Mexico
Income Generation and Social Protection for the Poor
(In Four Volumes) Volume III: An Overview of Social Protection
August, 2005

Colombia and Mexico Country Management Unit
Poverty Reduction and Economic Management Unit
Latin America and the Caribbean Region
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<td>Vice President</td>
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<td>Sector Director</td>
<td>Ana Maria Arriagada</td>
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Task Team: Gillette Hall, Laura Rawlings (co-task managers), Jaime Saavedra, Gladys López-Acevedo, Marcela Rubio, Time Lunde, Carlos Noriega (consultants) and Maria Guadalupe Toscano (research assistant).
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1. INTRODUCTION

This report provides a strategic overview of Mexico’s federal social protection system, which is comprised of both social insurance and social assistance programs. It assesses its performance to date regarding income risk management for vulnerable groups, and identifies options for stepping up that performance. In doing so it responds to an increasing consensus in Mexico regarding the need for a major social protection policy reform, even if the direction of those reforms is still in flux. The report is designed to provide a first stage diagnostic of major issues facing the social protection system, as an input to ongoing discussion and debate in Mexico, and as a platform for further technical work on the specifics of reform.

The report focuses on the role of federal government in the design and implementation of social protection policies, while recognizing that sub-national governments are playing an important role in the provision of these services, as will be explored in the next phase of the World Bank’s Mexico Programmatic Poverty work. In doing so, it draws upon the first phase of the Mexico Programmatic Poverty Work as well as the urban, rural and vulnerability studies being conducted in parallel with this analysis.

The report is organized into four chapters. Chapter 1 presents a brief review of social protection concepts, and establishes a framework for determining the optimal role for government in the provision of social protection (risk management) tools, as distinct from market-provided risk management tools and those undertaken informally by and between households. Chapter 2 discusses the major sources of income vulnerability in Mexico, identifying the major risks that Mexican families face, and explores the extent to which households have access to private risk management mechanisms for addressing these risks. Chapter 3 provides an overview and assessment of the social protection system in Mexico, and Chapter 4 discusses issues and options.

WHAT IS SOCIAL PROTECTION?

Social protection is a set of tools to manage income risk, ranging from formal mechanisms such as old-age pensions, health insurance and transfer programs to informal mechanisms such as remittances. Social protection has an important role to play in addressing not only short-term vulnerability, preventing households from temporarily falling into poverty, but a longer-term role in reducing risks that perpetuate chronic poverty. It is based on the idea that individuals, households, and communities are exposed to multiple income risks from different sources, both natural and man-made, individual and covariant (World Bank, 2001), that can lead to welfare losses unless public or private social protection mechanisms are available to assist households in managing risk.

WHAT IS THE ROLE OF THE GOVERNMENT IN PROVIDING SOCIAL PROTECTION?

There are two basic rationale for governments to provide social protection: (i) to address market failures that leave families or individuals without sufficient risk-pooling mechanisms to cope with shocks, and (ii) to achieve redistributive goals, including the protection
of vulnerable groups such as the ill or disabled, and via the provision of asset-building strategies, such as human capital development. The failure of private insurance markets to provide viable risk-management mechanisms provide a clear rationale for policy intervention by the government in those markets, in the form of public (or publicly-regulated) risk-pooling programs such as unemployment and health insurance. Income redistribution via social assistance programs (income transfers and asset-building programs to poor households) form the second core of social protection policy, and the extent to which governments take on this second role of social protection policy is largely a matter of choice and political will.

Social protection policies can be grouped into two major categories: social insurance and social assistance. Social insurance mechanisms are those where participants pay into the system and withdraw benefits when eligible, effectively pooling risk across all program participants. Social assistance programs are comprised of government transfers to targeted populations, funded by general tax revenues. Yet in practice the boundary between these two types of programs can break down. Social insurance programs may be partially funded from general tax revenues, such that a component of the benefit becomes in effect a subsidy. Social assistance programs, on the other hand, if not rationed by means of a budget constraint but instead available to anyone in the general population displaying conditions of eligibility, simply become risk-pooling mechanisms across the entire general population; contributions are paid via the tax system, and benefits drawn out according to need (World Bank, 2004).

What are the circumstances under which the government should intervene to provide social protection, and what is the optimal type of intervention? Building on World Bank, 2004, which draws on the comprehensive insurance framework (Erlich and Becker, 1972), we establish a basic typology of income risks, based on the two factors determining the cost of insuring against a risk, which are: (i) the frequency of the risk, from rare to constant, and (ii) size of the loss resulting from the risk, from small to catastrophic. From this typology we establish four main categories of risk, as illustrated in Figure 1: small and rare (dog bite), small and constant (minor illness), catastrophic and rare (job loss), catastrophic and constant (chronic poverty). Then we match these four major categories of risk with the consequent ideal social protection response, and the role for the government in providing that response. The role for the government is minimal in the bottom two quadrants of the figure – where informal mechanisms by and between households can be largely successful in managing risk – and becomes larger as the size of the potential loss moves up the figure to catastrophic losses, where the role for the government in social protection provision is greatest. Similarly, the type of intervention that is ideal differs from left to right – rare losses (to the right of the figure) are most efficiently dealt with via risk-pooling (insurance, either provided by the market or the government) whereas frequent and predictable income losses, which cannot be cost-effectively insured against, are most effectively addressed via re-distributive social assistance transfers (either from the government, or between households).
### Figure 1.1 Social Protection Responses and Role for Government, by Size and Frequency of Income Risks

<table>
<thead>
<tr>
<th>Size of Loss</th>
<th>Catastrophic and Rare i.e. unexpected job loss – transient poverty</th>
<th>Catastrophic and Frequent i.e. income volatility associated with informal employment, or permanent income loss due to disability or old age - and low asset base with which to manage income shocks</th>
</tr>
</thead>
<tbody>
<tr>
<td>Ideal SP response</td>
<td>risk-pooling</td>
<td>Ideal SP response: re-distributive transfers, and incentives for savings/human capital investment</td>
</tr>
<tr>
<td>Goal</td>
<td>address market failure (where insurance markets fail to provide)</td>
<td>Goal: income smoothing, prevention of negative coping, and increased human capital</td>
</tr>
<tr>
<td>Potential Role for Government: HIGH</td>
<td>Potential Role for Government: HIGH provide social assistance funded from general tax revenues (risk pooling across entire population) and where age-appropriate, incentives to invest in human capital.</td>
<td></td>
</tr>
</tbody>
</table>

**INSURANCE**

<table>
<thead>
<tr>
<th>Size of Loss</th>
<th>Small and Rare i.e. dog bite</th>
</tr>
</thead>
<tbody>
<tr>
<td>Ideal SP response</td>
<td>private risk management, i.e. coping</td>
</tr>
<tr>
<td>Potential Role for Government: MINIMAL - except incentives for positive coping behavior</td>
<td></td>
</tr>
</tbody>
</table>

**ASSISTANCE**

<table>
<thead>
<tr>
<th>Size of Loss</th>
<th>Small and Constant i.e. common cold</th>
</tr>
</thead>
<tbody>
<tr>
<td>Ideal SP response</td>
<td>private risk management, i.e. self-insurance (saving)</td>
</tr>
<tr>
<td>Potential Role for Government: MINIMAL - regulation of capital markets to facilitate access to savings mechanisms</td>
<td></td>
</tr>
</tbody>
</table>

**Appropriate social protection policy design takes into account both the potential negative effect of crowding out private transfers, and the potential positive effects of replacing detrimental private coping and mitigation strategies with formal mechanisms.** Public social protection –be it in the form of risk pooling or in the form of targeted redistribution—interacts with informal risk mitigating and coping mechanisms, including private transfers. One key question for policymakers is whether or not a public intervention will simply displace private risk management mechanisms, such as market insurance, or informal, inter-household transfer systems. In insurance, the appropriate role for government is in regulating private insurance markets, and stepping in to provide public risk-pooling programs where markets fail (such as in the case of unemployment insurance). In targeted redistribution efforts, programs need to take into account the existence of private transfer networks, including monetary transfers as well as the exchange of commodities (food, clothing etc.) and assistance such as help with child care. If public transfers crowd out private transfers, government intervention contributes less to recipients level and safety of income and consumption than initially thought.¹ Put differently, private safety

¹ This is particularly true for the level and fluctuation of consumption. Informal risk coping strategies, including private transfers, are insurance mechanisms used to protect consumption from adverse shocks to income. As a result, we would expect income to fluctuate more than consumption. Since welfare ultimately
nets might fill the gaps in the absence of publicly funded programs, and may at times alleviate poverty more efficiently than government intervention (Cox and Jimenez, 1990). However, a second set of questions relate to ‘negative’ coping mechanisms which increase a household’s vulnerability to risk and poverty in the future. Damaging behavioral responses to shocks adopted by the poor in order to mitigate (ex-ante) and cope (ex-post) with risk include, among others: the sale of productive assets, adverse incorporation under the wings of a patron, safer but low-return production techniques, and reduced investments in physical and human capital. Skoufias (2004) stresses the need to better understand the nature of private insurance strategies, pointing to the fact that a displacement of informal means of consumption insurance is not necessarily a bad consequence of government intervention. Ideally, optimal policy design takes into account both the potential negative effect of public transfers crowding out private transfers, and the potential positive effects of replacing detrimental private coping and mitigation strategies with formal mechanisms. The poor typically have relatively weak capacity for self-insurance, and limited ability to pool risks over and above extended families or other informal mechanisms. These informal mechanisms tend to be costly, and to break down in the context of covariate risks. Government action can be crucial in these areas.

Two main features of the role for publicly-provided social protection emerge from this typology. First, the role for government in the provision of social protection services or programs varies from minimal to high depending on the size of the potential income loss. In the bottom two quadrants of the graph, the size of the income loss, where the risk should occur, is low. Public resources are much less effectively spent to mitigate small risks in the bottom two quadrants, where private risk management mechanisms optimally predominate. Conversely, the potential role for government grows with the size of the potential loss. In the top two quadrants of the figure, where the size of the potential loss is high, public resources can very effectively be spent to address these types of risks, as long as interventions are designed to complement rather than replace risk management tools that markets or households provide for themselves.

Second, the optimal type of intervention – risk-pooling (insurance) to address market failure vs. targeted redistribution (assistance) – depends on the frequency of the risk. Risks that are rare can be insured against, and therefore are most appropriately managed via risk-pooling mechanisms among those exposed to the risk. Risks that are frequent cannot be effectively managed via risk-pooling, and are more suited to explicit social assistance via targeted income transfers. Thus the figure also illustrates the dichotomy between the two major roles for social protection: insurance (where markets fail to provide risk-pooling among households faced with relatively rare risks, that nevertheless induce high costs should they occur) and social assistance via redistribution (where households face frequent — or permanent — risks to income coupled with having a low asset base with which to manage risk, such that even small shocks to income can be catastrophic). For example, for populations vulnerable to ‘catastrophic and rare losses’ (such as job loss), shown in the upper left quadrant of the figure, the optimal role for the government is to provide funded risk-pooling mechanisms (e.g., workfare). The top right quadrant illustrates populations facing frequent income losses, and for whom the impact of the shock can be catastrophic due to an insufficient asset base to effectively manage those risks. The

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derives from consumption and since consumption accounts for households' private efforts at protection, it is generally the preferred measure. It is, however, worth noting that risk mitigating strategies that successfully lower variability of consumption by lowering variability of income lead to reduced income in the future and a permanent fall in median consumption levels. Focusing on variability of consumption should therefore be accompanied by a view to changes in the long run average level of consumption (see Skoufias 2004 for a review of the main arguments from economic theory). It is, however, worth noting that some risk mitigating strategies successfully lower variability of consumption.
population in this quadrant often faces chronic poverty in the absence of public interventions, and includes, for example, the poor self-employed with a permanently high degree of variability in earnings, and the poor who move into old age who experience repeated shocks as they continue to engage in the labor market but suffer decreased productivity/ability to work. For this type of risk, the role for the government is again high, and the optimal public intervention is targeted, redistributive transfers (such as conditional cash transfers, workfare, and old age minimum pensions). Some of these programs, such as conditional cash transfers, can be tied to human capital development where these are age-appropriate, in order to reduce recidivism and facilitate the exit from chronic poverty (see Box 1.1)

Box 1.1: Social protection and chronic poverty

Social protection has a particular role to play in addressing chronic poverty, notably by moving beyond risk-pooling to the use of targeted transfers. The combination of material poverty, extreme capability deprivation and various forms of social exclusion experienced by the chronic poor group calls for a multi-dimensional response.

Formal mechanisms for risk mitigation and coping are central to successful social protection strategies not only because they help prevent individuals falling into chronic poverty, but also because they facilitate exit from chronic poverty while preventing recidivism. Access to formal risk-pooling mechanisms matter to the chronically poor. The cost of realized risks is greater for this group due to lower endowments of physical and human assets which weaken the ability to manage shocks. Evidence also shows that the chronic poor experience higher frequency of income fluctuations, longer recovery periods, and short-range upward mobility which leaves them particularly vulnerable to recidivism. In the absence of public policy, behavioral responses adopted to mitigate and cope with risk and vulnerability can play a crucial role in maintaining the poor in poverty: “If the poor are more exposed to shocks than other groups, if they have fewer buffers to protect themselves against the realization of these shocks, and if to achieve short term security they are forced to adopt low return livelihood strategies which further increase their vulnerability over time, then risk and vulnerability will contribute to trapping individuals and households in poverty.”


Governments have a particular role to play in the provision of social protection services, in coordination with other public policies such as sectoral (health and education) investments and labor markets. A well designed set of social protection policies is one component of an effective poverty reduction strategy. Social protection policies can assist households in managing income risk, while education and health investments are critical to raising incomes over the long term. Social protection policies also depend on a well-functioning labor market, and the design of social protection programs must take into account labor market incentives or disincentives. Social insurance programs are funded via contributions and the level and nature of these contributions have an important effect on incentives for formality in employment. Further, social assistance programs can create disincentives to work if benefit levels are set too high or if there is no clear exit strategy inherent in the program design. Finally, assistance programs work best if they create strong positive links to employment. These issues will be discussed more fully in Chapter 4.

In sum, there is an important role for public provision of social protection where exposure to risk is high and the potential income losses are large—and where private risk management tools fail, are insufficient, or produce negative externalities that further embed a
household in poverty. The principles of social protection as laid out in this chapter can be summarized as follows: the role for government increases the larger the size of the income risk, and the type of government intervention that will be most successful varies with the frequency of the risk. Pooling risk across a large number of households (insurance) is most effective where risks occur infrequently but where the income costs are large, should the risk occur. Insurance becomes less effective the more frequent the risk, carving out a particular role for social assistance (income transfers) particularly for the poorest households who have limited assets for risk management (the chronic poor). Private risk management tools work best where the losses associated with risks are low and the role for government intervention increases with the size of the potential income loss. Chapter 2 builds on this framework to identify major sources of income risk to which households are exposed in Mexico, as well as the evidence on private risk management tools available for managing those risks.
2. HOUSEHOLD VULNERABILITY IN MEXICO

Individuals and households face a diverse set of income risks. Social protection comprises a series of risk management strategies including informal mechanisms (e.g., savings and remittances) and formal social protection instruments (e.g., social security and social assistance) to manage those risks. Drawing on available data and existing risk and vulnerability assessments, a mixed picture emerges. Mexico has made tremendous progress in reaching certain risk groups, particularly the young, poor and rural population. However, several key vulnerable groups can be identified for whom the frequency of risk and severity of loss compels a re-examination of government policy. Among these are the elderly living in poverty and the low-income population which faces very high costs associated with health care. In addition to these idiosyncratic (individual) risks, Mexicans are also periodically exposed to aggregate shocks (such as economic shocks or natural disasters), yet the evidence suggests that the overall variability of consumption in the face of these risks is low. Adjustment to macroeconomic shocks has largely taken place via falling wages, such that income losses as a result of economic downturns have been diffused across the working population, as opposed to resulting in unemployment focused on certain key sectors, although some evidence points to possible changes in this adjustment mechanism in the future. Private risk management is an important component of household responses to the above risks, but its limits are also apparent. The chronic poor, for whom private risk management tools are fewest, emerge as a particularly vulnerable group.

A household’s level of vulnerability, i.e., the likelihood of experiencing a loss of welfare in the future, is determined by: (i) the characteristics of risks it faces, and (ii) the household’s ability to manage risks via access to private or public mechanisms. Vulnerability can be defined as the probability of experiencing a loss in the future as measured by some benchmark of welfare, such as income or consumption. In this report we define vulnerability as the probability of falling into, or further into poverty. In other words, we will focus on the probability of becoming poor or poorer. The degree of vulnerability depends on the characteristics of risks (the size of the potential loss) and on the households’ ability to manage risk. Mexican households face a range of risks and employ a variety of risk management strategies, both public (i.e., social protection policies such as insurance or assistance) and private (i.e., own savings, family remittances). When the combination of private and public insurance and coping mechanisms is effective, risk ceases to be a concern as shocks do not result in adverse welfare effects.

Income shocks are idiosyncratic (individual) or covariant (economy-wide) and differ in terms of frequency, size of loss, and the mechanisms by which they are transmitted. Population-wide, the most common idiosyncratic risks affecting one’s capacity to generate sufficient income are low-human capital development during childhood, health or other shocks to primary wage earners during working age, and poverty in old age due to an inability to work and insufficient retirement savings. Vulnerability to the different types of idiosyncratic risks changes as an individual moves through the stages of the lifecycle, as will be shown below. The major sources of covariant risk are macroeconomic shocks that raise the risk of income losses economy-wide and natural disasters or weather-related risks that affect the living standards and income prospects of a large segment of households in one geographic area at once.
IDIOSYNCRATIC RISK AND VULNERABILITY IN MEXICO

This analysis begins by assessing idiosyncratic risk among the Mexican population through the lens of the lifecycle, consistent with the government of Mexico’s Contigo strategy. The analysis is based on data from the Encuesta Nacional de Ingreso y Gasto de los Hogares (ENIGH) from 1996 and 2002, from which leading risk indicators between the rural and urban poor populations using the official poverty lines have been calculated, as outlined in Appendix tables 1-4. Different sources of exposure to idiosyncratic risk can be identified across three basic stages of the lifecycle: children and youth, working age adults, and the elderly. Social protection policy responses also differ across these age groups. One major source of idiosyncratic risk – health shocks– occurs across the lifecycle, and is also discussed below.

- **Infants, children and youth** are often among the most vulnerable in a population because of the high concentration of youth among the poor and because of the long-lasting effects of shocks to the young. The young are most vulnerable to risks that affect the development of their human capital and thus future earnings potential, including malnutrition, little education and health shocks.

- **The working age population** are most vulnerable to shocks to their capacity to generate income, either idiosyncratic (i.e., health shock that impinges upon the ability to work or unemployment) or aggregate (i.e., economic crises), that cannot be coped with and therefore translate to consumption losses. Policy responses here include both income generation (by supporting training, access to credit and financial services and channels for accumulating assets) and income security (through market insurance mechanisms, notably in health and unemployment). For the income security function, the role for publicly-provided social protection is clear because these are market failure-related shocks with severe consequences, such as a serious illness, where risk pooling mechanisms are needed. The role for social protection is not clear-cut for income generation, as will be discussed below.

- **The elderly** are most vulnerable to idiosyncratic shocks to income as they become unable to work or generate sufficient earnings due to lost productivity in old age. There is a need to provide income security (mainly through pensions and health insurance).

- Health is a risk that spans all age-groups and for which the poor show high vulnerability, as reflected in high levels of out-of-pocket expenditure and catastrophic health shocks among the poor.

**Infants, children and youth: Long-term shocks to human capital**

Considerable advances have been made in Mexico over the past decade with respect to the human capital development of infants, children and youth. As outlined in World Bank (2004a), Mexico has now achieved close to universal primary education, with net primary schools enrollment among 6-11 year-olds rising from 88 percent in 1980 to 93.5 percent in 2000, and a

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2 See Chapter 3, Figure 3.14 for further details on the Contigo Strategy.
3 This work serves as (i) a complement to the vulnerability analysis carried out as part of the Mexico Poverty Programmatic work, based on the analysis of rural panel data from the Progresa evaluation from 1998-1999 and urban panel data from the ENEU applied in 1994 and in 2001 (Skoufias 2004); and (ii) an update of the past World Bank social protection review (Arriagada and Hall, 2001), using the same methodology to provide a consistent view of the evolution of risks and social protection over time.
rapid expansion of lower secondary enrollment. Similar gains have been made in health with considerable reductions in infant mortality (50.9 per 1,000 live births in 1980 to 20.5 in 2003), near universal vaccination coverage (97.7 percent) and decreases in maternal mortality (from 15.6 percent in 1980 to 7.3 percent in 2000).

### Table 2.1 School attendance and Age-for-grade 1996 and 2002

<table>
<thead>
<tr>
<th>School Attendance</th>
<th>Urban</th>
<th>Rural</th>
</tr>
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<tbody>
<tr>
<td></td>
<td>Extreme poor</td>
<td>All</td>
</tr>
<tr>
<td>Ages 6-11</td>
<td>1996</td>
<td>95.5</td>
</tr>
<tr>
<td></td>
<td>2002</td>
<td>94.8</td>
</tr>
<tr>
<td>Ages 12-14</td>
<td>1996</td>
<td>80.6</td>
</tr>
<tr>
<td></td>
<td>2002</td>
<td>88.5</td>
</tr>
<tr>
<td>Ages 15-17</td>
<td>1996</td>
<td>47.7</td>
</tr>
<tr>
<td></td>
<td>2002</td>
<td>49.3</td>
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</table>

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<th>Age for grade</th>
<th>Urban</th>
<th>Rural</th>
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<tbody>
<tr>
<td></td>
<td>Extreme poor</td>
<td>All</td>
</tr>
<tr>
<td>Ages 6-11</td>
<td>1996</td>
<td>1.04</td>
</tr>
<tr>
<td></td>
<td>2002</td>
<td>1.05</td>
</tr>
<tr>
<td>Ages 12-14</td>
<td>1996</td>
<td>1.14</td>
</tr>
<tr>
<td></td>
<td>2002</td>
<td>1.14</td>
</tr>
</tbody>
</table>

Source: WB staff calculations, ENIGH 2002.

Despite important progress in terms of meeting the needs of infants and youth, historical patterns of exclusion prevail beyond lower secondary school. Although smaller gains have also been achieved in upper secondary and tertiary, difference between income groups and urban and rural areas remain considerable. As shown in table 2.1, attendance is low and regressive at upper secondary levels, with marked urban and rural disparities. Upper secondary enrolment (among 15-17 year-olds) is 49.3 percent among the urban poor, compared to a general rate of 66.3 percent; in rural areas, enrolment drops to 44.6 percent among the poor and 53.4 percent overall. University enrolment is quite limited and markedly regressive (see appendix). It is important to note that although urban-rural gaps seem to persist, overall progress in rural areas was again matched by near stagnation of indicators in urban areas. This might have changed since 2002, in particular in the light of the decision in 2000 to extend Oportunidades to urban areas.

Sources of income risk during working age

In assessing the major sources of income risk among the working-age poor, two distinct groups can be identified: a younger, more urbanized, skilled population and the older, less-skilled population concentrated more heavily in rural areas. The first group has higher levels of human capital, having benefited from the advances made in health and education, notably over the past 15-20 years. By contrast, there is a lower-skilled but economically active population that constitutes 50 and 23 percent of the poor rural and urban population respectively, with no education or incomplete primary. This population is generally older, able bodied, but has limited productive capacity. Table 2.2 shows that the percentage of low-skilled workers is significantly smaller for the age group 25-40 than what is found in the age group 41-64.
Table 2.2  No education or incomplete primary (low skills) by age group, 1996 and 2002

<table>
<thead>
<tr>
<th>Ages</th>
<th>Urban</th>
<th>Rural</th>
</tr>
</thead>
<tbody>
<tr>
<td></td>
<td>Extreme poor</td>
<td>All</td>
</tr>
<tr>
<td>Ages 25-40</td>
<td>1996</td>
<td>36.7</td>
</tr>
<tr>
<td></td>
<td>2002</td>
<td>29.0</td>
</tr>
<tr>
<td>Ages 41-64</td>
<td>1996</td>
<td>69.9</td>
</tr>
<tr>
<td></td>
<td>2002</td>
<td>62.7</td>
</tr>
</tbody>
</table>

Source: WB staff calculations, ENIGH 2002.

