



The Impact of Mexico's Social Security Crisis

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The Mexican Social Security Institute (IMSS) financial crisis has been in the national media in recent months and is one of the most important challenges to public finance and economic policies. The way this crisis is resolved will determine future

social protection policies, which will in the long run have an impact on Mexicans' well-being.

A quick glance at the financial situation of Mexico's social security institutes shows that the main problem is a lack of resources to meet existing commitments. Among them is the lack of actuarial reserves to deal with the growing number of retirees and pensioners, creating a crisis in the pension system.¹

It should be remembered that the main objective of pensions is to be part of a social system that protects workers' present and future incomes in the event of disability or old age.

Wage workers in Mexico have a right to a pension when it is stipulated in their contract; today, this covers only 17.7 percent of the population, or 36.7 percent of the work force with jobs.² Clearly, coverage is very limited.

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Pensions are financed from three sources: the worker contributes according to his/her base wage and the employer matches that amount. The government makes up the difference.³

The social security institutions that provide these services are the IMSS, created in 1943; the State Workers Institute for Social Security and Services (ISSSTE), created in 1959; the Armed Forces Social Security Institute (ISSFAM) and decentralized public bodies and companies like *Petróleos Mexicanos* (Mexican Petroleum Company or Pemex); the *Comisión Federal de Electricidad* (the Federal Electricity Commission or CFE); *Luz y Fuerza del Centro*

the pension system was changed to a privately managed one of defined contributions and individual savings accounts.⁴ This system is obligatory for workers who began working in the private sector as of July 1, 1997.

If we take into account the small number of workers who have a right to a pension, the diversity of requirements and the obstacles to getting one, the lack of actuarial reserves to sustain the systems, the economic context mainly characterized by a long period of lack of sustained growth, the drop in income and wages for over 20 years, increased unemployment and informal activity (that situates 63.3 percent of

Key among the arguments justifying the reforms of the social security institutes is the impact of the demographic transition: a declining mortality rate and increased life expectancy. Mexicans' average life expectancy has jumped 28 years, going from 48 in 1943 to 76 by 2004. This has meant that pensions have to be paid out for longer periods. Since they are given after a certain number of years of work and not because the individual reaches a certain age, workers can retire before the age of 60. This pressures the finances of the social security institutions and if there is continued insistence on reforming the pension systems using the model of defined contributions, individual accounts and private management (*Afores*), in the transition period, current pensions will necessarily have to be paid by the government. The Ministry of Finance maintains that today, the state is spending 19.8 billion pesos a year on pensions, or 13 percent of the government budget.⁸

Without a doubt, these demographic changes affect the pension systems, but the way it affects them is more related to the dynamics of the economy and the change in the pattern of social reproduction implemented in the country more than 20 years ago, as well as with the systematic deficit in waged job creation. Nevertheless, demographic aging is a trend that must be taken into account when designing public policy since the number of people over 65 will grow very dynamically, almost 400 percent between 2000 and 2050. This will necessarily have an impact on, among other things, the cost of health care for older adults. However, it should be emphasized that what today has the largest impact on pension funds is the lack of econom-

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(*Light and Electricity of Central Mexico* or *LyFC*); and the development banks *Banobras* and *Nacional Financiera*. These social security institutes, in addition to providing pensions also offer health services and other benefits both to workers and their families, covering 49.2 percent of the total population.

The retirement system written into law in the 1940s and 1950s specifies defined benefits and is based on solidarity, using the formula that employed workers finance the passive workers. This is the characteristic of the entire system, known as the distribution system, although the different age requirements, time worked required and some additional benefits are what determine the big differences in today's retirement schemes. In the case of workers signed up with the IMSS, with the reform that went into effect in 1997,

the employed work force with no right to benefits),⁵ increased life expectancy and epidemiological changes, we can conclude that the pension systems need to be reformed. However, what is debatable is that this reform can have only a single orientation: substituting privately managed models of defined contributions for pay-as-you-go defined benefits systems based on solidarity.

I already said this when, some time ago, I did a rapid analysis of the 1997 reform of the IMSS. It should be noted that what was proposed to resolve the institute's financing has not been achieved, nor has greater coverage. Six years after the IMSS was reformed, it has 180 billion pesos in liabilities.⁶ In terms of coverage, in 1990, the IMSS provided medical care for 41.2 percent of the total population; in 1997, 39.5 percent; and in 2003, 39.2 percent.⁷

ic growth and the distortions in the Mexican economy, which have meant the dearth of formal sector job creation and the growth of informal activities, with the resulting creation of jobs without any kind of social security (and therefore people employed who are not paying into any pension fund). Obviously, given these circumstances, the ratio of active workers to retirees tends to shrink steadily. However, this situation would not have been so radical if the creation of waged jobs had not stopped, if public sector employment had not plummeted and if the drop in income had not been as large as it has been in the last 20 years.

