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COMPETITIVENESS-BASED RURAL GROWTH IN MEXICO

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MEXICO: COMPETITIVENESS-BASED RURAL GROWTH

A. Introduction

The North American Free Trade Agreement (NAFTA), upon ratification by the United States, Canada, and Mexico, went into effect January 1, 1994. NAFTA is the first trade agreement between a developing country and industrialized countries that incorporates agriculture – the most sensitive economic sector for trade negotiators.

Sluggish agricultural productivity and competitiveness deficiencies. Though many northern Mexican producers have done well, both the United States and Mexico feel the effects of Mexico's sluggish agricultural sector, which contributes to deficiencies in competitiveness. This lack of competitiveness increases social, political, and environmental stresses and hinders optimal market-led growth. If agricultural sector diversification is improved notably, this sector can provide a foundation for sustainable, broad-based growth, which is key to Mexico-U.S. relations. Raising productivity, however, must contend with: 1) decades of introverted political and economic structures; 2) land fragmentation and property insecurity; 3) limited rural finance services; 4) inadequate knowledge systems; and 5) and limited institutional capacity that hampers small and medium producers, livestock producers, and foresters' access to larger markets.

The NAFTA partnership provides a more collaborative forum and incentive structure for addressing key concerns. Many, less evident economic incentives exist for developing a more cooperative approach to addressing fundamental issues known to cause problems between the United States and Mexico, such as record numbers of displaced families and the catastrophic loss of biodiversity due to some of the highest rates of deforestation in the Americas.

Mexico is at a crossroads where structural changes will impact its ability to boost rural growth. The impending birth of the Free Trade Area of the Americas (FTAA) by 2005 will increase Mexico's need to raise its competitive stature among 31 other Latin American and Caribbean competitor countries. By 2008, trade tariffs on Mexico's agricultural products will be eliminated under NAFTA. All these changes at hand will increase Mexico's need to protect its own producers, particularly in its highly vulnerable southern flank that borders Central America, where these southern neighbors have negotiated better trade advantages under the United States-Central American Free Trade Agreement, or CAFTA. Furthermore, in 2006, the country will undergo further change when new national leadership takes over following presidential elections.

Stimulating rural growth. USAID/Mexico has requested an assessment of issues and options to help it adjust its natural resources management (NRM) portfolio to stimulate growth in rural areas. Mexico is not a traditional USAID development setting, and therefore an overview of Mexico's structural shifts presented below will highlight Mexico's extraordinary development challenges and opportunities. This paper presents options for USAID/Mexico to substantively and collaboratively contribute to discussions on Mexico's under-attended rural sector. In addition to providing a series of suggestions, this paper hopes to broaden USAID's and the U.S. government's strategic options.

B. Setting the Stage for New Initiatives

Neo-liberal reforms mark a major break from the past. In the time leading up to the mid-eighties, Mexico's economy was closed, controlled, and inwardly focused. Its agricultural sector – particularly primary cereals and staple crops – was the country's most protected sector with state-managed credit, input supply, product marketing, and delivery of basic extension services.

Like most countries of that era, the Government of Mexico (GOM) responded in the mid-eighties with structural adjustment lending reforms comprised of unprecedented macroeconomic reforms and major eliminations of public sector support for delivery of agricultural services. The GOM privatized state service, product markets, and food-related enterprises. It drastically reduced research and extension programs and opened the way for the first *ejido* land transactions.

Following decades of negative trade terms for the rural sector together with carry-overs from the earlier system, the private sector was slow in replacing the previous state-provided services, especially since the private sector perceived no market incentive to reach commercially viable enterprises.

NAFTA launched with GOM's transitional strategy. Not surprisingly, agriculture was considered Mexico's least competitive sector with the advent of the General Agreement on Tariff and Trade (GATT) and NAFTA: agriculture employed 23 percent of the work force while generating only five percent of the GDP. With tariff reductions, nearly 80 percent of enterprises producing cereals, legumes, and oil were of questionable competitiveness. Following NAFTA, producers and political parties increasingly reacted in opposition.

During NAFTA's initial transitory phase, scheduled to last until 2008, the GOM inaugurated a number of programmatic responses – including PROCAMPO, *Alianza para el Campo*, and *Oportunidades* – designed to stimulate enterprise shifts and help producers cope with competing, less expensive commodities. Since 1993, PROCAMPO, the largest initiative, has provided direct annual income payment transfers – currently averaging \$96 per hectare – to more than four million producers of traditional crops. In 2001, the Fox administration, backed by unanimous political party support, passed the *Ley de Desarrollo Rural Sostenible* that generated 12 rural development programs geared toward assisting the “fundamental base of rural poverty and food security.”

With the announcement of the U.S. farm bill in 2002 and further elimination of NAFTA tariffs in January 2003, producer and political opposition coalesced, illustrating the ever-growing politicization around NAFTA. A new comprehensive program was established: *El Acuerdo Nacional para el Campo*, a multi-faceted rural intervention focused on:

“Establishing the reform structures that are needed to confront the grave deterioration of the major productive sectors and rural society with a long term national development perspective by improving productivity, incomes, competitiveness, and transformation and productive diversification that improves the production, rural income, and economic dynamism en rural zones....”(GOM 2003).

