FRBSF Weekly Letter

Number 92-34, October 2, 1992

Ejido Reform and the NAFTA

The recently negotiated North American Free Trade Agreement (NAFTA) among Canada, Mexico, and the United States has received considerable attention, which has overshadowed somewhat the broad-based program of economic reform the Mexican government has been pursuing since the mid-1980s. These sweeping reforms, though not part of NAFTA, still have important implications for the country's trade with the U.S.

Mexico has unilaterally attempted to restructure its economy by allowing free markets to operate in areas where government intervention had dominated, as well as by deregulating other industries. Additionally, the Mexican government has worked to reduce uncertainty in the nation's business community by pursuing stable fiscal and monetary policies. Moreover, Mexico also has sharply lowered import tariffs and greatly reduced its import licensing program. Furthermore, reforms allowing foreign investment and ownership have led to waves of joint ventures in retailing and agriculture.

A recent change that has received little attention in the U.S.—but which may ultimately have important effects—is Mexico's restructuring of its agricultural land tenure policies. This restructuring likely will lead to increased consolidation of farming into larger, more efficient units, and to significant movement of the Mexican work force out of agriculture and into other sectors. The reform involves Mexico's ejido program.

In this *Weekly Letter,* we examine the effects of these reforms on Mexico and the U.S. The sweeping nature of these reforms, we argue, will have important impacts on agriculture in both countries, and can be expected to have major impacts on the Mexican work force. Moreover, while NAFTA may accelerate the effects of land reform, most of the predicted changes are likely to occur even if NAFTA is rejected.

Ejidos

Ejidos are Mexican farms or ranches under the collective control of groups that work them. Under the Mexican government's ejido program, a group of peasants could petition the government for access to farm land. The government dedicated public land to ejidos, and also acquired land for them from large private holdings. When the government formed an ejido, part of the land was held as a group enterprise, with the rest allocated to the use of individual farmers. By now, nearly half of Mexico's total land mass is held in 28,000 ejidos, occupied by more than 2.5 million farmers.

Although the ejido program did not become institutionalized until the 1930s, the government's role in this system is an outgrowth of the Mexican revolution that began in 1910. Under the regime of Porfirio Diaz (1876–1910), seizures of lands traditionally held communally by indigenous peoples were commonplace. In many cases, these seizures took place without due process and the land turned up in the hands of President Diaz' supporters. These abuses were among the motivations for the revolution that broke out against Diaz in 1910, when the chief advocate for land reform was the revolutionary general, Emiliano Zapata.

The new ejido system was designed to prevent the re-emergence of large private rural estates by making consolidation difficult or impossible. Ejido land could be farmed only by members of the cooperative or the individual farmer. Land size was limited (and has become smaller with further subdivisions by succeeding generations). Ejido farmers did not have clear title to the land, making it impossible to lease or sell the land, or to use it as collateral to obtain capital.

Despite the noble intentions of the ejido program, the result was a national agricultural system dominated by uneconomically small, undercapitalized farms. Although agriculture absorbs more than one-fourth of Mexico's workers, it is responsible for less than 10 percent of the nation's gross domestic product. Average income in this sector is only about one-third that of the rest of the economy. Most farmers in Mexico—inside or outside the ejido system—work properties of less than 12 acres. Moreover, because ejido farmers do not own the land, they have little incentive to invest in long-term capital improvements.

Ejido reform

The Mexican government has begun to pursue significant land reforms that have directly affected the ejido program. For example, last November, President Carlos Salinas de Gortari presented to Mexico's Chamber of Deputies an initiative for changes to the Mexican Constitution's Article 27, which covers agricultural land tenure. Noting Mexico's "insufficient output, low productivity," and "unacceptable living standards" in the agricultural sector, President Salinas proposed to open land ownership to greater market discipline by better defining property rights. Under the new rules, members of an ejido collective can rent land to non-ejido members, and can obtain full rights to the land—including the right to sell to other parties. Moreover, to protect those rights, the constitutional right to new ejido land has been eliminated, reducing the threat that newly private lands would be appropriated by the government for new communally held ejidos. Limitations on ownership are greatly reduced. Corporations now can own ejido land, for example. Moreover, foreign investment now is encouraged and foreign corporations can own Mexican agricultural land.

