Mexico: A Policy Agenda on Property Rights for the XXIst Century

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ABSTRACT
Mexico has a long history of a visible struggle between State, social and private control of property. From the communal agricultural land which, in Mexican law, belongs to communities that are historically bound to it, to the oil and mineral resources that belong to the State, private property is still a matter of debate in XXIst century Mexico. Newer forms of property, such as intellectual property, lack a legal framework that is appropriate for the creation of markets that could spur Mexican development and competitiveness.

Private property is stronger in some classes of assets, such as homes, which explains why they are a favorite destination for investment in Mexico. The differences in certainty and risk when holding certain assets makes Mexico over-invest in some types of assets and under-invest in others. These decisions have a significant cost in terms of economic growth and development.

This paper argues that Mexico should revamp its rule of law regarding property so there are no regulatory advantages of certain types of property over others. Arbitrary decisions and regulations of expropriation by the State must be barred from Mexican legislation, as well as policies that facilitate extortion and theft from public officials, lawyers, notaries, and criminals, against corporations and individuals. The State must pursue an agenda where the defense of property rights is a priority of the State in order to attain higher economic development, better wealth distribution, and reaching the Sustainable Development Goals set forth by the United Nations and the international community.

INTRODUCTION
In IPRI 2019, Mexico earned a score of 5.229, slightly below the world average (5.726). The lowest ranking was in the legal and political environment component (LP), where Mexico earned a score of 3.592, well below the world average of 5.16. Surprisingly, even though the legal and political environment is quite lacking, Mexico did not score as badly in physical and intellectual property protection. In the case of intellectual property, Mexico’s score was slightly above the world average.

What can explain a deficient legal and political framework, and yet an average (albeit not extraordinary) result in the protection of physical and intellectual property? This essay tries to provide an explanation. In addition, this essay will also try to convince the reader that the implications of property security for different types of assets are enormous in terms of quality of investment, and hence, economic growth.

LAND
In the Mexican Constitution of 1917, the original right to property belongs to the Mexican State. It is the State who decides what can be owned and by whom. In the case of land, private owners are
entitled to the soil on the surface of their terrain. Any oil or minerals that might exist underneath the surface are owned by the State.

To complicate things further, Mexico also recognizes social property. Ejidos, communal lands, are a form of property that comes from medieval Spain. Communal land existed in pre-Hispanic Mexico, which facilitated the use of the ejido properties, especially after the Mexican revolution of 1910. An estimated 53% of Mexican land is under the ejido form of property.

The word ejido comes from the Latin exodus, which referred to the communal land used for grazing since XIth century Spain. In Mexican agrarian law, ejidos are owned by the community: a list of registered owners or ejidatarios that have no exclusive right to any determinate plot of land, but have a collective right to use the land either for agriculture or for conservation. By law, ejido owners cannot sell land individually or cede their rights in the ejido list to any third party; an agreement of the totality of ejidatarios is necessary to sell the land and convert it to private property. The laws and regulations also make it hard (if not impossible) to sell ejido land or offer it as credit collateral. Hence, ejidatarios are often poor and dependent on government subsidies, despite having some of the best agricultural lands of Mexico (which were mainly seized from the hacienda owners in the Mexican Revolution).

During the liberal reforms of president Salinas (1988-1994), the legislatures reformed the Mexican Constitution so ejido land could be bought and sold freely. Some land changed its property to private land as a result of these reforms, although most of the ejido land remains in the collective property realm. The transaction costs, which often entail finding ejido rights’ heirs that might have migrated generations ago are just one hurdle. Usually, the notary, legal fees and registration costs entailed by the conversion of ejidos to private land are prohibitive.

The ejido is ruled by a governing group called asamblea ejidal. The assembly commands an authority, the comisariados ejidales, that have to enforce the resolutions put forth by the community. The agreements of the asamblea ejidal need not be registered, so it’s simple to forge them in order to revert negotiations, or extort additional payments from companies that invest in ejido land once the investments are in place. In the southern State of Oaxaca, it’s not uncommon for companies to make significant investments in ejido land just to find out shortly that there is a large group of ejidatarios that was excluded from the original deal, and that are demanding payments from the firms. It’s also common to find cases where agricultural companies make significant investments in trees, irrigation or land improvement in ejido lands. The ejido seizes the assets and forbids the investor company from harvesting or withdrawing the assets from the land.