It is important to mention that if *the reforms* of the pension system made up until today have been to create a privately managed system of defined contributions and individual accounts it is because they are prescribed by the economic model. That is, the reform of the IMSS was implemented when the structural reforms that changed the country's economic and social reproduction models had already been made after 1982, leading the way to an open economy based on the principles of the free market, shored up by the trade and financial opening, the liberalization of goods and services, the privatization of state and para-state bodies and the reform of the state. Therefore, the reform of social security is part of the so-called second generation structural reforms whose aim is for economic growth to be based on international competition, trade and financial liberalization and privatization. This has even led to the commercialization of services traditionally provided by the state, among them, health care and pensions. These matters are increasingly thrown into the sphere of indi-

vidual responsibility. That is, pensions and health care will depend increasingly on individuals' savings (which means that they have to have a paying job) and will stop being an obligation of the state, as is still stipulated by the Constitution.

We should consider that if we start from the current low income levels, even if they are managed very well and profitably, pensions are at most going to correspond to the income level with which contributions were made. According to the National Employment Survey, we find that by late 2002, 9.4 percent of employed persons did not receive any wage at all; 16.2 percent

savings, and taking into account that for every peso saved, only 75 cents would actually be deposited in their accounts with the rest going for administration costs,⁹ the remaining 26.9 percent would get a pension or income for life.

The pertinent question is: Why is a reform made based on defined contributions, individual capitalization and private management if it is very probable that in the long run most of the pensions will be guaranteed minimum pensions, which makes for a higher fiscal burden and, with the weight of labor liabilities and the payment of government bonds to which a large part of the worker's savings have been

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earned less than minimum wage; 25.14 percent earned between minimum wage and double that wage; 22.2 percent earned between twice and three times that amount; 15.8 percent earned between three and five times minimum wage; and only 11.14 percent earned more than five times the minimum wage. If all employed persons were part of a privately managed system of defined contributions and individual capitalization, 25.6 percent of those with jobs either would not pay any social security tax or their contributions would be so small that at the end of their life they would not have contributed enough to earn them a pension. Based on their income and contributions, 47.4 percent would get a minimum pension. And if we had economic growth, recovery of purchasing power and high interest rates for their

committed, public debt is growing and will continue to grow enormously? And why, when financing is required to foster economic growth, are very significant resources such as workers' forced savings managed by private companies, which quite naturally seek profitability and therefore see pension fund management as a juicy business deal that seems to leave few benefits to the domestic market?

Another of the aims of the 1997 IMSS pension reform is closely linked to financial market behavior and the possibility that most of the resources gathered from workers' forced savings could be channeled into productive investment and, with that, generate a virtuous circle of economic growth, which in the medium term would improve workers' earnings and the creation of more waged jobs.

The reality has been quite different. Domestic savings has dropped from 24 percent of gross domestic product (GDP) in 1997 to 18 percent in 2002. Investment behavior also shows this effect: the economic recovery still does not have the push needed to make fixed gross investment grow. Then, where are the workers' forced savings, the financial resources being managed by the Private Administrators of Pension Funds (Afores)?

The resources managed by the Afores are channeled into the Pension Fund Investment Societies (Siefores), regulated by the National Savings for Retirement Commission (Consar). The

another factor for financial invariability of the country's economy if the amount of resources—which are significant—becomes part of the mass of financial resources that have been inserted into the dynamic of the international financial market.

If we are faced with the need to continue to reform the pension system to ensure appropriate financial viability and security to retirees of today and the future, what should be proposed?

Taking into account that the population over the age of 60 represents 5 percent of the work force, that 21.7 percent of households state that the head of the household is over 60, that only 17

tutions if the new reforms are to have positive results.

Equally, any proposal to reform the pension system must include everyone who is carrying out productive activity. Concretely, mechanisms for incorporating the informal sector must be created. The different existing pension schemes should also be harmonized with regard to requirements like the years the individual must pay into the fund, minimum retirement age, etc.

The pension commitments of all the institutions are said to have already reached 130 percent of GDP. The discussion of this issue seems to have just started and the only proposal until now is to continue with private management of these savings, without analyzing the consequences for social security.

