should be terminated. Climbing food prices will create incentives for farmers to produce more. As domestic food production rises, Mexico's bill for costly food imports would fall. Government food subsidies to consumers also should be ended. Initially this would cause retail food prices to increase. But the savings from reduced food imports and subsidies could be used to finance food stamps and other kinds of direct assistance for Mexico's poorest citizens to cushion the impact of rising food prices. Allowing the price of food to rise to its market value will introduce more competition into food processing, importing and retailing. This will reduce Mexico's costly dependency on food subsidies and eliminate shortages of food.

♦ ♦ **Remove legal restrictions on foreign investment.**

The Foreign Investment Law of 1973 requires that the majority share (at least 51 percent) of domestic businesses must be owned by Mexicans. Modifications to this law were announced last May 15. The new rules, imposed by Salinas, permit wholly-owned foreign investments in businesses valued under $100 million and in some selected sectors of industries such as tourism. The original 1973 statute, however, still empowers the state to review and restrict foreign investment. The new regulations also fail to allow conversion of foreign debt into shares in Mexican companies. To modify the statute, Mexico's Congress must amend the 1973 law by a two-thirds majority. Presidents following Salinas could rescind the new regulation without legislative approval.

Salinas should encourage PRI legislators, as well as members of the center-right National Action Party (PAN), to modify the 1973 Foreign Investment Law. Executive authority to restrict foreign investment in Mexico should be removed. By doing this, Salinas would lure foreign capital into vitally important agricultural marketing and shipping industries and encourage Mexicans investing abroad to bring their capital home.

CONCLUSION

Mexico's agricultural system suffers from a crisis of productivity – declining food production and the inefficient use of resources – caused by state intervention in the economy. Government price controls on wholesale and consumer goods have produced farmers who are fleeing the land and urban consumers who depend increasingly on subsidized food imports. Excessive public spending financed by domestic and foreign borrowing has stolen capital from the countryside. Constitutional restrictions on private property rights have robbed Mexican farmers of financial security and economic opportunity.

Restoring Mexico's farm economy in effect is a struggle for the country's economic and political independence. Mexico relies on food imports and foreign loans to sustain a population increasing by 2.5 percent each year. The agricultural crisis not only prevents the economy from supporting a growing population, it contributes to the illegal migration of hundreds of thousands of Mexicans northward into the U.S. each year. Peasants looking to migrate to the U.S. or to Mexico's already overcrowded cities may reconsider if they could make a better living at home.

New Economic Revolution. Salinas can revitalize the economy if he is willing to reform Mexico's agricultural system fundamentally. The success of his presidency, and of Mexico's entire economic reform program, depends on his willingness to move against such vested interests as unions and the state agricultural bureaucracy. The place to start Mexico's new economic revolution, as in 1910, is on the farm. To do this, Salinas should lift state price controls on wholesale food; privatize state-owned agricultural monopolies; end state ownership of farmland; and remove restrictions on foreign investment in Mexico. U.S. officials attending the upcoming U.S.-Mexico Commission meeting, to be held this summer in Washington, should encourage Salinas to initiate these fundamental reforms.

Mexico is not blessed by nature with the agricultural resources of other nations in North America, yet it does have the potential to significantly improve its food output. Property rights, free markets and competition will empower farmers with greater self-sufficiency and economic choice. The consequence will be not only an improved standard of living for Mexico's poorest farmers, but a stronger Mexico.

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