Agriculture and Agri-Food Canada
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Mexico Agriculture Policy Review

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One in a series of policy notes on work of the OECD of interest to Canada

Context and Overview

The Mexican government asked the OECD to review its agri-food policies to better inform their policy framework in 2005. This policy review summarizes the OECD's findings.

Serious economic shocks in the 1980s and 1990s led Mexico to a more market-oriented and outward macro policy framework (Box 1). The North American Free Trade Agreement (NAFTA) was an important milestone in Mexico's turn away from a centrally directed, inward-looking economic system, towards a market-oriented economy.

As in other OECD countries, the relative importance of agriculture to the Mexican economy has declined, such that it now accounts for about 5% of Gross Domestic Product and 15% of the workforce. Although much of the north of Mexico is arid or semi-arid, the semi-tropical climate gives the country a natural advantage in the NAFTA market for many commodities. Mexico's agricultural sector however, is characterized by great disparities in farm types from highly commercialized to subsistence farmers and critical issues relating to the management of land and water resources.

Box 1: Macro shocks affected growth

Mexico's pre-reform policies inhibited its integration into the multilateral trading system. The economy suffered two major crises, prompting domestic reform. In 1982, due to a huge fiscal deficit, Mexico was unable to service its foreign liabilities. The ensuing debt crisis pushed Mexico's economy into a recession. Mexico's government responded by tightening fiscal policy and implementing a more disciplined monetary policy to stabilize the exchange rate. Trade policy was liberalized as Mexico joined the General Agreement on Tariffs and Trade (GATT) in 1986. In addition, product markets became freer with the deregulation of transportation and communication and the abandonment of price controls.

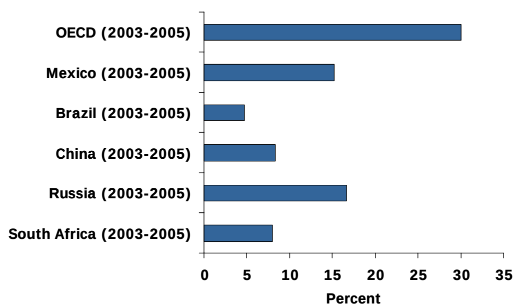
The Mexican banking sector was hit by another crisis in 1995, requiring massive intervention, including bank recapitalizations, take-over of some banks and debtor support programs. Mexico's banking sector is on more solid footing today. However, growth in domestic credit has been slow to recover and many small producers still lack access to credit services. The 1995 crisis also retarded economic growth and increased the incidence of poverty because of a loss of purchasing power.

Focused monetary policy and fiscal discipline, together with further market liberalization, helped the economy rebound, while limiting inflation. The creation of NAFTA and WTO membership combined with Mexico's reforms to promote further openness and integration. This boosted both imports and exports and concurrently attracted foreign direct investment, creating new jobs. While living standards have improved, disparity and poverty remain a challenge, especially in rural areas; most people living below the poverty line live in rural areas and are employed in agriculture. Remittances from migrant workers in the U.S. and, increasingly, Canada continue to be an important source of income for rural families.

Mexico has also undertaken significant agricultural policy reform. In the early 1990s, main Mexico's agricultural policies were a combination of price support and general consumption subsidies. Trade barriers and direct market intervention prevailed. Since the mid-1990s, the Mexican government has shifted away from commodity support to more decoupled forms of support, while also encouraging market liberalization. It has also deregulated input markets and partially reformed land tenure.

Overall support to agricultural producers, expressed in terms of Producer Support Estimate (PSE) percentage, has increased since the mid 1990s. It is high relative to other emerging economies like Brazil, China and South Africa, but remains modest compared with an OECD average (Figure 1). Producers of sugar, maize and milk receive the highest level of support.

Figure 1: Producers Support Estimates relative to gross farm receipts (% PSE) including non-member countries



Source: OECD, PSE database, 1986-2005.
OECD Monitoring and Evaluation: Non-OECD Countries, 2007.

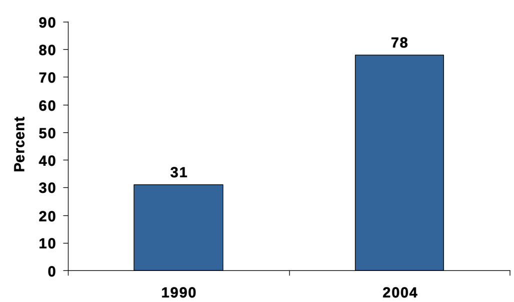
While improvements have been noteworthy, significant challenges remain. Market price support and input subsidies – the most distorting types of support identified by OECD – remain the leading forms of support to Mexican producers. Under-developed transportation and telecommunications infrastructure, low education levels, and problems in resource governance continue to act as a drag on Mexico's efforts to reduce within-country disparity and to close the gap vis-à-vis high income countries. How Mexico deals with these challenges will have implications for the agri-food sector, the environment, and the rural-urban divide.