The State is largely absent from ejido land, so contracts with ejidatarios cannot be easily enforced. At the federal level, historically ejidatarios had a Secretariat of State, Secretaría de la Reforma Agraria, to enforce regulation, but mainly to preserve ejido property as common land. For most of the XXth century, Reforma Agraria was dedicated to distribute land seized from large haciendas to poor peasants; but in practice, the Secretariat distributed an amount of land equivalent to several times the size of the Mexico. In the administration of President Peña, Reforma Agraria became SEDATU, a
secretariat for territorial and urban development. But in the end, its legal framework lacked teeth for actually organizing property and land.

There are many instances where a potential buyer of rustic plots of land faces serious uncertainty about the property modality of a particular piece of land. It might be full ejido land for agriculture or conservation, or ejido land converted to private land, or ejido land in dispute between ejidatarios, private owners, or both. Due to that uncertainty, it is difficult to assess the value of land and its productive potential.

Therefore, ejido land cannot be offered as collateral in a bank credit. Since it’s not easily bought and sold, the land market lacks mobility. People who inherited ejido rights and cannot sell are usually poor and have to remain in the land in order to maintain their ejido rights. Ejido land prices are determined by the potential difficulty of converting the land to private property than by the actual productive potential of the land. Not surprisingly, Mexican primary activities attract less capital than expected. Investment in agriculture and forestry is around 0.5% of total investment, while the whole primary sector adds about 3% of national GDP.

**NOTARIES AND POLITICIANS**

The other half (47%) of Mexican land holdings are private. In the Mexican Constitution, notaries are completely under the jurisdiction of State governments. The Federal Government has its own mechanisms for public faith in federal land or in federal business. Notaries are appointed by State governors.

The concept of public faith in Mexico is closer to the Roman-Napoleonic tradition than to the Anglo-Saxon tradition. In Anglo-Saxon legal systems, any person, not necessarily a lawyer, authorized by the State, might perform functions of public faith. In these systems the notary does not need to know or validate the legality of an agreement or a property contract. In the Roman-Napoleonic tradition, notaries are experts of the law (usually lawyers) that not only recognize the identities of the intervening parts of an agreement, but also validate the legality of whatever is agreed in the documents that are presented to them.

In the French system, for example, notaries are assigned by opposition contests. The notaries own an insurance mechanism through a mutuality that absorbs liabilities from wrongful notarial activity. The record of mistakes by a notary is a strong element in the decision of the State to renew the patent of a notary.

In Mexico, notaries are closer to the colonial tradition where public posts were bought and sold. A Mexican notary may cede a notary patent to her heirs. Governors decide how many notary posts to grant and where, which favors the creation of local monopolies; or at least a market structure where
the notaries have significant market power to extract rents from the public\(^1\). While registering a property in Texas might cost around 0.5% of its value, in Mexico it may cost from 6 to 12%. It’s not unusual in Mexico that notaries are former politicians that are granted notary payments in exchange for political favors.

The Mexican Competition Authority (COFECE), the official anti-trust agency, has made attempts to change the market structure of notaries that have been unfruitful. Notaries have responded by lobbying and convincing the State that they should not be considered an “economic agent” and thus regulated by COFECE. Since public faith is a delegated function of the State, notaries in Mexico want the State to consider them as a special form of public agents that can set their own prices. This situation creates all sorts of perverse mechanisms. Since the public registry of property and trade is beyond the scope of control of notaries, local bureaucrats in these offices know that their seal is essential for notaries to perform their function (and to extract a rent from the public). Hence, an informal market of facilitators (gestores) exists, where the notaries must share a portion of the rent with the bureaucrats at the registry and the facilitators.

Every attempt to reform this crooked system has failed. Notaries and heirs to notary patents are everywhere in the Mexican bureaucracy, legislatures and even the Supreme Court. Not surprisingly, many Mexicans do not register their property, which makes inheritance cases a mess.

**HOMES AND EVERYTHING ELSE**

Since possession (actually occupying and using the land) is essential in Mexico to safeguard property, the property of homes is the strongest form of property in Mexico. Criminal laws against despojo (unlawful appropriation of a property) are very strong, especially in cases of invasion of an occupied home. Thus criminals think twice before doing that.

However, the invasion of idle land and commercial property (such as warehouses) is not uncommon, and is linked to political movements that bet on the impossibility of owners to prove property and the sluggishness of the authorities to act on the invasion of large pieces of property. Land is quickly divided and subdivided, and the invading political movement usually finds a way to add public services to the invaded land. Under Mexican law, the peaceful, long-standing possession of land is a valid legal precedent for property. So after a few years of receiving an electricity bill and municipal land taxes in an invaded piece of land, occupants might file a trial for usucapion.

