


9-7

Coffee, Policy, and Stability in Mexico

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CASE STUDY #9-7 OF THE PROGRAM:
“FOOD POLICY FOR DEVELOPING COUNTRIES: THE ROLE OF
GOVERNMENT IN THE GLOBAL FOOD SYSTEM”
2007

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Executive Summary

The fact that poor people will resort to violence to change the political and economic system that they believe is responsible for their poverty is not new. The link between poverty, violence, and instability has started to figure prominently in the agenda of strategic discussions in global fora and national governments, sparked by the increased sense of threat from terrorism felt by societies in developed countries. Analysts seem to agree that poverty, combined with a long list of factors, including ethnic disparities, social and economic inequalities, and resource disputes, can prepare the ground for conflict.

Although poverty itself does not cause violent conflict, it does provide a basis for it. This case study is about the probable link between poverty and violent social uprisings in rural Mexico. It illustrates how the sudden exacerbation of poverty and exclusion, provoked largely by the implementation of market liberalization policies, may have been the trigger that led thousands of people to turn to violent rebellion against the rule of law, with immense and far-reaching social, economic, and political costs.

In the early 1990s, coffee-producing populations in southern Mexico, already living in poverty and in generally marginal conditions, suddenly and simultaneously experienced a precipitous reversal of cash flows and an alteration in their usual paths of economic exchange. These changes resulted partly from an institutional change that happened too fast. The 1989 collapse of the International Coffee Agreement and the 1990 dismantling of the Mexican Coffee Institute triggered a sudden drop in coffee prices and disarray in domestic coffee markets that destabilized the economies of thousands of coffee-producing households.

This case study argues that the suddenness and magnitude of the so-called coffee crisis that ensued may help explain when, how, and why two paramilitary armies with strong backing from the local population made their first public and violent appearance in the Mexican countryside in the mid-1990s. Through this real-life example, this case study aims to stimulate thinking about what went wrong with policy and discussion on what can be

done, or done better, by stakeholder groups to achieve both poverty and stability goals.

The assignment is to identify key lessons learned for the design and implementation of government action in situations similar to the one described in this case.

Introduction

"Poor people will resort to violence ... to change the political and economic system that they believe is responsible for their poverty" (Ferraro 2003, 6).

The hypothesis posed in this case study is that the sudden exacerbation of poverty and exclusion may constitute a "trigger" for a people's acceptance of violent means and their rebellion against the order of law. This case study is about how coffee-producing populations in southern Mexico, already living in poverty and in generally marginal conditions, suddenly and simultaneously suffered a further economic setback. Two simultaneous crises destabilized the economies of thousands of coffee-producing households. First, producers experienced a precipitous reversal of cash flows, partly provoked by an institutional change that happened too fast. Second, they faced a drastic alteration in their usual paths of economic exchange.

In her 1998 book on the remaking of Mexico's economy, Nora Lustig links the rise in rural violence in southern Mexico during the 1990s to the increased poverty of its inhabitants. This case study documents Lustig's assertion and claims that this may help explain how and why, during the 1990s, two paramilitary armies, or guerrillas,¹ made

¹ The Spanish term *guerrilla* means "small war." The sense in which the term has been used to describe these two movements corresponds to Karsner's (2005) definition. According to him, the fact that the guerrilla soldier selects military and government targets differentiates him or her from the "terrorist," who generally selects non-combatant civilian and nongovernmental targets for a different kind of psychological impact. He cites Robert Tabor's book *The War of the Flea* (Tabor 1969) to note another key distinction between the two: For the guerrilla, the local population is the key to the entire

their first public and violent appearance in the Mexican countryside. It was the suddenness and the magnitude of these two crises that helped trigger action by the Ejército Zapatista de Liberación Nacional (EZLN) in the state of Chiapas and the Ejército Popular Revolucionario (EPR) in the state of Oaxaca. Although some authors (such as Cano 1996 and Pazos 1994) claim that both uprisings were the result of manipulation of “susceptible” indigenous populations by well-organized groups with ulterior, mainly political, motives, this case study argues that years of exclusion and poverty provided fertile soil for this “susceptibility.” The cash flow and transition crises were the rain that helped the latent seed of discontent germinate into a supply of willing, if naïve, recruits from the local population. If imagining scenarios based on hypothetical counterfactuals is useful, we should ask ourselves whether both guerrilla movements, and the tremendous social and economic costs they imposed, could have been averted had the Mexican government made different policy choices. The assignment is to identify the “right” policy choices.

