IASCP Biennial Conference
Bloomington, Indiana
31 May through 4 June 2000

SUBVERTING LOCAL INSTITUTIONS: ARRESTING SOCIAL CAPITAL FORMATION AND ENVIRONMENTAL CONSERVATION IN LATIN AMERICA

Douglas Southgate
Department of Agricultural Economics
Ohio State University
(southgate.1@osu.edu)

and

Hugo Ramos
San Salvador, El Salvador
(hramos@ejje.com)

Much of what is written about local institutions for natural resource management in the developing world is more an exercise in celebration than in analysis. That said, it cannot be denied that rural communities in various places have managed to establish their own arrangements for handling environmental conflicts that, left unresolved, would diminish agricultural output, the quality of forest management, and so forth. Hayami (1990), for example, calls our attention to the contributions that local rules for water allocation have made to irrigated rice production in Southeast and East Asia.

Serviceable though they often are, traditional institutions have been exposed to great stress in modern times. Sometimes, the stress has had to do with population growth. Especially in areas experiencing rapid immigration – along agricultural frontiers, for instance – winning the consensus needed to effect or even to maintain rules governing access to natural resources has been a considerable challenge. But by no means has institutional deterioration been an exclusively demographic phenomenon. All too frequently, local institutions have deteriorated as a result of being undermined by outside authorities.

This process was obvious during the era of European colonialism. But by the middle of the twentieth century, the source of subversion had shifted to national capitals in the developing world. The nationalization of Nepal's village (*panchayat*) forests in 1958 is a case in point. Perhaps influenced indirectly by early contributions to the economic literature on open access problems – in which no distinction was made between resources owned by no one at all and common properties, which by definition are owned by a well-identified group that typically observes its own resource use and management guidelines – officials in Katmandu decided that all tree-covered land needed to belong to the government. Had the public sector actually invested in management and controlled access, environmental benefits might have accrued, although the injustice of taking village resources without compensation would have had to be redressed. But management never occurred. Neither was access controlled. All the results of nationalization, then, were negative, forests in which villagers previously had some sort of ownership stake – an imperfect one, some might contend – being converted into a truly open access resource (Bromley and Chapagain, 1984).

Wholesale land appropriation is not the only way that subversion has been, and continues to be, accomplished. National policies, often adopted ostensibly to protect local institutions and their members, can actually undermine those same institutions, diminish individuals' incentives to engage in collective action, or both. In particular, paternalistic laws and regulations prevent local institutions from engaging in normal, commercial activities that would benefit their members. This is true of *comunas* in the tropical forests of northwestern Ecuador and of the agrarian reform cooperatives in El Salvador, both of which are examined in this paper.

The two case studies suggest that the viability of local institutions often depends on policy changes that allow them to function like limited-liability corporations, with their members becoming, for all intents and purposes, shareholders. Pressure for reform of this sort is sure to intensify as the value of community resources grows.

<u>Depletion of Community Forests in Northwestern Ecuador</u>

The shortcomings of paternalistic restrictions on local institutions are readily apparent in northwestern Ecuador, where most of the country's timber is harvested and where forests are being cleared at a rapid pace to make way for new cropland and pasture.

A curious aspect of deforestation in the region is that it is occurring in spite of policy changes intended to reward timber production. In particular, tariff- and non-tariff trade barriers – adopted when Ecuador pursued a development strategy predicated on import-substituting industrialization (ISI) – were dismantled during the late 1980s and early 1990s. While those barriers were still in place, domestic prices for plywood and other products were artificially high and the market value of raw materials were too low. Trade liberalization has caused the gap between internal and border prices for finished products to close. However, as Southgate *et al*. (forthcoming) have documented, log prices in Ecuador remain well below efficient levels. In particular, nominal protection rates – defined as the difference between domestic and border prices divided by border prices – for unprocessed timber range from –65 to –78 percent.

To come to grips with why this inefficiency persists, one must first bear in mind the monopolistic conditions that arose before trade liberalization, under ISI. When and where commerce is restricted between a small economy, like Ecuador's, and the outside world, lack of competition is bound to be a chronic problem. In many markets, domestic demand can accommodate the output from, at most, a handful of firms. These firms, needless to say, are in an excellent position to exercise monopoly power. During

Ecuador's experiment with ISI, for example, practically all the country's plywood was produced by just two companies, which, as has been mentioned already, charged a lot for their output and did not pay very much for raw material inputs.