In spite of it all, home ownership is a fairly safe investment in Mexico. Mexicans invest heavily in residential houses. Real Estate Services is a huge economic class in Mexican GDP (around 15%). There is an estimated inventory of 5 million abandoned residential homes, which were built on inadequate land plots, without adequate public services (the absence of piped water and public security are

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quite common). Only 150 thousand of these abandoned homes is owned by Infonavit, the Mexican public institution that finances residential construction for workers at the Federal level.

Mexicans commonly lack a pension fund or other forms of financial savings and investments, but usually own homes, as they deem them as the only possible safe destination for savings. This explains why the IPRI physical property score is relatively high in the Mexican case, despite the deficient legal and political framework.

Land property in cities can be tricky because of discretionary decisions of local authorities regarding land use. Some zones are banned from having industrial or commercial activities. Large residential homes built in decades past are not adequate as homes anymore but can be reconditioned or rebuilt as businesses. The contrary may also happen, though it’s not as common: reclaimed industrial land can be fractured into apartments or houses. However, this shift on the registered use of land is costly for construction businesses because of enormous corruption around land uses.

When you see the skyline of an American city, adjacent buildings standing on an avenue are roughly the same size. The reason is that if my neighbor gets a permit to build, say, 25 floors, I should get a similar permit. The Mexican skyline on any avenue in any city (but especially large cities) is uneven. If your neighbors got a permit to build a 30 floor building, that permit is probably the result of a corrupt dealing with the municipal authority.

**COMPANY OWNERSHIP**

Mexico is a highly entrepreneurial country that boasts around 4 million individual firms. Most of them are in the informal sector. The great majority are small companies with less than 5 workers. More than firms, these companies are families that are organized to produce and/or sell products and services.

Registering a firm in Mexico was harder in the past. It’s become easier over the years, as both the Federal Government and the States have made significant efforts to ease registration of firms.

However, the incentive to register is still low, due to a number of factors. First, hiring and firing workers is costly in Mexico. This explains why the micro-businesses never grow beyond the family realm. Dispute settlement with workers is easier in a family environment than with strangers, as severance payments for a dismissed employee that sues the company in labor court can be extremely expensive. Especially in low value-added sectors, payroll taxes and social security costs are prohibitive, so small business families never formalize their business operations into a corporation. Also, the notary costs are a big hurdle against registration of a business.

Notably, a registered business needs a minimum volume of operation to comply with all the fiscal regulations. Smaller, poorer businesses cannot even afford an accountant, which is a necessity in Mexico.
Culturally, business activity in Mexico is not seen as a desirable occupation. Bankruptcy cases are very complicated in Mexico, even for large companies, like the defunct airline Mexicana de Aviación. There is always the suspicion (in many cases correct) that the administration of businesses subject to bankruptcy proceedings was fraudulent. Under duress, businesses that request the protection of judicial authorities to restructure their balance sheet end up in liquidation. The Mexican law favors fiscal and workers’ interests in bankruptcy cases over other types of creditors. Unsurprisingly, business ventures in Mexico are not considered reliable creditors by banking institutions. Banks finance entrepreneurs who own assets and use those assets as collateral for credit. Unless Mexico produces a better framework for bankruptcy, assets will never be allocated to their most productive uses. This is a dead weight for the Mexican economy in terms of growth.

Businesses in Mexico are subject to loads of contradictory regulation from the three orders of government. Taxation is complex and arcane; Mexico is one of the few countries, for example, with a profit-sharing scheme with workers. Unsurprisingly, in their records, businesses rarely reflect the real value of their business. This makes businesses valuable as survival tools for entrepreneurs, but not property that can be easily bought and sold. If Mexican authorities were more pro-business, more investments would happen in companies and less in land and other less productive forms of property. Economic growth would follow as a consequence.

Recent legal reforms have equaled non-compliance in tax matters to organized delinquency. Despite the sophistication of digital invoices (CFDIs, in the Mexican fiscal lingo), there is still a market for forged invoices that are used to illegally reduce the tax burden of companies through engrossed expenses and simulated operations. Under the new laws, the authority may seize the property of the fiscal offender – be it a company or a person – and sell it in the market immediately. Following a judicial process, if the presumptive offender is found innocent, the proceeds of the sale of assets are returned to her. Since organized delinquency crimes may elicit jail, this is one of the crudest attacks on property rights and entrepreneurial liberties in Mexico, and one that needs to be carefully observed in the years to come.