Background

Coffee, Poverty, and Wealth

Coffee represents an important source of income for some 481,000 Mexican households that cultivate 665,000 hectares of coffee and hire at least 1 million laborers annually. It is estimated that some 3 million mostly rural people are employed in activities related to coffee production, processing, and sales—approximately 6 percent of the economically active population of Mexico and close to a quarter of the economically active rural population. A labor-intensive crop, coffee grows well on small and steeply sloped parcels of land. Small-scale producers, often with landholdings smaller than 3 hectares, constitute the majority of coffee producers in the country and are concentrated in some of its poorest regions. The major producing

struggle. Karsner quotes Talbot as saying that in guerrilla warfare “it is the population that is doing the struggling. ... A supportive civilian populace is a guerrilla’s camouflage, quartermaster, recruiter, communications network, and all-seeing intelligence service.” The survival of a guerrilla movement is entirely dependent upon the support of the populace, who provide combat and support troops, food, shelter, intelligence, and medical support.

areas are mountainous, with poor communications infrastructure, and some 84 percent of the communities in which coffee is a primary agricultural activity have high or very high poverty indexes. Sixty percent of coffee producers live in extreme poverty, and more than half belong to one of Mexico’s 52 ethnic groups. Chiapas and Oaxaca, two major coffee-producing states, have the lowest level of welfare in Mexico.

The situation in Chiapas is archetypical: almost 60 percent of its population lives in rural areas, almost 40 percent in housing with earthen floors, and more than 22 percent of the population above the age of 15 is illiterate (the average for Mexico is less than 10 percent). In Chiapas, coffee is second only to corn in terms of cultivated area. It is the state’s main export crop and the major source of income for almost 25 percent of the economically active population. Official statistics reveal that in Chiapas alone, some 500,000 people are employed by the coffee sector, and of these, 120,000 are coffee producers, mostly with landholdings smaller than 2 hectares (CMC 2004; Eakin et al. 2005; Hernandez-Navarro and Celis-Rojas 1994; Milford 2004; Pérez-Grovas et al. 2001; Style 2001).

Ironically, despite the clear link between poverty and coffee, a significant proportion of the harvest is exported. Indeed, in 1990, Mexico was the fourth-largest producer in the world (Renard 1997), and coffee exports generated enormous wealth for the national economy. That year, coffee was the country’s third-largest source of foreign exchange (after petroleum and automobiles), representing 3 percent of the country’s total export earnings and 42 percent of total agricultural exports (Pérez-Grovas et al. 2001).

Two major events caused a drastic decline in Mexico’s strength in the world coffee market, and in coffee’s strength as foreign exchange earner in the Mexican economy. The first was the collapse in 1989 of the International Coffee Agreement (ICA) managed by the International Coffee Organization (ICO), and with it, the primary international mechanism for controlling world coffee supplies and prices.² Meanwhile, the precipitous fall in world

² The ICO’s cartel-like quota system to maintain world coffee prices above a certain level was inevitably followed by oversupply and a long-term decline of market equilibrium prices. This price decline, plus the difficulty of negotiating and ensuring compliance with the

coffee prices was further fueled by Vietnam's emergence as a major exporter. Particularly as a result of the dismantling of the ICO agreements, coffee prices in international markets plummeted from an average of US\$1.32 a pound in 1986 to US\$0.53 a pound in 1992 (Lustig 1998).

Second, Mexico simultaneously embarked on an ambitious structural reform of agricultural markets that reduced state intervention in commodity production and marketing. Part of this reform involved the dismantling in 1990 of the Mexican Coffee Institute (Instituto Mexicano del Café, or INMECAFE), the parastatal organization that subsidized coffee production and marketing.

The combination of these two events caused what has been called "the coffee crisis," owing to the dramatic effects that the ensuing drop in prices and disarray in domestic coffee markets had on Mexico's coffee sector. By 1993, coffee represented only 0.6 percent of the country's total export earnings and 15 percent of agricultural exports. Between 1990 and 2004, coffee production in Mexico fell by 21 percent, and exports, by 56 percent. During the same period, coffee export revenues fell 80 percent, from US\$450 million in 1990–1991 to US\$250 million in 2004 (SourceMex 2004). The drastic drop in domestic production and in exportable coffee reflected the deeper crisis faced by coffee producers in rural Mexico.