The *Acuerdo* went into effect in April 2003 and is presently implemented in a highly decentralized multi-institutional structure by the GOM's Sub-Secretaría de Agricultura,

Ganadería, Desarrollo Rural, y Alimentación (SAGARPA). Over the years, tenacious political and producer special interests have generated additional subsidies and distortions that constrain market-based responses.

Sobering conclusions about Mexico and the NAFTA experience. Despite Mexico's 1994 financial collapse, during NAFTA's first decade, Mexico experienced positive income, growth, trade, and investments (The Economist 2004). For the agricultural sector, it was the expansion of exports, which had stagnated prior to Mexico's joining GATT. Following the country's signing of GATT in 1986, exports increased annually to 5 percent. Under NAFTA, annual exports doubled to 10.2 percent (Sarmiento 2003). Highly efficient commercial producers, usually residing in the north, dramatically expanded production of fruits and vegetables for export to the United States. Mexico's supermarket industry enjoyed extraordinarily rapid growth, as reported in Tom Reardon's accompanying theme paper, "The Rise of Supermarkets in Mexico."

During NAFTA, Mexico has become the leading agricultural supplier to the United States, providing 10 percent of all agricultural tariff lines such as lettuce, tomato, lime, zucchini, celery, garlic and many others (Lopez-Cordova, 2001). Furthermore, agro-food processing exports increased 9.4 percent annually, which is crucial for "agriculture's broader job and income contributions" (Sarmiento 2003).

Despite unprecedented export growth, Mexico's agricultural sector has "under-performed relative to the economy as a whole," (Lopez-Cordova, 2001) contributing to high levels of extreme poverty affecting 42 percent of all families in rural areas (Sarmiento 2003). Most rural producers are confined to the south, producing basic primary crops. Income disparities are high, which has been further exacerbated by demand shifts and international supply causing precipitous drops in limited value-added crops since 1985 (IICA 2002). These dynamics keep incomes low and the absorptive capacity of other economic sectors cannot sufficiently offset rural income needs.

With Mexico's year-round growing season and diverse agro-ecological conditions, ideally land and labor production would increasingly be applied to more remunerative endeavors. This could occur more rapidly in Mexico due to its proximity and easy access to the world's largest market.

However, as observed in an earlier USAID/LAC comparative study of the region's agricultural dynamics, Mexico recorded one of the lowest levels of intra-sector diversification of any LAC countries (Bathrick, Byrnes, and Stovall 1996). This study found that Mexico and Guatemala were the only countries that did not begin to shift from the cereals sub-sector, remarkably demonstrating slight trend line increases. Other LAC countries experienced positive shifts from cereals to more remunerative sub-sectors (fruits, vegetables, meats, and oils) that generate considerably more value-added jobs and income growth multipliers. The study noted that the more significant the intra-sectoral shifts, the more robust a country's national growth (Bathrick, Byrnes, and Stovall 1996).

Compared to similar countries, Mexico exhibits slow diversification of its agricultural sector and slow growth. From 1991 to 2000, Mexico's annual sector growth averaged 1.4 percent (World Bank, 2001). During this period on the world scene, the World Bank's eight fastest growing

“middle-income and low middle income countries” introduced positively regarded structural adjustment reforms and grew by 2.2 percent (World Bank 1997 and Institut de la Statistique 2002). One of Mexico’s leading rural economy analysts concludes that, with the exception of fruits and vegetables, *significant structural impediments* prevail across Mexico’s rural sector (USDA 2003 and Yunez-Naude 2002).

C. Addressing “Structural Impediments”

Twenty years ago the GOM began gradually to introduce unprecedented economic and trade reforms and major agricultural sector liberalization after decades of unsustainable “protectionist” policies. The Fox administration has expanded these reforms, maintaining essential monetary policies and introducing governance reforms and decentralization. Though some improvements have resulted, the rural sector has not grown sufficiently and current trends are not sustainable. While the NAFTA transition period to 2008 has been facilitated by various program interventions, significant structural impediments remain.

A more dynamic agricultural sector. Under the NAFTA trade partnership, the United States and Mexico now recognize that sound macro policy and trade integration form essential foundations, yet are insufficient to generate needed gains. To provide the foundation for broad-based economic growth, a more dynamic agricultural sector is required, coupled with effective land resource users and complementary off-farm employment. To successfully make the transition to 2008, it behooves both the United States and Mexico to involve more small and medium land-based producers in creating value-added employment that will link producers to national and international markets. This strategic approach forms the underpinnings of USAID/LAC’s “Rural Economy Prosperity White Paper.”

Surpassing traditional, production-driven programs. New linkages between producers and international buyers entail a sustained medium- to long-term commitment, facilitated by policies to reduce risk and enhance investment. Infrastructure and an institutional support framework will help stimulate powerful vertical and horizontal linkages through linking new products with Mexico’s manufacturing, industrial, and transport sectors. The serious challenge within this framework is to surpass traditional, production-driven programs. Producers can proactively analyze market-based needs and find ways to expand cost-effective support linkages among products, goods, and national and international processors and markets.