**INTELLECTUAL PROPERTY**

The 2019 IPRI scores rank Mexico highly in intellectual property protection. However, Mexico does not produce as many patents and utility models as other industrialized countries, such as Germany. World International Patent Office (WIPO) data\(^2\) show that Mexico has 296 patent applications for every million workers, while Germany has 1,558. Smaller economies by GDP, like Costa Rica and Chile, have 229 and 323, respectively.

There are several hypotheses explaining the lack of patenting in Mexico that rule out lack of useful innovations in the economy. Mexico is not as advanced in manufacturing as South Korea, Japan or Germany, but it has made strides in manufacturing value added. The *maquila* (offshoring) operations

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of the 1990s have been replaced now by manufacturing plants that are quite sophisticated when compared to other countries in the region. One hypothesis is that the system of public incentives for researchers and inventors favors academic production over patent registration.

Yet, there is another plausible set of explanations for the lack of intellectual property production outside the creative arts in Mexico. For example, software is not patentable in Mexico, as it’s subject to author law, in the same category as novels and artistic production.

Another possibility is the absence of an adequate understanding of the market for innovations. Mexican law favors the monopoly of the inventor over the market for an innovation. Also, the enforcement of a patent, once it’s out, is nearly impossible. A Mexican inventor would probably find the litigation and hassle to enforce her patent and collect royalties from infringement to be prohibitive. Therefore, innovations are rarely patented and are best kept as industrial secrets.

Other contradictory legal bodies are also an obstacle to patents and utility models. The Mexican labor law, for instance, says that any innovation produced in work sites belongs to the company, not the workers. Under such a scheme there is no incentive to reveal the innovation and patent it or produce a spin-off from a company based on an innovation.

Other forms of intellectual property, such as artistic property protected under author law, need to be better enforced. Recent scandals around indigenous designs call for a better enforcement of Mexican cultural patrimony. Brand infringement is another source of worry for Mexican entrepreneurs. A few years ago, a Chinese company produced one million boxes of a beer called “Cerona” whose packaging and branding closely resembled those of “Corona”. A couple of decades ago, a Chinese entrepreneur and producer of decorative lights tried to register La Virgen de Guadalupe as his own design. Last year, the U.S. fashion company, Michael Kors, presented a rag sweatshirt as part of its collection. The design closely resembled a common design sold in Mexican informal markets (sudadera de jerga). Jewelry designers and fashion brands also use indigenous geometrical designs, and it’s not clear in Mexican or international law if the communities that have preserved such designs for centuries are entitled to a payment for their use.

PROPERTY-SPECIFIC TAXATION

The main sources of fiscal revenue in Mexico are Value Added Tax (IVA, in Spanish), Income Tax (ISR), and special taxes which are all collected by the Federation. In the past, the oil rent made up almost half of public revenues; today oil adds around one-sixth of the total fiscal bill.

Under the Mexican fiscal pact, the Federation collects most of the taxation and allots monies to its own expenses under the federal budget; it also distributes resources to State and municipal governments, according to a fiscal distribution formula. States are mainly funded on federally collected taxes and special taxes such as payroll and car ownership taxes. Municipalities also receive federal fund allotments, and are allowed to collect land property taxes.
Mexican municipality collections of land property taxes is one of the lowest in OECD countries (almost 1.5% of the total tax collection). The pact between citizens and municipalities is a broken one: since municipalities receive very little resources from predial (the Mexican property tax), the incentive to protect property, invest in public goods and services and provide adequate public security is very low. Instead of being a local counterbalance to Federal power, mayors and governors are submissive to the political will of the Federation.

CONCLUSIONS

Mexico has fared well in property protection indices such as IPRI, but the legal and political framework is frail. In all, property is a political arrangement all over the world. However, the Mexican case is one where property is still very much dependent on the political and fiscal pact, and on sovereign, arbitrary decisions of who owns what and why. This has implications in terms of investment decisions of families and companies, which in turn reduces the efficiency of the economy. If Mexico policymakers really want the Mexican economy to grow, they must make private property protection transparent with policy measures that empower individuals and reduce the margin for State discretionary measures.

The recent reforms that make fiscal misdemeanors and faults equal to organized crime is a severe attack on private property, and will likely deteriorate Mexico’s position in international property and competitiveness rankings. The Mexican fiscal authorities need to empower States and municipalities to link taxes to property and link public services to tax compliance by property owners.