The Rise and Fall of INMECAFE and the Coffee Crisis

Created in 1958, INMECAFE had become the most important buyer and seller of coffee in Mexico, and for most producers, the only source of credit, fertilizers, coffee plants, and technical assistance. At its peak, INMECAFE serviced more than 85 percent of mainly small producers and bought 45 percent of the country's coffee harvest through a network of cooperatives called Unidades Económicas de Producción y Comercialización (UEPCs). Through the UEPCs, the parastatal channeled subsidized credit and inputs and received payment in coffee (Renard 1997). INMECAFE's support at the production level and its provision of a guaranteed market promoted strong entry of small landholders into the coffee sector. Not

surprisingly, INMECAFE's presence induced the expansion of coffee plantations into lowland areas that were inadequate for the production of high-quality coffee. Indeed, although INMECAFE reduced its support levels starting in 1982 owing to an economywide crisis, the number of UEPCs and members continued to grow (Pérez-Grovas et al. 2001).

INMECAFE was dissolved in 1989–1990, with the aim of removing market inefficiencies created by the parastatal and of eliminating the agency's rampant corruption (Serrano 1998).³ For the next three years, public sector intervention in the Mexican coffee sector was limited to transferring INMECAFE's infrastructure to the surviving UEPCs. The system of guaranteed prices disappeared with the agency, coffee export permits were eliminated, and customs requirements were simplified, effectively "freeing" the domestic coffee market.

This sudden collapse of the state-controlled production–processing–marketing pyramid exposed small producers to the vagaries and easy exploitation common in other commodity markets.⁴ Under INMECAFE, producers did not participate in marketing or processing and were completely dependent on the expertise of INMECAFE (Milford 2004). Without transport, processing facilities, financing, or knowledge of markets, the average Mexican coffee producer did well to sell his coffee harvest to the middleman (*coyote*, in local parlance) who had a vehicle and could pay cash. The negotiations tended to be one-sided. Producers had no information on world coffee prices, to which domestic prices are indexed.⁵ Even the scales were often "loaded," according to many producers' first-hand accounts (Pérez-Grovas et al. 2001). Furthermore, although many international coffee marketing and processing companies initially established offices in coffee-producing regions and attempted to take the place of INMECAFE as buyers and

³ INMECAFE disappeared, along with the state-run Aseguradora Nacional Agrícola y Ganadera, which provided insurance to producers against crop losses.

⁴ The continued overvaluation of the Mexican peso also contributed to a deterioration of the terms of trade for coffee producers (Gilly 1995).

⁵ Domestic coffee prices, at which coffee exporters buy from middlemen and sell in domestic and export markets, closely follow daily coffee "Contract C" spot prices quoted by the New York Board of Trade.

agreements, led to cheating and ultimately to the collapse of the system (Brandt 1991; Krivonos 2004).

credit providers, they soon disappeared. The few left behind charged oligopolistic interest rates and fixed prices based on their oligopsonic position (Renard 1997).

Funes (1992) estimates that by June 1992, because of the disarray in global and domestic markets, farm prices for coffee in Mexico had fallen by more than 50 percent with respect to 1989, to levels often below average production costs, severely affecting the rural economy in coffee-growing areas (Figure 1). With such low prices, and without the credit to purchase inputs and carry out required plantation maintenance, productivity per hectare slumped by 50 percent from 1989 to 1993. Producers reacted to the crisis with cost-saving strategies: reducing maintenance activities drastically and harvesting their plots only partially. Both strategies reduced yields (and quality) in present and future crop cycles, exacerbating the income-reducing effects of the exogenous drop in the price of coffee. Indeed, many producers simply decided not to harvest. Of the 760,000 hectares planted in coffee, only 560,000 were harvested in 1993 (Pérez-Grovas et al. 2001). According to Gilly (1995), thousands of coffee producers abandoned their farms between 1989 and 1993.⁶

Among the hardest hit by the coffee crisis were producers in indigenous communities in the south-

east and the south of Mexico. Lustig (1998) claims that "it is reasonable to attribute" the rise in poverty in these regions to the behavior of coffee prices in the early 1990s. Serrano (1998) and Harvey (1994) document the case of Chiapas. The effects of the sudden dismantling of a state support apparatus that been in place for five decades and that had created a dependent population was worsened by plummeting international coffee prices and by a 1988 law that severely restricted forestry in the state. According to these authors, these events provoked a drop in household incomes of 65 percent by 1993, deprived producers of traditional coffee-marketing channels, and severely restricted the supply of credit. The number of producers eligible to receive credit went from 20.4 percent in 1985–1989 to 12.7 percent in 1990, and credit reached only 5.7 percent of producers, usually the large ones. Furthermore, in her article on the Chiapas uprising, Darlington (1995) suggests that seasonal workers were the hardest hit by the drop in the demand for labor caused by the coffee crisis.⁷

The situation in Oaxaca was no different. Cano (1996) reports that between 1989 and 1994 coffee prices dropped by 60 percent in that state, affecting at least 55,000 coffee-producing households with 180,000 hectares of coffee.