More Decoupled Policy

In the early 1990s, Mexico's main agricultural policies were a combination of price support and general consumption subsidies. Trade barriers and direct market intervention prevailed. The *Compańia Nacional de Subsistencias Populares* (CONASUPO, National Company of Popular Subsistence) was the main policy institution. It supported producers through price floors on staples like maize and beans. It also subsidized urban consumers. Since then, the Mexican government has shifted away from commodity support to more decoupled forms of support, while also encouraging market liberalization. It introduced PROCAMPO, deregulated input markets and reformed land tenure.

In 1993, Mexico introduced PROCAMPO, the *Program of Direct Payments to the Countryside*, to help agricultural producers cope with lower trade protection and with removal of direct price support. By linking the payments to historical use of land, the program was designed to aid producers in switching to more profitable crops in the context of a more competitive economy. At the same time, by paying all land owners who grew one of the crops covered, the program benefits were also extended to small-scale, subsistence producers.

Figure 2: Estimated Transfer Efficiency of Mexican Agricultural Policy, 1990-2004



Source: OECD.

Improvements in policy design are also reflected in improvements in transfer efficiency. Defined as the ratio of the change in producer welfare to the change in policy expenditure, transfer efficiency is an important measure of agricultural policy efficacy. The effectiveness of Mexican agricultural policies at transferring income to agricultural producers has more than doubled over the last 15 years (Figure 2). While PROCAMPO was initially intended to be in place for 15-year transition period following the establishment of NAFTA, Mexico recently announced plans to continue the program until 2012.

Resource Governance Challenges

Lands and water resource governance issues are critical policy concerns in Mexico. A large part of the rural population is tied to small-scale farms; restrictions on land rental and sales have retarded the expansion of both small-scale and commercial farms. The 1992 Ejido reforms were an attempt to address some of the unintended adverse effects of these arrangements (see Box 2).

Water availability is a constraint on Mexico's development, but policies have encouraged the over-use of water resources by the agriculture sector. The government has provided agricultural water use exemptions from extraction fees. It has also provided sizeable subsidies to energy needed for irrigation. These subsidies have encouraged overuse of both energy and irrigated water. When farmers do not bear the full costs for water, they have little incentive to ensure that irrigation systems function properly, leading to over-use and low efficiency.

Water allocation reflects the subsidies received, not necessarily the highest and best use. OECD estimates that only one tenth of the water used goes to high value activities such as fruits, vegetables and oilseeds production, while half of total consumption is used for production of low-value cereals and forages.

The *National Water Law* (1992) aimed to regulate rights through concessions to specific quantities of water. However, due to a lack of monitoring and enforcement, extractions often exceed the amount permitted by water concessions. If concessions are not enforced, they do not limit water use, nor do they establish effective property rights. The number of aquifers known to be over-exploited has risen from 32 in 1975 to over 100 in 2005, endangering associated ecosystems and leading to growing soil salinity.[1]

The Mexican government has taken important steps towards proper pricing of access to water. In 2003, the government ended farmers' exemption from water abstraction charges. In 2004, it amended the *National Water Law* to involve stakeholders more directly in the management of water quantity and quality.

Box 2: Ejido land reform

Mexican agriculture is characterized by the two main forms of land ownership. One is private property where owners make productive decisions on an individual basis. The other form, the *ejido* system, is based on social property rights and accounts for more than a half of the Mexican territory redistributed during the "Agrarian Reform" era (1917-1992).

The *Ejido* Reform of 1992 was designed to strengthen private property rights by generating functional land markets and more efficiently allocating land. It allowed land rental and sales of land within community, but sales to outsiders still required permission of the assembly. Full privatization requires a 2/3 majority vote among community members.

Less than 1% of community members have chosen to privatize as a result of remaining restrictions, current tax treatment and the absence of social safety nets. Still, by freeing up labor on *ejidatarios* with limited agricultural comparative advantage, the reform may have contributed to an improvement in household welfare within communities through the expansion of non-agricultural activities that now represent the greatest share of income in rural areas. Defining property rights more clearly and allowing land exchanges both within and outside *ejido* would enable farmers in these communities to benefit still further.