D. Suggested Adjustments to USAID’s Natural Resource Management (NRM) Portfolio

USAID/Mexico’s new economic growth interventions are outlined in its FY 2003-2008 Mexico Country Plan. These interventions are focused on the “Improved Management and Conservation of Critical Watersheds Development Strategic Objective (SO).” This SO commands resources between \$14.6 and \$29.9 million for disbursement to projects via numerous partners. Additional resources will likely be added this year. The NRM portfolio is highly regarded and operates through projects implemented by strong, seemingly well-run NGO and GOM programs.

Southern Mexico. The proposed options for expanding links with rural economic development are based on document review, meetings with project implementers and managers, and a visit to

Oaxaca. The adjustments are concentrated in southern Mexico, the central focus of USAID's NRM program, and the area with potential to benefit from CAFTA commerce beginning in 2005. Southern Mexico is the area of greatest economic need due in large part to the concentration of small-scale staple crop producers, growing areas of illicit crops, and limitations to infrastructure. Nevertheless, the area has commercial crops with great production and value-added potential (World Bank 2003).

Market opportunities for these producers, depending on market demands and ability to produce for those markets, will include NAFTA countries United States and Canada; CAFTA countries, with direct opportunities for Costa Rica, El Salvador, Guatemala, Honduras, and Nicaragua; and indirect opportunities for the northern NAFTA countries through value-added processing in the CAFTA countries for export to the United States and Canada.

These options increase to the extent that the number of free trading partners under NAFTA and CAFTA are expanded to include other LAC countries under the FTAA or potential plurilateral agreements (for example, "Group of 14").

Expanding southern residents' market-based experiences. To increase chances for southern residents to compete under improved market opportunities, the program builds on project relationships fostered through the portfolio's "*manchas de verde*" (patches of green) projects. The focus is further building upon recent early achievements in expanding southern residents' market-based experiences by facilitating linkages between regional and international markets to create larger "*islas de cambio sostenible*" (islands of sustainable change).

Establishing a strong beachhead on these islands of sustainable change, by increasing their capacity to produce higher-value and value-added agricultural goods for domestic, regional, and export markets — is the foundation for increasing rural sector demand for non-tradable goods and services, which will serve as the catalyst for increasing sustainable impact of the engine of rural economic growth and poverty reduction (J. Mellor, 2004).

Establishing sufficient product supply will generate value-added product transformation critical for broader economic multipliers. The consequence of these wealth-enhancing and risk-reducing measures stimulates producer and investor replication, which are essential for sustainable enterprise development.

To facilitate this essential economic transformation process, three illustrative support activities have been identified that can help link small and medium-sized producers to markets in ways that avoid engendering traditional local-level paternalistic dependencies. As envisioned, they could be supported within a competitive grants fund. Proposed support activities might include: 1) stimulating greater economic focus through promising local development projects as illustrated by one of the Office's current partners in Oaxaca; 2) aggressively expanding promising product lines; and 3) the provision of complementary marketing and support services as offered below.

D1. Stimulating Greater Economic Focus through Promising Local Development Projects: El Comité Técnico de Aguas Subterráneas de los Valles Centrales, Oaxaca

This USAID-assisted, Oaxaca-based NGO has worked with *La Comisión Nacional de Aguas*, an organization comprised of 140 water user organizations, local municipalities, producers, and irrigation and business leaders, who will introduce water efficiencies via aquifer and watershed management throughout the Alto Atoyac Watershed. The vast majority of producers depend on production of low-value maize and bean on half-hectare plots.

Crop diversification through improved drip irrigation has proven one of the most promising USAID initiatives in the area. Through provision of the improved water system, production on traditional plots has been intensified by introducing alfalfa for fodder for small dairy (milk and cheese) production operations. Traditional maize production methods generate \$53 per annum; while the drip irrigation innovation generates \$247 per annum for maize producers; and \$1,651 for alfalfa producers.

Northern Mexico currently fills the demand for 35,000 tons of tomatoes required by the local supermarkets. In addition, there is an identified local demand for chile and cauliflower products that could be produced locally.

El Comité Técnico de Aguas Subterráneas de los Valles Centrales, Oaxaca (COTAS) has recently provided 50 of its 450 members with tomato production technologies to meet the demand of local supermarkets. Initial estimates indicate that irrigated tomatoes on the same land area will generate \$3,669 (COTAS, 2004). These new product lines have attracted producer interest for project expansion and a follow-on concept proposal to USAID is being developed.

Given the importance of this initiative at this moment in USAID's program, below are some initial points for the Mission to consider in its review, with a brief description of an illustrative competitive grants project, SMDSF, as a new mechanism for stimulating similar agricultural activities in the south.

Guidance to COTAS for Proposed Expanded Phase. Recently COTAS has been involved in critically important initiatives designed to respond to the market and to facilitate small farmers' engagement in more highly remunerative market-driven activities. Several potentially problematic observations were made: 1) tomato seed did not yield uniform harvests and plant variations; 2) greater care is needed in producer production, post harvest, sorting, and packaging technologies; 3) no systematic market system exists that could serve as the master guide for initial variety selection, organizing production, and coordinating harvesting cycles; and 4) there is no institutional capacity to help local producers achieve sustainability.