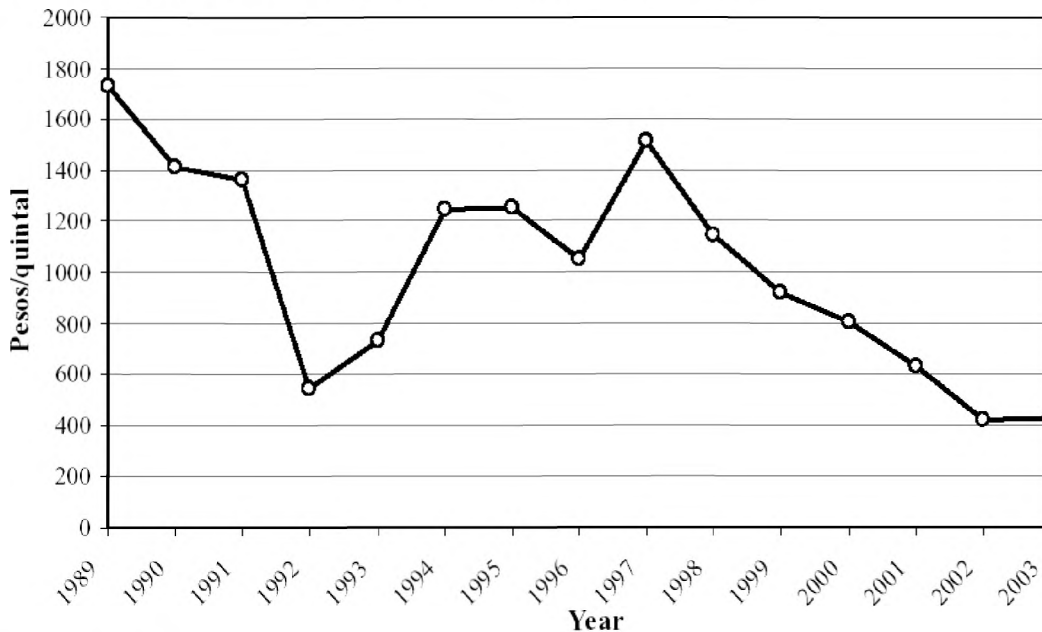
Coffee and Stability

Guadarrama (1992) quotes the following statement by President César Gaviria of Colombia during a meeting about drug traffic in Dallas, Texas: "The underlying issue regarding world coffee quotas is the consideration, on the part of the United States, of the potential impact of their removal on the political stability of Central America and the level of drug production and drug traffic in Colombia, both issues of national security." Indeed, according to Renard (1997), stability was the key motive behind the establishment of the quota system as the basis for International Coffee Agreements. The idea of maintaining world coffee prices above a certain level by limiting globally traded supplies originated during the Cold War years that followed

⁶ The effects of the coffee crisis and the downward spiral that it created for coffee producers has been documented by Batz et al. (2005) for Oaxaca and by Flores et al. (2002) for Mexico. Statistics presented for Mexico by Flores et al. show that the crisis hit production mainly through a reduction in yields (which dropped at an average annual rate of 9.8 percent from 1990 to 1995, while the area even increased slightly. A key finding from numerical simulation modeling by Batz et al. was that a coffee grower's decision to abandon his or her farm is typically the last stage of a long downturn touched off by a decline in coffee prices. When prices fall, many growers migrate to cities after harvest season to supplement their incomes. In doing so, they forgo important farm maintenance, such as pruning coffee plants after harvest. As a result, the yields from coffee plants decline significantly in the next season. Lower yields imply growers will again need to find off-farm work and will again forgo maintenance. In this way, bad prices in one year can set in motion a downward spiral of falling incomes and yields. Eventually, coffee yields drop so low that growers are forced to clear trees to grow subsistence crops and, ultimately, to abandon their plantations.

⁷ Indeed, an important part of the crisis may also have had to do with an internal labor market collapse, as large coffee *fincas* responded by decreasing the demand for farm labor, eliminating an important source of off-farm income for the rural population.

Figure 1: Historical Coffee Prices for Oaxaca, Mexico, 1989–2003



Source: Batz et al. 2005

Note: Prices are given in constant 2000 Mexican pesos per quintal (100 pounds) of parchment coffee. Parchment coffee results from de-pulping coffee cherries. The parchment-like skin needs to be removed to produce the green coffee sold in international markets.

World War II, as part of the U.S. “Alliance for Progress” strategy in Latin America. In this strategic plan, high and stable coffee prices would provide incomes and stability to producers in Latin America, preventing the rise of communist movements akin to the Cuban Revolution.