Each of these populations requires distinct public policy interventions; the role for social protection is largest among the older working poor, soon to become elderly. The younger, more skilled population is best positioned to benefit from interventions that fall largely outside the scope of social protection, such as training (though international experience here also points to the limits of training programs in generating higher earnings), more education and improved access to financial markets. The role for social protection becomes clearer when addressing short-term income risk arising from unemployment—however, unemployment is not a major risk at present (see below). Among the older working age population, with very low skill level and declining productivity as they approach old age, there is more scope for social protection intervention, particularly in the form of a means and age-tested targeted minimum pension benefit as this population moves into retirement age.

Unemployment is low and relatively stable in Mexico; however, the urban poor show somewhat higher unemployment than other segments of the population. In the period 1987-2003, with the important exception of the Tequila Crisis in 1995, unemployment remained below 5 percent despite constant increases in labor participation (Montes, Santamaria and Bendini, 2004). Unemployment rates in Mexico are very low by regional standards, including when compared to the most developed economies, such as Colombia and Chile, which experienced similar or stronger episodes of growth than Mexico. Moreover, unemployment duration has also been low, with most skilled and unskilled workers finding a job within a six-month period.

Table 2.3  Unemployment and part-time employment, 1996 and 2002

<table>
<thead>
<tr>
<th>Unemployment</th>
<th>Urban</th>
<th>Rural</th>
</tr>
</thead>
<tbody>
<tr>
<td></td>
<td>Extreme poor</td>
<td>All</td>
</tr>
<tr>
<td>1996 Male</td>
<td>4.6</td>
<td>3.2</td>
</tr>
<tr>
<td>Female</td>
<td>2.5</td>
<td>1.8</td>
</tr>
<tr>
<td>2002 Male</td>
<td>5.7</td>
<td>2.6</td>
</tr>
<tr>
<td>Female</td>
<td>1.7</td>
<td>1.9</td>
</tr>
</tbody>
</table>

<table>
<thead>
<tr>
<th>Part-time job*</th>
<th>Urban</th>
<th>Rural</th>
<th></th>
<th></th>
</tr>
</thead>
<tbody>
<tr>
<td>1996</td>
<td>20.3</td>
<td>18.5</td>
<td>33.3</td>
<td>30.2</td>
</tr>
<tr>
<td>2002</td>
<td>27.7</td>
<td>17.9</td>
<td>42.1</td>
<td>33.5</td>
</tr>
</tbody>
</table>

* Share of employed population working part-time.
Source: WB staff calculations, ENIGH 2002.
A growing share of the working poor are employed in part time jobs. The percentage of the population employed in part-time jobs increased significantly more for the extreme poor in both rural and urban areas. In fact, in urban areas, the percentage of the workforce in part time jobs declined slightly, while the percentage of the extreme poor working in this status increased from 20.3 percent in 1996 to 27.7 percent. In rural areas the share of part-time employed had an overall increase, but it was significantly more pronounced among the extreme poor. This trend can be explained both by economic cycles/structural change (market liberalization) and by the increased female participation in the workforce. An increase in part time jobs among the poor does not necessarily imply an adverse phenomenon. It may be that the poor are beginning to find part time jobs. However, the situation poses a challenge to the social security system, as part time employment rarely allows the worker to contribute sufficiently to social security systems.

With respect to unemployment insurance, Mexico’s historic wage flexibility has proven to be a relatively efficient safety net in past crises in Mexico. In the 1995 crisis, GDP per capita fell by 5 percent. The labor market adjusted through a 25 percent fall in wages but relatively little unemployment. This had the effect of spreading losses relatively evenly across the population rather than concentrating the losses on a particular group (World Bank, 2004). González-Anaya (1999) finds that this adjustment mechanism was observed in many Latin American countries during the nineties. However, this adjustment through prices (wages) a less through quantities (employment) might be changing, and with lower inflation rates unemployment might be again a more likely risk (see discussion in companion report Urban Poverty in Mexico, World Bank 2005).

In addition, informal coping mechanisms that involve increased labor force participation of spouses effectively protect the incomes of households when faced with unemployment shocks to heads of households, and does not translate into increased school non-attendance or reduced educational performance (year-to-grade) among children. In a recent study of the determinants of household vulnerability in urban Mexico, Skoufias (2004) finds that it is only during the Tequila crisis (i.e., an aggregate shock) that the loss of a job by the household head is associated with an increase in income risk. Estimates of the determinants of labor force participation show that increased labor market participation of women (added worker effect) is a common informal risk management strategy of urban households. Combined with the estimated small impact of unemployment shocks on income, this finding suggests that strategies that adjust the labor market participation of spouses have been largely successful coping mechanisms.

Box 2.1: Informal Household Risk Management Strategies in Mexico

Households engage in a number of informal risk management strategies that need to be understood in order to craft effective formal, public social protection policies. A recent study suggests that families in urban Mexico employ both household self-insuring techniques as well as risk pooling techniques at the local level in the face of shocks as means for smoothing consumption.

Spouse added worker strategies are a substantial form of informal self-insurance. There is evidence of the “added worker effect,” where non-working wives enter the workforce when confronted with the loss of a spouse’s income. The research found substantial reductions in household work when a woman entered the labor market, suggesting that there may be hidden costs to this type of risk management such as less time with children and losses to social capital.

Child added worker strategies are limited. Putting children in the labor force can be seen as transferring future family income to the present and hence another self-insurance strategy with potentially high private and social costs. However, only certain groups of poor girls appear to drop out of school when a father or mother loses his or her job. The largest effect on workforce
entry appears when a mother opens a micro-enterprise. As found in studies elsewhere, child labor in Mexico appears to be pro-cyclical.

**Extended families** are probably efficient insurers and may offer protection not easily observed in the data. The sociological and anthropological literatures suggest that extended families provide possibilities of pooling risks, while maintaining the correct “self-protection” incentives at the household level.

**Migration** is often resorted to as a form of income diversification and remittances play an important role in risk management in Mexico. Incomes of foreign workers are uncorrelated with their home economy and exchange rate devaluation increases the value of transfers in peso terms. However, the cost of this self-insurance strategy tends to be high in terms of lower education attainment.

Informal labor markets are not complete safety nets that offer readily available jobs. Most of those entering unemployment enter from the informal sector and the duration of unemployment is only 22 percent less than formal sector workers. This makes sense given that micro-enterprises everywhere have high failure rates.

Informal capital markets in the form of rotating credit associations, reciprocal loans, *guelaguetza*, or relations of *compadrazgo* may offer consumption smoothing and risk pooling possibilities.

**Informal risk management strategies** of rural households depend on two additional activities: diversification into non-farm occupations and subsistence farming.

**Diversification of income sources:** Diversifying income through non-farm economic activity has been an important way for Mexican rural households to concurrently increase income and mitigate risk. In reaction to the *Tequila Crisis* in 1994-95, rural households in Mexico increased their involvement in non-farm occupations, particularly low return ones which are easier to access.

**Subsistence economy:** Subsistence economy is commonly understood as the agricultural production of food crops carried out by farmers in one or several small plots of land for self-consumption, using family labor. Subsistence farming is rarely practiced alone but rather as a supplement to other production such as coffee or other cash crops, and it is not exclusive to poor farmers. The importance of the subsistence economy has been declining rapidly but it still is the number one safety net in rural areas.


The ability of households to effectively protect incomes against unemployment shocks via added-worker effect depends on: (i) the demographic composition of the household; (ii) macroeconomic conditions (ability to mitigate the effects of employment shocks improves when the economy is growing, and falls during economic crises); and (iii) level of gender-based segmentation of labor markets. As referred to the above, Skoufias (2004) shows that increased labor market participation of women (added worker effect) is a common informal risk management strategy of urban households. This implies that protection against the risk to urban incomes from unemployment depends on household composition such as the existence of a non-working spouse. The inability of households headed by single women to employ added-worker risk management strategies might indicate higher exposure to risk, however this seems to be a rushed conclusion. Maloney et al. (2003) find that during the 1994-95 tequila crisis, female-headed households did not do any worse than the median household in terms of exposure to income risk, when corrected for income volatility in normal times. Unemployment rates in Mexico are presently low and in this context private coping mechanisms function well. However,
the scope for the impact of future crises to be absorbed via downwards wage adjustments (as opposed to rising unemployment) may be limited. This is further discussed in section on economic downturns and crisis.

**The Elderly**

Old-age poverty is an important risk facing individuals in Mexico, and poverty rates are higher among the elderly than for the population as a whole. Recent data from international comparisons indicate that there is a gap between the national poverty rate and the 65+ poverty rate, with poverty among the elderly being more pronounced. This gap in poverty rates is not unique to Mexico among countries in the region; table 2.4 shows that a higher incidence of poverty among the elderly than for any other age group is found in six out of the eight Latin American countries included. The regional comparison, however, also shows that the rate of poverty among the elderly in Mexico is high given the country’s level of development. This result is not surprising as Mexico has concentrated its poverty alleviation efforts and programs on children and young adults, a priority that is, from a social return point of view, an understandable focus, due to Mexico’s thin tax base and scarce public resources. Still, the vulnerability of the elderly demands a closer look at the social protection mechanisms offered to this population.

<table>
<thead>
<tr>
<th>Entire Population</th>
<th>65 and older</th>
</tr>
</thead>
<tbody>
<tr>
<td>Bolivia</td>
<td>30.5%</td>
</tr>
<tr>
<td>Brazil</td>
<td>24.6%</td>
</tr>
<tr>
<td>Chile</td>
<td>20.8%</td>
</tr>
<tr>
<td>Colombia</td>
<td>24.0%</td>
</tr>
<tr>
<td>Costa Rica</td>
<td>21.7%</td>
</tr>
<tr>
<td>Guatemala</td>
<td>19.1%</td>
</tr>
<tr>
<td>El Salvador</td>
<td>27.4%</td>
</tr>
<tr>
<td><strong>Mexico</strong></td>
<td><strong>22.1%</strong></td>
</tr>
</tbody>
</table>

Note: Comparison based on total income that includes both monetary and non-monetary income. Source: Gill, Packard and Yermo (2004)

Access to public pension schemes among the poor is virtually non-existent in today’s Mexico. Only 6.7 percent of the elderly extreme poor in urban areas and less than 1 percent in rural areas receive a pension (Table 2.5). An immediate result of lacking income security at old-age is that a large share of the elderly poor continue to work, particularly in rural areas. Coverage of pensions systems and other forms of income support among Mexico’s elderly is discussed in more detail in Chapter 3, yet it is worth noting that a series of social assistance programs and transfers reach the elderly poor, including *Procampo, Oportunidades* (in 600,000 beneficiary households, the support is received by an elderly person), *Liconsa, Programa para Adultos Mayores* (covers 98 percent of elderly in Mexico City), *Acuerdo Nacional para el Campo* and *Programa Alimentario* (see appendix). With the exception of Mexico City’s universal pension scheme, most of these programs target the rural poor. However, despite these programs, poverty remains prevalent among the elderly in Mexico.
Table 2.5  Pension coverage and labor force participation among the elderly, 1996 and 2002 (shares)

<table>
<thead>
<tr>
<th></th>
<th>Urban</th>
<th></th>
<th>Rural</th>
<th></th>
</tr>
</thead>
<tbody>
<tr>
<td></td>
<td>Extreme poor</td>
<td>All</td>
<td>Extreme poor</td>
<td>All</td>
</tr>
<tr>
<td>Receives pension</td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>1996</td>
<td>7.9</td>
<td>21.2</td>
<td>0.9</td>
<td>5.5</td>
</tr>
<tr>
<td>2002</td>
<td>6.7</td>
<td>22.1</td>
<td>0.8</td>
<td>5.3</td>
</tr>
<tr>
<td>Works and does not receive a pension</td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>2002</td>
<td>29.8</td>
<td>24.9</td>
<td>57.9</td>
<td>49.7</td>
</tr>
</tbody>
</table>

Source: WB staff calculations, ENIGH 2002.

Informal risk management strategies rely on extended families, private transfers (remittances), and accumulation of assets (savings or investments). It is worth noting that the comparisons in Table 2.4 are based on total income poverty. Accumulated assets tend to increase with age, and the elderly would tend to be better off relative to other groups, if these are included. However, the value of assets held by the elderly depends critically on two institutions that are often lacking or malfunctioning in Latin America: (i) legal institutions that protect property rights, and (ii) financial institutions that allow households to convert illiquid assets into income for consumption in old age. In addition, it is important to better understand the existing informal risk management and private transfers (inter-generational) in place, and to understand how these are affected by socio-demographic changes.

Private strategies to cope with income-risk in old-age may have adverse long-term effects. One example is how the need to protect against old-age poverty affects land inheritance patterns in rural areas. The main perceived risks faced by old land-owning men, whose possibilities of migration or participation in the labor market are diminished by age, are to be left alone, and to be unable to earn enough income to survive. Common responses to this situation observed in ejidos and comunidades are: (i) old owners cling to their land resisting any pressures to pass it on in life; (ii) at least one of the sons or daughters stay in the household to look after parents and help till the land, often with the promise that they will inherit it; and (iii) parents keep the family bound such that transfers keep coming in from distant children. As such, the resistance of Mexican small land holders of advanced age to pass on their lands to the young generation is part of a broader survival cum risk management strategy identified in field studies (see *A Study of Rural Poverty in Mexico*, World Bank, 2005). However, it also results in reduced agricultural productivity, youth exodus, and demographic imbalances.

Current demographic changes indicate that addressing old-age poverty may become an increasing challenge, due to the aging of the Mexican population. A recent study of demographic trends in Mexico found that the percentage of the population above 60 years of age rose from 6.6 in 1989 to 8.57 in 2002. As shown in Figure 2.1, the increase in average age of household heads is particularly pronounced in rural areas. Higher life expectancy is increasing the number of elderly relative to young, which puts pressure on private risk management strategies of extended families and inter-generational transfers and formal pension systems alike. An aging population, together with urbanization and changing socio-cultural norms, also affects household composition and the effectiveness of the extended families as a safety net in old-age. Over the past decade the average number of members per household has decreased, as single-member households or two-member households without children become more common. Given that women live longer than men, many of the one-member households are composed of women above 60 years of age (Arriagada, 2001), while the growth in two-member families is driven

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4 Ariza and de Oliveira (2004)
mainly by an increasing number of older couples whose kids have left the household, the so-called empty-nesters (Ariza and Oliveira, 2004). From 1989 to 2002, the share of single-member households in urban areas rose from 4.6 to 6.5 percent, while the share of two-member households with no kids rose from 6.3 to 8.3 percent.5

**Figure 2.1. Age of Household Heads, 1992-2002**

Source: ENIGH 2002.

**Idiosyncratic health shocks, a major source of risk across all age groups**

Exposure to health shocks twinned with insufficient capacity to manage those shocks is a major risk associated with poverty at all stages of the lifecycle. The low-income population in Mexico faces very high costs associated with health care. More than 5 million Mexican citizens face catastrophic health expenditure, resulting in at least 2 million of them falling into poverty.6 In addition, the distribution of out-of-pocket expenditure is regressive as the poor show much higher levels of out-of-pocket expenditure than the rich. This translates into a higher frequency of catastrophic health shocks and suggests that available risk-pooling mechanisms do not reach the poor and/or do not offer efficient protection. When the survey Lo que Dicen los Pobres asked the poor in Mexico what they feared most in the coming 10 years, only unemployment and the death of a family member ranked higher than illness.7

**Out-of-pocket expenditure and catastrophic health shocks.** Estimates show that about 50 percent of total health expenditure in Mexico is private, almost all of which is out-of-pocket. The share of health expenditures absorbed privately by households is large based on international comparisons—for reference, the share of private expenditure of total is 25 percent in Colombia and 3 percent in the United Kingdom. Further, these costs imply a particular financing burden on the poorest households. Based on Mexico’s Ministry of Health definition of catastrophic health shocks (30 percent of disposable consumption, after spending on food, education and housing), the extreme poor are more likely to experience such shocks than the rest of the population (Table 2.6). About 47 percent of the poorest, urban and rural, experienced catastrophic shocks to income in 2002, compared to 26.3 percent of rural and 21.7 of urban non-poor.

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5 Ibid.

6 “Seguro Popular and the Reform of the Mexican Health System”, World Bank, processed. Catastrophic health shock defined as more than 50 percent of household income net of basic nutritional consumption.

7 Secretaría de Desarrollo Social, Lo que Dicen los Pobres, October 2003.
Table 2.6  Percentage of population that experienced catastrophic health shocks, 2002

<table>
<thead>
<tr>
<th></th>
<th>Rural</th>
<th>Urban</th>
</tr>
</thead>
<tbody>
<tr>
<td>Extreme poor</td>
<td>46.8</td>
<td>47.2</td>
</tr>
<tr>
<td>Moderate poor</td>
<td>36.5</td>
<td>35.0</td>
</tr>
<tr>
<td>Non-poor</td>
<td>26.3</td>
<td>21.7</td>
</tr>
</tbody>
</table>


**Findings on catastrophic health shocks reflect inequities in health expenditure and health insurance coverage.** There are significant inequalities in public health expenditure, and the poor are in general uninsured. Consequently, they frequently pay out-of-pocket for health services. Households in the first decile spend around 11 percent of income on health care while the richest spend less than 4 percent, pointing to severe problems of efficiency and equity of public health subsidies. The link between public social insurance and vulnerability to catastrophic health shocks becomes even clearer when we look at households who fell into poverty as a result of illness and related out-of-pocket expenditure. A recent study found that while only 9 percent of insured households fall below the poverty line after catastrophic health care expenditures, 40 percent of uninsured households are impoverished when suffering a health shock. In 2002, 73 percent of households impoverished from health expenses were not insured. There is also an urban-rural gap, as 60 percent of rural households fall below the poverty line as a result of catastrophic health care expenditures, while 17 percent of urban households face the same problem.

**Box 2.2: Vulnerability to Health-Related Risk in Rural Mexico and the Impact of Oportunidades**

Oportunidades cash transfers combined with free access to health clinics, played an important role in protecting income from falling when household heads experience short-term illness. In a recent empirical analysis of vulnerability in rural Mexico, Skoufias (2004) found that in communities not covered by Oportunidades, households with an ill household head experienced an average income growth rate that was between 20.4 percent and 21.7 percent lower than for households where the head did not get ill. This implies that households are unable to protect their income from short-term illness. In communities covered by Oportunidades, the growth rate of income did not vary much as household heads experienced short spells of illness. More serious illnesses (in terms of duration in days and inability to leave the bed) turned out to have a smaller negative effect on income (not significantly different from zero). There were also no apparent differences between those covered and not covered by Oportunidades.

Consumption appears to be well insured in terms of short-term illnesses even without the access to Oportunidades. Consumption appears to be insured even from more severe illness shocks, as estimates using serious illness shocks instead of light illness shocks did not reverse the results. One possible explanation for this is that long illness is not really a shock but rather a permanent state.

The study concludes that vulnerability could be more effectively tackled with an insurance-type of program that ensures that household welfare (consumption or income) does not fall below a socially acceptable norm. Skoufias also argues that the absence of strong effects of health shocks on consumption does not imply that households will not get any welfare.

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9 Ibid
10 Defined as being confined to bed for a maximum of 3 days out of the last 30 days
11 Defined as being confined to bed for more than 6 days over last 60 days.
benefit from health insurance. Improved health increases welfare directly, but this effect cannot be measured directly.


Variations in health status across incomes, population groups and regions may also be seen as a reflection of unequal health expenditure and limited access to social insurance programs. Mexico's many achievements in the health sector over the past decades (expanded access to basic services, increased spending) have led to significant improvements in the health status of the population. Infant mortality has fallen sharply while immunization among children has become nearly universal. Yet, health status remains unequal, indicating continued inequities in access to social services. For instance, children of women living in extreme poverty are 2.5 times more likely to die before the age of one than the children of women who are not poor (World Bank, 2003). Children mortality rates from infectious diseases are over three times the national average in Chiapas, and 2.5 times in Oaxaca. The three southern states have the lowest rates of life expectancy and relatively high rates of infant and child mortality. Finally, the indigenous population also score lower on health status indicators. For instance, mortality levels are higher in the states with a high concentration of indigenous population. As will be shown in Chapter 3, differences in health status across incomes, regions and populations reflect unequal access to and quality of health and social services.

<table>
<thead>
<tr>
<th>Table 2.7 Geographical variations in health status, 1998 and 2000</th>
</tr>
</thead>
<tbody>
<tr>
<td>Life expectancy at birth 2000</td>
</tr>
<tr>
<td>Male</td>
</tr>
<tr>
<td>National</td>
</tr>
<tr>
<td>Chiapas</td>
</tr>
<tr>
<td>Oaxaca</td>
</tr>
<tr>
<td>Guerrero</td>
</tr>
</tbody>
</table>


The lower health status of poor and indigenous households, and households in poorer regions, may be in part due to the lower share of these populations that is covered by health insurance. However, another factor could be the generally much lower access to various basic infrastructure services, such as pipe water, sanitation, and electricity, experienced by these populations.  

In managing idiosyncratic risks to income, significant progress has been made in Mexico among the very young, where major changes in the acquisition of human capital are occurring as a result of public policy. Gaps persist in managing old-age poverty and catastrophic health shocks. There have been recent, major improvements in human capital development among the younger population, particularly for the rural population largely due to the notable expansion in basic health and primary education, as well as to the Oportunidades transfer program. At the same time, beyond lower secondary school historical patterns of disparity are still reflected in gaps between urban and rural areas and poor and non-poor populations in terms of access to lower and upper secondary school and university. Among the working age, unemployment is low and the duration of unemployment spells short in Mexico, while informal

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coping mechanisms seem to protect households against idiosyncratic unemployment shocks. However, structural changes in the way labor markets adjust might signal an increased frequency of such shocks, signaling an emerging vulnerability which will be discussed in the next section. Old age poverty is a significant problem in Mexico, which has the second highest poverty rate among the elderly in the region; the problem is also likely to grow given demographic changes signaling the aging of poor (rural) households in particular, and of the Mexican population in general. Health shocks or illness are also an acute risk for the poor in Mexico, regardless of age. High vulnerability is reflected in the frequency of catastrophic health shocks and linked to limited access to health insurance.

AGGREGATE SHOCKS, RISK AND VULNERABILITY

While the above analysis focused on individual (idiosyncratic) risk, this section looks at the role of two economy-wide, aggregate shocks in the vulnerability of Mexican households: (i) economic downturns and crises, and (ii) natural disasters.

Economic downturns and crises

In terms of poverty reduction, the positive growth effects of the entire past decade were erased by the devastating effect of the 1994-95 Tequila Crisis. As shown in the report Poverty in Mexico, poverty rates in Mexico are only now returning to pre-crisis levels. As documented by Maloney, Cunningham and Bosch (2003), the Tequila Crisis that erupted in late 1994 and the ensuing economic collapse came with dramatic social consequences. In 1995, prices rose 35 percent and output fell 6.2 percent. As wages remained fixed in nominal terms, real wages declined by 25-35 percent. Unemployment, while low by global standards, almost doubled from 3.9 percent to 7.4 percent.13 Welfare outcomes were dismal: household incomes declined by roughly 30 percent, extreme poverty more than doubled between 1994 and 1996 (going from 10.1 to 26.5 percent), while moderate poverty increased from 43 to 62 percent.14 In the period since 1995, Mexico has not experienced a major economic crisis, and successful macroeconomic policies have stabilized fundamentals such as exchange and interest rates. However, increased trade liberalization and exposure to international competition are also occurring, signaling at once major trade opportunities as well as exposure to future macroeconomic shocks with differential effects across the Mexican population and economy.