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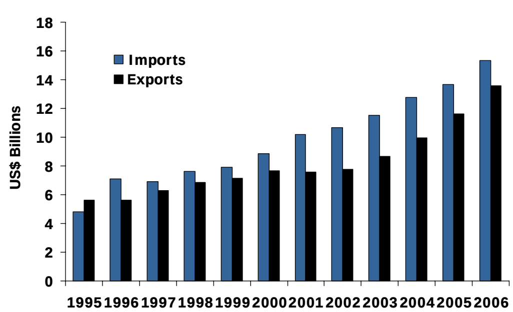
[1] These data relate only to the 202 aquifers measured and certified out of the existing 653, but are thought to accurately reflect national trends.

Agri-food Trade Grows Strongly

Both agricultural exports and imports have dramatically increased since the inception of NAFTA, reaching 13.6 and 15.4 USD billion respectively in 2006 (Figure 3). The European Union's share of Mexico's total imports is now much lower, while Canada's share has doubled. The United States remains Mexico's main trading partner, providing more than two-thirds of Mexico's imports and purchasing the vast majority of Mexico's exports. Mexico now exports more fruits and vegetables, processed foods and higher value products. This, combined with an overall increase in exports, gives evidence of Mexico's more market-oriented agri-food sector.

Figure 3: Mexico's Agricultural Trade, 1995-2006



Source: World Trade Atlas.

Policy Objectives Constant but Delivery Vehicles Improved

Mexico's policy objectives have remained relatively unchanged since the early 1990s, but targeting and efficacy have improved greatly. Objectives still include: raising the technical performance of both commercial and non-commercial producers; improving subsistence farmers' access to markets for inputs and services; and reducing rural poverty.

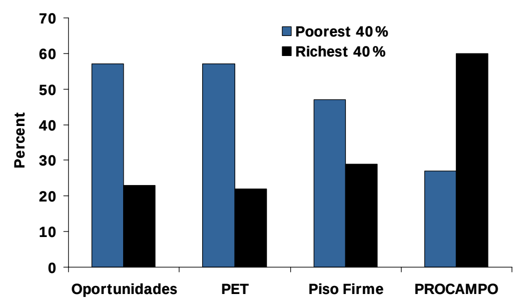
In its 2001-06 agricultural policy framework, Mexico attempted to:

- Raise agricultural production in an environmentally sustainable manner;
- Align productivity development programs with marketing opportunities domestically and abroad;
- Promote policies that create a level playing field with other NAFTA members; and
- Enhance efforts to eliminate poverty.

Rural poverty continues to be an ongoing challenge for Mexico as almost 60% of the poor live in rural areas and household food security is tenuous. However, macro reforms and trade liberalization seem to have improved matters since the mid-1990s, promoting greater diversity within the rural economy and improving access to NAFTA markets. Data from a survey of rural households show that the most important sources of rural household income now are non-agricultural salaries and wages (41%), followed by farm production (18%) and migrant remittances (12%). Total income generated by agricultural activities, including agricultural salaries and wages, now accounts for less than one-third of total rural household income.

While Mexico continues to use agricultural programs such as PROCAMPO to target rural development and poverty, it realizes that commodity programs are inefficient for meeting poverty-focused objectives. Broader social programs such as *Oportunidades*, the *Programa de Empleo Temporal* (PET) and *Piso Firme* are more effective in reaching the poor (Figure 4).

Figure 4: Distribution of Selected Programs within the Rural Population



Source: OECD.

Future Prospects

The progress Mexico has made in the course of its reforms is evident. It provides a platform from which to introduce further growth-enhancing policy reforms.

Challenges remain however – notably rural poverty, low productivity, under-developed infrastructure, and unclear property rights for both water and land. Improved incentives and targeted efforts and investments in these areas could improve the structure and consequently the competitiveness of the agricultural sector.

Agricultural policies are insufficient to address these challenges without coordinated initiatives elsewhere. Coordination across government initiatives is essential to ensure a coherent set of policies is put in place and implemented in a consistent, predictable way. Mexico's prospects at achieving sustainable growth depend on its ability to address these remaining challenges.

Mexico is Canada's third largest export market for agricultural commodities. In 2006, total Canadian agri-food exports exceeded $1.1 billion while agri-food imports exceeded $800 million. The full implementation of NAFTA on January 1, 2008 will put Canadian exporters of maize and dry beans on a more equal footing with U.S. exporters (who previously received favourable treatment), as these commodities cease to be subject to tariffs and tariff rate quotas.

Sources

OECD, Agricultural and Fisheries Policies in Mexico: Recent Achievements, Continuing the Reform Agenda. 2006.

For a link to the report:

OECD Agricultural and Fisheries Policies in Mexico: Recent Achievements, Continuing the Reform Agenda
http://www.oecd.org/document/26/0,2340,en_2649_201185_37704090_1_1_1_1,00.html

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