The Ejército Popular Revolucionario (EPR)

Depending on the source, reports Cano (1996), between 40 and 100 *guerrilleros* participated in the attack on police headquarters at La Crucesita, a town next to the Bahías de Huatulco tourist resort in the state of Oaxaca, in September 1996. The police station in the town of Tlaxiaco, in the Oaxaca’s Mixteca region, just bordering the southern coffee-producing mountain ridge known as the Sierra Sur, had been attacked two hours earlier, along with police offices in the city of Oaxaca, the state’s capital. In Cano’s words, “local authorities fear that entire communities in the coffee-producing Sierra Sur of Oaxaca, where 9 out of 10 people are poor or very poor, are backing the EPR.” He reports that after the attack on La Crucesita, the guerrillas fled to a coffee region known as

Loxichas, where some of the detained confessed they were from.

The Ejército Zapatista de Liberación Nacional (EZLN)

Because the EZLN movement happened first, was much larger, had a successful global media strategy, and had a significant impact on Mexico socially, politically, and economically, it has captured much more attention and been more widely studied than the EPR. Many of those who have tried to understand the origins of *zapatismo* mention the coffee crisis as a trigger (Altamirano-Fajardo 2003; Collier 1994; Mestries-Benquet 2001; Darlington 1995; Gilly 1995; Pérez-Grovas et al. 2001). Mestries-Benquet’s description is particularly interesting. According to him, the coffee crisis provoked the dissolution of incipient producer organizations and “an exodus toward the Zapatista movement” (Mestries-Benquet 2001, 121). Furthermore, he says, coffee producers identified with the Zapatista cause, which associated the coffee crisis with the free market policies that closed INMECAFE. The North American Free Trade Agreement (NAFTA) that Mexico had just negotiated with Canada and the United States was

seen as the culmination of those policies, and this is why the Zapatistas chose to come out publicly on January 1, 1994, the day NAFTA came into effect.

Policy Issues

Two policy questions seem especially relevant for the case at hand and are addressed separately here:

1. Why did Mexican government officials not implement effective policies to prevent the coffee crisis, or at least diminish its impact on poor coffee producers?

Although policy makers in Mexico were justified in questioning INMECAFE's existence, closing it down was not the only, or necessarily the best, alternative. Krivonos (2004) mentions that coffee growers in developing countries have historically received a very small share of the export price of coffee and that a key culprit has been government intervention in the sector. Her research shows that government regulation of domestic markets, in the form of fixed producer prices and monopsony power of marketing boards, has created a significant wedge between producer prices and the world price of coffee, imposing an implicit tax on producers. Export taxes to raise government revenue have burdened producers, who have also been swayed by "low" but stable guaranteed prices. Additionally, Brandt (1991) reports that the coffee and exchange rate policies of almost all producing countries have reduced real producer prices by more than 50 percent below world market parity level (world market price at an undistorted exchange rate, minus marine freight and domestic transformation costs). INMECAFE also crowded out private market agents and promoted resource use distortions by encouraging expansion of production into marginal lands with no real comparative advantage for the crop. The agency's systemic corruption was the icing on the cake, so to speak, harnessing the necessary political support for its closure.

On the other hand, it would be naïve to think that policy makers in Mexico did not know about the prevailing discontent in the country's coffee-growing areas and the potential destabilizing effects of a sudden elimination of government support in the context of plummeting world prices and continually eroding terms of trade from an overvalued peso. However genuine their motives, Mexican policy

makers seem to have seriously miscalculated the consequences of closing INMECAFE, and this is probably why they did close it, so precipitously, just at the moment when coffee producers most needed support.

Many sectors find government support addictive,⁸ and Mexican coffee producers were no exception. Perhaps Mexican government officials failed to recognize the magnitude of the dependence that INMECAFE had provoked in producers, especially the smallest and most vulnerable. Why did they not choose to restructure INMECAFE, to make it a more transparent and accountable agency, while using its valuable network of UEPCs to funnel additional support to producers? Could not INMECAFE have been gradually converted into today's Mexican Coffee Council (CMC) (more on this to follow), and its support programs gradually redesigned to be less distorting? Did Mexican officials succumb to pressures from international financial institutions? Or were they blinded by the mirage of benefits that NAFTA was supposed to bring?