Shocks to income from economic crisis are transmitted through different channels and affect rural and urban populations differently. An economic crisis can affect household income through a range of channels: (i) via labor markets in the form of lower labor demand, increased unemployment, decreased probability of finding new employment and a decrease in the level of earnings of those still employed; (ii) changes in relative prices; (iii) cut backs in the level of public transfers; and (iv) changes in the value of and returns to assets (Skoufias 2003). As pointed out by Poverty in Mexico, macroeconomic stability and avoidance of an economic crisis since 1995 have been a major positive development in terms of reducing the risks facing Mexican households. However, the severity of shocks to income experienced in the 1994-95 crisis warrants a critical review of vulnerability to this type of shocks and the risk management mechanisms available.

The urban population in Mexico is particularly vulnerable to macroeconomic instability and labor market adjustments, as most of their income derives from labor. At the

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13 Maloney, Cunningham and Bosch (2003).
14 Montes, Santamaria and Bendini.
same time, risk coping strategies depend heavily on the labor market. Both rural and urban poverty increased dramatically as a result of the macroeconomic crisis in 1994-95, however the effect was particularly strong in urban areas. For the urban population in Mexico, shocks to income from a domestic macroeconomic crisis are first and foremost transmitted via the labor markets in the form of increased unemployment and decreased real wages. The incomes of urban poor depend heavily on the labor market as 92 percent of the income of the poorest 2 deciles derives from labor, compared to a rural average of 81 percent and a regional urban average of 74 percent. The urban poor also rely more on labor market strategies as informal coping mechanisms, via the adjustment of the labor supply of household members or added-worker strategies, thus illustrating the dual role of labor markets as both a source of income risk and a means of ex-post income protection. The dependence of the rural poor on labor income is lower, which implies that even if wages and employment are affected in similar ways as in urban areas, the income shocks transmitted via labor market developments are smaller.

The rural poor are particularly exposed to potential policy reversals and budget cuts affecting public transfers that occur during economic downturns; in addition, macroeconomic shocks place strain on the private risk management mechanisms that protect both urban and rural populations in normal times. Income transfers (both private and public) represent a greater share of rural incomes. As a result, rural households are more prone to income shocks arising from changes in the macroeconomic environment that play out in terms of cuts in public expenditures on social programs (especially in countries with pro-cyclicality in public expenditures, such as Mexico) as well as changes in private transfer flows. Economic crises have been shown to depress the flow of private transfers, particularly those that originate domestically. Glewwe and Hall (1998) found that in Peru, transfer networks assisting the poor in relatively stable periods do not protect them during a major shock, where the domestic transfer network shrinks both in terms of the number of recipient households as well as the size of inter-household transfer flows. This finding is replicated in Mexico, where the crisis affected rural households not only via lowered real wages, but also in terms of a reduction of private transfers (Poverty in Rural Mexico). As in Peru, transfers did however provide assistance when originating from abroad, which points to the potential prominent role of international remittances (and by extension, migration). During the Tequila crisis, transfers from friends and relatives outside of Mexico (largely in the US), i.e., sheltered from the impact of the crisis, increased, mitigating the shock to some extent.

Despite the dismal effect of the 1994-95 crisis on welfare, poor households did not experience more variability in income compared to normal times. Surprisingly, relative income variability did not increase for households generally considered to be among the more vulnerable groups, such as the self-employed and informal workers, single-parent families, young and old workers, with two important exceptions: households where the head had no income at the beginning of the period became decidedly worse off during the crisis, while households headed by less-educated heads actually did better than during normal times. Finally, a comparison of rural and urban households shows that rural households experienced lesser shocks on average — probably due to the greater reliance of rural households on self-consumption. These findings are likely explained by two factors: first, the fact that the bulk of the shock was absorbed via downward pressure in wages, which diffused the income effect of the shock across a wide range of households, and second, that households employed a range of informal strategies for coping with shocks (see Box 2.1).

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15 World Bank Mexico Labor Market Study (forthcoming).
The most common private risk management strategies during the Tequila crisis were out-migration to the US and increased income diversification. After 1995, migration to the United States increased alongside increased diversification of rural incomes. In both rural and urban areas, however, poorer households may lack savings and other means to smooth consumption, resulting in higher consumption shocks than those households better able to mitigate (ex-ante) and cope (ex-post) with shocks to income.

In Mexico, macroeconomic shocks have not typically resulted in higher unemployment; however, this may change and wage flexibility may cease to be a safety net. To date, macroeconomic crises in Mexico tend to have resulted in labor market adjustment via a lowering of real wages as opposed to unemployment – the result of fixed nominal wages combined with inflation. Mexico’s historic wage flexibility has proven to be a relatively efficient safety net in crises in Mexico. In the 1995 Tequila crisis, GDP per capita fell by 5 percent. The labor market adjusted through a 25 percent fall in wages but relatively little unemployment. This had the effect of spreading losses relatively evenly across the population rather than concentrating the losses on a particular group (Maloney, Cunningham, and Bosch, 2003). Recently, however, weaker labor market conditions combined with low total factor productivity suggest that the low unemployment that has characterized Mexico until the late 1990s will be more difficult to sustain in future crises (see Box 2.2). If this is the case, future macroeconomic shocks could be associated with more long-term unemployment, reducing the effectiveness of private risk management strategies of both urban (added-worker effect), and rural (migration to urban areas to find jobs) households. These trends may indicate an increased need for formal mechanisms such as workfare programs or unemployment insurance that mitigate covariate employment shocks.

Sectoral crises, such as the collapse in real agriculture prices experienced in the 1990s and the even more concentrated coffee crisis also represent an important source of risk to income. As shown in Rural Poverty in Mexico, the fall in real agricultural prices experienced by Mexican farmers in the 1990s resulted in a positive reaction through increased output and yields. Price incentives, however, remain low. This is largely the result of the openness of the economy, which is increasing under NAFTA, and the conditions of unequal competition faced by Mexican farmers in most crops vis-à-vis their northern neighbors, given their poorer endowments coupled with extensive agricultural subsidy programs in the United States and Canada. While Mexico also operates a comparatively small agricultural subsidy program, Procampo, in practice it is functioning more as a rural safety net (with moderately pro-poor targeting, though a sizeable portion of benefits also flows to farmers in higher income deciles). Impact evaluations indicate positive consumption effects on small farmers as well as some income multiplier effects on medium and large-scale farmers; however, it has been less successful in achieving its stated goals of supporting domestic producers of basic staples in adjusting to international competition under NAFTA, and helping farmers switch to more competitive crops (Rural Poverty in Mexico); it is also set to expire in 2008 (more on Procampo in Box 3.3).

Box 2.3: Has risk and vulnerability to economic shocks changed since the Tequila crises?

Numerous factors, including greater openness to trade, the fall in inflation, the slow growth in labor productivity and the weakening of labor unions may have led to more frequent labor market adjustments through unemployment than what was seen during the 1994-95 crisis.

Greater openness to trade and increased competition. One concern that has been raised with regard to trade liberalization is that increased competition leads to greater product
demand elasticity which again leads to greater own wage elasticity. As a result, shocks are more
directly translated to the labor market and workers face higher aggregate risk. Lessons from Nafta
found little indication of higher unemployment or increased volatility of the labor market in
Mexico following NAFTA. Looking at individual income risk in various manufacturing sectors in
Mexico (Krebs, Krishna and Maloney, forthcoming), however, find that tariff reform has a
significant short run effect on income risk. They also find that tariff reductions increase the cost of
recessions substantially.18

Lowered inflation. A general increase in the propensity to be fired may also have
emerged because of the success in fighting inflation. Price stability makes it more difficult to
respond to aggregate shocks by reducing real wages by holding nominal wages fixed. The ability
of wages to adapt to changes in economic activity and absorb shocks in times of recession seems
to have declined since the late 1990s when inflation hit single-digits. The structural relationship
(Okun) between output and wages seem to have suffered a break around 1999, as every decline in
output has since translated into smaller declines in wages. While Mexico experienced a decline in
its growth rate between 2000 and 2001, mean real remunerations kept increasing through 2002.

Labor productivity. Despite slow labor productivity growth, Mexico was able to remain
competitive in the US market until 1998 thanks to its low dollar-denominated wages. However,
since the late 1990s, real wages have been steadily rising in spite of declining GDP and low labor
productivity. During the last recession (2001-02), wages and unemployment increased in spite of a
large GDP fall, disproportionately affecting export-oriented firms. If wages continue to rise and
factor productivity is not improved, it will become increasingly difficult for Mexican exporters to
remain competitive abroad, which can afflict the labor market as a whole, and particularly the
poor, who have greatly benefited from export growth after 1996.

Weaker labor unions. Historically, labor codes negotiations in Mexico have emphasized
employment stability. This is reflected both in the legal framework, which heavily protects
employment and mandates generous severance pay and in the importance given to corporatist
bargaining mechanisms such as the PACTO However, the process of privatizing and deregulating
state-owned enterprises, and in general exposing firms to greater external competition, may have
altered the bargaining power of workers. At the same time, various agreements and policies made
by the government during Mexico’s inflationary period of the late 1980s and early 1990s, urged
firms to exercise restraint in raising wages and prices.

With increased competition, lost wage flexibility, continued low TFP growth and
weaker bargaining power of workers, the low unemployment that characterized Mexico
until the late 1990s will be more difficult to sustain. Alternatively, it may trigger an increase in
informality, which could also hurt opportunities for the poor. It is important to keep in mind that
macroeconomic stability (lowered inflation) and less rigid labor markets are both key in reaping
the full benefits of increased trade liberalization and economic integration. Given the disastrous
impact of the Tequila crises, macroeconomic stability is probably the single most important risk
and vulnerability reducing policy of the post-crisis period.

Source: Lederman, Maloney and Servén (World Bank 2004), Montes, Santamaria and Bendini (World Bank 2004), and Krebs, Krishna and Maloney (Forthcoming).

Natural disasters and weather related risks

Public and private risk management strategies seem largely effective in managing
natural disasters and weather-related shocks. In a recent study of vulnerability in Mexico,
Skoufias (2004) finds that for all rural households, covariate risks, mostly related to weather shocks, significantly affect household incomes and consumption, although households carry out income smoothing practices that partially protect their incomes from such risks. Systemic shocks, however, are shown to be of secondary importance with respect to idiosyncratic ones. Also, panel data shows that systemic shocks related to weather and other natural disasters can have very different impacts on households, and that shocks affecting income do not necessarily lead to consumption changes. Successful practices of consumption smoothing make consumption more protected than income. Most agricultural insurance in Mexico is oriented to middle and large commercial farmers, and as such, crop and livestock insurance is not relevant for very poor farmers.

**Among production-related shocks analyzed in Skoufias (2004), plagas (pest) is the one with a more significant impact on income.** Households who experienced a problem of pest and diseases had an average income growth rate 16 to 17 percent below other households. Again, the impact on consumption was much smaller, which was reduced by only 3 percent.

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**Box 2.4: Fondo de Desastres Naturales (FONDEN) and other risk management mechanisms**

The Mexican government allocates budgetary funds for disaster relief and reconstruction efforts by placing them in FONDEN, thus providing for the repair of uninsured infrastructure, immediate assistance to restore the productivity of the farm population, and relief to low-income victims of disasters via: (i) support to rebuild homes; (ii) compensation for crop and livestock losses; (iii) temporary income and employment support over and above that traditionally offered by PET; and (iv) reconstruction of local infrastructure.

The World Bank study *Poverty in Rural Mexico* assesses FONDEN as a very useful instrument to absorb some of the income impact of large covariate shocks, but it compensates for part only of the losses and depends on a number of procedures and discretionary actions such as the declaration of emergency that limits its impact. More recently, FONDEN has started to adopt objective rules for declaring catastrophic events. This removes an ad hoc dimension in the declaration of catastrophes and reduces the political interference in FONDEN's operations.

The intention is not to compete with private insurance, and operating in parallel to FONDEN is a group of mutual insurance funds amongst farmer organizations. These farmer organizations are called *fondos de aseguramiento*, formed to provide mutual crop insurance to their members. Analysis of historic reinsurance payouts reveals that weather events, similar to those covered under FONDEN, are the primary source of systemic payouts by the fondos.


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As seen in urban areas, **rural households also resort to a variety of risk mitigating and coping strategies as a way of self-insurance.** These include the accumulation of assets, income diversification, sending women and children to work, withdrawing children from school, input and crop choices, precautionary savings, migration, marriage, income transfers among friends and relatives, and other informal risk sharing arrangements such as share cropping or input sharing (Skoufias, 2004). The subsistence economy, i.e., the production for self-consumption of food crops and small animals in small plots with family labor together with the access to collectively owned natural resources, is a very important safety net in rural areas. Much of the food security of small peasant farmers is linked to this type of production (Box 2.1 discusses private risk management strategies, including subsistence farming in more detail). *Poverty in Rural Mexico* found that poorer households (two bottom quartiles) experienced less shocks than richer ones,
probably reflecting a higher risk-aversion leading to less risky investments and behavior among the poor. Low yields due to production-related shocks were significantly smaller in the bottom two quartiles, which the report attributes to the planting of lower risk crops and the use of low risk technology by this group.

Yet, natural disasters and other weather related phenomena are an important source of income risk primarily to rural populations, and a key determinant of inefficiencies in crop production. The high incidence of realized shocks among farmers in rural Mexico can be seen as a reflection of the risk of agricultural production. Using data from a sample of 666 crop farmers of different parts of Mexico in 2002, the Poverty in Rural Mexico report shows that weather-related shocks are very frequent among farmers—as many as 44 percent reported having experienced one in that year. The most common shock reported was drought followed by excessive rain or hurricane. Finally, efficiency analysis showed that shocks of natural origin (rains, frosts, droughts, hail, pests, etc.) are a major determinant of inefficiency in crop production.

While coping with natural disasters once they occur falls clearly within the domain of social protection policy, rural experts place a relatively heavy focus on policies to reduce and mitigate the effects of natural disaster and weather-related risks, which fall beyond the scope of social protection. Poverty in Rural Mexico emphasizes the importance of promoting the use of technologies less vulnerable to prevalent risks in particular regions through appropriate research and extension. This includes promotion of crop varieties more resistant to water stress or to pests, or crops maturing at a good time according to local weather patterns. Pest control and sanitary measures in general constitute additional measures to reduce natural shocks.

Access to financial and insurance services could also play a crucial role in self-insurance strategies toward natural disasters and weather-related shocks. Again—this falls beyond the scope of social protection. Formal crop insurance is not seen as particularly useful for the rural poor, whose main income is not from independent farming and for whom the insurance is too expensive. Parametric insurance systems linked to weather parameters offer an interesting alternative. Finally, a well-developed financial system and rural financial services could play a crucial role in self-insurance and risk management strategies among the rural poor, mostly by facilitating savings and personal loans.

Box 2.5: Remittances as a source of private risk management for Mexican households

The increasing importance and magnitude of remittances

- Remittances from Mexican workers abroad reached a record 13.3 billion dollars in 2003. It exceeded foreign direct investment as a source of foreign income and amounted to some 2 percent of the country’s GDP in 2003.

- Although migration is not a recent phenomenon, much of the capital flows from remittances seem to be. In general, about half of the recipients included in a study of remittances in Mexico said they had received remittances for 3 years or less.\(^\text{19}\)

Remittances played a role in the recent growth of rural incomes, especially poor incomes

\(^{19}\) Pew Hispanic Center & MIF. “Receptores de Remesas en Mexico”, Mexico City: IADB.
• The reduction in extreme poverty in the year 2000-02 was associated with rapid wage increase and for rural areas sine gains from remittances and transfers.

• The highest proportion of households receiving remittances is found among the poorest 20 percent of the population. In 2002, 11.2 percent of households in the poorest quintile received remittances compared to a national average of 1.2. For the poorest 20 percent of rural households this number rises to one-fifth.

<table>
<thead>
<tr>
<th>Quintile</th>
<th>Rural</th>
<th>Urban</th>
<th>National</th>
</tr>
</thead>
<tbody>
<tr>
<td>1st Quintile</td>
<td>19.5</td>
<td>4.0</td>
<td>11.2</td>
</tr>
<tr>
<td>2nd Quintile</td>
<td>6.8</td>
<td>0.8</td>
<td>2.5</td>
</tr>
<tr>
<td>3rd Quintile</td>
<td>4.2</td>
<td>0.7</td>
<td>1.0</td>
</tr>
<tr>
<td>4th Quintile</td>
<td>1.7</td>
<td>0.4</td>
<td>0.9</td>
</tr>
<tr>
<td>5th Quintile</td>
<td>1.0</td>
<td>0.0</td>
<td>0.1</td>
</tr>
<tr>
<td>Total</td>
<td>3.5</td>
<td>0.5</td>
<td>1.2</td>
</tr>
</tbody>
</table>

Note: Quintiles calculated using current income per capita net of transfers (remittances, Oportunidades, Procampo and other).

While ‘coverage’ of remittances is progressive and pro-rural, it is also limited. Only a minority of the extreme poor have access to remittances:
• 86.5 percent of the poorest households do not receive remittances.
• Using post-transfer income, the share of households receiving remittances is lower for the poorest 20 percent of the population than for any other income group. The different conclusions arrived at from using post and pre-transfer income simply reflect the fact that transfers (including remittances) are an important driver of income growth among the households fortunate enough to have access to these transfers (see table below).

### Percentage of households receiving remittances by income deciles (post transfers), 2002

<table>
<thead>
<tr>
<th>Income Deciles I-X, poorest to richest</th>
<th>Deciles calculated using total current income per capita (post-transfer).</th>
</tr>
</thead>
<tbody>
<tr>
<td>I</td>
<td>3.2</td>
</tr>
<tr>
<td>II</td>
<td>2.1</td>
</tr>
<tr>
<td>III</td>
<td>11.2</td>
</tr>
<tr>
<td>IV</td>
<td>7.6</td>
</tr>
<tr>
<td>V</td>
<td>3.0</td>
</tr>
<tr>
<td>VI</td>
<td>8.1</td>
</tr>
<tr>
<td>VII</td>
<td>6.3</td>
</tr>
<tr>
<td>VIII</td>
<td>5.9</td>
</tr>
<tr>
<td>IX</td>
<td>4.9</td>
</tr>
<tr>
<td>X</td>
<td>4.7</td>
</tr>
</tbody>
</table>

Note:

Deciles calculated using total current income per capita (post-transfer).
Source: ENIGH 2002.


### CHRONIC POVERTY AND VULNERABILITY

Chronic poverty is the inter-generational transmission of extreme poverty, often accompanied by exclusion. Its distinguishing feature is extended duration, as distinct from those who move temporarily into (and out of) poverty in the face of risk. Evidence suggests that for the chronic poor, transitory fluctuations are more frequent. In addition, poverty exits are short-range and the levels of recidivism high (Yaqub, 2002). As shown in Box 2.6, chronic poverty in Mexico corresponds to the 20 percent of the population that lives in extreme poverty.
Box 2.6: Evidence of Chronic Poverty in Mexico, Is there a ‘Nucleo Duro’ of Poverty?

International evidence suggests that chronic poverty is characterized by: (i) low economic mobility but often more frequent fluctuations of income, (ii) low endowments of physical and human capital, and (iii) low return on assets which is often linked to social exclusion or discrimination. This describes well the situation of the poorest segments of the population in Mexico.

The characteristics of the extreme poor in Mexico includes: patterns of lower schooling levels, higher dependency ratios, and variable job quality coupled with some evidence of labor market discrimination are apparent. Extreme poverty is more concentrated among rural and indigenous populations, for whom poverty rates have been relatively stagnant over time and who face important aspects of social exclusion and discrimination in the labor market and elsewhere.

A recent analysis of household in Mexico over the period 1984-2000, finds that there is very little mobility of households across the income distribution, and that this lack of mobility is particularly pronounced for households in the bottom quintile (poorest 20 percent) of the distribution. Initial ranking in the income distribution is the single most powerful factor associated with mobility. Twinned with the fact that extreme poverty in Mexico has hovered around 20 percent of the population over this same period, with little downward movement in the rate, these findings suggest the existence of a ‘nucleo duro’ of chronic poverty concentrated in the bottom 20 percent of the income distribution.

Are things improving? Substantial progress has been made in addressing human capital development issues among the young, and particularly among the extreme poor, notably through the introduction of the Progresa/Oportunidades program. However, the jury is still out regarding these relatively new programs’ long-term impact on the intergenerational transmission of poverty and ultimately, reduced income inequality. Furthermore, major federal social protection programs, notably Oportunidades, do not reach all of the extreme poor, nor do private remittances reach the extreme poor to a significant degree. Recent initiatives have been introduced that are aimed at closing this gap, such as the Programa Alimentario (providing cash or in-kind food benefits), though it is too soon to be able to assess their impact. In sum, while Oportunidades represents a major advance and new, promising initiatives are being introduced, Mexico does not yet have in place a complete strategy for addressing chronic poverty, particularly with respect to income vulnerability.

The chronic poor are those households least equipped to manage income risk as a result of their low asset base and limited access to private and public risk management tools. They are therefore among the most vulnerable to income shocks, whether idiosyncratic or aggregate. They are also the most likely to engage in negative risk coping strategies, which ultimately serve to perpetuate their poverty. Long-term costs of informal practices of risk coping (and ultimately survival) may cause permanently lowered incomes and chronic poverty. Damaging behavioral responses adopted by the poor in order to mitigate (ex-ante) and cope (ex-post) with risk include among others: adverse incorporation under the wings of a patron, safer but lower production techniques, reduced investments in physical and human capital. The immediate cost of planting a traditional, safer crop, rather than a more profitable but riskier one, is obvious and constrain upward mobility. Other costs, however, are less obvious as some risk management strategies reinforce not only poverty but also the structural determinants thereof. For instance, the use of informal insurance networks offered by patrons promotes clientelism and patronage both in

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labor markets as well as in other spheres of society. This, again, can affect both the capacity of the poor to invest and save, as well as the accountability of public service provision. Formal risk pooling mechanisms offer better, less damaging alternatives to these practices.

While extreme poverty rates have been reduced significantly in terms of national average, certain sub-groups, particularly rural and indigenous households, show little progress. Preliminary evidence indicates that the rate of change of extreme poverty rates differs greatly among different sub-groups of the Mexican population. A recent study of indigenous poverty in Mexico, for example, finds striking differences in the pace with which indigenous and rural households move out of poverty vis-à-vis the rest of the Mexican population (World Bank, forthcoming). As shown in Figure 2.2, the national extreme poverty rate declined by 9 percent over a 10-year period (1992-2002), and urban poverty rates fell by 15 percent. At the same time, there was very little change in rural and indigenous poverty rates (3 percent), such that the vast majority of indigenous and rural households remained poor. The incidence of poverty is also much higher in both rural and indigenous municipalities than non-indigenous municipalities. And while there is a significant overlap between indigenous and rural municipalities, indigenous municipalities also have a significantly higher incidence of extreme poverty than rural municipalities on average. This difference is important because it suggests that indigenous people are poor for different or additional reasons than the simple fact that they mainly live in the rural sector.

Figure 2.2. Rate of Change in Extreme Poverty Rates Across Different Population Groups in Mexico: 1992-2002

![Figure 2.2. Rate of Change in Extreme Poverty Rates Across Different Population Groups in Mexico: 1992-2002](image)


Extreme deprivation (living on less than a dollar a day), has been practically eliminated among the non-indigenous, yet affects 30 percent of the indigenous population. Another way to look at this same question is to note that by international standards, Mexico has all but eliminated extreme deprivation for the non-indigenous population (defined as households living on less than US$1 per day, using values adjusted for Purchasing Power Parity (PPP). Over the past decade (1992-2002), the non-indigenous extreme poverty rate according to this measure dropped from 6.1 to 1.3 percent. However in 2002, 30 percent of the population in indigenous municipalities was still among the extreme poor according to this international measure. In sum, indigenous people make up just 12 percent of Mexico’s national population, yet are vastly over-represented among the extreme poor, and may comprise an important component of chronic poor

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households, for which the chances of moving out of poverty are vastly lower than for the rest of the population.