Trade liberalization removed an important barrier to the sort of competition required to drive up log prices, which is a necessary (though probably insufficient) condition for sustainable natural resource development. Cheap raw materials ought to have encouraged new firms to get involved in Ecuadorian forestry, at least as buyers. However, other barriers have remained in place. One relates to corruption, which Southgate *et al*. (forthcoming) emphasize has been exacerbated by a complex set of environmental regulations adopted in 1995. The burden of suborning government personnel in a position to enforce restrictions on harvesting, log transportation, and other activities need not be very onerous for existing companies, which possess the sort of knowledge and contacts needed to keep bribery expenses to a minimum. By contrast, potential entrants lack these advantages. Liable to suffer much more from corruption, they are apt to stay out of the business entirely.

Weak property rights are another impediment to new investment in the Ecuadorian forestry sector. Old colonization laws – which assigned property rights to people who occupied, cleared, and farmed land formerly covered with trees – have been removed from the books. However, land invasions continue, especially where formal adjudication of property rights is yet to occur. Since adjudication delays are common – and invasion risks are particularly serious – in tree-covered hinterlands, the lack of secure, formal ownership rights helps to explain why forestry investment is limited, generally, and the forestry sector is not attracting new entrants, specifically.

Likewise, weak formal tenure and associated invasion risks are a problem for *comunas* (called *ejidos* in Mexico and Central America), which occupy vast tree-covered tracts. Only during the past few years has significant effort been dedicated to delimiting communal holdings in northwestern Ecuador and other parts of the country. In spite of recent progress, many forested hectares remain unadjudicated.

Since passage of the 1994 Agrarian Law, which strengthened property rights in rural areas, *comunas* have enjoyed limited scope to buy and to sell real estate, although the Ministry of Agriculture must still approve major transactions. Relaxing what used to be a total ban on land transactions, stipulated in the *Comunas* Law of 1937, local communities can now use real estate as collateral, thereby gaining access to financial markets. Furthermore, the 1994 law allows *comuna* members to acquire individual tenure in their respective holdings.

Thousands of rural households in various parts of Ecuador have taken advantage of these policy changes. Exceptional in this regard is the northwestern part of the country, where very little privatization has occurred. It is entirely sensible to manage forests in large, unified parcels, as opposed to the 50-hectare plots traditionally awarded to the beneficiaries of land distribution initiatives. However, the 1994 Agrarian Law did not rescind the 1937 *Comunas* Law, which circumscribes community-level governance in various ways. By and large, the law hinders *comunas'* participation in the market economy as well as their ability to develop natural resources efficiently.

One restriction on governance relates to the terms of communal office-holders. To be specific, the 1937 law requires that local governing *cabildos* stay in office for just twelve months. The frequent leadership turnover that results from this arrangement exposes forest dwellers to business practices that are unfair, uncompetitive, or both. Accusations that community leaders have been bribed to accept logging agreements that stipulate low prices and weak environmental controls are common in northwestern Ecuador. Although specific evidence of local malfeasance is difficult to come by, it is undeniable that stumpage values are very low in the region, averaging just a few dollars per cubic meter of standing timber (Southgate *et al.*, forthcoming). As a rule, logging takes place with little or no attention paid to containing environmental damage.

<u>Poor Performance of Agrarian Reform Cooperatives in El Salvador</u>

The consequences of giving local communities control over resources while simultaneously interfering with their internal governance and limiting their commercial decision-making prerogatives are no less disappointing in El Salvador than they have been in Ecuador.

Traditional group tenure, of the sort "protected" by Ecuador's *Comunas* Law of 1937, has not existed in El Salvador since the onset of rapid growth in coffee production and exports. In 1882, common property was formally abolished, thereby allowing for an expansion of privately-owned, commercial farms of medium and large size. For the rural poor to produce food, temporary access was given to farm fields, but always subject to specific agreements between landowners and tenants.

The concentration of land and other wealth that was reenforced during the coffee boom of the late 1800s and early 1900s led to conflict at various times during the twentieth century. In October 1979, after several years of mounting violence, a group of military officers seized power. Shortly afterwards, they stated their commitment to achieving a "new economic and social order" by means of comprehensive agrarian reform as well as the nationalization of financial and marketing institutions (Prosterman, Riedinger, and Temple, 1981; Thiesenhusen, 1995).

The reform program, announced in March 1980, was aimed squarely at the economic base of El Salvador's rural elite. A limit of 150 hectares was placed on what any single individual could own, with land in excess of this limit subject to state expropriation. To make sure that former owners did not gradually reacquire the land they lost due to agrarian reform, expropriated holdings were assigned to cooperative associations, which were forbidden to sell real estate. The March 1980 program also gave tenant farmers the right to claim freehold title in up to seven hectares used by them. Nationalization of financial and marketing institutions was effected as well (Prosterman, Riedinger, and Temple, 1981; Thiesenhusen, 1995).