The Mexican government's attempt to ease the crisis had serious flaws and came too late. From 1989 to 1992, to help the poorest coffee producers adjust to the closure of INMECAFE, President Carlos Salinas de Gortari established a program to support coffee producers, embedded in the nationwide pro-poor social development program called PRONASOL and implemented by Mexico's Institute for Indigenous Peoples (INI). The program gave fresh credit for crop maintenance and harvest to producers with up to 10 hectares of coffee who had paid earlier debts with the government (Ontiveros-Ruiz 1995). The program's design, however, had serious flaws; it covered only the fraction of producers that least needed help (that is, the ones who had been able to pay their debts). In addition, it failed to tackle the underlying problems of low farm prices and dysfunctional market channels. Furthermore, because coffee prices were often below production costs, even eligible producers may have decided not to participate. Were credit amounts enough? Did disbursements reach

⁸ Does the continued failure by industrialized nations to dismantle their US\$0.8 billion per day agricultural subsidies sound like another case of addiction? See Pinstrop-Andersen (2003) for more details.

producers on time? Were producers' transaction costs for participation too high?

In 1993 the government created the CMC, a multi-sectoral policy advisory body in which government programs were to be discussed and reviewed.⁹ It was not until 1994/1995, however, that the CMC replaced the previous program with one based on per-hectare payments. Under this program, called Programa Nacional de Apoyo a Productores de Café (PNAPC), registered producers with fewer than 10 hectares of coffee received the equivalent of US\$200 per hectare (Pérez-Grovas et al. 2001). Evidently, though, the PNAPC was too little too late, at least for Chiapas. The EZLN uprising occurred right in the middle of the 1994/1995 harvest season. Its root causes were too deep and its momentum too strong to be halted by such a program. Since the program was, by design, decoupled from production and required no proof of harvest, such payments were most likely used for household consumption or debt payment, which may have eased discontent. Indeed, it is not farfetched to imagine that some producers used some of the program's payments to finance the guerrillas.

2. Moral or ethical concerns apart, would Mexican taxpayers have been willing to see their tax money used to support coffee-producing regions in Mexico, if they had known the socioeconomic situation in coffee-producing regions, known that these uprisings would occur, and foreseen the magnitude of the political, social, and economic costs that they would impose?

The following paragraphs give a rough sketch of the social, economic and political costs of the uprisings.

In the case of the EZLN, fighting between the rebels and the army lasted only a few days. It ended when then-President Carlos Salinas de Gortari implemented a unilateral cease-fire. But while the

two sides attempted to negotiate an end to the standoff, land invasions and often violent retaliations continued for more than a year in Chiapas (Darlington 1995). Since then, the army has moved deeper into rebel territory, sending rural inhabitants fleeing into the jungle and escalating tension throughout the region that continues up to today.

Bose et al. (2001) document the migration effects of the coffee crisis and the instability of the ensuing uprisings. They cite an estimate by Javier Ojeda, president of Mexico's National Coffee Producers' Union, that 30,000 mostly indigenous producers had left the country by 2001 seeking work as seasonal laborers. He also refers to a report in a "recent" Mexican newspaper estimating that 500 families a week were leaving the state of Chiapas in search of a livelihood in other states or in the United States.

The impacts of the uprisings were also felt at the macroeconomic level. In a 2004 study of the causes of capital flight in Mexico, Díaz-Bautista and Olivas-Andrade (2004) found a clear positive correlation with the political events in the first three months of 1994. They mention the EZLN and the assassination of Luis Donaldo Colosio in March of the same year, in the midst of his campaign for the presidency. Indeed, many Mexicans link the two events: the Zapatista uprising increased Colosio's confrontational attitude against Salinas de Gortari, the outgoing president, in what had already become a distant relationship. A widely held conspiracy theory maintains that Salinas de Gortari was the mastermind of Colosio's assassination. What is certain is that the capital flight provoked by the combination of both events was instrumental in the ensuing series of major peso devaluations, which provoked one of the worst financial crises in Mexico's history.¹⁰ By 1995 interest rates had risen to between 60 and 90 percent, causing the closure of thousands of firms in the country. The money funneled to rescue Mexico's banks has cost the country dearly up to this day: the total private debt acquired by the government to save the banks from bankruptcy—taxpayers' money that is being paid to the banks—is roughly equivalent to 16 percent of GDP (IFAI 2003).

⁹The CMC consists of representatives of federal agencies (Ministry of Agriculture, Ministry of Economy, Ministry of Social Development, and Ministry of the Treasury); coffee-producing state governments; producer organizations; and industry, represented by the Mexican Association of Coffee Exporters (Pérez-Grovas et al. 2001).

¹⁰ For a vivid description of the political and economic events that led to Mexico's 1994/1995 financial crisis, see Oppenheimer (1996).

Finally, there is no doubt about the political costs of the series of concatenated events that the Zapatista and EPR uprisings helped bring about: the PRI, which had maintained the Mexican presidency without interruption for 70 years, lost the elections in 2000 and 2006.