**Oportunidades** provides major benefits to the extreme poor; however, these households still need access to risk management tools. **Oportunidades** provides access to health services and income from cash transfers, which provide major poverty reduction benefits for poor households. The program was not designed as a risk management tool, and therefore not surprisingly, Skoufias (2004) finds that in the villages that receive **Oportunidades**, recipients still resort to private coping mechanisms that in the long run prevent the accumulation of assets and an exit out of poverty. For certain types of shocks, households in **Oportunidades** villages are in fact significantly more likely to sell animals or other possessions than households in control villages (non-recipients).

**SUMMARY OF FINDINGS ON RISK AND VULNERABILITY IN MEXICO**

Mexican households have been more vulnerable to idiosyncratic than to aggregate risk. Two immediate priority areas for government intervention in addressing exposure to idiosyncratic risk emerge: insurance against catastrophic health expenditures and against the risk of poverty in old age. In addition, unemployment risk maybe more important during aggregate shocks in the future. For a large proportion of the population, in particular among the poor, vulnerability to the first two risks is high. This is reflected in the gap between poverty rates for the population at large and the elderly, and in the high costs of health care for the poor, the frequency of catastrophic health shocks, and the large proportion of people who may fall into poverty as a consequence of catastrophic health shocks. At the same time, as will be discussed in the next chapter, public social protection programs in these areas are still limited and incidence as well as expenditure patterns are regressive, notably in the provision of old-age income insurance. While the poor employ a wide range of private strategies (extended families, intra-generational transfers, among others) to insure against health and old-age risks, these are limited, maybe hampered in the future due to demographic changes and at times carry adverse long-term effects. While these are the risks that are most immediately apparent from current patterns of vulnerability in Mexico, an emerging risk may be that of unemployment and catastrophic income loss among poor segments of the population in the face of future aggregate shocks; while the risk of unemployment has been low in the past, labor market conditions may be changing such that shocks may no longer be easily absorbed via wage adjustments but through changes in employment. While private strategies to cope with unemployment are largely effective in good economic times, the opportunity to do so is reduced during aggregate economic shocks, indicating the need for mechanisms to deal with covariate employment shocks. Finally, the chronic poor are particularly exposed to income risk due to their low asset base and limited access to both public and private risk management tools, perhaps explaining the ‘stickiness’ of Mexico’s extreme poverty rate over time, and highlighting a particularly vulnerable group as an important target for public policy intervention.
3. MEXICO’S SOCIAL PROTECTION SYSTEM: OVERVIEW AND ASSESSMENT

Mexico’s social protection system has shown progress in terms of long-term financial sustainability and on improving welfare among the poor. However, the system is still fragmented with problems of equity and efficiency. As a result, a large share of the population—particularly low-income and those employed in the informal sector—experience low or non-existent protection in the face of income risks. The characteristics of the Mexican social protection system are broadly similar to those prevailing in the rest of Latin America, but Mexico also spends less than countries at similar income levels on the social sectors in general. However, the share of public social expenditures as a percentage of public expenditures is not low by international standards reflecting a thin tax base and low tax revenue. A fiscal reform is needed to continue improving and expanding poverty reduction programs as well as increasing the coverage of the social protection system. The social security system for private workers was reformed in 1997, leading to a more financially sound system. Coverage of the system has increased, although necessary further increases are still a challenge for the country. The system is regressive in terms of coverage reflecting the inequality of Mexican income distribution. The social security system for public sector workers however is highly regressive and shows huge problems of financial sustainability which generate a huge fiscal burden to current and future taxpayers. Regarding social assistance, while absorbing a relatively small share of the social protection budget \(^22\) (7 percent), the Oportunidades program (originally Progresa) represents an innovation of great value to poverty reduction in Mexico. At the same time, due to its design, it faces limits as a risk management tool for the poor. Other major initiatives target important risk groups, such as Procampo (a program of agricultural subsidies designed to aid rural farming households in competing under NAFTA), and Seguro Popular (a new health risk management system offering subsidized health insurance to poor households). However these programs face challenges of implementation, financing and institutional coordination as Mexico faces the challenge of providing adequate coverage to the majority of its population.

AN OVERVIEW OF THE MEXICAN SOCIAL PROTECTION SYSTEM

Mexico’s well-established social protection system is comprised of a formal sector based social insurance component providing both private and public sector workers with health benefits and retirement pensions, a national health system for the uninsured, and a wide array of social assistance programs. Elements of the social protection system have shown progress in improving coverage and welfare among the poor. However, important challenges remain to increase the coverage and efficiency of the system.

The government’s commitment to social protection dates back to 1943 and the creation of the formal social insurance program for private sector workers ran by the Instituto Mexicano del Seguro Social (IMSS), and a national health system, the Sistema de

\(^{22}\) Social protection defined as social security expenditure and poverty-targeted social programs. Social security includes total expenditures in IMSS and ISSSTE, which includes workers’, employers’ and the federal contributions.
**Salud.** Originally, IMSS was a partially-funded defined benefits system but in reality operated from the start as a pay-as-you-go (PAYG) system. In 1997, the system was radically reformed and system of private administration of individual pension accounts was introduced. Public sector workers are covered by the Instituto de Seguridad y Servicios Sociales de los Trabajadores del Estado (ISSSTE), which manages federal employees’ accounts. In addition, the state oil company (PEMEX), the armed forces as well as other public enterprises and state governments have developed individual insurance systems. IMSS remains the most important in terms of the number of affiliates with 14 million rights holders in the formal private sector, followed by ISSSTE which covers 2.3 million government workers. The figure below provides an aggregate picture, showing coverage by deciles lumping all types of workers. As observed, despite the progress, the overall coverage of major social security programs across income groups is still regressive. Similar patterns are observed for a host of programs: housing credit, paid vacations, pensions, childcare, life insurance, to name a few (Tinajero 2003). Social insurance mechanisms for the population excluded from formal sector benefits, whose workers and their families make up the majority of the population, and who tend to be poor, are weak. This segment of the population is served by the national health system and an array of social assistance programs.

**Figure 3.1. Social security (IMSS, ISSSTE, PEMEX) coverage across income deciles, 2002**

Source: ENIGH 2002.

Social assistance policy has evolved over time, closely tied to national economic development objectives, with explicit poverty-targeted programs being introduced only after the 1980s debt crisis. The largest social assistance program, both in terms of coverage and expenditures, is Oportunidades which provides cash transfers to poor households conditional on children’s school attendance and basic health care, has proven to be a successful transfer mechanism tied to human capital accumulation objectives. Oportunidades is the most important social assistance program in Mexico, with an annual budget in 2002 of about 17 billion pesos (approximately 1.6 percent of total spending) and coverage of over 4 million households, equivalent to about 20 percent of the Mexican population. The program has been instrumental in Mexico’s tremendous progress in education coverage, particularly at the primary level. The most direct impact of Oportunidades, which has been

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implemented primarily in rural areas to date (but is currently being expanded to urban areas) and targets the extreme poor, has been in narrowing the gap in access to education across poverty levels and between rural and urban areas. The figure below shows Oportunidades coverage as highly progressive, covering almost 60 percent of households in the poorest decile in 2002. Administrative data suggest that the actual number of beneficiaries of Oportunidades was higher than that indicated in survey data. Estimates that attempt to correct the survey data based on Oportunidades’ own administrative data suggest that 20% of the population in the decile 1 and 40% of the population in decile 2 were uncovered. 24

Figure 3.2. Oportunidades Coverage Across Income Groups, 2002

![Oportunidades Coverage Across Income Groups, 2002](image)

Source: ENIGH 2002.

Despite the advances of Oportunidades, a significant portion of the extreme poor may remain uncovered. Major social assistance interventions such as Oportunidades are extremely well-targeted to the poor, yet still leave a significant portion of the extreme poor (households in the two poorest deciles) uncovered. According to the ENIGH household survey, in 2002, almost 40 percent of the population in the poorest decile and 46 percent of those in decile 2 – over 8 million Mexicans—were not affiliated to any public social insurance program, nor did they receive benefits from the major social assistance program, Oportunidades (Table 3.1). These may be taken as upper bound estimates for the number of uncovered, given that as noted above, administrative data for the program suggest even higher coverage rates for Oportunidades among the bottom two deciles.

24 Revised estimates of Oportunidades coverage as calculated by SEDESOL and provided to World Bank staff, 4.22.05.
Table 3.1. Household coverage of major social security programs and *Oportunidades* in the poorest 2 deciles, 2002

<table>
<thead>
<tr>
<th>Programs</th>
<th>Decile 1</th>
<th>Decile 2</th>
</tr>
</thead>
<tbody>
<tr>
<td>Covered by IMSS, ISSSTE, PEMEX, etc.</td>
<td>3.94%</td>
<td>18.21%</td>
</tr>
<tr>
<td>Receives <em>Oportunidades</em></td>
<td>%</td>
<td>35.20%</td>
</tr>
<tr>
<td>Neither of the Above</td>
<td>%</td>
<td>46.17%</td>
</tr>
<tr>
<td>Total</td>
<td>100%</td>
<td>100%</td>
</tr>
<tr>
<td>Neither of the Above - but covered by another pension plan</td>
<td>0.06%</td>
<td>0.15%</td>
</tr>
<tr>
<td>Neither of the Above - but receives medical benefits through work</td>
<td>0.05%</td>
<td>0.27%</td>
</tr>
</tbody>
</table>


To what degree do the extreme poor – who have limited access to social insurance – have access to some form of social assistance? Mexico’s national household surveys only allow a limited answer to this question, since incidence figures are not collected for all social assistance programs. Further, some programs, such as *Seguro Popular*, have been recently implemented such that incidence data are not yet available. However, one can begin to pose the question by crossing data on access to social insurance with data on coverage of Mexico’s single largest social assistance program, *Oportunidades*, for which incidence data are collected in the national household survey. Interestingly, upper bound estimates indicate that up to one third of households in the poorest decile, and almost one half of households in the next decile, may not covered by either social insurance or *Oportunidades* (Table 3.1). Further, very few of these households have access to another pension plan, or report receiving medical benefits through work (less than 1 percent in all cases). Further, very few of them report having access to the second largest rural assistance program, *Procampo* (see Box 3.1).

Box 3.1: Who are the 8 million extreme poor uncovered by *Oportunidades*?

Over eight million extreme poor people (close to 40 percent of the extreme poor) in Mexico live in households that do not have access to the country’s formal social insurance system, nor do they receive benefits from the flagship poverty reduction program, *Oportunidades*. What are the defining characteristics of this population? First, a majority (63 percent) live in rural areas. Given that the *Oportunidades* program is focused on rural areas, why are these households excluded from coverage? Most probably these are households that live in villages so small and isolated that *Oportunidades* does not operate there, given that it requires that a school and health post be in close proximity to beneficiary communities. These households also appear to be out of reach of the other major rural program, *Procampo* – less than 2 percent report receiving benefits from this program (see Box 3.3, below). They also have slightly older household heads, and more elderly inhabitants; one in five household members are over age 65, compared to one in eight among covered households. These findings suggest that isolated rural households, particularly those with elderly members, may be a particularly vulnerable group currently uncovered by the country’s major social protection initiatives.
SOCIAL PROTECTION IN MEXICO – OVERVIEW OF EXPENDITURE TRENDS

Mexico’s expenditures in social programs, both social assistance programs aimed at reducing poverty as well as in social insurance are low given the level of development of the country. However, the share of social expenditures as a proportion of public expenditures is comparable to countries such as Argentina, Chile, and Brazil because total public expenditures are low. This reflects a major challenge for the country, as public resources needed to continue improving and expanding poverty reduction programs and increase social insurance coverage, in particular among vulnerable groups, is currently too limited. This implies that a fiscal reform which can expand this limited fiscal space is critical.

Mexico’s Social Spending Relative to International Comparisons

According to international comparisons developed by ECLAC, per capita social spending in Chile and Brazil is more than twice as high as Mexico’s, while Argentina and Uruguay spend more than three times as much. This is despite steep cumulative declines in GDP between 1999 and 2001 in both the latter countries. Social spending in Mexico also falls short of the regional average. When disaggregating the figures, Mexico is below the regional average for spending on both health and social security. Expenditure on education is well above the regional average while expenditure on social assistance is just above the average. In both categories, however, spending in Mexico is still only a half or even a third of what countries such as Argentina and Chile spend (Table 3.2).

Mexico’s share of social expenditures as a proportion of public expenditures is above 60%, similar to Argentina, Chile and Brazil. However, public expenditure as a percentage of GDP is lower than other middle-income countries in Latin America, so the challenge is not to increase the share of social expenditures but to generate an expansion of the fiscal space. While countries like Chile and Brazil devote 16 and 19 percent of GDP respectively to social spending, Mexico’s allocation to the social sector remains at about 10 percent (see Table 3.2). Differences between countries in how expenditure is defined and recorded account for some but far form all of the difference. The critical issue is the direct link between the percentage of GDP allocated to public and social sector allocation, and the state’s ability to collect taxes. The low figures shown for Mexico of per capita social expenditures and for the share of social expenditures to GDP are a direct reflection of a thin tax base and low tax revenue. The fiscal priority of social sector spending is as high in Mexico as in other upper-middle income countries (as measured by percentage of total public spending allocated to the social sector).

25 As noted by ECLAC, statistical series on total public expenditure and social expenditure in the region differ in terms of methodology and coverage, in particular due to different ways of defining and recording social spending in national accounts. It should be noted that the figures do not include social spending funded by sub-national governments with own revenues (but do include that portion that is funded via transfers from the federal government). As the degree of decentralized state and local funding varies by country, public social spending figures are underestimated and therefore not fully comparable. Despite this caveat, the difference between social spending in Mexico and comparable middle-income countries—both in dollar terms per capita and as a percentage of GDP—is too large to be fully explained by locally financed social spending. State expenditures financed via own revenues are still relatively small in Mexico, particularly in the poorest states. For example, in Mexico’s three southern states of Oaxaca, Guerrero and Chiapas, state expenditures funded by own revenues represent just 4-6 percent of total spending, the rest of which is financed via federal transfers (World Bank. Mexico Southern States Development Strategy, 2003).
Note: Social Assistance is the residual social spending once education, health and social security are accounted for.

Table 3.2. Budgetary Pressure and Fiscal Priority in Latin America, 2001-2002

<table>
<thead>
<tr>
<th>Total public spending as a percentage of GDP (Budgetary pressure)*</th>
<th>Percentage of total public spending allocated to social sector (fiscal priority of social expenditure)</th>
<th>Under 40%</th>
<th>Between 40% and 60%</th>
<th>Over 60 %</th>
</tr>
</thead>
<tbody>
<tr>
<td>Over 30%</td>
<td>Nicaragua</td>
<td>(13.2)</td>
<td>Costa Rica</td>
<td>(18.2)</td>
</tr>
<tr>
<td></td>
<td>Colombia</td>
<td>(13.6)</td>
<td></td>
<td></td>
</tr>
<tr>
<td></td>
<td>Panama</td>
<td>(25.5)</td>
<td></td>
<td></td>
</tr>
<tr>
<td>Between 30% and 50%</td>
<td>Honduras</td>
<td>(10.0)</td>
<td>Bolivia</td>
<td>(17.9)</td>
</tr>
<tr>
<td></td>
<td>Venezuela</td>
<td>(11.3)</td>
<td></td>
<td></td>
</tr>
<tr>
<td>Under 20%</td>
<td>El Salvador</td>
<td>(4.2)</td>
<td>Guatemala</td>
<td>(6.2)</td>
</tr>
<tr>
<td></td>
<td>Dominican Rep.</td>
<td>(7.6)</td>
<td>Paraguay</td>
<td>(8.5)</td>
</tr>
<tr>
<td></td>
<td>Peru</td>
<td>(8.0)</td>
<td></td>
<td></td>
</tr>
</tbody>
</table>

Note: Figures in parenthesis show the percentage of GDP allocated to social expenditure.
Mexico’s Social Protection as a Share of Federal Social Spending

The following section presents information on social protection expenditures as reported in the Anexo Estadístico del Cuarto Informe de Gobierno, 2004. It follows the functional programmable expenditure categories as presented in the PEF (Presupuesto de Egresos de la Federación), as follows:

- ‘Social spending’ reflects the budget category desarrollo social (social development) used in the PEF, and includes, as seen in Figure 3.4, 6 major sub-categories: education, social security, health, regional and urban development, food and social assistance, and labor.
- “Social security” is a sub-category of social spending, and includes all federal government outlays in pensions (which are funded by employee and employer contributions as well as transfers from the federal government);
- “health” is a sub-category of social spending, which includes expenditures undertaken by the Ministry of Health (SSA), Ramo 33 (FASSA) as well as health services provided by IMSS and ISSSTE; and health insurance benefits;
- “poverty reduction” is a cross-cutting category including all targeted poverty reduction programs; these programs are classified under both ‘social spending’ and ‘economic sector spending’.

Figure 3.4. Composition of Federal Social Spending in Mexico, 2002

Source: Based on Anexo del Cuarto Informe de Gobierno 2004.

Social spending in Mexico is dominated by three expenditure categories: education (40 percent), social security (25 percent), and health (21 percent). As shown in the figure below, social spending is divided between five main categories: food and social assistance; social security; health (including SSA, and health benefits provided under IMSS and ISSSTE); education; rural and urban development; and labor. Education, health, and social security together account for about 86 percent of total social spending. An additional 11 percent is spent on regional and urban development, leaving roughly 3 percent to labor and food/ social assistance interventions.

Table 3.3 provides a breakdown of social spending, and separates out programs that also fall under the crosscutting category Poverty Reduction (Superación de la Pobreza). Using this category to capture social assistance spending, an estimate of total social protection spending
would include all targeted poverty reduction expenditures plus social security, or roughly 33 percent of total social expenditures (noting that some poverty reduction expenditures are classified under the economic as opposed to social sector), and 3.4 percent of GDP. Total social spending equals about 10 percent of GDP and close to 60 percent of total programmable spending. Table 3.4 identifies all the major programs under Poverty Reduction, including those classified under social spending and included in Table 3.3 as well as those under economic sector spending (such as agriculture and fishery development, for example) which increases the total spending on targeted poverty reduction programs from 50.5 billion pesos to over 70 billion pesos – or 0.8 percent of GDP. Social security expenditures are 2.6 percent of GDP.

### Table 3.3. Federal Social Spending in Mexico by sector, 2002

<table>
<thead>
<tr>
<th>In MX pesos (Million)</th>
<th>Spending per capita</th>
<th>Percentage of programmable spending</th>
<th>Percentage of social spending</th>
<th>Percentage of GDP</th>
</tr>
</thead>
<tbody>
<tr>
<td>Food and Social Assistance</td>
<td>14,582.8</td>
<td>141.5</td>
<td>1.4</td>
<td>2.3</td>
</tr>
<tr>
<td>Social Security</td>
<td>159,980.9</td>
<td>1,552.6</td>
<td>14.8</td>
<td>24.9</td>
</tr>
<tr>
<td>Health</td>
<td>132,878.7</td>
<td>1,289.6</td>
<td>12.3</td>
<td>20.7</td>
</tr>
<tr>
<td>Education</td>
<td>259,588.9</td>
<td>2,519.3</td>
<td>24.1</td>
<td>40.4</td>
</tr>
<tr>
<td>Labor</td>
<td>2,486.0</td>
<td>24.1</td>
<td>0.2</td>
<td>0.4</td>
</tr>
<tr>
<td>Regional and Urban Development</td>
<td>73,112.4</td>
<td>709.6</td>
<td>6.8</td>
<td>11.4</td>
</tr>
<tr>
<td>Total social spending</td>
<td>642,629.7</td>
<td>6,236.7</td>
<td>59.6</td>
<td>100.0</td>
</tr>
</tbody>
</table>

Poverty reduction

<table>
<thead>
<tr>
<th>In MX pesos (Million)</th>
<th>Spending per capita</th>
<th>Percentage of programmable spending</th>
<th>Percentage of social spending</th>
<th>Percentage of GDP</th>
</tr>
</thead>
<tbody>
<tr>
<td>50,564.0</td>
<td>813.6</td>
<td>4.7</td>
<td>NA</td>
<td>0.8</td>
</tr>
</tbody>
</table>

*Calculated using population estimates for 2002 from the Secretaria de Gobemacion (Consejo Nacional de Poblacion projections based on the XII Censo General de Poblacion y Vivienda del 2000).  
*Total Net Public Expenditure in 2002 was 1,484,256 million pesos, of which 73 percent (1,078,860 million pesos) was programmable.  
*Federal spending only.

Source: Own calculations based on the Anexo del Cuarto Informe de Gobierno 2004.

### Table 3.4. Federal Spending on Selected Poverty Reduction Programs, 2002

<table>
<thead>
<tr>
<th>In MX pesos (Million)</th>
<th>Spending per capita</th>
<th>Percentage of programmable spending</th>
</tr>
</thead>
<tbody>
<tr>
<td>Total</td>
<td>77753.5</td>
<td>754.6</td>
</tr>
<tr>
<td>Oportunidades</td>
<td>17,003.8</td>
<td>165.0</td>
</tr>
<tr>
<td>Programa de Desayono Escolares</td>
<td>1,752.1</td>
<td>17.0</td>
</tr>
<tr>
<td>Programa de Abasto Social de Leche</td>
<td>-</td>
<td>-</td>
</tr>
<tr>
<td>Programa de Abasto Rural</td>
<td>568.0</td>
<td>5.5</td>
</tr>
<tr>
<td>Programa de Empleo Temporal (PET)</td>
<td>3,867.4</td>
<td>37.5</td>
</tr>
<tr>
<td>Programa de Opciones Productivas</td>
<td>520.9</td>
<td>5.1</td>
</tr>
<tr>
<td>Subsidios para Vivienda</td>
<td>628.9</td>
<td>6.1</td>
</tr>
<tr>
<td>Other</td>
<td>53,412.4</td>
<td>518.4</td>
</tr>
</tbody>
</table>

*This refers to spending per family in the case of Oportunidades and Subsidios para Vivienda, per producer in the case of Programa de Opciones Productivas, per job in the case of PET, and per individual for the rest.  
*bIncludes federal, state and municipal spending.  
*cIn 2000 and 2002, LICONSA was entirely self-financed and did not receive any federal transfers. In 2003, federal expenditure on this program was 267.6 million MX pesos.


The largest single program classified under the targeted poverty reduction category is Oportunidades, absorbing one fifth of the total budget. In addition to Oportunidades, the
largest poverty reduction programs include Programas Compensatorios del CONAFE, Programa de Empleo Temporal (PET), Programa de Desayunos Escolares, Programa Opciones Productivas and Subsidios para Vivienda. “Other” represents expenditures on multiple small programs for which individual budgets are not available in the Anexo del Cuarto Informe del Gobierno.

Figure 3.5. Trends in Social Spending and Social Protection Spending, 1995 – 2002

Social spending has grown rapidly in recent years, driven mainly by growing social security obligations in the unreformed ISSSTE and transition costs in IMSS; targeted poverty reduction expenditures have also increased, though less rapidly. During the 1990s, social spending overall recovered from the severe budget cuts of the 1980s. As seen in Figure 3.5, social protection expenditure (represented by spending on social assistance, social security and poverty reduction) was among the fastest growing expenditure categories, with social security spending exhibiting a relatively dramatic increase of 14.9 percent per year over the decade.