In its follow-on proposal to USAID, COTAS wisely contemplates significant producer contributions generated by the PROCAMPO and *Alianza* producer diversification support programs. The proposal anticipates \$1.3 million in USAID support to expand greenhouse operations, cold storage and packing facilities, and other investments. In order to build upon project progress and for successes to carry over into the next phase, an evaluation of tomato production practices is recommended. In addition, a specialized product marketing professional should carry out an assessment of alternate markets to capitalize on year-round demand not satisfied by producers in the north.

Given the demand from the local supermarket and restaurant trade, a projected business plan should be outlined for USAID approval. The plan will serve as the basis for elaboration of a sustainability strategy, which will ensure that beneficiaries make the requisite labor, management, and financial commitments to ensure product quality, competitiveness, and significant returns. Contract buyer arrangements, business-to-business and joint ventures, business incubator services providers, and producer-owned *empresas campesinas* should be developed to ensure continuity of services and infrastructure.

Creating the Southern Mexican Diversification Support Fund, SMDSF. Prior to availability of funds through new sources, an assessment of the SMDSF should examine funding and regulations for the *islas de cambio sostenible*. Guidelines for funds management need developing, and an introductory workshop held to present the fund to bidders. Once the application process is defined, potential fund recipients can participate in a bidders conference. NGOs and other organizations would participate in a competitive grants program focused on stimulating commodity diversification, employment generation, and institutional capacity building. Grantees would receive advances of capital to invest in key technical, marketing, and management services, and basic plant stock or inventory, as defined by market assessments.

Proposals would undergo rigorous review by either a Mexican institution or an external implementer (to be determined during the initial SMDSF review), which would be responsible for the fund's overall management, review and award of grants, monitoring, financial control, grantee procurement services, and provision of as-needed technical and management support. The first three to five years of the program would be geared toward development of quality products, improving operational efficiencies, business plan development, and facilitation of the transition to a sustainable institutional relationship.

D2. Aggressive Promotion of Promising Products

Virtually all USAID NRM programs and some GOM collaborator initiatives deal with resource-based product lines and associated business development. Many NRM initiatives address the same products, including the very promising shade grown and organic coffees. Cacao is also among promising products, including non-timber products, certified timber and timber products, intensified livestock/dairy operations, and tourism, which can take advantage of Mexico's net importer status, and which should be supported under the fund. In addition, the World Bank has identified potential product lines, including tropical fruits, wood and non-wood forest products, which demonstrate considerable potential (World Bank 2003). These product lines provide another avenue for receiving priority assistance under the SMDSF.

Broader, product-specific lines will facilitate the creation of the *islas de cambio sostenible* by providing critical product supply that will generate more robust economic and sustainable impacts. While the notion is not to pick "winners," similar selection criteria could be used to broaden the range of products to develop diverse production activities in the south, if determined to foster cost-competitiveness. Grantees need not be participants in the program, and could include organizations with direct ties to national and international businesses. Over time, the goal is to expand the geographic area and number of producers benefiting from these *islas de cambio sostenible* so that, as they expand and begin to overlap (intersect), they will create an "ocean of

sustainability,” meaning a sustainable rural sector that is a vibrant contributor to overall economic growth and poverty reduction in Mexico.

Case Study: Promoting quality shade grown and organic coffee. The Mexican coffee market presents notable paradoxes. On the one hand, Mexico is the world’s leader in organic coffee exports, with 90 percent of production going to export. It prides itself on having one of the most highly acclaimed shade grown coffee projects in the world, the product of a partnership between Conservation International and Starbucks in Chiapas. On the other hand, Mexico’s coffee has a poor market image and it is generally perceived as low quality, an image that results in low commodity exchange prices for Mexico at the New York Stock Exchange: this negatively impacts the income of non-niche, non-specialty coffee producers.

Furthermore, for all its wealth, Mexico is one of the lowest per capita consumers of coffee that could be addressed via improved product marketing and promotion activities. Quality enhancement and promotion are needed to maximize Mexican coffee’s potential and improve its image and price in the world market. A coordinated approach will counteract the prevailing low quality “bland blend” filler image that reduces producers’ incentives to strive toward producing higher quality products. To assist Mexico in breaking into the specialty coffee market, the Mexico Mission should be represented at this year’s annual meeting of the Specialty Coffee Association of America (SCAA) in Atlanta. Mexican participation in the SCAA coffee World Cup will afford the country’s delegation the opportunity to witness the market’s 15 percent annual growth rate.

Working with Mexican specialty producers, industry leaders, and SCAA leaders, Mexico can identify first steps needed to break into the market. SCAA coffee promotion experts can assist the Mexican specialty coffee movement in development of a national coffee appreciation campaign to highlight specialty coffees and promote coffees to hotels, supermarkets, and through cupping competitions.