Though still in its early stages, this modernization of Mexican agriculture has already started to affect its relationship with the U.S. Even before President Salinas's initiative of last November, California growers had aggressively expanded into Mexico. Reforms removing many limitations on joint ventures between Mexican and foreign companies led to a large number of such ventures, particularly in the production of a variety of vegetables. While no firm statistics are available, informal surveys suggest that most large California agribusinesses are pursuing some operation in Mexico.

The implications of these reforms for Mexican agriculture are dramatic. Because ejido collectives can lease or sell their land, it will be possible to consolidate some of the fragmented ejido plots into larger, more efficient farm units. Furthermore, establishing private ownership rights to the ejido members creates a collateral base upon which to raise capital to modernize agricultural production.

Impediments to modernization

Ejido reform faces strong opposition in some regions. For example, agricultural reform is expected to prompt large relocations of Mexico's work force. At present, about 26 percent of Mexico's labor force is engaged in agricultural production, compared to less than 2 percent in the U.S. With increasing investment in Mexican agriculture and falling trade barriers, competitive forces are likely to motivate greater mechanization and consolidation and convergence toward U.S. levels of productivity per worker. As these efficiencies are realized, Mexico's demand for agricultural workers will fall, and it will be necessary for larger numbers of current agricultural workers to find other jobs. The large size of Mexico's agricultural work force suggests that these relocations are potentially very significant, and will involve considerable social cost.

Modernization also is inhibited by the lack of certain market institutions. Most grain in Mexico is sold to a state-run monopoly, CONASUPO. No commodities market exists. Moreover, while rights to ejido lands are better defined, they are still not completely defined, which makes it difficult to establish collateral values to raise capital for investment.

Physical infrastructure also remains limited. U.S. growers operating in Mexico report that while labor costs are only a fraction of those in the U.S., other costs, such as capital equipment, chemicals, and transportation are far higher because of current trade restrictions.

Role of NAFTA

Dramatic changes in Mexican agriculture can be expected regardless of the NAFTA's fate. Mexico has embarked on a course of modernization, and unless that whole effort is reversed, the process will require a reallocation of resources away from agriculture toward the production of other goods and services.

NAFTA can have an impact on the adjustment process, however. One of the strongest arguments for an agreement is the concern about waves of migrants leaving rural Mexico as agriculture is modernized. If NAFTA helps to speed development of Mexico's industry, through capital investments, joint ventures, and access to a broader market, jobs will be created to allow the farmers to retrain and stay in Mexico.

NAFTA also can speed the modernization of Mexico's agricultural industry. Access to U.S. machinery, pesticides, and fertilizers at significantly lower tariffs also should help boost efficiency and production in Mexico. Moreover, competition with highly mechanized U.S. corn and grain producers will force small ejidos to consolidate or change crops. Similarly, opportunities created by improved access to the large U.S. market will encourage more investment in vegetable and fruit production.

Implications for U.S. agriculture

Land reform poses a series of opportunities and challenges to U.S agricultural producers. Increased competitiveness of Mexican agriculture will keep pressure on U.S. firms to raise productivity or shift crops to those in which the U.S. has a comparative advantage, such as grains and livestock. Modernization is likely to expand Mexico's agricultural production and raise its ability to export vegetables and specialty products to the U.S.

The expected decline in the rural population may boost the availability of low-cost labor in the short run. Potentially large dislocations of rural Mexicans could lead to larger than normal immigration to the U.S., because other Mexican industries have limited short-term capabilities to absorb the displaced peasants.