Stakeholders

Stakeholders Directly Involved in the Mexican Coffee-Producing Sector

The CMC and the state-level coffee councils constitute the institutional settings in which the different stakeholders directly involved in the coffee sector discuss and negotiate coffee policies and programs. Small producers not affiliated with any organization are left out.

The major stakeholders directly involved in the coffee sector are coffee producers, industry, and the private sector.

Coffee producers. Coffee producers consist of small-scale coffee producers not affiliated with an organization, small-scale coffee producers affiliated with an organization, and large-scale coffee producers, most of whom are affiliated with an organization.

Key producer umbrella organizations are represented in both the CMC and state-level coffee councils. The most important producer organizations are the Confederación Nacional Campesina, Coordinadora Nacional de Organizaciones Cafetaleras, Central Independiente de Obreros Agrícolas y Campesinos, Confederación Nacional de Propietarios Rurales, and Confederación Mexicana de Productores de Café.

Industry. The domestic market for coffee is highly concentrated. Nestlé is the largest private buyer and toaster of Mexican coffee, and it sells 84 percent of the instant coffee consumed in Mexico. Other important transnationals operating in México are Far-Man, J. Aron, Omnicafé, Becafisa, TIASA, and Rotphos. Together, they account for 67 percent of the coffee exported from Mexico.

Industry is represented at the CMC through the Mexican Association of Coffee Exporters, an umbrella organization.

The public sector. Public sector stakeholders include federal government agencies (Agriculture, Economy, Social Development, and Treasury), which have a seat at the CMC. According to Pérez-Grovas et al. (2001), the federal government agencies have "effective hegemony" over the CMC. State-level government agencies (usually Agriculture) also have a seat at the CMC and in the corresponding state-level coffee councils.

Stakeholders Not Directly Involved in the Mexican Coffee-Producing Sector

Other stakeholders are Mexican coffee consumers, international coffee consumers (industry and final consumers), the Mexican population in general (which bears the costs of instability), and taxpayers in particular, who knowingly or not, pay to maintain the social, economic, and environmental attributes associated with coffee production.

Policy Options

Poverty and social exclusion cannot be solved by isolated sector policies. A series of actions need to be taken, both nationally and internationally, to combat these two evils. Pinstrip-Andersen (2003) summarizes them as follows:

- institutional innovation in the international arena to help assure accountability, participation, and empowerment of the poor and deal effectively with the international spillovers of national actions in such areas as trade, environment, health, security, poverty, and hunger;
- investments in rural infrastructure (such as hospitals, clinics, schools, electricity, roads, clean water, drainage);
- investments to improve governance capacity at the domestic and local levels, including institutional developments to make private markets work in rural areas (such as common standards and measures, the enforcement of contracts, clear property rights);
- social safety nets to help people out of hunger and poverty in the short run; and
- the expansion of international development assistance, primarily to assist the poor.

Mexican policy makers, and Mexicans as a whole, seem to have learned the lessons of the 1990s. Poverty and frustrated expectations from an economic modernization with no or negative payoffs for many inhabitants can trigger a backlash, undoing several years of sound macroeconomic policies and market-oriented reforms (Lustig 1998). Evidence of this is the Mexican government's significant efforts to combat poverty in the past decade, especially in rural areas. By 2004 public spending in social development in Mexico represented 45 percent of total public spending, and it has grown at an average 5.9 percent annually since the mid-1990s, compared with 3.1 percent real annual growth in total public spending in the same period (Flores-Alonso and Barrera Chavira 2004).

Two programs are worth mentioning because of their significant impact on poverty alleviation. The first is PROCAMPO. Since 1993 roughly 4 million farmers have received annual direct per hectare payments through the program, at a total cost of US\$1.3 billion in 2003 (Ávalos-Sartorio 2006). The second is Oportunidades (which literally means "opportunities" and was formerly called PROGRESA, "progress"). Since 1997 the program has funneled financial resources to women in poor households to finance their children's schooling and the family's health and basic foodstuff needs. The program aims to develop the human capital in poor households and to break the vicious cycle of malnutrition, morbidity, high infant mortality rates, high fertility, high school dropout rates, and unhealthy living conditions, which keep people trapped in poverty. In 2005 Oportunidades reached nearly 5 million households (roughly 20 percent of all households in Mexico), 80 percent of which are located in rural areas, at an annual budgetary cost of US \$3.5 billion in 2005, nearly 1 percent of Mexico's GDP (IFPRI 2002; SEDESOL 2006). It is no coincidence that the program has reached 60 percent and 70 percent of the rural population in Oaxaca and Chiapas, respectively. (Indeed, the program has been so successful that it is serving as a model across Latin America.)