Product development campaigns should be designed and attention drawn to production and post-harvest fermentation controls in order to introduce maximum quality control and product differentiation practices. A commodity-specific proposal, complete with marketing, promotion, and institutional development needs should be elaborated to identify mechanisms for generating broader economic impacts. These will be developed based on a market industry-oriented review with SCAA and Mexican specialty coffee leadership.

D3. Stimulating Complementary Market Support and Sustainable Economic Growth

NRM office partners expressed that a common limitation to facilitating greater economic impact for rural, inappropriately equipped producers is the inability of producers to deal effectively through the prevailing oligopolistic intermediation and segmented system (World Bank 2000).

Much of this is the consequence of the legacy of state-run services that fostered little private competition. Scarce private competition reduces producers’ incentives to invest in the production of higher quality products and capture the resulting higher remuneration and value-added gains that can be achieved by selling those products to the market.

Traditionally, NGOs have provided only limited expertise in technical, marketing and support services, which are critical for achieving potential economic multipliers. Thus, for the most important products, these services are required to maximize benefits from USAID and other GOM-sponsored programs with donors such as the World Bank's *Programa de Conservación y Manejo Forestal* (PROGCYMAF). The PROGCYMAF is presently constrained due to the lack of support services.

Technical expertise and support services will improve product marketing assistance to develop special systems with the potential to generate maximum producers' returns. Rural producers need mechanisms for gathering market intelligence and other services ranging from label preparation to product promotion in the United States or in Mexico's supermarkets, as well as supplemental market support services to projects financed by the SMDSF.

Additional support is needed for business, management, and institutional strengthening services provided by specialists in accounting, auditing, legal, credit application, and business plan development [The support should target local first- and second-tier activities, and possibly for key medium and small enterprises (MSMEs)], and help access the very best of production and post harvest technical skills.

E. Strategic Options for USAID and the U.S. Government

A preliminary evaluation of strategic options could be carried out quickly if implemented collaboratively by USAID and the GOM. The anticipated outcome of this evaluation would be a list of examples of how a larger number of small and medium-sized producers could gain a share of the growing national and regional market.

On a broader scale, mutually supportive interventions are needed to respond to the growing range of trade liberalization issues. A series of more complex, second generation issues must also be considered. Although the GOM and some private sector members have begun to address these issues, additional measures will be required to facilitate the transition.

Broader bilateral issues must be brought to the table rather than the current overemphasized commodity-specific concerns, according to a senior GOM official deeply involved in the process of transforming Mexico's agricultural sector. The system is not sufficiently addressing the complex issues that will hamper both countries' progress.

Therefore the following section outlines the processes required to achieve a strategic assessment, political support, and public awareness. The section examines areas of primary technical importance and roles and responsibilities of each member of the political structure.

E1. Strategic Assessment Paper

USAID/Mexico's current review stresses key thematic areas: property markets, rural finance, and supermarkets, however, broader needs must be considered. For example, the United States Department of Agriculture (USDA) has identified a comprehensive listing of structural challenges that "will likely become increasingly pressing" (USDA, 2003).

Accordingly, further analysis of dynamics is needed to stimulate greater synergies with our fastest growing trading partner, for example: 1) the likelihood of USAID receiving additional resources; 2) the large resources that the GOM has invested and the contributions made by other donors; and 3) the growing importance of this topic to the Mexican and U.S. governments.

Such an activity could also serve as a useful program format for USAID investments and could facilitate reforms and complementary support in critical areas related to: 1) more favorable policy framework and constraints in mutually supportive factor markets and product linkages with other economic sectors to stimulate more optimal broad-based growth; 2) stimulating critical infrastructure needs in key areas ranging from farm-to-market roads to regional packing points, irrigation technologies, information systems infrastructure, improved refrigeration, processing, and manufacturing facilities; 3) facilitating greater market linkages, business skills, and related transition mechanisms adaptable to the realities of economies of scale to stimulate greater rural investments; 4) providing the framework necessary to stimulate broader marketing and rural financial services; and 5) introducing dynamic knowledge dissemination systems and technologies related to diversification, providing value-added transformation products, and natural resource management practices. This exercise will improve the countries' chances of making a suitable transition.

E2. Support for the Mexico-U.S. Agenda

As Mexico's transition advances toward tariff-free NAFTA status in 2008, increased sensitivities related to agriculture's performance and further politicization create potential obstacles. Both countries have made important transitory commitments, but divergent issues and dynamics on both sides during increasingly fragile economic and political times cause increased vulnerabilities.

Considering the anticipated expansion in the assistance program, an additional, admittedly unorthodox, strategic intervention may be warranted in light of these challenges and the relatively short window of opportunity.

Sustained political leadership through 2008 is not constitutionally possible, therefore, a special transitory "window" should be explored. Given President Fox's commitment to NAFTA and the modern changes introduced by his administration, he might pursue a more aggressive agenda if his trading partner were making a more comprehensive government-to-government gesture of support.

During this high stakes transition period, such a high-level, collaborative effort has the potential to stimulate broader support to keep momentum going past 2006 through 2008, which will advance the framework critical to NAFTA. The aforementioned Strategic Assessment Paper could be an important tool in framing this endeavor.