Over the longer term, the supply of low-cost agricultural labor from Mexico may be disrupted. As more of the rural population moves to urban areas in search of nonagricultural jobs, the available supply of potential migrant workers from Mexican rural communities may be reduced.

Opportunities also are emerging, as California producers already have discovered. With the elimination of many of the restrictions on foreign ownership, Mexico now offers U.S. producers a way to diversify production geographically. Because of differences in seasonal climates, California vegetable growers, for example, can produce vegetables in Mexico to fill gaps in the growing season and provide supplies year-round. Low-cost Mexican labor also can allow U.S. growers to produce and process labor-intensive crops in Mexico (hand-picked tomatoes), while producing capital intensive varieties in the U.S. (machine-picked canning tomatoes).

Moreover, lower tariffs are likely to be a major boon to U.S. producers. Livestock and grain producers are expected to benefit from an expanded export market. Rising incomes in Mexico are likely to boost the Mexican demand for fruits, vegetables, and specialty crops. Because the U.S. and Mexican growing seasons are staggered, rising demand for such products will help producers in both countries.

Conclusions

By turning to a more market-based economy, running prudent fiscal and monetary policies, and encouraging foreign investment, Mexico continues to restructure its economy in ways that will allow it to benefit from trade with the United States. Land reform, in particular, promises to cause long-term changes in agricultural production, and, more generally, in the role of agriculture in Mexico's economy.

NAFTA may speed the transition of Mexico's economy to the extent that it lowers trade barriers and encourages capital flows into Mexico. However, failure to reach agreement on NAFTA is unlikely to reverse the forces already underway in Mexico. Even without NAFTA, Mexico and the United States can expect to become increasingly interdependent as businesses build ties that straddle the border.

Ronald H. Schmidt
Senior Economist

William C. Gruben
Senior Economist and Policy Advisor
Federal Reserve Bank of Dallas

Research Department
Federal Reserve
Bank of
San Francisco
P.O. Box 7702
San Francisco, CA 94120

Index to Recent Issues of *FRBSF Weekly Letter*

DATE	NUMBER	TITLE	AUTHOR
3/13	92-11	Will the Real "Real GDP" Please Stand Up?	Motley
3/20	92-12	Foreign Direct Investment: Gift Horse or Trojan Horse?	Kim
3/27	92-13	U.S. International Trade and Competitiveness	Glick
4/3	92-14	Utah Bucks the Recession	Cromwell
4/10	92-15	Monetary Announcements: The Bank of Japan and the Fed	Hutchison/Judd
4/17	92-16	Causes and Effects of Consumer Sentiment	Throop
4/24	92-17	California Banks' Problems Continue	Zimmerman
5/1	92-18	Is a Bad Bank Always Bad?	Neuberger
5/8	92-19	An Unprecedented Slowdown?	Trehan
5/15	92-20	Agricultural Production's Share of the Western Economy	Schmidt/Dean
5/22	92-21	Can Paradise Be Affordable?	Cromwell/Schmidt
5/29	92-22	The Silicon Valley Economy	Sherwood-Call
6/5	92-23	EMU and the ECB	Walsh
6/19	92-24	Perspective on California	Sherwood-Call
7/3	92-25	Commercial Aerospace: Risks and Prospects	Cromwell
7/17	92-26	Low Inflation and Central Bank Independence	Parry
7/24	92-27	First Quarter Results: Good News, Bad News	Trenholme/Neuberger
8/7	92-28	Are Big U.S. Banks Big Enough?	Furlong
8/14	92-29	What's Happening to Southern California?	Sherwood-Call
9/4	92-30	Money, Credit, and M2	Judd/Trehan
9/11	92-31	Pegging, Floating, and Price Stability: Lessons from Taiwan	Moreno
9/18	92-32	Budget Rules and Monetary Union in Europe	Glick/Hutchison
9/25	92-33	The Slow Recovery	Throop

The *FRBSF Weekly Letter* appears on an abbreviated schedule in June, July, August, and December.