During the same period, poverty reduction expenditure also increased, yet at a slower rate. While the ratio of targeted spending to social security spending was about nine tenths in 1995, it had fallen to about one-half in 2002. A look at preliminary figures for 2003 and 2004 reveals that total spending on poverty reduction has increased by nearly 30 percent in the past two years (with a total of 100,848.6 million MX pesos budgeted for 2004).

SOCIAL INSURANCE POLICY IN MEXICO – OVERVIEW AND MAJOR CHALLENGES

Mexico’s social insurance system shares many of the characteristics and challenges of many Latin American economies. On one side a formal social security system provides retirement and health benefits to formal sector employees through two different subsystems, one for private sector workers and one for public sector workers; on the other, there is a challenge of providing adequate and sustainable coverage to people in the informal sector whose workers and their families make up a large share of the population. IMSS was original characterized as a partially funded defined benefits system but in reality operated from the start as a pay-as-you-go
(PAYG) system. Since the 1940s, additional insurance schemes have been added, which provide often generous benefits to federal employees, the most important of which is the Instituto de Seguridad y Servicios Sociales de los Trabajadores del Estado (ISSSTE) which manages federal employees’ accounts. In addition, the armed forces, the state oil company (PEMEX) and other state companies have developed individual social insurance systems.

In 1997, a social security reform limited to IMSS was carried out, which moved toward a defined contribution system with individual accounts and private account management. The push for reform came mainly in response to the three most severe problems of the old system: financial disequilibrium, inadequate pensions and high levels of evasion resulting in low coverage. The 1995 Ley de Seguro Social paved the way for social security reform which began in 1997, while a second set of laws passed in 1996, Ley de los Sistemas de Ahorro para el Retiro, allowed for privatized management. The reform moved IMSS from a PAYG (pay-as-you-go) defined benefit system towards a defined contribution system. The reform eliminated the old PAYG scheme; providing IMSS affiliates –at the time of the reform- with a choice between benefits under the old system or accumulated balances under the new system; introducing a guaranteed minimum pension for low-income workers whose accumulated savings fall short of a post-retirement income at that level; and eliminating cross subsidies among IMSS insurance branches. Finally, the introduction of individual retirement funds or Sociedades de Inversion Especializadas en Fondos para el Retiro (SIEFORES) managed by specialized companies or Administradores de Fondos para el Retiro (AFORES) represented a huge change to both the financing and provision of services. The results of this reform are discussed in further detail below.

ISSSTE has not been reformed and represents an important contingent liability. Problems of the social security system’s financial sustainability need to be addressed. In 2003 the social security scheme for public employees had a deficit of 21.2 billion MX pesos, set to increase to 35 billion by 2006. Today’s present value of ISSSTE’s implicit future liability equals 45 percent of GDP in 2002. For every peso of income, 2.5 pesos is needed in subsidy, a precarious and unsustainable financial stance (Ministry of Finance, 2004).

Social security and pensions

IMSS incorporates two redistributive measures: (i) a flat account subsidy to all affiliates (Cuota Social), and (ii) a minimum pension to poor affiliates. The Cuota Social is a subsidy offered to all affiliates, with substantial poverty prevention effects for the poorer segments of the affiliates. The subsidy does not vary with income and is calculated as a percentage of the minimum wage. As all affiliates receive the same amount, the Cuota Social share of total pension contributions is greater the smaller the affiliates income. Gill et al. (2004) find that the Cuota Social contributions represent more than 25 percent of total contributions of the 68.5 percent of the Mexican workforce earning 3 minimum wages or less. For these workers,

26 In a PAYG system contributions from current workers are used to pay benefits to current retirees. In a fully funded system, assets in the pension fund reserve equal the liabilities (including future) in the pension system.


the Cuota Social covers commission charges and allows eventual benefits to be greater than contributions, and can be seen as an incentive for low-income workers to join the system. In addition, Mexico has adopted the Chilean model of ensuring a minimum pension for contributing affiliates. The government finances the pension directly when the balance of the individual account is exhausted. Affiliates with at least 25 years of contribution and whose accumulated savings fall below a given minimum annuity are eligible for the minimum pension.

The degree of redistribution depends on whether or not coverage expands. The design of the new system is meant to be both redistributive and to provide the correct incentives for workers to contribute, thus increasing coverage. According to the Mexico Public Expenditure Review (World Bank, 2004), as long as coverage expands, federal transfers to the scheme will be reasonably targeted. At any point in time, redistribution only takes place within the covered population.

**Figure 3.6. Distribution of Additional Public Expenditure on Pensions, 1996-2002**

![Graph showing distribution of additional public expenditure on pensions, 1996-2002.](image)


The distribution of increased federal expenditure on pensions, in particular given the subsidies that go to public sector workers, in the past decade has been highly regressive. Federal transfers to finance pensions of formal private and public sector workers increased greatly over the last decade. Figure 3.6 shows the share of the total increase in transfers that accrued to each income decile over the period 1996-2002. For IMSS, increases were related to the transitional costs of the 1997 IMSS reform and they will diminish in time, while in the case of ISSSTE the increase in federal transfers was driven by a need to finance a growing gap between current contributions and pensions payments. Federal transfers to IMSS increased by 147 percent from 1997 to 2002 (from 21,021 to 51,986 million pesos). In the same period the ISSSTE deficit grew by 336 percent (from 3,377 to 14,728 million pesos).

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30 Mexico Public Expenditure Review (World Bank, 2004).
Finally, significant inequalities exist between the pension systems for public and private employees and within the public system. A focus on IMSS and ISSSTE fails to reveal the full extent of existing inequalities within formal pension schemes in Mexico. In addition to ISSSTE, a range of systems cover specific groups of public employees. These groups, which include the armed forces (SEDENA, SECAMAR), public workers employed by local governments, the principal state companies (PEMEX, CFE, Luz y Fuerza), and IMSS employees, have been able to negotiate exceptionally generous contractual obligations from the federal government, resulting in inequalities between public and private sector workers, and inequality within the public sector. For instance, while PEMEX, Luz y Fuerza and IMSS employees represent only 8 percent of all pensioners, they absorb more than a third of the benefits.

Regardless of positive changes in the incentives to participate, increasing coverage of social security systems for private workers is still an important challenge to the system. The objectives of the wave of reforms in Latin America in the nineties, were, among others, to make the system financially sound and increase coverage through providing better incentives to workers and firms. As with many of the reforms implemented in Latin America, observers still debate the impact of the 1997 social security reform for private sector workers in Mexico (Kaplan, 2004), particularly with respect to formal employment, but overall coverage ratios remain low, especially among the poor. In Mexico, there was a rapid surge in affiliation during the 4 years following the reforms, however, the pace of new affiliations stagnated with the deceleration of growth. In any case, systemic changes that lead to a better link between contributions and benefits are a move in the right direction. Uniform contributions to health insurance are a good example of how linking contributions to benefits increases the incentives to participate in the formal labor market and social insurance schemes. Under the old defined benefit system, contributions varied in line with the wages of the affiliate, while benefits were the same for all. In the new defined contributions system, the contribution is uniform and based on the minimum wage, removing the perception of an extra tax on anyone earning above minimum wages relative to those who earned only minimum wage but received the same benefit. Estimates suggest that the strengthened link between contributions and expected benefits had a positive impact in Mexico resulting in an immediate surge in formal employment (Montes and Santamaría, 2004). Another view attributes the surge in formal employment to improved...
registries. A considerable increase in federal contributions, from 0.6 to 13.9 percent of the minimum wage, was also designed to act as an aggressive stimulus to formalization (Montes and Santamaria, 2004).

In 2002, about 40 percent of the Mexican population was not covered by any pension system. Also, according to the World Bank’s assessment of the government poverty reduction strategy (2004), half the population falls out of the formal health insurance system, while one tenth is without access to healthcare. Furthermore, as informal employment is linked to lower income, social insurance coverage is not only limited but also highly regressive. As a result, the overall social insurance system is dualistic, i.e., divided in terms of the covered and uncovered population, which corresponds to the formal and informal populations.

Further, there are some threats to the financial sustainability of IMSS. According to a recent evaluation of the system published in the *Tercer Informe de la Situación Financiera y los Riesgos del Instituto 2003-2004*, IMSS needs to resolve three critical challenges in order to perform its functions in a sustainable and efficient manner.

First, there is an ongoing dispute between the institute and its employees over the particularly advantageous retirement benefits enjoyed by these workers. Average age of retirement for IMSS employees is 53 years compared to 65 for other IMSS affiliates, yet employees of the institute retire with a pension that is on average 30 percent higher than their last salary, while other IMSS affiliates receive a pension upon retirement that is on average lower than their last salary. Consequently, the pension of an ex-IMSS employee is on average 8.3 times the size of that of any other affiliated worker – in spite of having worked on average 12 years less. This generous pension scheme is largely paid for by contributions of other IMSS affiliates and not by those of the IMSS employees themselves. The calculations in the above mentioned report show that only 6 percent of the cost is covered by IMSS employees’ contributions, while 77 percent is paid for by other affiliates, representing 19 percent of total worker and employee contributions. Urgent reform is needed to redress this disequilibrium and to avoid even graver damage to the financial viability of the institute. The report projects a doubling of the number of retired IMSS employees in less than a decade.

Second, the demographics of the Mexican population result in a relative decrease in the number of working, contributing affiliates relative to the number of retired, benefitting affiliates. Increased life expectancy will increase the weight of medical expenses for pensioners, in particular those related to chronic illnesses. Contrary to the first challenge which is particular to the Mexican system, the problem of demographic change poses challenges similar to other OECD countries’ social security systems.

Third, IMSS is far from fulfilling its social obligation of securing all Mexican non public sector workers. Due to years of backlog in formal job creation and the impact of the economic downturn since 2001, only 29 percent of the economically active population was covered by IMSS in 2003. With no change in limited coverage, 11 million workers will retire with no pension in the following 25 years. The need to increase the coverage ratio runs against the urgent need to increase IMSS revenue as higher contribution rates would further decrease the incentives for informal workers and employers or self-employed to register formally. In fact, decreased contribution rates might be envisaged as one way to provide the needed incentives for

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31 Comments received during the June 10-11, 2004 Poverty Assessment workshop in Mexico City.
workers and employers to register formally. The problem of low coverage is further complicated by dynamic changes in the labor market as job creation over the past years has taken place mainly in service and commerce sectors with smaller business structures and a high incident of micro-enterprises and self-employed. It is a known fact that the probability of formal registration increases with size. In Mexico, affiliation is optional for the self-employed. Finally, the proportion of temporary as opposed to permanently employed workers is increasing, creating problems of insufficient time of contribution. Female participation in the labor force is increasing – a population for which temporary work is more widespread. Agricultural day-workers are in a particularly fragile position due to seasonal changes in labor demand, while the problem is exacerbated among migrant workers that divide their time between Mexico and the United States.

Some state governments have introduced non-contributory transfers to the old-age population in an effort to address the existing gap in old-age insurance coverage; the elderly are also covered in part by national programs such as Oportunidades and Procampo. In 2001, Mexico City Government (MCG) launched a program providing transfers to the elderly (Programa de Apoyo Alimentario y Servicios Médicos y Medicamentos Gratuitos para los Adultos Mayores de 70 años). The program was initially poverty targeted as only the elderly living in poor sections were eligible beneficiaries of the pension scheme. In 2003, coverage was extended to all residents at the age of 70. Other states operate transfer programs for the elderly poor, including the Canasta Alimentaria Básica (Michoacán), the Programa de Atención al Adulto Mayor (Nuevo León), and the Pensión para Adultos Mayores (Guerrero). National programs that are targeted to the poor also reach the elderly; Oportunidades reaches close to 400,000 families headed by someone over the age of 70, while more than 650,000 Procampo beneficiaries were over age 70 in 2004. In sum, multiple initiatives exist which reach the elderly poor either by design or accident, and government entities at multiple levels are stepping in to attempt to address the issue. There is still the need of a coherent policy for addressing the issue of old-age poverty in an efficient, fiscally sustainable manner.

**The national health system and health insurance**

Overall public expenditure on health services is mildly regressive; however, it becomes neutral if private contributions to IMSS are deducted. The mid-regressive pattern in total public expenditures in health results from regressive expenditure on services for the insured (a result of limited and regressive coverage) coupled with highly progressive expenditure on services for the uninsured. As shown in Figure 3.8, federal expenditure on health services can be divided into funding of institutions servicing the uninsured (Ministry of Health – SSA) and the insured (ISSSTE and IMSS). When looking at the distribution of expenditure across income deciles, public financing of health services for the uninsured is highly progressive, while the public financing of health services for the insured population in the public system is regressive in absolute terms, but not relative to income.

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The expansion of public expenditure on health services in the period between 1996 and 2002 was accompanied by increased progressivity and more pro-rural spending. Overall, federal health expenditure rose by 40 percent in the time period 1996-2002. During the same period, the share of federal expenditure targeting the uninsured (SSA) increased from 21.5 percent of total expenditure in 1996 to 33.4 percent in the 2002. This illustrates how the expansion in public expenditure between 1996 and 2002 favored the uninsured, narrowing the gap between the two parts of Mexico’s dualistic health system. As such, between 1996-2002, public spending on health became more pro-poor as the poorest 2 deciles accounted for 15 percent of spending in 2002 compared to 8 percent in 1996. It also became more pro-rural–up to 28 percent from 20 percent–reflecting both increased spending on SSA services in rural areas and an expansion of IMSS coverage in rural areas between 2000 and 2002.
However, per capita health spending varies widely geographically, with poorer states receiving less than richer ones. The state that receives the highest per capita expenditure on health (Baja California) receives more than three times more than the state that receives the least (Michoacán). Geographical differences become even starker when distinguishing between the insured and uninsured: the insured population in Baja California receives more than five times as much in per capita health expenditure as the uninsured population in Puebla. ⁴

Finally, Mexico’s national health system is characterized by a parallel and strong presence of private health providers that serve both the covered and uncovered populations. As a result, the national health system consists of a fragmented public system and a significant private sector operating largely in parallel with very little coordination (Cercone 2000). In short, the system is built on three pillars: one serving the insured, another serving the uninsured, and a third pillar—the private sector—serving both. First, there are the mandatory social insurance programs for formal sector employees, employers and government, funded by contributions and run by IMSS, ISSTE etc. Second, there is the social assistance program for the uninsured financed by general revenue and provided by the public sector (i.e., SSA). Third, there are private sector health providers, used by both insured and uninsured and financed by out-of-pocket expenditures. Following the decentralization of health services in the mid-1990s, states are responsible for health services provided by the SSA to the uninsured. States also run their own health institutions.

To address the problem of limited health insurance coverage among the poor and health shocks, a voluntary insurance scheme—the Seguro Popular (SP)—was launched by the Ministry of Health in 2001. The Seguro Popular program was first piloted in 2001 and by early 2004 became known as the national program Sistema de Protección Social en Salud (SPSS); as of May 2005 the program provides coverage to 2,000,000 families. Although based on

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traditional insurance design features, the Seguro Popular effectively operates more as a targeted transfer mechanism built around the package of basic health services due to a heavily subsidized package of benefits coupled with a progressive contribution structure. In addition to the self-targeting mechanism of minimum benefits, the Seguro Popular uses an income/assets survey to evaluate capacity to pay. Although the program is funded and administered by the Ministry of Health, the actual provision of health services included in the package is devolved to the states. As of April this year, 700,000 families have signed up for the Seguro Popular, and the government estimates that by the end of the year 1.5 million households will have signed up. It should be noted, however, that the program presents new fiscal liabilities that must be considered, especially since the number of services offered by the program continues to grow. A second voluntary insurance scheme, the Seguro de Salud para la Familia (SSF), compliments the SP. The SSF operates within existing social security institutions and targets informal and self-employed workers able to pay a premium contribution. SSF coverage is still very low about 350,000 beneficiaries and has not increased much in the last year, about 2 percent.

Box 3.2: Decentralization of social spending and service provision in the 1990s – Health and Education

In the 1990s increasing decentralization led to a consequent change in the composition of social spending between federal and sub-national levels of government. Decentralization of public expenditure was rapid, and massive in terms of the magnitude of decentralized expenditure. Decentralized spending represented 42 percent of total social spending in 2000, compared to 29 percent in 1994.35

Rapid decentralization of resources, coupled with continued centralization of taxation and lacking incentives for states to increase their own revenue has left sub-national governments highly dependent on federal transfers. The disconnection between expenditure and revenue has emerged as one of the key challenges of fiscal federalism in Mexico.

Two waves of decentralization with significant transfers of social spending and basic service provision to local governments:

- Late 1980s - Early 1990s: Tax authority was not devolved, however responsibilities were delegated to states and supported by transfers. Continued federal control over spending priorities was ensured by earmarked (and conditional) transfers. Starting in the late 1980s, the provision of basic health services was gradually transferred to states, while responsibility for basic education devolved more rapidly following the 1992 Acuerdo Nacional para la Modernización de la Educación Básica
- Late 1990s: Continued decentralization, driven by increased political competition and demands from state governments ran by opposition parties. Decentralization relied on transfers, however earmarking and linkages to expanded responsibilities were greatly relaxed. Major reforms included the creation in 1998 of a new budget line–Ramo 33–which increased the predictability of health and education transfers to the states.

With the exception of the new Seguro Popular program, none of these decentralization reforms affected social protection policy. Both social assistance transfers and social insurance remained centralized. Seguro Popular, a program which involves heavily subsidized health benefits for the poor and therefore some risk pooling across households has been largely devolved to the states, following the massive decentralization of health services that occurred in the 1980s and 1990s.


SOCIAL ASSISTANCE POLICY IN MEXICO – OVERVIEW AND MAJOR CHALLENGES

The 1980s and 1990s brought about great changes in federal social policy in Mexico, as the focus of social assistance shifted towards poverty alleviation. While programs in the 1980s focused on ‘compensating’ the poor for their situation, the 1990s saw the emergence of more dynamic programs geared towards the development of human capital and productive capacities in the poor. This trend culminated in the launch of Progresa in 1997. The program combined innovative program design built on conditional transfers and cross-sectoral synergies with rigorous monitoring and evaluation.

A new wave of social policy initiatives coincided with the first structural reforms of the late 1980s and early 1990s, initiating a move away from generalized subsidies towards targeted poverty alleviation incorporating decentralized, local participation. Acknowledging that the poor were the most disadvantaged both in terms of coping under economic stress and in terms of adapting to structural adjustments, the Salinas administration developed Programa Nacional de Solidaridad (PRONASOL). This program was one of the first to specifically target the poor, representing an important break with earlier policy. A second innovative feature of PRONASOL was its focus on community participation, coupled with the decentralization of both resources and decision-making. Despite these advances, the majority of poorly-targeted generalized subsidies remained in place. Furthermore, programs within PRONASOL lacked well-specified objectives as well as corresponding monitoring and evaluation, contributing to the perception of PRONASOL as a vehicle for clientelism.

By the 1990s the policies of PRONASOL had been discredited, paving the way for innovative social policies that turned the focus of social assistance towards building the human capital and income generating capacities of the poor. The move away from general subsidies toward targeted social assistance initiated by PRONASOL continued throughout the 1990s. Changes were made to some but not all subsidies. Generalized food subsidies such as the universal tortilla subsidy were phased out giving way to food subsidies targeted to the poor. In addition, important advances were made in terms of increased transparency and accountability, by ways of more systematic monitoring and evaluation.

The launch in 1997 of the Programa de Educación, Salud y Alimentación (Progresa, now called Oportunidades), a social assistance program targeting rural infants and youth, is the clearest manifestation of this new wave of policy initiatives. Progresa is a conditional cash transfer (CCT) program that provides money to extremely poor families conditional upon investments in human capital such as sending children to school or bringing them to health centers on a regular basis. This conditionality makes CCT programs an instrument not just for short-term social assistance, but for longer term human capital investments. CCT programs are

36 López-Calva refers to an evaluation of generalized subsidies realized by the SECOFI in 1992, which shows that of every peso disbursed in the Programa de Subsidios Generalizados, only 50 centavos reached the beneficiaries due to high administrative costs. In addition, by favoring the urban middle class, the subsidies left behind large portions of the population. Conference proceedings from “Innovations in Social Policy Conference”, SEDESOL, Mexico City, April 2003.

37 Perceptions of clientelism were also generated by the practice of having earmarked transfers sent directly to PRONASOL committees, bypassing mayors and municipalities, following ‘a distinctive political logic’ (Haggard and Webb, 2004). Díaz-Cayeros and Magaloni (2003) found that the timing of PRONASOL expenditure responded to the federal electoral cycle, and allocation was in part determined by the competitiveness of electoral contests.
part of a new generation of social programs that use demand-side financing to target the poor that includes school voucher programs and subsidized health insurance schemes. These programs’ reliance on market principals, using demand-side interventions to directly support beneficiaries, is a marked departure from traditional supply-side mechanisms such as general subsidies or investments in schools, health centers and other providers of social services.

*Oportunidades* pioneered a new generation of social assistance programs (conditional cash transfers programs) that have been emulated internationally. It also introduced consistent monitoring along with rigorous, independent evaluation. In addition to enforcing the trend towards targeted poverty alleviation, the program reoriented the focus of social assistance to building the productive capacity and human capital of the poor. Finally, by linking nutrition, health and education, the program marked a transition towards a more integrated approach to poverty alleviation. A cross-sectoral approach was seen as more effective than isolated programs in responding to the multidimensional needs of the poor. While *Oportunidades* targets infants and youth, such an integrated approach has been used in recent regional development programs developed under the current administration, including *Habitat* (urban areas) and *Microregiones* (remote and marginalized rural areas). One of the main current challenges in reforming the social protection system is to consolidate these new trends in social assistance and to disseminate the principles and lessons from *Oportunidades* to all parts of the social protection system. So far, take-up has been low.

**Figure 3.10.** Distribution of Households benefiting from public Scholarship Programs, 2002

![Figure 3.10](image)


*Increased spending on education has been highly progressive as a result of Oportunidades and the increase in means-tested scholarships.* Figure 3.11 shows how *Oportunidades* has grown to become the largest public scholarship program in Mexico. More importantly, the graph also illustrates how progressive the program is. Of all households
receiving *Oportunidades* transfers, a total of 93.4 percent were in the bottom half of the income distribution. 63.6 percent were among the poorest 20 percent of the population and 39.5 percent among the poorest 10 percent. More than 80 percent of *Oportunidades* households were in rural areas in 2002, however this has changed in the past two years due to the roll-out of the program to urban areas (see Figure 3.11). Households benefiting from other scholarships are concentrated in urban areas (76.4 percent). This positive trend holds mainly for primary and lower secondary, while the distribution of scholarships for upper-secondary and tertiary education remains regressive.

**Figure 3.11. Extension of *Oportunidades* coverage, 1997-2004 (thousands of families)**

![Figure 3.11](image)


Coverage of *Oportunidades* has increased considerably in the past couple of years as the program moved to include upper-secondary students in 2001, followed by an expansion into urban areas in 2002. In 2002, the program provided more than 2.5 million scholarships to primary school children and 1.3 million scholarships to secondary school adolescents nationwide. Coverage was about 60 percent more than in 2000. The original program design has not changed as a result of urban expansion, but recent experience in adapting the program to urban areas without considerations of how the model would function in a different context suggests that some program modifications may be needed. Figure 3.11 shows the number of beneficiaries over the time period 1997-2004, broken down by rural, semi-urban and urban.