Political support for agrarian reform was consolidated during the early 1980s, when El Salvador's civil war was especially intense. Important in this regard was the decision of Napoleón Duarte, the leader of the Christian Democratic Party, to join the governing junta in January 1980, approximately two months before the agrarian reform was decreed. In March 1982, the junta stepped down and a constituent assembly, in which Christian Democrats did not enjoy an absolute majority over a combination of right-wing parties, took office. Nevertheless, one of the assembly's first acts was to ratify the entire agrarian reform, issued originally as a series of junta decrees. Further reenforcement occurred in May 1982, when Alvaro Magaña, who was demonstrably committed to reform, was installed as provisional president (Strasma, 1989; Thiesenhusen, 1995).

Agrarian reform was to proceed in three phases. The first, which was carried out, affected 262 properties, each larger than 500 hectares. Another 1,800 holdings, all between 100 and 500 hectares in size, were to be broken up during the second phase. Since these farms comprised the core of productive Salvadoran agriculture, it was decided that the vast majority would remain intact and in private hands; only 66 were confiscated. Due to administrative constraints and limited funding, the third phase, which focused on the title claims of small-scale tenants, was not fully implemented (Prosterman, Riedinger, and Temple, 1981; Thiesenhusen, 1995).

To say the least, conditions during the early 1980s were inauspicious for Salvadoran agriculture, generally, and the cooperatives established during the first phase of agrarian reform, specifically. A sharp, global recession drove down prices for coffee and other commodities. Also, the civil war took a major toll. Of the 320 cooperatives that had been created during the first two years of agrarian reform, 28 were already abandoned by 1982 and another 21 were in danger of abandonment (Thiesenhusen, 1995).

A truer test of the viability of agrarian reform cooperatives was to come as the fighting wound down, especially after peace accords were signed in 1992. By and large, that test has been failed. The 328 cooperatives occupy 240,000 hectares of El Salvador's best land. In particular, FUSADES (1996) claims that they possess one-fifth of all the soils in the country falling in the top four categories featured in the U.S. Department of Agriculture's eight-level classification scheme. But of these resources, more than a quarter sat idle as of the middle 1990s (Shaw, 1997). The impacts on commodity production have been considerable, even at the national scale.

Cooperatives' poor performance as agricultural enterprises has much to do with political agendas at the time of their founding (Strasma, 1989). While the general purpose of agrarian reform twenty years ago was to weaken the elite's hold on economic and political life in the countryside, stabilizing rural communities with ties to the government was of great importance during the war. As a reward for loyalty, cooperative members, who numbered between 22,000 and 30,000 during the 1980s, had much better access to public sector services than did the majority of rural dwellers. Many of those members belonged to the governing Christian Democratic party.

The practical effect of agrarian reform has been to establish a new sort of hierarchy in the countryside. Only 20 percent of the people living on cooperative lands are full-fledged members. They serve as cooperative officers and reserve all the permanent jobs for themselves, family members, and friends. The remainder of the cooperative population comprises settlers and refugees, who farm small plots if they are not offered occasional work paying a modest, daily wage. It is the latter people who have suffered disproportionately from cooperatives' poor performance. For example, the ratio of wage jobs (typically held by non-members) to permanent positions (again, reserved for members) has fallen from 4-to-1 during the 1980s to 2-to-1 at present (Shaw, 1997). At the same time, non-members' access to health and other services provided by the public sector does not begin to compare with what members and their friends and relatives enjoy.

Even if cooperative members had wanted to run their organizations in a more business-like manner, producing more output and employing more people and land as commercial opportunities were pursued, their ability to do so was sharply circumscribed for many years. As has been mentioned already, there was great concern two decades ago that expropriated landowners would reacquire real estate, thereby undermining agrarian reform, if redistributed real estate could be bought and sold. To avoid this outcome, cooperatives were prohibited from selling their holdings. Similar to the effects of identical prohibitions in other countries, this prohibition excluded agrarian reform beneficiaries not just from real estate markets, but from financial markets as well, thereby discouraging the sort of investment needed to enhance or to maintain farm productivity (Strasma, 1989).

Transfers of cooperative land are now permitted. However, cooperatives still find themselves in a poor commercial position. For one thing, few members and leaders have the type of managerial and marketing experience needed to compete successfully in national, regional, and international markets. This problem is being addressed by a recently initiated training and institutional-strengthening project funded by the U.S. Agency for International Development.