E3. Increasing Public Awareness

Economic uncertainties create fears around agriculture, which has become a lightning rod for controversy and conflict. Apart from the difference of opinion on competitiveness, polarization has occurred over subsidies, dumping, and non-tariff barriers, and potential exists for

manipulation and creation of confusion and discord. Special activities and target groups are proposed below to help bring all stakeholders to the table.

E4. Political leaders

These complex topics are often subject to misunderstanding. There is no equivalent to the United States Congressional Research Service to provide more balanced assessments and to help interpret the consequences of proposed legislation, intervention, and treaties in the context of the broader national good. Certain USAID projects, such as that in Honduras Economic Policy Project (PEP), have provided alternative information and research summaries to national political parties and parliamentarians, as the Government of Honduras prepares for CAFTA. Given the sensitivities and numerous rent-seekers, a nationally coordinated and operated service warrants consideration.

E5. Producer groups

Diversity of opinion abounds and current and reliable information is lacking. This impedes constructive dialogue among producer groups, national and state policy makers, and political leaders. Discussion of costs and competitiveness are necessary for constructive dialogue. Special consideration should be given to providing assistance based on reliable data and supply and demand in order for producers to make informed and pragmatic decisions. Periodic seminars and publications presented in layman's terms become increasingly important.

E6. Mass Media

During this period of major economic change and related uncertainties, significant but poorly understood adjustments are occurring across societal lines. For example, in general terms consumer benefits arise from cheaper products while in general, in the agricultural sector, there are many diverse losers in relation to cheaper imports and winners in relation to expanded market opportunities. Some commodity specific groupings will of course increasingly defend their interests as tariffs are reduced. As observed in Chile, Costa Rica, and until recently in the Dominican Republic, the sooner the appropriate responses to these concerns and dynamics are addressed in ways that advance national interests, the more rapid and agile economic adjustments are embraced.

Reliable information needs to be gathered at all levels in order to support the learning curve. Major national competitiveness challenges must be articulated and embraced. These themes will require special messages in terms of news briefs, television and radio broadcasts, and seminars for communication of information in order the debate may be fomented.

E7. Special Exposure

While diverse target groups require foremost attention, there are complementary means for sharing perspectives. These range from conducting seminars and information exchanges for these groups to providing assistance through research grants for independent research. More direct assimilation and identification could be done through study tours examining similar situations, for example, in Chile where participants can witness the best example of serious and sustained

efforts made to maximize the Chilean resource base and increase labor force competitiveness over the past 25 years.

E8. Priority Issues Requiring Review and Response

In addition to the priority needs and opportunities provided in the other Theme Papers, special research, comparative analysis, and innovative responses should be elaborated on several key topics. This research should be conducted by preeminent Mexican and international specialists, and could be used to help shape national policies, strategies, public and private sector investments, and to contribute to a national debate. These should be considered early as additional complementary elements in this multi-faceted process toward facilitating change.

E9. Improving Mexico's Rural Sector Competitiveness

Increasing Mexico's competitiveness is urgent to national well-being. The World Bank will be initiating a study during the course of the year. Given the topics' importance, it is vital that the research and analysis be performed as soon as possible and that the key strategic responses be clearly cast. In this regard, USAID would be wise to participate in the development of the scope of work, and in the implementation process.

E10. Investing in New Technologies

In light of neglect to technological development and the role it plays in improving productivity, new knowledge systems are critical. The donor community must stretch beyond traditional production-driven systems to look at real market needs and market-driven opportunities, efficiencies, competitiveness, and the sustainable use of natural resources. USAID and USDA and their elaborate industry outreach systems and the land grant university system could work collaboratively with the GOM and the Inter-American Development Bank (IDB) and the World Bank to design and establish the most appropriate mechanism for responding to changing needs.

E11. Articulating the Rural Diversification Process

Clearly a variety of potential interpretations and needs must be outlined and shared broadly. They range from responding to food security needs via staple crop intensification that frees up limited land for more remunerative pursuits to actual safety net programs. These build on the GOM's current transition programs and provide additional materials with which to confront growing uncertainties. For example, for a considerably large portion of the producer population, maize availability forms the immediate, family food security priority. Prior to commencing with any meaningful farm enterprise land use shifts to more remunerative crops, maize self sufficiency is paramount. The International Maize and Wheat Improvement Center (CIMMYT) is doing some limited research of this kind which may lead to "freeing up" land for other pursuits. Other priority areas include mixed agro/silva/pastoral work and the enhancement of priority market-based commodity systems. The articulation of illustrative guidelines and complementary programs is needed to further facilitate enterprise shifts.

E12. CAFTA and an Adjustment Strategy for Southern Mexico

Little strategic planning appears to be underway in this area. Most of Central America produces similar crops to those in southern Mexico. A study to assess competitiveness challenges and opportunities to mobilize support mechanisms is crucial for maximum mutual gains. Given the region's poor basic infrastructure system, Tapachula or Oaxaca are examples of successful product collection and processing centers for national and Central American products. These cities possess warehouse and sorting areas for efficiently forwarding supplies north. Under such a study, regional development would enhance the ability to view the region more broadly and strengthen new market activities that could create southern/northern synergies around agricultural, rural and urban demands and opportunities. The sooner these approaches are studied and promoted, and the sooner investments are made in these approaches, the better.