However, I think it is viable to implement a national pension system funded by the state that would establish transparent rules with appropriate investments, favoring national productive sectors, with low operating costs, free from political interference.¹³ If one of the country's basic problems today is financing economic growth, it would be a shame that workers' resources were once again lost, that their savings not contribute to establishing viable social security, with pensions that can give them some certainty, and that these resources not be channeled into the country's productive activity. **MM**

What has the largest impact on pension funds today is the lack of economic growth and the distortions in the Mexican economy.

regulations aim to protect the workers' savings, even though they have no guarantee of their profitability. Up until now, these resources have been invested in the following way: 82.4 percent are turned into government bonds; 10.8 percent is channeled into corporate credit; 4.4 percent to financial institutions; and 2.3 percent to state bodies.¹⁰ Of the monies that go to corporations, 70 percent goes to the largest companies, linked to the service sector, and, in second place, to manufacturing.¹¹

By January 2004, the accumulated savings of the workers came to 403.6688 trillion pesos, which represented 6 percent of GDP. The paradox of the 1997 reform is that it was made to financially alleviate the IMSS, which today is reporting greater financial difficulties, since its public debt has increased geometrically and may even become

percent of those over 60 have a pension,¹² that 80 percent of those households live in poverty, I think that pensions, as an essential part of the social safety net, must be returned to the public sphere. Therefore, they should be removed from the logic of private business's single-minded quest for profitability. In situations where the population has insufficient coverage and such high wage and labor heterogeneity, pension models are only actuarially sustainable if they are based on redistributive solidarity since the risks of illness, disability and labor matters are also diverse. In addition, we have to keep in mind that if social security is financed with state, business and workers' contributions, we must have sustained economic growth as a general precondition, and in particular, better use must be made of the resources earmarked for the insti-

NOTES

¹ From 1980 to 2003, the number of active workers per retiree has gone from 13.1 to 6 in the IMSS. In the State Workers Institute for Social Security and Services (ISSSTE), the ratio has dropped from 19 to 4. *Tercer Informe de Gobierno* (Mexico City: Presidencia de México, 2003).

² This percentage has been calculated using information from the 2003 National Employment Survey, published by the National Statistics Institute and the Ministry of Labor in Aguascalientes, the state social security institutes and the statistical compendia from the September 2003 President's Report to the Nation.

³ In the case of government employees, obviously social security payments are made only by the worker and the government.

⁴ Pension systems can be based on defined benefits or defined contributions. The defined benefit systems (pay-as-you-go or solidarity-based systems) stipulate that at the time of retiring, the right to the pension and its amount are decided according to the average wage in a specified number of years and weeks that the worker made payments into the system. The body that gives the pension guarantees its payment until the worker's demise. In the defined contribution plans, benefits depend on the funds accumulated individually. When the worker retires, he/she receives the bal-

ance accumulated and if what has been saved is sufficient, he/she can contract with the private fund manager a life-long income or programmed retirement. He/she assumes the risks of financial profitability and of surviving longer than expected.

⁵ Instituto Nacional de Estadística, Geografía e Informática-Secretaría del Trabajo y Previsión Social, *Encuesta Nacional de Empleo* (Aguascalientes: INEGI-STPS 2003).

⁶ Jaime Sánchez Susarrey, "Salvemos al IMSS," *Reforma* (Mexico City), 15 May 2003. This was an editorial based on an interview with Santiago Levy, the general director of the IMSS.

⁷ *Anexo al Tercer Informe de Gobierno* (Mexico City: Presidencia de la República, 2003), p. 80.

⁸ *Reforma* (Mexico City), 21 May 2004.

⁹ Commissions are charged on the basis of the integrated base wage. That is why the Afores have made such high profits since they were

instituted. See Ángel Guillermo Ruíz Moreno, *Las Afores* (Mexico City: Porrúa, 2002).

¹⁰ *Anexos 1, 2 y 3, Tercer Informe de Gobierno* (Mexico City: Presidencia de la República, 2003).

¹¹ Among the companies are America Movil, Telmex, Televisa, Grupo Carso, Telecom, Bimbo, Coca-Cola Femsa, Cigarrera La Moderna, Imsa and Kimberly Clark. Of the monies invested in the financial sector, they represent 10 percent of the total in Afores; and the financial institutions that absorb them are Ford, General Motors Company, Casita, Crédito y Casa (Consar, "Valores corporativos en las carteras de las Siefores Básicas," www.consar.gob.mx/estadisticas/2004/febrero).

¹² Berenice Ramírez, "Envejecimiento demográfico, pensiones y desarrollo económico en México," unpublished paper, 2003.

¹³ This model has been implemented in 26 countries. The closest example is in Quebec, Canada.

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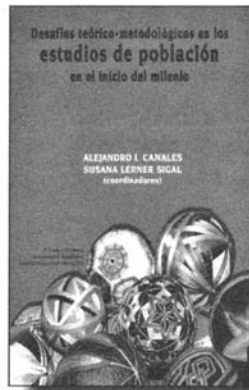


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