Another problem that the cooperatives continue to face is financial in nature. When rural properties were expropriated during the 1980s, former owners received compensation, part in cash and the remainder in agrarian reform bonds (which were already trading in the secondary market at a substantial discount in 1982). Titles to these properties were held by the Salvadoran Institute for Agrarian Transformation (ISTA). Cooperatives acquiring titles likewise assumed a portion of the original debt. By the middle 1990s, many cooperative leaders were contending that this debt could not be serviced, and hence should be forgiven. This demand being met, cooperatives found themselves free of past liabilities. However, they also found banks unwilling to extend them new credit (Shaw, 1997), which has created acute financial constraints.

Unable to borrow money and lacking business expertise, some cooperatives are giving serious consideration to dissolving themselves. Old restrictions on land sales having been jettisoned, subdivision of cooperative lands is now an option.

The Option of Joint Ventures

There are differences between traditional *comunas* in tropical forests and agrarian reform cooperatives. The former have existed in Ecuador for a long time, since before passage of the 1937 law that gave them official status, while the latter represent a comparatively recent tenurial innovation, one made under the duress of rural insurrection. Regardless, general lessons emerge from this paper's two case studies. In particular, assigning non-transferable land rights to marginalized rural populations has yielded disappointing dividends in Ecuador as well as El Salvador.

One response to poor performance is to invest in human capital, thereby raising managerial and marketing capacity. This approach has been adopted in the aforementioned USAID project now being implemented in El Salvador. But another way to improve the commercial viability of *comunas* and cooperatives is to encourage joint ventures with private-sector partners. By no means does the latter approach preclude the former. Indeed, human capital formation and the pursuit of joint ventures can be highly complementary. However, it must be emphasized that joint ventures will be organized only if local institutions are allowed to make their own decisions about land transactions, modes of governance, and related matters. For many of these institutions, a sensible reform is to convert themselves into limited-liability corporations, with their members becoming shareholders.

In Ecuador, for example, laws that make it hard for *comunas* to develop and to implement long-term plans for renewable resource development also render those institutions unattractive as joint-venture partners. One foreign investor who tried but failed to organize a joint forestry venture reported in 1993 that the current *cabildo* in the area where he was working always seemed to be asking for money to pay for a *fiesta*, motorcycle, or something else. He reasoned that the group taking over in a few months would make similar requests, as would the *cabildo* that would take office one year later, and so on. The expenses that would be incurred during the several decades required for standing timber to mature are obvious (Southgate *et al*., forthcoming).

Private investors' reluctance to do business with local communities comprises a very serious impediment to sustainable resource development in northwestern Ecuador. The former group possesses the managerial expertise and marketing contacts required to derive full value from the natural resources owned by the latter group. If joint ventures are not pursued, forest dwellers will continue to have no alternative besides selling timber in monopolized markets at inefficiently low prices.

Similarly in El Salvador, joint ventures involving cooperatives have much appeal. To date, the strict prohibition that remains in place on private holdings larger than 150 hectares has been one of the factors discouraging the sort of agricultural and agribusiness investment that other Central American nations have attracted. The only large tracts of land in the country, of the sort that much of this investment requires, are owned by cooperatives. Joint ventures would allow the labor and natural resources they possess to be combined with managerial and management expertise and capital, contributed by private partners. Moreover, the recent record of El Salvador's cooperatives suggests that, if joint ventures or some other alternative approach is not adopted, it is likely that cooperatives will continue to fail commercially. This will lead to their being dissolved and all group land holdings being subdivided.

References

Bromley, D. and D. Chapagain. 1994. "The Village against the Center: Resource Depletion in South Asia" *American Journal of Agricultural Economics* 66: 868-873.

Fundación Salvadoreña para el Desarrollo Económico y Social (FUSADES). 1996. *Diagnóstico del Sector Agropecuario.* San Salvador.

Hayami, Y. 1990. "Community, Market, and State" in A. Maunder and A. Valdés (eds.), *Agriculture and Governments in an Interdependent World: Proceedings of the Twentieth International Conference of Agricultural Economists.* Aldershot, England: Dartmouth Publishing Company.

Prosterman, R., J. Riedinger, and M. Temple. 1981. "Land Reform and the El Salvador Crisis" *International Security* 6: 53-74.

Shaw, C. 1997. "Rural Land Markets" (report 16253-ES), World Bank, Washington.

Southgate, D., P. Salazar-Canelos, C. Camacho-Saa, and R. Stewart. Forthcoming. "Markets, Institutions, and Forestry: The Consequences of Timber Trade Liberalization in Ecuador" *World Development*.

Strasma, J. 1989. "Unfinished Business: Consolidating Land Reform in El Salvador" in W. Thiesenhusen (ed.), *Searching for Agrarian Reform in Latin America*. Boston: Unwin Hyman.

Thiesenhusen, W. 1995. *Broken Promises: Agrarian Reform and the Latin American Campesino*. Boulder: Westview Press.