E13. Expanding Capacities in Northern Mexico

Northern Mexico has been the real agricultural sector winner under NAFTA. The ever-diversifying fruit and vegetable product line has sparked ever-expanding and greater market shares.

Given this rich productive base and the major transformations that will take time to stimulate in the south, there may be ways to expand job growth in such areas as: 1) improving critical infrastructure; 2) greater adherence to plant and animal health and meat standards; 3) promoting special niche market product lines in the growing organic food products industry; 4) expanding value-added product processing and food industry activities from national products including slaughterhouse and organic meat; and 4) pursuing greater north/south product linkage ties to provide growing season complementarities or product diversification within established market systems. Research should be conducted to determine how this initial positive experience can expand in ways that enhance competitiveness and generate more jobs.

F. U.S. Governmental Support Activities

F1. State Department

Clearly the importance of development has been internalized, which forms an institutional base for mobilizing U.S. resources and national interests to facilitate national rural sector transformation process. The reinforcement of recent events and the mutually supportive message from the U.S. ambassador downward serves a critically important role at all operational levels. Sharing this message at all levels of Mexican society is an important vehicle for stimulating action and engendering widespread confidence in the system.

F2. USAID

Mission management has assumed responsibility for assisting the U.S. government in confronting this development challenge. USAID is a key institution in advancing a critically important U.S. government objective within an atypical environment that will require robust, innovative, and dynamic support measures. USAID/Washington will have to provide support commensurate with this unique mission.

At the outset, appropriate responses will build on ongoing projects, but in time they will require the establishment of broader programmatic initiatives to achieve far-reaching results. Measures will have to be taken to set the stage for sustainability of new policies within the GOM. An injection of new technical expertise in economics, agronomy, and business development will be needed.

USAID will need to work with the multilateral donor community to help harness their programs along with new support relationships with the Instituto Interamericano de Cooperación para la Agricultura (IICA), the Food and Agriculture Organization of the United Nations (FAO), the International Fund for Agricultural Development (IFAD), and CIMMYT.

F3. USDA

USDA has provided invaluable support to advancing NAFTA, mostly in the agricultural sector. Given USDA's mandate, this responsibility has not always generated acceptance in certain circles of Mexican society, which do not fully appreciate USDA's responsibility to comply with U.S. government regulations.

USDA enjoys a tremendous range of official, commercial, political, and producer contacts and exerts particular efforts to explain the U.S. farm reality and to relate the increasingly sensitive issues raised by the diverse and powerful commodity groups in the United States. Increasingly many Mexicans view these less favorably nonetheless. To advance sector-specific assistance, Deputy Administrator Luis Luna advanced a high-level mission last October that helped identify many cooperative and collaborative assistance issues actively addressed in this effort. With the advancement of a more directly supportive and facilitating role for Mexico during this extremely sensitive transition period, this broader effort should help facilitate the pursuit of initiatives of mutual interest to the United States and Mexico.

F4. Treasury

The multilateral donors have commanded the greatest presence in bolstering many of the large GOM's agricultural support programs geared toward facilitating producer transformation. These donors made significant investments in rural sector finance and agricultural research and extension. Some programs have not been as effective and adaptation to changing realities has been slow. Under this multi-faceted USG/GOM initiative, more regular sessions will be needed with the highly supportive Mexican-based offices for the IDB and the World Bank. Perhaps joint reviews of the most critical investments should be undertaken. Given the importance of harnessing the best program response to different realities and dynamics, special efforts will be required to facilitate regular exchange with the U.S. executive director in Washington.

G. Conclusion

Mexico is fully aware that a most pressing challenges lies with enhancing the competitiveness of its rural sector in order to generate greater and more sustainable growth. The evolving dynamics created by a decade under NAFTA permit both Mexican and U.S. trade partners to see the importance of collaborating to confront this pivotal issue that will prove essential to the well-being of both nations.

The preliminary findings from this review indicate that Mexico has observed important economic contributions (Economist 2004) as a result of NAFTA. However, despite GOM efforts to overcome remaining structural impediments and the agricultural sector's significant contributions to Mexico's economic growth, these issues continue to hamper the sector from enjoying more robust and sustainable growth.

Compared to other countries that compete with Mexico in the hemisphere and around the world, Mexico's agricultural sector has many complex impediments that limit its capacity to compete fully while generating broad-based growth. This is due, in part, to the disproportionately large segment of the agricultural producer population still dedicated to cereal crops that suffer diminishing market and value-added contributions when compared with other land uses and off-farm endeavors. This continued trend will likely only widen economic inequalities that are exacerbated by limited competitiveness. In addition to creating many byproducts, the reality stimulates increased social migration and environmental degradation, which are especially notable in southern Mexico where free trade has not demonstrated broad benefits.