Coffee Sector Policies

In spite of such nationwide efforts, coffee producers are still mostly poor and continue to face considerable obstacles adjusting to the coffee

crisis.¹¹ Technical assistance in the communities is inadequate, formal credit is still scarce, and informal credit is prohibitively expensive. Many producers express skepticism about the utility of farm organizations, associating producer groups with fraud and political manipulation. Lacking a formal organizational structure with which to access price information and select best buyers, many still hope that conditions will improve or that the public sector will intervene to provide solutions to their situation.

Today, the Mexican government operates a series of programs targeting the coffee sector. Among these, the flagship coffee program is the Price Stabilization Fund (FEC), a US\$80 million permanent fund that provides a guaranteed price to producers when international prices drop below a pre-established floor of US\$85 per hundredweight (cwt)¹² of green coffee (CMC 2004). Operated by the Mexican Ministry of Agriculture, the FEC provides a maximum subsidy of US\$20 per cwt of coffee for up to 20 cwt per participating producer. In order to participate, coffee producers must be registered in the National Coffee Census (*Padrón Nacional Cafetalero*), must sell their coffee to registered buyers, and must pick up their subsidy checks in person at the designated local government office. FEC rules establish a mechanism for maintaining the fund. Participating producers commit to accepting a discounted price when the international price of coffee surpasses US\$85. The amount of the discount is used to replenish to the fund.¹³

Unfortunately, the FEC has weaknesses: research by Ávalos-Sartorio and Blackman (2005) on the impact of the FEC in the southern Sierra and coastal regions of Oaxaca shows that the guaranteed price provided by the program is not nearly high enough to cover production and marketing costs for many producers. Their results also show that in the

¹¹ This section borrows heavily from Ávalos-Sartorio et al. (2006).

¹² The standard measure of coffee, a cwt is equivalent to 46 kilograms.

¹³ The discount varies from US\$3 per cwt when the international price is between US\$85 and US\$89.50 per cwt to US\$20 when the international price is US\$140 or more. To be continuously eligible to participate, producers must demonstrate that they have participated in the FEC's replenishment in years when international prices have exceeded the price ceiling.

2002/2003 crop season, the program's second year of operation, support reached less than a third of producers in that region. Certain types of producers consistently chose not to participate, presumably because they faced high transaction costs (including transporting coffee to the town where a registered buyer is located, which is usually farther away than the unregistered middleman, and commuting to the city, often far from the farm, to receive and cash the government check in a bank). Producers in this group included those located more than 20 kilometers from the nearest paved road (about one-third of the producers in our study area), those in towns with an indigenous population greater than 20 percent (about one-third of the towns in the region), and those in towns where women producers represent the majority owing to significant male outmigration (60 percent of towns in the region). Logically, these findings suggest that to increase participation, those responsible for the FEC's design and implementation must take actions to reduce transaction costs of participation, especially for producers located far from paved roads, indigenous people, and women.

The direct per hectare payments program implemented in 1994/1995 by the CMC is now called the Productivity Support Fund (PAP) and has the formal objective of promoting productivity improvements through fertilization and pruning. The PAP has probably not had this effect in practice, however, because it has no farm-level mechanism for verifying output, so program payments are made regardless of whether the producer harvests or not (Avalos-Sartorio et al. 2005). One means of mitigating this deficiency would be to redirect financial resources now used for the PAP to the FEC. The additional resources could be used to create incentives for producers to enter the specialty coffee market by subsidizing certification costs. Alternatively, or in addition, producers could get an additional price premium for producing sustainable or high-quality coffee, or both, subject to some verifiable monitoring mechanism.

In recent years, consumer demand in the developed world has given rise to a number of innovative strategies to revive the coffee industry. Among them, certification schemes for organic, shade-grown, and fair trade coffee are the most popular. Although Mexico is the world's biggest producer of certified organic coffee, so far few producers

have been able to participate in organic and other certification-based specialty coffee markets. Furthermore, even such progressive producers face a feeble situation. In their evaluation of the impact of fair trade and organic certification in Oaxaca, Calo and Wise (2005) conclude that, given the current price and cost structure of coffee production, certification by itself is not sufficient to make coffee profitable for most producers. They write that "only hard-won government support programs, in the end, brought producers to a more reasonable rate of return from their coffee production" (Calo and Wise 2005, 2). They refer primarily to the FEC and the FAP.

Assignment

The assignment is to identify key lessons learned for the design and implementation of government action in situations similar to the one described in this case.

Additional Readings

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