In 2002, the Mexican government introduced the *Contigo* strategy, an ‘umbrella’ framework designed to achieve greater coherence and impact in social protection policy. Programs are designed around age and gender groups and action areas so as to ensure that individuals’ needs of government services and assistance at different times in their life and in different welfare dimensions are covered. Its stated goal is to provide basic social benefits to all Mexicans, including quality healthcare and education, adequate nutrition, housing, employment security and pensions (*Secretaria Técnica*, 2003) (see Figure 3.12 below). In addition, the conceptual framework includes four transversal principles, applicable to all areas of public action: (i) equity to allocate more resources to disadvantaged groups; (ii) transparency to avoid discretionary or political use of government and society; (iii) joint responsibility between the

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38 Rubio and Soloaga (2002)
Recent social protection initiatives illustrate the new social protection framework, in particular in terms of delivering integrated interventions drawing on synergies between sectors and programs:

- The inclusion of upper-secondary students in *Oportunidades* was accompanied by a savings plan for participating high school students called *Jóvenes con Oportunidades*. The program offers a bonus which grows each year from ninth grade through graduation and turns into a savings fund if the student completes high school before turning 22. The program has important links with other services. Students can use the bonus to buy health insurance such as the *Seguro Popular*, for collateral either in micro-credit or to enter into the government’s housing credit program, *Tu Casa*. Alternatively, the savings can help fund higher education. By 2004, *Jóvenes con Oportunidades* operates close to 40,000 savings accounts on behalf of *Oportunidades* beneficiaries.

- *Microregiones* is a new, largely rural crosscutting program focusing on local development in remote and marginalized areas often outside of the reach of *Oportunidades*. The main objective of the program is to build basic social infrastructure complemented by strategies to integrate the marginalized area into a broader economic network. The program is participatory in that local communities, via local councils, take part in the decision-making process by proposing and prioritizing investments. The program also seeks to identify and support strategic centers within each region.
As a complement to Microrregiones, the Estrategia de Abasto, Alimentación y Nutrición offers food subsidies to families living below the food poverty line in remote and marginalized areas, specifically outside the reach of Oportunidades. While there is evidence that the percent of underweight children was practically halved over the course of the decade, estimates for the share of children under 5 years of age that still suffer from stunted growth in its moderate form range as high as 18 percent. Moreover, 18.6 percent of total households had a per capita income below the minimum requirement to fulfill their daily energy food intake included in the INEGI-ECLAC’s basic food package. About 35 percent of these households are located in remote areas with less than 500 inhabitants, and the program focuses on reaching these marginalized communities which often do not systematically receive any other support. The food subsidy is distributed using the network of Diconsa stores and with the support of the Microrregiones program.

A third cross-sectoral social assistance program, Hábitat, was launched in 2003 to combat urban poverty. The program combines and coordinates poverty reduction programs and urban development projects and targets both poor neighborhoods and poor households. Hábitat has been instrumental in improving the quality and access to basic services such as water, electricity and sewage in targeted urban areas, and has helped create community development centers (Centros de Desarrollo Comunitario) and child care centers. Special attention is given to female heads of households, the elderly and the disabled. The program covers about 180 cities and the latest extensions of the program have focused on border cities in the North and South and 10 historic city centers. The budget for 2004 was MX$5 billion, up from MX$2 billion in 2003.

Even though Mexico’s various social assistance programs may be justified by the different demands of a heterogeneous population, their sizeable number reflects potential problems of overlap and coordination. Many programs are aimed at the same target population but vary in terms of the geographical region attended, the economic sector in which the population is located, the type of instruments employed, or merely the entity responsible for its operation. The number of programs, by itself, generates a serious problem of inefficiency. Coordination problems grow with the number of programs, efforts are duplicated, and as a result some segments of the target population may be left unattended or covered simultaneously by more than one program.

Finally, programs formally belonging to other sectors perform central social protection functions, as seen in the income security and redistributive functions of Procampo (agricultural subsidy). Aside from Oportunidades, Procampo is the government’s main poverty-targeted transfer program. In general, the Mexican state has been heavily involved in rural development. Expenditure in agricultural and rural development represents 34 percent of all line-ministry expenditure and almost 2 percent of GDP (Rural Poverty in Mexico, 2004). Naturally, many Agricultural and Regional Development (ARD) policies and programs are not directly targeted to poverty reduction, however while pursuing other goals (e.g., farm modernization or competitiveness), they directly or indirectly affect rural poverty and inequality. A subsidy such as Procampo also provides income security for the poor. Government transfers, both in terms of social assistance and ARD, constitute a considerable share of the incomes of the rural poor. There is an increasing trend in ARD expenditure and some evidence of increased targeting of programs. The dependency of rural poor on transfers is contrasted by the relative absence of transfers in the

incomes of urban poor, new, smaller initiatives such as Hábitat notwithstanding. Finally, Urban Poverty in Mexico (World Bank, 2004) underscores the importance of the labor market as a risk coping mechanism for the urban poor.

**Box 3.3: Procampo**

Aside from Oportunidades, Procampo is the government’s main poverty-targeted transfer program. PROCAMPO, introduced in 1993, is a program of direct payments scheduled to end in 2008, which compensates producers for the loss of input subsidies, price supports, and import protection incurred by Mexico’s entry into NAFTA. The program covers 2.8 million producers out of which 2.3 million are farmers on ejidos. Planned expenditure for the program was 12.4 billion pesos in 2002.

**Main objectives:**
- Support domestic producers of basic staples to face competition from the United States
- Help Mexican farmers switch to more competitive crops under a liberalized context

**Procampo has a progressive overall distribution** as poor subsistence farmers represent a large proportion of producers of basic crops, the poor (as defined by the food poverty line) benefit from 33 percent of transfers. Estimates referred to in the PER show that for the poorer ejidatarios, the Procampo transfer represents up to 40 percent of income. But over 80 percent of households in the poorest households do not receive program benefits, and incidence stretches significantly across the income distribution.

**Distribution of Procampo Transfers across income deciles, 2002**

![Distribution of Procampo Transfers across income deciles, 2002](image)

Despite a progressive distribution of transfers, Procampo reaches few poor households not covered by either Oportunidades or public social security schemes. Less than 2 percent of extreme poor households not covered by Oportunidades or IMSS receive Procampo transfers (ENIGH 2002).

Source: Mexico Public Expenditure Review (World Bank 2004) and Poverty in Mexico (World Bank, 2004)

In sum, although the Contigo strategy works well as a conceptual framework, earning the government deserved acclaim, the strategy has yet to be fully operationalized (World Bank, 2004 - Poverty Assessment Report). With the exception of a few cross-sectoral programs including Oportunidades and Hábitat, it is unclear how the wide variety of social assistance programs fit in the Contigo strategy. Most social and economic policies affecting the poor seem to continue along sectoral and ministerial lines; as seen in Table 2.2, social assistance policy today is delivered via almost 90 different programs, from a multitude of responsible entities, incorporating little of the Contigo framework into decision making.
WHERE DOES THE SOCIAL PROTECTION SYSTEM STAND TODAY?

To conclude, Mexico’s social protection system is at a critical juncture. The 1997 IMSS reform of the pension system for private workers moved in the right direction by linking contributions and benefits thereby improving the financial underpinnings of the system. The ISSSTE system covering public sector employees, however, is still unreformed. As a whole, the social protection system in Mexico, as in many Latin American countries, is still fragmented on the basis of labor market status and a large fraction of the population still has no or inadequate coverage. Social insurance programs which constitute the bulk of social protection spending continue to suffer from financial instability and insufficient coverage among the poor, and despite progress in Oportunidades, social assistance remains fragmented.

Mexico’s social protection system has seen major progress in the past two decades, as illustrated by major innovations such as the Oportunidades program, and the conceptually strong framework now provided by Contigo. Innovative approaches have emerged dealing with the multidimensional characteristics of poverty, notably through cross-sectoral programs such as Oportunidades, Microregiones and Hábitat. Monitoring and evaluation practices are becoming increasingly rigorous. However, the majority of social assistance programs have yet to incorporate these concepts as rigorously as the government’s flagship social assistance program Oportunidades, nor is it clear how some of the smaller social assistance programs fit into an integrated Contigo framework.

Box 3.4: Argentina’s experience with workfare programs in times of crisis – Jefas y Jefes de Hogar

In response to the 2001 crisis, the Argentine government launched the workfare program, Jefas y Jefes de Hogar Desocupados (Unemployed Heads of Household). The program provides 150 pesos per month to unemployed household heads or their spouses in exchange for 20 hours per week of community service work, job training or work as a temporary employee of a private company. Eligible households are those with at least one of a child under the age of 18, a pregnant woman and/or a handicapped member. Either the husband or the wife can participate in the program, provided that their spouse is not working.

Program eligibility criteria were not tightly enforced – about one third of those receiving the program did not satisfy eligibility criteria. Yet, given the evidence that a fall in real wages, rather than unemployment, was the significant factor behind the decline in living standards participation by people who were not formally eligible may not have been a bad thing. In addition, the fact that beneficiary unemployment status is hard to verify in economies with high rates of informality makes this eligibility requirement unenforceable. Indicators of structural poverty such as having dependents and/or living in households with no members in the formal labor markets may have been more effective eligibility criteria in ensuring pro-poor targeting. Overall, targeting was good as about over half of the participants came from the poorest fifth of Argentine families, and all but 10 percent fell below the official poverty line.

The program is estimated to have reduced Argentina’s unemployment rate by only about 2.5 percentage points. However, the effect on poverty, and more particularly on extreme poverty, was significant: close to 10 percent of the participant would have fallen below the food poverty line without the program. The program helped participants who would have suffered an appreciably sharper drop in their income without the program. Among the lowest quintile, income to males from work programs increased from 2 to 16 percent of total household income; for females, the equivalent increase was from 3.4 to 21.8 percent.

Source: Adapted from Poverty in Urban Mexico, Mc Kenzie (2003); Galasso and Ravallion (2004).
With regard to social security, workers in the formal sector and their families are provided social protection by social security institutes, the most prominent of which are the IMSS and ISSSTE. The private pension system has the challenge of increasing coverage, while the pension system for public sector workers provides generous benefits remains unreformed and maintain severe financial imbalances. Informal workers and their families, in contrast, have relatively limited access to social protection. For health care, these citizens rely mostly on the Secretaria de Salud (SSA) or out-of-pocket fee-for-service in the private sector. In old age, these citizens do not have a pension and hence rely on own savings and intra-family support. A large group of people, however, neither have access to these programs nor to the formal social security institutes; these citizens represent the “missing middle” of Mexico’s social protection system.

Chapter 2 raised the issue of increasing risk and vulnerability to job loss and unemployment: Mexican labor markets seem to be increasingly absorbing output shocks through higher unemployment rates, yet current unemployment protection system only protects formal employees. The Poverty in Urban Mexico report takes note of this gap in social protection, highlighting the need to develop safety nets that protect the urban poor and help them mitigate risks, particularly workfare and other social insurance programs that can be quickly deployed when a crisis hits. Lacking unemployment insurance and the limited access and uncertain future of workfare programs such as PET, may become an obstacle to the provision of comprehensive social protection of Mexican workers.

In short, despite important advances, Mexico faces substantial problems in its social protection system that must be acknowledged and addressed. Reforming the social insurance system remains a priority both in terms of addressing the coverage gaps particularly among the poor in the informal sector, as well as in response to growing financial obligations under the present system. Cast in terms of the framework established in Chapter 1, the bulk of Mexico’s social protection interventions (and resources) flow towards providing risk-pooling mechanisms where markets fail to provide. Financing for these programs, particularly in the provision of retirement insurance, involves both contributions from affiliates and a subsidy from general tax revenues, mainly for public sector workers pensions - while a substantial proportion of the population is excluded from coverage – thus, the persistent dualistic nature of the Mexican social protection system. There have been important reforms in social protection initiatives targeting the chronic poor, but resource flows are still insufficient and the major assistance program—Oportunidades—does not in and of itself constitute a shock insurance mechanism. Two other major programs, Procampo and the new Seguro Popular program, do provide some form of risk management for the chronic poor, yet implementation and financing questions remain, and an important proportion of the extreme poor population appear to be excluded from even these programs. The system as a whole is less a ‘system’ than a set of new social assistance initiatives. Whereas Contigo presents a compelling and elegant framework, it has yet to be fully operationalized, and programs under its umbrella remain largely fragmented and uncoordinated.

Three key issues can be identified:

- First, the social protection system remains dualistic and fragmented, with large gaps in coverage for key vulnerable groups. Potentially promising new programs remain uncoordinated institutionally and present challenges of financial viability. The Contigo strategy remains largely conceptual and the individual reforms remain ad hoc and cannot

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41 The Instituto Mexicano de Seguro Social and the Instituto de Seguridad y Servicios Sociales de los Trabajadores del Estado, respectively.

42 The current unemployment system consists primarily of a defunct severance pay system.
be anchored within a coherent social protection system without fundamental reform to the structure and composition of the overall system. And without fundamental reform, these individual reforms will not be sufficient to address the core, structural issues outlined above.

- **Second, Mexico faces the challenge of stepping-up and mainstreaming the social protection reform agenda.** Many of the laudable qualities Mexico brought to the reform of its social assistance system through the introduction of the flagship Oportunidades program need to be introduced throughout the social protection system more broadly. Indeed, without paying attention to strengthening the accountability relationships between clients, service providers and government throughout the system, the overall functioning of the system will almost certainly suffer from quality and performance problems. From a public sector management perspective, Mexico needs to mainstream the practice of introducing new programs while phasing out less viable and costly alternatives, allowing evidence-based policy to guide those decisions, and thus depoliticizing the process.

- **Third, the reform must be grounded within a strong fiscal strategy** with clear decisions made as to how reforms will be financed. Choices include reallocating expenditures within the current social protection expenditure envelope (in particular, reallocation of existing subsidies embedded in the system), or, addressing existing tax structures in order to generate greater public resources to finance the social protection system. If these questions are not addressed, new add-on policy initiatives risk further weakening the solvency and stability of the social protection system as a whole.
4. TOWARDS AN INTEGRATED SOCIAL PROTECTION STRATEGY IN MEXICO: A DISCUSSION OF ISSUES AND OPTIONS

The objective of this chapter is to lay out the most important issues that need to be addressed in the current social protection debate. The principal social protection challenge facing Mexico today is how to place risk management mechanisms within the reach of the population not currently covered by the existing social security system (the poor and the informal sector), while securing the financial underpinnings of the system. Choices used by different countries range from higher efficiency of the formal sector system in order to improve the structure of incentives faced by workers, to supplemental programs and benefit packages for informal sector and non-working groups, to de-linking the system entirely from the labor market, moving towards a unified system of universal coverage. Different policy avenues pose huge institutional and fiscal challenges that should be part of the policy debate. This chapter identifies four priority issues for the Mexican social protection reform agenda which emerge from our analysis, including: (i) the fiscal and institutional challenges of the current social security systems; (ii) inadequate health care and health insurance coverage for the poor; (iii) the lack of a strategy for addressing Mexico’s high old-age poverty rates; and (iv) the need for an integrated approach to balance risk management and chronic poverty reduction. The chapter closes with a discussion of key questions for the future.

Most social protection systems in the region, including Mexico’s, are dualistic, leaving a significant share of the poor population with insufficient access to health insurance, old-age pensions, and social assistance. At the center of the system are social insurance programs comprised of retirement and health plans for formal sector employees. Mexico is facing a classic problem of low-coverage and high-cost formal social insurance systems that are due to both the transitional costs of the IMSS’ reforms and, more worryingly, the rising subsidies needed to pay benefits in the as-yet unreformed pension systems for public sector workers, mainly ISSSTE. Choices on how to address this core issue must be made. The remainder of the system is comprised of social assistance programs, with insufficient resources, are fragmented, and characterized by gaps in coverage, missing, incomplete or overlapping interventions for different vulnerable groups outside of the formal sector. The prevalence of and the number of extreme poor outside the reach of Mexico’s flagship Oportunidades anti-poverty program, twinned with the limited capacity of that program to act as a risk management tool, all point to the prevalence of important at-risk groups that might be better served by public policy. Oportunidades clearly follows best practice program design principles, and successfully targets and reaches many of the poorest households. However, it falls short of offering an integrated strategy for risk reduction among the chronic poor, and some key groups, notably the elderly, are left uncovered by this initiative. The central government has also taken the lead in beginning to address the high exposure of the poor to catastrophic health shocks, as witnessed by the new Seguro Popular health insurance initiative, yet the question remains of whether the dualistic system should in fact be maintained.
PENSION REFORM: ISSUES FOR THE FISCAL AND INSTITUTIONAL POLICY DEBATE

The current pension systems require urgent reforms in order to assure financial stability. The particularly advantageous retirement benefits enjoyed by IMSS’ own employees constitute a significant and rapidly increasing financial burden.\textsuperscript{43} In the case of ISSSTE, the increase in federal transfers was driven by a growing gap between current contributions and pensions payments. In 2003, ISSSTE had a deficit of 21.2 billion MX pesos, set to increase to 35 billion by 2006. For every peso of income generated by the system, 2.5 pesos is needed in a subsidy from the federal budget, a precarious and unsustainable financial stance.\textsuperscript{44} The liabilities emanating from IMSS added up to 42 percent of GDP in 2002 and will diminish in time. The liabilities arise from the transition cost of the reforms and the annual cost will begin to decline in the next five years. The unreformed pension system in ISSSTE represents a contingent liability that now stand at around 45 percent of GDP and continue to increase at a rate of close to 2% of GDP a year.\textsuperscript{45}

A country like Mexico may consider several broad avenues of policy reform, not necessarily exclusive from each other, and each one with different institutional and fiscal challenges that have to be part of the country’s policy debate. A first avenue is to increase the coverage of the current system by improving it. A second avenue is to shift toward financing from general revenues and de-linking social protection from labor-market status. A third avenue is to create new institutions to cover the currently excluded population.

Increasing coverage through the first avenue requires a set of reforms aimed at lifting the current obstacles to expanding coverage: improving value for the money in social protection services, reducing costs of formality imposed by labor legislation rigidities, more effectively sanctioning tax evasion, and, at least for a segment of the population, increasing subsidies from general revenues. When workers and firms value the benefits attached to a formal contract less than the costs, the job will be informal. So improving service quality could increase the benefits of formality and more workers will be willing to pay for formal social protection. Likewise, relaxing rigid labor legislations could reduce the costs of accessing social protection, while unbundling health and pensions – which allows for a better alignment of the system with workers’ preferences – may also promote formalization. In addition, more effectively sanctioning non-compliance could encourage formality. These measures by themselves would lead to a gradual increase in coverage of the formal social security institutes, financed by payroll taxes. This implies an enlargement of the relative size of the formal sector which will gradually, cover larger groups of the population. Still, despite the reform efforts that this option entails, additional efforts to improve tax collection would be needed in order to provide adequate social protection to the poor, at least during a transitional period.

Another avenue, implemented in many OECD countries, implies de-linking social protection from labor-market status and financing the system from general revenues. In this system, coverage would be based on citizenship, not on the labor-market status of individuals. Costs of formality unrelated to social protection would no longer impact social protection

\textsuperscript{43} In section 3.3, we show that the pension of an ex-IMSS employee is on average 8.3 times the size of that of any other affiliated worker – in spite of having worked on average 12 years less.

\textsuperscript{44} World Bank staff estimates presented to government on October 1, 2004.

\textsuperscript{45} The numbers for IMSS come from Sphere Institute and Universidad Iberoamericana, 2004, referred to in “Social Protection reform in Mexico: Key Issues and Policy Options”, World Bank Policy Memorandum, November 2004. The estimations for ISSSTE were made by the Ministry of Finance in Mexico.
coverage. In fact, the distinction between a formal and informal worker would be irrelevant in terms of social protection. The challenge in this case is to improve revenue collection capacity and expand the tax base dramatically in order to be able to finance the system from general taxes only. By reducing payroll taxes, this option would increase demand for labor and thus potentially create jobs and increase efficiency. A transition would have to be carefully planned, so as to provide incentives for workers to join contributory risk-pooling schemes and to incrementally foster the use of general taxation to replace these contributions over time. The institutional, financial, and political challenges in terms of reforming the tax system are large and would need to be debated nationally.

The final avenue entails creating new programs to cover population groups currently excluded from the formal social security system, even if that implies maintaining a fragmented system. This option would avoid de-linking and may require finding the fiscal space to finance new expenditures. Any new program has to be carefully designed so as to be consistent with the current systems and would need to focus on two sometimes contradictory goals: expanding coverage and maintaining incentives for formality. Such a design, which would provide benefits to older people who did not have a chance to accumulate savings for their own pensions, will have non-contributory benefits, and should accomplish the anti-poverty goals without being more generous than the formal-sector benefits.

**BETTER COVERAGE OF HEALTH RISKS FOR THE POOR**

The issue of how to offer better health access and financial protection for the poor is at the forefront of the social insurance policy debate in Mexico. The introduction of the Seguro Popular program raises two issues central to the policy debate. The first is whether to operate a dualistic or ‘tiered’ system which offers different categories or quality of benefits to different populations based on their income level or employment status, or to provide a single, universal health care system. The second issue is, in the case of a dualistic system, whether it is optimal to have different components of the system operated by different public institutions (as is currently the case in Mexico), or whether there are significant benefits to vertical integration. Again, countries have chosen very different approaches to the challenge of extending health care to the poor. This section offers some examples from international experience that may be useful to consider in the Mexican context: the case of Thailand, which has opted for a transitional phase where the dual system is maintained while moving towards a universal system, and the case of Costa Rica, where vertical integration of the health insurance system has accompanied expanded coverage.

**“Financial Protection” as a health system goal.** Financial protection can be defined as the instance in which all households are protected from falling into poverty as a result of health costs—and where, likewise, no household is prevented from moving out of poverty due to spending on health care. Achieving a higher degree of financial fairness—e.g., fairness of contributions to health costs—is key to making health systems beneficial for the poor. Mexico’s new and promising initiatives in the health sector were in part inspired by findings in the World Health Report (2000) in which Mexico had an overall ranking of 51 out of 191 countries, yet ranked 144 on financial fairness, i.e. the fairness of contributions to cost. Since the ranking was

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47 Fairness is measured in terms of out-of-pocket expenditure as a percentage of disposable income. In a perfectly fair system the share of health expenses is equal across the income distribution.

made, the Fox administration has launched a new health insurance scheme in which contribution varies with income and tends to zero for the poorest two deciles. Coverage has expanded rapidly, in particular among the target population – the poor. What is fair financing? According to WHO an easy way to gauge this is according to the share of disposable income that households have to pay to improve or protect their health, and that high shares (e.g., >50 percent) are unfair. According to this logic, a system is fair if all households pay the same proportion of disposable income on health. The most important determinant of how fairly a health system is financed is the share of repayment in total spending. As noted by WHO (2000), out-of-pocket payment is usually the most regressive way to pay for health care, and the way that most exposes people to catastrophic financial risk. Therefore, how revenues are collected has a great impact on the equity of the system.

**Figure 4.1 Pooling to redistribute risk, and cross subsidy for greater equity**

![Pooling to redistribute risk, and cross subsidy for greater equity](image)


*How revenues are combined so as to share risks also matters*: the argument in favor of a single pool or a small number of pools of adequate size, and against fragmentation, concerns the financial viability of pools, the administrative costs of insurance, the balance between the economics of scale and (when there is little or no competition) the risks of capture and unresponsiveness, and the limitation of risk selection (which is a matter of efficiency as well as equity). Inefficiencies in collecting and pooling revenues reduce both the funds available for investment and for providing services, and people’s access to those services that can be financed.

Purchasing, finally, also affects both equity and efficiency, by determining which investments are made and which interventions are bought, and for whom. Revenues may be collected fairly and with minimal waste, and be pooled so as to assure that the healthy help support the sick and the rich help support the poor. The performance of the system will still fall short of its potential if the pooled resources are not used intelligently to purchase the best attainable mixture of actions to improve health and satisfy people’s expectations.