This theme paper has aimed to provide USAID/Mexico with possible strategic adjustments to its ongoing portfolio. These adjustments focus on providing support to a broad strategic vision that will help stimulate a larger number of small and medium-sized agricultural activities. Land resource users and complementary off-farm employment activities are expected to generate more remunerative, value-added employment opportunities that link producers to national and international markets. From this initial effort, a new experiential base can be formed to demonstrate to producers and investors that risks can be reduced, market niches carved and maintained, and that new participants can make gains.

G1. Development of the SMDSF

If USAID, through further analysis, decides to pursue the SMDSF option, the SMDSF would build upon established local promotion projects where trust has been built around nascent market-driven experiences. Sub-grants would be awarded through a competitive grants mechanism managed by the SMDSF to enhance competitiveness. Sub-grants would also promote enterprise diversification and increase local institutional capacity to create sustainable enterprises for a larger producer base that would address one of the most important challenges: that of creating a mechanism to enable the maximum number of appropriately equipped producers to achieve market access with higher value products and merchandise.

To better understand the SMDSF's operations, this paper describes how one ongoing project in Oaxaca – *El Comité Técnico de Aguas Subterráneas de los Valles Centrales* with its efforts to respond to the 35,000 ton shortfall of tomatoes to Oaxaca supermarkets – might be accomplished through the adoption of new drip irrigation technologies introduced to traditional producers.

This paper describes how this potential “model” might be reviewed and promoted for the benefit of producers to create a base for larger, sustainable impacts. The section describes how promising product lines engaged or identified by the World Bank in southern Mexico could be expanded via innovative, market-responsive ways to generate multiple impacts. The most viable initial example appears to be for shade and organic coffees, while others include cacao, non-

timber forest plants and products, certified timber and timber products, tropical fruits, intensified livestock/dairy operations, and tourism. The initial programmatic intervention would provide for essential complementary market skills covering critical topical areas from market intelligence to product labeling for national markets to address, for example, the major expansion of the supermarket industry throughout Mexico, or in neighboring CAFTA countries, and in the United States. Other interventions would involve technical and management expertise to support production and post harvest technologies and business support and sustainability services

Given the magnitude of issues Mexico confronts, the second objective of this paper is to provide strategic options for the USAID and the U.S. government to collaboratively pursue in Mexico. In relation to the needs both countries express, and the growing opposition to trade liberalization, a broader series of interventions are required to frame the broader responses.

G2. Strategic Support to NAFTA

Time constraints and the complexity of Mexico's challenges and opportunities did not provide sufficient time to develop the analysis and strategic framework commensurate with Mexico's special needs. A medium-term strategic framework developed in close collaboration with a variety of Mexican institutions is warranted, given the mutual importance and likelihood of additional resources, and the need to help focus other donor resources.

G3. Direct Support for Mexico/U.S. Agenda

Many of Mexico's politically sensitive structural impediments affect NAFTA's transition to 2008. Squeezed within this reality are national elections. Given the mutual importance and historic nature of the times, the political risks and diversions could be reduced via a major joint support effort to enhance Mexico's rural competitiveness. In this context, it would be imperative for the USAID and the U.S. government – starting of course with the ambassador – to craft a support program through 2006 and for the medium term beyond 2008.

G4. Increasing Awareness Across the Board

In all parts of the world, today's changing economic realities cause new and complex economic, business, and societal uncertainties. The rural sector is vulnerable due to the uncertainties of competitiveness, subsidies, dumping and non-tariff barriers, plus the prevailing attitude of limited regard for agriculture.

Rarely is the agricultural sector seen where land and labor comparative advantages and access to the world's largest market place it in an advantageous position as a critical additional engine for national prosperity. Appropriate interventions to the specific target groups defined below need attention.

G5. Issues That Require Special Attention

A series of critical areas requiring special research, comparative analysis, and innovative response is imperative to help Mexico enhance its rural competitiveness. These areas can be examined through the efforts of learned Mexican experts, collaboration with other donors, and

USAID consultants. Key priority areas identified initially relate to: 1) analyzing Mexico's rural sector competitiveness; 2) assessing Mexico's market-based technology generation and diffusion systems; 3) analyzing and articulating the rural diversification process to help producers identify options and assistance efforts ranging from enterprise diversification, food security, safety nets; 4) assessing CAFTA and the development of a southern Mexico adjustment strategy to gain and prosper; and 5) reviewing product expansion and value-added capacities in northern Mexico to generate more Mexican growth.

In addition, to better highlight the essential mutual supportive nature for helping harness the most mutually beneficial transition period, a section describing the essential support activities for the U.S. government is provided to include the State Department, USAID, USDA and Treasury.

It is hoped that during this special historical transition period toward a new era of Mexican and U.S. relationships, this paper provides some initial guidance and direction. Timing and sector dynamics requires special urgency, focus, thought, and joint consideration based on the evolving partnership. What happens over the next few months will be crucial in establishing the initial bases essential for better influencing the uncertain path. The anticipated progress will address rural sector dynamics occurring worldwide. What lessons learned here in the new era of rural sector transformation forms a potential primer for shaping assistance efforts for other countries for years to come.

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