**A second set of challenges involves the institutional design of health systems.** A high degree of vertical segmentation characterizes health systems in most Latin American countries, including Mexico. Different organizations such as the Ministry of Health, social security funds, the armed forces, charitable organizations or the private sector may pay their own providers, raise and allocate funds and provide services for different populations, leading to higher administrative
costs and inefficiencies than may be optimal. At the other end of the spectrum are health systems in which one single organization raises, pools and allocates funds to a fairly monolithic group of independent service providers. Norway operates a health system similar to this. Some countries with multiple health insurance (social security) organizations have introduced central collecting agencies in charge of risk equalization between population pools (Colombia, Germany and the Netherlands). International experiences show how the optimal institutional design differs with a country’s socio-economic characteristics and its existing institutional framework. In addition, each system design carries its advantages and disadvantages. While central control of funds in the case of Norway makes sense, there is still scope for improved efficiency through better regional cooperation and planning. Key challenges in Mexico also include the incentives (or disincentives) to formality created by the existing dual health system (as well as changes to the incentive structure that would be brought about by further reform), federal-state relations, single vs. multiple insurers and providers, the question of portability of benefits across systems and public/private providers, and lastly, the incidence of subsidies. Many developing countries are facing challenges similar to Mexico, with some countries lending particularly useful lessons from their efforts to address these challenges via reform. Box 4.1 highlights international experience with reforming health and social security systems. As seen in the four cases discussed below, countries have approached the issue of expanding health insurance coverage differently. In addition, the four cases all show how vertical integration of health systems has accompanied or followed reform to expand coverage.

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**Box 4.1: International experience with extending coverage of health services and insurance**

**Costa Rica:** One-step universalization of coverage, followed by the creation of a single risk pool. However, Costa Rica’s universalization may have come at the expense of fiscal sustainability. Health services and social security coverage was universalized in Costa Rica in 1971. Affiliation to the Caja Costarricense del Seguro Social (CCSS) is mandatory for formal sector employees while self-employed and informal workers are encouraged to join voluntary plans with different contribution structures depending on income. Voluntary affiliation is high and CCSS today covers 89 percent of the total population. The one-step universalization was complemented by an incremental vertical integration of functions to address inefficiencies and overlaps in a fragmented health system. The mandate to provide health services, together with Ministry of Health facilities and employees, was transferred to the CCSS, which today operates as a national health insurance and pension fund, and administrator of the public health infrastructure. CCSS now has a legal mandate to extend its coverage to 100 percent of population, regardless of nationality or employment status.

**Thailand:** Building on a dualistic system in the transition to universal health care provision. A heavily subsidized insurance scheme for the poor, children and elderly was launched in 1975, and has since been gradually expanded. After adding two compulsory insurance schemes for public and private employees, and voluntary insurance schemes including private health insurance, over 80 percent of the population was covered in 1998. After a series of studies, the Thai government decided that the best way to move towards universal health insurance coverage was to start with a dual system for formal and informal sector before moving to a single-payer, national health insurance in the future. In 2001, the government launched a new health insurance policy, “30 bhat treat all”, to target the 20 percent of the population not yet covered by health insurance. For incidents other than accidents and emergencies, the insured must pay a contribution of 30 bhat per period. With this contribution, accessible health services are practically the same as for the other insurance schemes. After one year, 96.6 percent of the target population was registered under the new scheme.

**The Republic of Korea:** Gradual extension of compulsory pension and health care coverage in the 1980s, followed by vertical integration in the late 1990s. In the early 1980s,
pilot programs to cover the rural and urban poor were introduced and these were generalized by
the end of the decade to cover all rural and urban areas. Likewise, pension coverage has been
extended incrementally. First, self-employed workers in rural areas were covered, with the
government assuming two thirds of the 9 percent contribution, a subsidy that was phased out over
10 years. Later, self-employed workers in urban areas were covered on the same basis. After
expanding coverage via this segmented approach, Korea pursued an integrated system. In 1998,
the health insurance schemes for the self-employed (92 in rural and 135 in urban areas) merged
with the public insurance program for government and school employees. In 2000, the 142
schemes covering industrial workers merged into the National Health Insurance Corporation,
which became the single insurer. This resulted in all affiliates receiving the same statutory benefit
package and all health care providers being reimbursed according to a standard schedule. In 2001,
the schemes of government and school employees merged with that of industrial workers;
however, the incorporation of the fund of the self-employed was delayed to 2004.

Taiwan: From fragmented to universal coverage with a mandatory health insurance
scheme. In 1995, when Taiwan introduced legislation to create a mandatory national health
insurance scheme, only half of the population was covered by a social security scheme. At first,
the process seemed extremely rapid given the fact that one year later 92 percent of the population
was covered. However, the process in reality started more than a decade before in the Council for
Economic Planning and Development (CEPD). The first planning stage took two years of studies
and the original proposal included a project to phase in the nationwide insurance program
progressively until reaching universal coverage by the year 2000. The first pilot project for the
expansion started with well-organized farmers groups in 1987. Political events in the first half of
the 1990s created a strong political incentive to give priority to the fast expansion of social
security to the whole population. A careful analysis of the pilot projects and the lessons learned
from the farmers’ experiences and studies on trends of health expenditures allowed introducing the
legislation in 1995.


PROVIDING OLD-AGE INCOME SECURITY FOR THE POOR

The future of old age security in Mexico will depend on two key sets of decisions and
actions: (i) focused reform and rationalization of the existing social security system (as discussed
in section 4.1), and (ii) tackling Mexico’s old-age poverty problem. Mexico’s high rates of
poverty among the elderly given its level of development, combined with the progressive aging of
the Mexican population under current demographic trends, highlight the importance of
developing a pro-active approach to reducing the risk of poverty in old age as an integral part of
Mexico’s social protection system. Options used by different countries are related to the
implementation of targeted non-contributory pension. In what follows there is a discussion of the
pros and cons of these systems and the experience of several countries.

Pension systems, both public and private, are the primary means of providing
financial security to the elderly and to those unable to work due to disability. Because
pensions are designed to replace income previously earned, they usually apply only to those in the
labor force. Because they are often funded by payroll taxes, they also have implications for labor
costs and employment. The three main goals of pension systems are: (i) to provide a savings
vehicle (to allow individuals to redistribute across their own lifetime to avoid poverty in old age);
(ii) providing a social safety net for those who become unable to work (insurance); and (iii) to
redistribute from the rich to the poor to prevent poverty in old age.

When the challenge is to expand pension coverage, if more than one program or
mechanism is devised, they have to be designed as part of one integral system. For example,
Non-contributory systems may reduce incentives to formalization for both businesses and workers. Consequently, when using these systems it is essential to structure benefits for subsidized pensions so that only the poor want them, i.e., a minimum pension or a very basic package of health services. Modest benefits thus prompt a form of self-targeting mechanism. If a focus is kept on contributions, the informal workforce that generally includes the poorer segments of the population remains uncovered. Most systems operate with a combination of contributory social insurance and non-contributory social assistance structured around minimum benefits. Giving more weight to the latter can increase coverage but requires a country to generate the fiscal space needed to increase current expenditures permanently. Box 4.2 provides a summary discussion of the pros and cons of implementing targeted, non-contributory benefit plans for the elderly.

**Box 4.2: Pros and Cons of introducing a targeted, non-contributory benefit program into the social protection system include the following:**

The **major strengths** of introducing a targeted non-contributory benefit program include:
(i) Covering the risk of poverty among the elderly with a system that is "blind" to labor market history; and (ii) "Erasing" the distinction between "formal" and "informal" at least with respect to poverty in old age.

The **major weaknesses** of introducing a targeted non-contributory benefit program are:
(i) The system, depending on the benefit levels it provides, can introduce disincentives for people to participate in and contribute to the contributory system, which they need to do to help them smooth consumption, and which is desirable because the more participants, the better the system works (this is true whether public pooling or private individual savings); and (ii) Fiscal costs could quickly get out of hand since at least one of the eligibility criteria (old age) will be met by most people; this is no small "con" and there are plenty of examples worldwide where, because of poor targeting, the non-contributory component ends up creating enormous fiscal outlays.

**In what ways can these weaknesses be addressed?**

- The incentive issue can be addressed by making the non-contributory benefit modest, (the Chilean benefit is 30 percent of the minimum wage)
- Fiscal and incentive issues can be addressed by adopting an "insurance" concept of coverage, i.e., only those that suffer the bad state (poverty in old age) actually get the benefit, but all are "covered" (just as in any insurance program, participants are covered though the risk of the eventuality occurring is small)
- Fiscal problems can also be minimized by making the non-contributory benefit taxable, along with all other sources of income (this also encourages participation in the tax system – to receive the benefit, one must file a tax claim).
- Costs can also be minimized – particularly targeting costs – by piggybacking on an existing, well-targeted poverty program, like Oportunidades. Chile has done this by designing a special version of the Puente program (see below) for elderly households
- Large savings can arise from creating time-flexible parameters around age criteria for eligibility, as life-expectancy changes, both for the contributory and the non-contributory systems. Many fiscal problems arise simply because old-age benefit programs are not designed at their inception to take into account the reality of changes in life expectancy over time.
Non-contributory, universal benefits are simple to administer and may be effective in combating old-age poverty but impose high fiscal burdens. As pointed out by Packard (2004), a universal benefit system does away with the entire covered/uncovered debate, as it by definition covers the entire population. Universal benefits have many advantages over both orthodox, contributory systems and non-contributory systems targeted to the poor— they are the simplest public poverty-prevention mechanism to administer, with the lowest transaction costs. At the same time, universal benefits can be extremely costly and are viewed by many as a luxury only available to high-income nations such as New Zealand (see section 4.5, Box 4.5). While many countries, including Denmark and the Netherlands, have universal elements to their pension systems, New Zealand appears to be the only one where all state provision is made through a universal flat pension. With its current low capacity to raise general revenue, it is not clear how Mexico could sustain the financial burden of universal pension benefits.

Non-contributory and/or minimum pension guarantees targeted to the poor through means-testing can provide a more efficient use of funds by funneling scarce resources to the elderly poor, but are more challenging in terms of efficient administration. Non-contributory and/or minimum pension guarantees are often more akin to social assistance than insurance, and have been implemented in many Latin American countries (see Table 4.1). Minimum pension guarantees can be nested within existing contributory social security systems as seen in the Chilean example below or in the Mexican experience with IMSS, and typically target poor workers whose low contributions have resulted in an income after retirement that falls short of some pre-defined minimum level. The gap between the actual pensions received based on earlier contributions and the minimum level of income is filled by a social assistance cash transfer—financed by general tax revenue. Non-contributory pensions often function outside the formal social security system; others are nested in existing formal pensions systems, such as Brazil’s rural pension program (Box 4.3).

Table 4.1. Expenditure and Coverage of Non-Contributory Pension Programs

<table>
<thead>
<tr>
<th>Country</th>
<th>Expenditure as percentage of GDP</th>
<th>Expenditure as percentage of total expenditure on Social Security</th>
<th>Expenditure as percentage of total Social Sector Spending</th>
<th>Percentage financed from general revenues</th>
<th>Coverage: Old Age Beneficiaries as percentage of Elderly Poor</th>
</tr>
</thead>
<tbody>
<tr>
<td>Argentina</td>
<td>0.2%</td>
<td>4%</td>
<td>1%</td>
<td>100%</td>
<td>47a</td>
</tr>
<tr>
<td>Brazil</td>
<td>0.3%</td>
<td>5%</td>
<td>2%</td>
<td>100%</td>
<td>86b</td>
</tr>
<tr>
<td>Chile</td>
<td>0.4%</td>
<td>6%</td>
<td>2%</td>
<td>92%</td>
<td>37c and 79d</td>
</tr>
<tr>
<td>Costa Rica</td>
<td>0.3%</td>
<td>7%</td>
<td>2%</td>
<td>48%</td>
<td>45d</td>
</tr>
<tr>
<td>Uruguay</td>
<td>0.6%</td>
<td>6%</td>
<td>3%</td>
<td>100%</td>
<td>17 and 12c</td>
</tr>
</tbody>
</table>

Notes:
- b. Share of recipients 67 and over with per capita income less than ½ minimum wage receiving a pension (assistance or rural), 1999
- c. Share of recipients 65 and over in deciles 1 and 2, urban and rural areas, 2000
- d. Share of poor aged 65 and over, 2000


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49 Willmore (2000).
Box 4.3: Latin-American Experience with Non-Contributory Pensions and Minimum Pension Guarantees

Extending pension coverage to the poor when informality is high: Brazil’s experience with non-contributory pension programs.

Brazil has achieved remarkable declines in old-age poverty, largely due to two non-contributory pension programs with uniform benefits.

- A rural scheme covers about 7 million with benefits, including pensions for old age, survivors and invalidity, as well as benefits for maternity and occupational accidents. Benefits are calculated based on the minimum wage, while eligibility is based on length of service in agriculture, fisheries etc.

- The Beneficio de Prestação Continuada provides a pension of one minimum salary paid to the elderly and disabled in households with per capita family income less than one-fourth the minimum salary. The Beneficio de Prestação Continuada is the largest spending category within social assistance in Brazil and accounted for 45 percent of social assistance spending in 2002.

Estimates of effective poverty reduction do not differentiate between the different types of pensions; however, when looking at the impact of all pensions on beneficiaries, destitution is reduced by about 96 percent and poverty by 29 percent. While the programs strongly reduce poverty, they also contribute to Brazil’s fragile fiscal situation.

Chile: Reducing poverty with a combination of targeted non-contributory pensions and minimum pension guarantees for affiliates of public social security

The Chilean pension system combines a minimum pension guarantee (MPG) for registered workers with a social assistance pension (PASIS) targeted to poor, informal workers. The MPG is available for all insured workers that have reached a contribution threshold of 20 years, as long as the sum of pensions, income and remuneration is equal to less than the minimum pension. The workers have earned the right to an annuity initially financed out of the funds in their individual accounts. When these funds are exhausted, the shortfall is financed with a transfer from the government. Both the MPG and the PASIS are financed from general revenue, primarily VAT. Coverage of PASIS increased significantly in the period 1990-2000, and statistics show that the social assistance pension also increasingly reduced poverty over the decade. The effect is strongest amongst the extreme poor, where by 2000 poverty had fallen by 69 percent in households benefiting from the PASIS. Finally, the program also became more progressive, with beneficiaries from the first quintile growing from 35 percent in 1990 to 53 percent in 2000.


What are the key linkages and complementarities between contributory and non-contributory pensions? The growing importance of non-contributory pensions will in the long run lead to an unsustainable financial situation for the overall pension system. As such, tax-financed benefits should not replace contributory pension schemes. Along the same lines, in a financially sustainable pensions system, contributory schemes need to cover more than a minority of the population. Improving the efficiency of collection of contributions remains crucial. Along the same lines, non-contributory pension benefits must be structured in a way so as not to provide disincentives to pay contributions. This has shown to be a particular concern when non-

contributory pensions are combined with a minimum benefit component for contributory programs, as workers can continue to evade contribution, and still be guaranteed of receiving the same minimum amount.

The ability to operate non-contributory schemes hinges on the ability to finance them via general tax resources, which explains why they are most widely used in developed countries. Most developing and middle-income countries struggle with thin tax bases and problematic tax collection in general. In addition, scarce revenues lead to a range of competing priorities, and the sustainability of a universal scheme is easily questioned from one year to another in response to changing economic and political conditions. For instance, the gross cost of the New Zealand universal pension scheme represented 5 percent of GDP in 2001, and is estimated to rise to about 10 percent of GDP by 2051. Reforming social insurance systems with a view to expand coverage in most cases entails giving more weight to non-contributory pensions.

STRIKING THE RIGHT BALANCE BETWEEN ADDRESSING VULNERABILITY AND COMBATING CHRONIC POVERTY

The priority reforms discussed above – reforming the social security systems for public sector workers to restore fiscal soundness, extending health insurance coverage to the poor, and addressing old-age poverty – are all crucial steps toward a more effective and equitable social protection system. Yet, these changes alone will likely be insufficient in creating a cohesive, comprehensive SP strategy that can successfully address the needs of the most vulnerable in society – the chronic poor.

From international evidence we know that the chronic poor are equally, if not more, prone to experiencing income shocks. At the same time they are the least endowed with risk management tools to respond effectively to those shocks in the absence of effective public policies. As a result, transitory movements in income are more frequent among the chronic poor, recovery periods tend to be longer, while movements out of poverty are often short-range, with a high probability of recidivism. A comprehensive social protection strategy will include both the traditional risk management mechanisms and targeted policies designed to address the heightened vulnerability and thus, persistent poverty of the chronic poor. First, coverage of traditional risk management instruments need to be extended. Second, targeted redistributive transfers need to address the income vulnerability and lower physical and human endowments among the chronic poor such policies would involve. Ideally, all components of the social protection system—whether aimed primarily at risk management or primarily at redistribution and poverty reduction—need to be linked and form an integrated approach consistent with the nation’s broader social protection strategy.

Chile’s experience in the 1990s offers an example of how traditional social policies, regardless of how aggressive, can fail in reaching a hard core of chronic poor. To meet the challenge posed by this particularly resilient concentration of poverty, Chile switched toward a new and innovative poverty eradication strategy focused on integrated, family and community-centered interventions (Box 4.4).

How could Mexico proceed to strike the right balance between interventions addressing short-term vulnerability to risks and programs aimed at alleviating long-term structural, poverty? To meet this challenge, traditional social insurance mechanisms will need to be linked to other components of the social protection system, particularly assistance components. The entire system will also need horizontal coordination and design features that promote dynamism, flexibility and positive incentives to move up and out of the assistance
system into the traditional social insurance network and labor market. Finally, design features that promote coordination across programs in response to the multi-dimensional needs of the poorest families are fundamental. Chile Puente is designed for exactly this purpose. As shown above, it promotes tailored bundles of programs from the Chile Solidario strategy to answer the specific needs of particularly hard to reach households, providing a ‘bridge’ for these neediest families into the social insurance network.

The past decade has seen impressive efforts in designing asset generating and multidimensional social assistance interventions to combat extreme poverty in Mexico (i.e., Oportunidades), yet these programs do not constitute a perfect substitute for formal risk pooling mechanisms, nor do they represent a concerted move toward a more cohesive overall social protection system. Conditional cash transfer programs facilitate risk management in some areas, e.g., by lowering the risk of school non-attendance and protecting consumption in times of crises, however they often do not correlate with other risks frequently faced by households, particularly adult household members, such as job loss, natural disasters or health problems (Rawlings 2004). Recent evidence suggests that while Oportunidades enables income smoothing over time, the program does not appear to provide any additional insurance or protection benefit over and above that of existing programs and informal mechanisms (Skoufias, 2004). In addition, Oportunidades has worked largely in isolation from other social assistance or insurance initiatives. A key challenge here is to build links between Oportunidades and other programs and to structure the set of programs in such a way that incentives for moving up and out of social assistance are built into the programs.

Box 4.4: Chile’s Puente Program

Despite steady declines in poverty over the last two decades in Chile, the share of the population in extreme poverty has remained virtually constant at just above 4.2 percent. The existence of this hard core of chronic poverty seemingly unresponsive to existing policies and programs, spurred the formulation of a new poverty reduction strategy, Chile Solidario. The proactive approach of the strategy and its most prominent component—Chile Puente—differ substantially from the norm for social programs in the region.

Puente acts as an entry point to the social protection system for the 225,000 households targeted by the Chile Solidario initiative. It combines a temporary cash transfer with intensive family-based psychosocial support and is based on proactivity, a strong family focus, and a coordinated response. Apoyos Familiares (AF) follow assigned households for 24 months, providing psychosocial support as the family seeks to improve its living conditions. The characteristics of Puente beneficiaries largely coincide with the characteristics of structural or chronic poor in Chile. The four principal components of the program are:

- **Psychosocial support** to the household via the relation that the AF establishes with each family assigned to them in the homes of these families;

- **Training and education of the AF**, based on developing knowledge of the benefits and characteristics of the Program and to transfer a methodology for working with the families;

- **A regional fund for initiatives** made up of private and public sources to finance services or benefits currently not in place, that are required by the families to reach one or more of the defined minimum conditions of well-being; and

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Monitoring and evaluation: An online system used by the AF gathers all family information that emerges from the work sessions. Based on this system, the advancement of the program can then be viewed in each municipality, province, and region, or at the country level at whole. The system also provides statistics on main characteristics of participating families, achievements of minimum conditions after intervention, and the mobilization of resources in favor of the families.

Sources: MIDEPLAN (2003), Secretaría Ejecutiva Sistema Chile Solidario (2003); Packard (2004).

One way to improve coordination is to tackle existing overlap among agencies providing benefits and services, particularly in social assistance. Social assistance in Mexico is dominated by the flagship program Oportunidades. A few of other programs have taken the same integrative approach, including Hábitat and Microrregiones. However, the efficiency of operating a multitude of other programs is questionable especially with regard to potential overlap and duplication of efforts. The effectiveness is also uncertain due to the fact that many of these smaller programs lack rigorous monitoring and evaluation mechanisms, and are so small that in fact extensive impact evaluation would not be cost effective. These concerns have spurred debate on possible rationalization and consolidation, especially when put in the context of the more integrated and dynamic approach to assistance envisaged by the Contigo strategy. Indeed, one of the transversal issues emphasized in the Contigo strategy is the need for integration, i.e., the need to encourage efficient social spending by exploiting synergies, eliminating duplication and ensuring coherence in different program objectives. In general, poor implementation of the principles applied in Oportunidades and conceptualized in the Contigo strategy is a problem across the social assistance spectrum. How can Mexico build upon its established success in Oportunidades to bring reform to other areas of the system? The strengthening and expansion of good programs such as Oportunidades is a positive trend and in many aspects a direct result of rigorous monitoring and evaluation. The continued existence and resilience to change of the not-so-good programs is a problem, and often linked to the lack of standardized monitoring and evaluation. Finally, the Contigo strategy itself is being challenged on different fronts. By focusing on responding to changing needs and risks across the lifecycle, important dimensions of risk and vulnerability may be lost, such as spatial differences, ethnicity and the distinction between chronic and transient poor. Addressing the needs of the chronic poor likely requires a greater emphasis on redistribution via social protection policies, more than what the current social assistance framework and expenditure envelope allows for. Finally, beyond SEDESOL, from which the Contigo framework emerged, there is less ownership and therefore acceptance of the basic principles, which could in part explain why the framework has not been operationalized more extensively.

A second challenge is posed by the insufficient linkages and coordination both between programs within the social protection systems (internal coherence) and between social protection and policies in other sectors of the economy (external coherence). Coherence and coordination also affect how dynamically the system is able to perform. This debate can be illustrated by taking the example of Oportunidades and its linkages to other programs and sectors. The program has been very successful in its impact on the health and education outcomes for extreme poor infants and youths in rural areas. The poverty alleviation impact is however determined by whether increased human capacity translates into a higher earning capacity, which again depends on interactions between Oportunidades graduates and the labor market and/or the agricultural sector. While the return to human capital is determined by other sectors of the economy, graduates are still in need of insurance and assistance. If graduates enter into the informal sector, having no health insurance makes them as vulnerable to catastrophic health shocks as the next person. At the same time, there is no reason why poor
mothers should be in less need of health benefits after their children graduate from the program. Jóvenes con Oportunidades is an attempt to build dynamic linkages that addresses some of these issues. First, it creates bridges to other programs in the social protection system. For instance, the savings earned and received upon graduation can be used to buy health insurance (Seguro Popular) or to enter into the government’s housing credit program (Tu Casa). A dynamic link to other economic sectors is created by supplementing the human capital of graduates with access to credit markets, as the savings can also be used as collateral for micro-credit or as a down payment on a house. Jóvenes con Oportunidades is a nascent program and its impact has not yet been formally evaluated. However the approach taken illustrates how linkages between sectors and programs can be used to create incentives and assistance for beneficiaries to move ‘up and out’ of the system.

Clarity of objectives and a transparent operation of programs are keys to a more coherent and balanced social protection strategy. In order to build a more cohesive social protection strategy, the objectives of individual programs need to be clearly stated to facilitate evaluation, avoid possible duplication of efforts, and assist overall coordination.

Finally, to reach special groups and to increase the responsiveness of the social protection system to particularly excluded groups, countries have tailored their social protection delivery systems to meet ‘customer’ needs rather than mimicking government structures. Australia and Canada are among the leading countries in terms of customer-centered delivery of social services (see Box 4.7). The principle for both countries’ delivery systems is to provide services along the lifecycle, rather than on the basis of governmental structures. Their experience also shows that Information Technology (IT) offers great opportunities to support the social protection system, in particular in terms of increasing responsiveness through a restructured delivery system. Again, IT systems used in social protection have been focused on the requirements and expectations of citizens rather than on the organizational structures of government institutions. For customer-centered solutions to be successful, stove-piped operations are often turned into a single-point-of-contact system (one-stop shop) that allows integrated delivery of social services via physical or electronic channels. Chile Puente also takes a one-stop shop approach by providing the extreme poor with a single entry point to the programs and benefits of the country’s social protection system. The Chilean program pushes the customer-centric approach one step further by actively seeking out the hard-to-reach, extreme poor, in a sense ‘recruiting’ them for the program.

Structural determinants of chronic poverty, such as discrimination and high levels of inequality, call for a broader set of policy interventions. While a mix of risk pooling mechanisms and redistributive transfers is necessary to address the problem of chronic poverty, it might not be sufficient in dealing with social and economic structures that obstruct escape from poverty for certain groups or individuals. Tackling chronic poverty requires a multidimensional, integrated response, beyond the narrow scope of social protection.

Box 4.5: Australia’s Centrelink: A government agency set up to provide a “One-stop shop” for a range of government services

Centrelink is a public service provider, established to produce more efficient and streamlined delivery of government services. The agency offers a one-stop shop for a range of services on behalf of 25 government agencies including ten ministries (departments). Main features of this one-stop shop are:
A customer-centered organizational structure: The organization of Centrelink services is based on the requirements and expectations of citizens rather than on the organizational structures of government institutions. Customer service networks include customer service centers, call centers, and other specialist customer service outlets and community agents.

Using information technology: Centrelink’s comprehensive website operates as an information hub for all the different governmental services and programs. Customers can access and update personal information, including income statements. They can also estimate eligibility for different programs as well as file requests for certain services. In addition to the website, Centrelink Call comprises 27 networked call centers located around Australia, and automated systems are widely used.

Social justice and equity in access and service delivery: Centrelink uses a range of measures to ensure that customers have equitable access to products and services, and that people are not disadvantaged by service delivery arrangements. Department of Immigration, Multicultural and Indigenous Affairs customers review the center each year to ensure that customers receive fair and equitable treatment.

Source: www.centrelink.gov.au

FINAL REMARKS

To summarize, this chapter has focused on four key emerging issues within social protection in Mexico: (i) social security reform, (ii) health risks among the poor, (iii) old-age poverty, and (iv) the need to balance public risk management mechanisms with a more integrated strategy to combat chronic poverty.

In order to tackle these challenges, Mexico faces a range of political choices. Firstly, how much redistribution? As discussed below, the role of social protection policy in promoting redistribution is not clear-cut. While largely a question of national preference, the answer also hinges on the ability to raise tax revenues and the political will to redirect subsidies currently benefiting less needy segments. A second set of questions emerge in relation to the choice of institutional design. The current system based on a payroll-financed social security system for formal sector employees may be reformed in order to increase its efficiency. Expanding coverage requires, among other, improving the value for money, improving the quality of services. Raising the quality in service provision is critical to achieving better outcomes, yet requires a political commitment to altering accountability relationships between different levels of government, service providers and the ultimate beneficiaries. It also requires complementary reforms to labor market legislation as to reduce the costs of formality. Also, even if it maintains a dualistic structure, it may be complemented by targeted social assistance to the very poor, strengthening the latter. Alternatively, some countries move to a single benefit system with universal –at least minimum- coverage, de-linked social protection benefits from the labor market. Implicitly, this alternative also questions Mexico’s ability to undertake the tax reforms needed to support a model funded by general revenues.

How much redistribution?

How much will Mexico seek to use social protection policy as a vehicle for redistribution? As discussed in Chapter 1, the state has a clear role in providing risk-pooling mechanisms where private insurance markets fail (e.g., old age and health insurance), but the role of social protection policy in promoting redistribution is more an issue of national choice. That choice, however, has clear consequences for equity and poverty reduction outcomes. The
economic trade-off between growth and equity, and thus between growth and redistribution, has been refuted by both theoretical advances and international experience in recent years. At the same time, redistribution is bound to result in some economic efficiency trade-off, as exemplified in the design of social security systems where redistribution typically creates labor market distortions (Orszag and Stiglitz, 2000). For instance, the change from a defined benefit system where everybody gets the same benefits regardless of contribution, to a defined contribution system where benefit levels are linked to contributions, enhances incentives to participate. At the same time it reduces the progressiveness of the system. Indeed, international experience points to examples where redistribution has been achieved in a wide variety of ways. It was done via land reform and education in Korea, via affirmative action in Malaysia or via aggressive social policies in Chile, to name but a few examples. The choice is therefore two-fold: how much distribution; and through which means? The relative importance given to redistribution and the role assigned to the social protection system in achieving equity objectives is a question of national objectives, but is crucial to guiding the direction of social protection policy reform.

Should risks be bundled?

While the Seguro Popular and Seguro de Salud para la Familia are designed to extend health insurance to the uncovered, this population is also in need of protection against other risks, in particular related to old age. Despite national recognition of the need for extended pension coverage, the country faces several challenges as to how to do this, i.e., whether increase the efficiency of the current social security system, use targeted social assistance pensions or move towards universal pensions. However, Seguro Popular sets a precedent and critical issues of institutional and operational design will have to be addressed before moving towards more coherent and integrated social insurance. For instance, the institutional design of Seguro Popular suggests a continued dualistic system; however, how would a pension’s scheme for the uncovered fit in this picture? Should old-age insurance be bundled together with the Seguro Popular, thus reinforcing the dualistic character of the system? If bundled with health insurance, would it make sense for the ministry of health to maintain stewardship? If not, is there a need for a new, fully-fledged social security institute operating alongside IMSS? And finally, should operation and provision of the pension benefits be decentralized to states as has been the case for the Seguro Popular? Answers to these questions depend on political factors and an institutional context particular to Mexico. However, it is clear that the current fiscal situation limits the range of feasible options and that fiscal reform will be a prerequisite for the establishment of a truly integrated social insurance system.

Should social protection be de-linked from the labor market?

A review of international experience shows that countries choose to do this very differently, but few (in fact, only New Zealand) actually go all the way in fully de-linking social insurance schemes from the labor market. Far more commonly, countries vary in how far they choose to go in de-linking the system, that is, how they mix and match contributory and non-contributory schemes, and whether the system design is dualistic (with separate providers for formal and informal sector) or universal (national insurer that covers both sectors). Evidence indicates that if the aim is to improve low coverage of social insurance among the poor, relatively more emphasis needs to be placed on developing non-contributory schemes. However, many countries have contributory programs for informal workers and extending coverage to the informal sector – poor and non-poor – often implies tailored schemes that accommodate the different needs and capacity to contribute of distinct population groups.
## APPENDIX TABLES

### Table 1. Mexico. Leading Indicators of Social Risk by Age, Region, and Poverty Lines, 1996

<table>
<thead>
<tr>
<th>Population Group/ Main Risk</th>
<th>Leading Risk Indicators</th>
<th>Indicator Value, Urban Area</th>
<th>Indicator Value, Rural Area</th>
</tr>
</thead>
<tbody>
<tr>
<td></td>
<td></td>
<td>SEDESOL</td>
<td>SEDESOL</td>
</tr>
<tr>
<td><strong>Ages 0–5:</strong></td>
<td></td>
<td>PL1</td>
<td>PL2</td>
</tr>
<tr>
<td>School attendance (age 5 only)</td>
<td>69.5%</td>
<td>72.3%</td>
<td>78.6%</td>
</tr>
<tr>
<td><strong>Ages 6–14:</strong></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>Low human capital development</td>
<td>School attendance (ages 6–11)</td>
<td>95.5%</td>
<td>95.9%</td>
</tr>
<tr>
<td>Age-for-grade* (ages 6–11)</td>
<td>1.04</td>
<td>1.04</td>
<td>1.03</td>
</tr>
<tr>
<td>Prop. not in correct Age-for-grade</td>
<td>28.50</td>
<td>27.50</td>
<td>22.90</td>
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<tr>
<td>School attendance (ages 12–14)</td>
<td>80.6%</td>
<td>82.1%</td>
<td>85.9%</td>
</tr>
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<td>Age-for-grade (ages 12–14)</td>
<td>1.14</td>
<td>1.13</td>
<td>1.10</td>
</tr>
<tr>
<td>Prop. not in correct Age-for-grade</td>
<td>51.47</td>
<td>49.00</td>
<td>41.75</td>
</tr>
<tr>
<td>Low human capital</td>
<td>Child working not in school (ages 12–14)</td>
<td>5.9%</td>
<td>5.4%</td>
</tr>
<tr>
<td>Housekeeping and not in school (ages 12–14)</td>
<td>7.8%</td>
<td>7.4%</td>
<td>5.7%</td>
</tr>
<tr>
<td></td>
<td></td>
<td>0.3%</td>
<td>0.3%</td>
</tr>
<tr>
<td></td>
<td>Male</td>
<td>15.2%</td>
<td>14.3%</td>
</tr>
<tr>
<td></td>
<td>Female</td>
<td>2.4%</td>
<td>2.0%</td>
</tr>
<tr>
<td>Violence/crime</td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td></td>
<td>Inactivity—neither work nor attend school (ages 12–14)</td>
<td></td>
<td></td>
</tr>
<tr>
<td><strong>Ages 15–24:</strong></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>Low human capital development</td>
<td>School attendance (ages 15–17)</td>
<td>47.7%</td>
<td>49.6%</td>
</tr>
<tr>
<td>School attendance (ages 18–24)</td>
<td>13.2%</td>
<td>15.1%</td>
<td>18.3%</td>
</tr>
<tr>
<td>University enrollment (ages 18–24)</td>
<td>4.3%</td>
<td>5.0%</td>
<td>7.4%</td>
</tr>
<tr>
<td>Population Group/ Main Risk</td>
<td>Leading Risk Indicators</td>
<td>Indicator Value, Urban Area</td>
<td>Indicator Value, Rural Area</td>
</tr>
<tr>
<td>-----------------------------</td>
<td>-------------------------</td>
<td>-----------------------------</td>
<td>-----------------------------</td>
</tr>
<tr>
<td></td>
<td></td>
<td>SEDESOL</td>
<td>SEDESOL</td>
</tr>
<tr>
<td></td>
<td></td>
<td>PL1</td>
<td>PL2</td>
</tr>
<tr>
<td>Low human capital</td>
<td>□ Housekeeping and not in school (ages 15–17)</td>
<td>14.0%</td>
<td>7.4%</td>
</tr>
<tr>
<td></td>
<td>Male</td>
<td>1.4%</td>
<td>1.2%</td>
</tr>
<tr>
<td></td>
<td>Female</td>
<td>29.9%</td>
<td>30.0%</td>
</tr>
<tr>
<td></td>
<td>□ Housekeeping and not in school (ages 18–24)</td>
<td>29.1%</td>
<td>27.0%</td>
</tr>
<tr>
<td></td>
<td>Male</td>
<td>0.8%</td>
<td>0.8%</td>
</tr>
<tr>
<td></td>
<td>Female</td>
<td>51.6%</td>
<td>49.0%</td>
</tr>
<tr>
<td>Low income</td>
<td>□ Unemployment (ages 15–24) Male</td>
<td>21.3%</td>
<td>19.5%</td>
</tr>
<tr>
<td></td>
<td>Female</td>
<td>13.0%</td>
<td>12.4%</td>
</tr>
<tr>
<td>Violence/crime</td>
<td>□ Inactivity (ages 15–17)</td>
<td>7.8%</td>
<td>7.3%</td>
</tr>
<tr>
<td></td>
<td>□ Inactivity (ages 18–24)</td>
<td>10.1%</td>
<td>9.3%</td>
</tr>
<tr>
<td>Ages 25–64:</td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>Low income</td>
<td>□ Unemployment: Male</td>
<td>4.6%</td>
<td>4.4%</td>
</tr>
<tr>
<td></td>
<td>Female</td>
<td>2.5%</td>
<td>2.6%</td>
</tr>
<tr>
<td></td>
<td>□ Part-time job (as % of all employed)</td>
<td>20.3%</td>
<td>19.7%</td>
</tr>
<tr>
<td></td>
<td>□ No education or incomplete primary (low skills) (ages 25–40)</td>
<td>36.7%</td>
<td>33.2%</td>
</tr>
<tr>
<td></td>
<td>□ No education or incomplete primary (low skills) (ages 41–64)</td>
<td>69.9%</td>
<td>66.8%</td>
</tr>
<tr>
<td></td>
<td>□ Receives pension (ages 41-64)</td>
<td>3.2%</td>
<td>3.4%</td>
</tr>
<tr>
<td>Ages 65+:</td>
<td>Low income</td>
<td>□ Receives pension</td>
<td>7.9%</td>
</tr>
<tr>
<td>General population:</td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>Low-quality housing</td>
<td>□ No piped water</td>
<td>13.9%</td>
<td>13.0%</td>
</tr>
<tr>
<td></td>
<td>□ No piped sewerage</td>
<td>32.8%</td>
<td>29.6%</td>
</tr>
<tr>
<td></td>
<td>□ No electricity</td>
<td>2.0%</td>
<td>1.7%</td>
</tr>
</tbody>
</table>

*Age-for-grade is calculated as [(age—grade) + 1]/6, such that an individual in the appropriate grade for age will have an age-for-grade equal to 1, whereas an individual in a lower grade than appropriate for his or her age will have an age-for-grade greater than 1.
### TABLE 2. MEXICO. LEADING INDICATORS OF SOCIAL RISK BY AGE, REGION, AND POVERTY LINES (SEDESOL), 2002

<table>
<thead>
<tr>
<th>Population Group/ Main Risk</th>
<th>Leading Risk Indicators</th>
<th>Indicator Value, Urban Area</th>
<th>Indicator Value, Rural Area</th>
</tr>
</thead>
<tbody>
<tr>
<td></td>
<td></td>
<td>SEDESOL PL1</td>
<td>SEDESOL PL2</td>
</tr>
<tr>
<td><strong>Ages 0–5:</strong></td>
<td>□ School attendance (age 5 only)</td>
<td>75.6%</td>
<td>79.2%</td>
</tr>
<tr>
<td><strong>Ages 6–14:</strong></td>
<td>□ School attendance (ages 6–11)</td>
<td>94.8%</td>
<td>95.0%</td>
</tr>
<tr>
<td>Low human capital development</td>
<td>□ Age-for-grade* (ages 6–11)</td>
<td>1.05</td>
<td>1.04</td>
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<tr>
<td></td>
<td>Prop. not in correct Age-for-grade</td>
<td>30.92</td>
<td>28.65</td>
</tr>
<tr>
<td></td>
<td>□ School attendance (ages 12–14)</td>
<td>88.5%</td>
<td>87.2%</td>
</tr>
<tr>
<td></td>
<td>□ Age-for-grade (ages 12–14)</td>
<td>1.14</td>
<td>1.13</td>
</tr>
<tr>
<td></td>
<td>Prop. not in correct Age-for-grade</td>
<td>50.22</td>
<td>48.71</td>
</tr>
<tr>
<td>Low human capital</td>
<td>□ Child working not in school (ages 12–14)</td>
<td>4.1%</td>
<td>5.0%</td>
</tr>
<tr>
<td></td>
<td>□ Housekeeping and not in school (ages 12–14)</td>
<td>3.6%</td>
<td>3.2%</td>
</tr>
<tr>
<td>Violence/crime</td>
<td></td>
<td>Male</td>
<td>0.8%</td>
</tr>
<tr>
<td></td>
<td>Female</td>
<td>6.4%</td>
<td>6.0%</td>
</tr>
<tr>
<td><strong>Ages 15–24:</strong></td>
<td>□ Inactivity—neither work nor attend school (ages 12–14)</td>
<td>1.0%</td>
<td>0.9%</td>
</tr>
<tr>
<td>Low human capital development</td>
<td>□ School attendance (ages 15–17)</td>
<td>49.3%</td>
<td>52.9%</td>
</tr>
<tr>
<td></td>
<td>□ School attendance (ages 18–24)</td>
<td>12.7%</td>
<td>14.5%</td>
</tr>
<tr>
<td></td>
<td>□ University enrollment (ages 18–24)</td>
<td>52.4%</td>
<td>47.0%</td>
</tr>
<tr>
<td>Population Group/ Main Risk</td>
<td>Leading Risk Indicators</td>
<td>Indicator Value, Urban Area</td>
<td>Indicator Value, Rural Area</td>
</tr>
<tr>
<td>-----------------------------</td>
<td>-------------------------</td>
<td>-----------------------------</td>
<td>-----------------------------</td>
</tr>
<tr>
<td></td>
<td></td>
<td>SEDESOL PL1</td>
<td>SEDESOL PL2</td>
</tr>
<tr>
<td>Low human capital</td>
<td>□ Housekeeping and not in school (ages 15–17)</td>
<td>12.9%</td>
<td>14.4%</td>
</tr>
<tr>
<td></td>
<td></td>
<td>Male</td>
<td>0.0%</td>
</tr>
<tr>
<td></td>
<td></td>
<td>Female</td>
<td>25.4%</td>
</tr>
<tr>
<td></td>
<td>□ Housekeeping and not in school (ages 18–24)</td>
<td>27.2%</td>
<td>27.9%</td>
</tr>
<tr>
<td></td>
<td></td>
<td>Male</td>
<td>1.0%</td>
</tr>
<tr>
<td></td>
<td></td>
<td>Female</td>
<td>48.7%</td>
</tr>
<tr>
<td>Low income</td>
<td>□ Unemployment (ages 15–24) Male</td>
<td>12.3%</td>
<td>10.9%</td>
</tr>
<tr>
<td></td>
<td></td>
<td>Female</td>
<td>7.5%</td>
</tr>
<tr>
<td>Violence/crime</td>
<td>□ Inactivity (ages 15–17)</td>
<td>5.2%</td>
<td>5.0%</td>
</tr>
<tr>
<td></td>
<td>□ Inactivity (ages 18–24)</td>
<td>5.2%</td>
<td>4.5%</td>
</tr>
<tr>
<td>Ages 25–64:</td>
<td>□ Unemployment: Male</td>
<td>5.7%</td>
<td>5.0%</td>
</tr>
<tr>
<td></td>
<td></td>
<td>Female</td>
<td>1.7%</td>
</tr>
<tr>
<td></td>
<td>□ Part-time job (as % of all employed)</td>
<td>27.7%</td>
<td>26.4%</td>
</tr>
<tr>
<td></td>
<td>□ No education or incomplete primary (low skills) (ages 25–40)</td>
<td>29.0%</td>
<td>25.7%</td>
</tr>
<tr>
<td></td>
<td>□ No education or incomplete primary (low skills) (ages 41–64)</td>
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<td>57.1%</td>
</tr>
<tr>
<td>Ages 65+:</td>
<td>□ Receives pension (ages 41–64)</td>
<td>1.5%</td>
<td>2.7%</td>
</tr>
<tr>
<td>Low income</td>
<td>□ Receives pension</td>
<td>6.7%</td>
<td>8.4%</td>
</tr>
<tr>
<td>General population:</td>
<td>□ No piped water</td>
<td>13.9%</td>
<td>12.0%</td>
</tr>
<tr>
<td></td>
<td>□ No piped sewerage</td>
<td>28.5%</td>
<td>28.0%</td>
</tr>
<tr>
<td></td>
<td>□ No electricity</td>
<td>0.8%</td>
<td>0.7%</td>
</tr>
</tbody>
</table>

*Age-for-grade is calculated as [(age—grade) + 1]/6, such that an individual in the appropriate grade for age will have an age-for-grade equal to 1, whereas an individual in a lower grade than appropriate for his or her age will have an age-for-grade greater than 1.

Source: INEGI household survey: ENIGH 2002
## TABLE 3. MEXICO. COVERAGE AND INCIDENCE OF SOCIAL PROGRAMS TARGETED TO KEY SOCIAL RISKS, BY REGION AND POVERTY LINES (SEDESOL), 1996

<table>
<thead>
<tr>
<th>Population Group/ Main Risk</th>
<th>Program Coverage</th>
<th>Indicator Value, Urban Area</th>
<th>Indicator Value, Rural Area</th>
</tr>
</thead>
<tbody>
<tr>
<td></td>
<td></td>
<td>SEDESOL PL1</td>
<td>SEDESOL PL2</td>
</tr>
<tr>
<td>Ages 0–5:</td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>Stunted development</td>
<td>□ Family receives <em>Progresa</em> transfers</td>
<td>n.a.</td>
<td></td>
</tr>
<tr>
<td></td>
<td>□ ECD coverage</td>
<td>n.a.</td>
<td></td>
</tr>
<tr>
<td>Ages 6–14:</td>
<td>□ Receives scholarship to attend school (6–11)</td>
<td>1.9%</td>
<td>2.0%</td>
</tr>
<tr>
<td></td>
<td>Receives scholarship to attend school (12–14)</td>
<td>1.9%</td>
<td>2.0%</td>
</tr>
<tr>
<td>Ages 15–24:</td>
<td>□ Receives scholarship to attend school (ages 15–17)</td>
<td>1.9%</td>
<td>1.6%</td>
</tr>
<tr>
<td></td>
<td>Receives scholarship to attend school (ages 18–24)</td>
<td>4.5%</td>
<td>4.0%</td>
</tr>
<tr>
<td>Ages 25–64:</td>
<td>□ Has attended training program</td>
<td>2.0%</td>
<td>2.7%</td>
</tr>
<tr>
<td></td>
<td>Has access to social security system</td>
<td>20.4%</td>
<td>23.2%</td>
</tr>
<tr>
<td></td>
<td>Receives ‘<em>ayuda alimentaria o dispensa</em>’</td>
<td>3.1%</td>
<td>3.9%</td>
</tr>
<tr>
<td>Ages 65+:</td>
<td>□ Receives pension</td>
<td>7.9%</td>
<td>10.6%</td>
</tr>
<tr>
<td>General population:</td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>Low-quality housing</td>
<td>□ Access to housing credit</td>
<td>4.0%</td>
<td>5.0%</td>
</tr>
<tr>
<td>(ages 25–64)</td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>Low access to savings/credit facilities</td>
<td></td>
<td></td>
<td></td>
</tr>
</tbody>
</table>

Source: INEGI household survey, ENIGH 1996
<table>
<thead>
<tr>
<th>Program Coverage</th>
</tr>
</thead>
<tbody>
<tr>
<td>Indicator Value, Urban Area</td>
</tr>
<tr>
<td>SEDESOL PL1</td>
</tr>
<tr>
<td>Indicator Value, Rural Area</td>
</tr>
<tr>
<td>SEDESOL PL1</td>
</tr>
</tbody>
</table>

<table>
<thead>
<tr>
<th>Population Group/ Main risk</th>
<th>Ages 6–14: Receives scholarship to attend school (6–11)</th>
<th>2.9%</th>
<th>2.8%</th>
<th>2.9%</th>
<th>2.4%</th>
<th>29.4%</th>
<th>29.8%</th>
<th>27.1%</th>
<th>23.8%</th>
</tr>
</thead>
<tbody>
<tr>
<td>Low human capital development</td>
<td>Receives scholarship to attend school (12–14)</td>
<td>8.3%</td>
<td>8.1%</td>
<td>5.3%</td>
<td>4.3%</td>
<td>63.6%</td>
<td>61.4%</td>
<td>56.0%</td>
<td>46.0%</td>
</tr>
<tr>
<td>Violence/crime</td>
<td>Receives scholarship to attend school (ages 15–17)</td>
<td>1.8%</td>
<td>2.5%</td>
<td>1.9%</td>
<td>3.4%</td>
<td>58.8%</td>
<td>56.7%</td>
<td>49.6%</td>
<td>37.4%</td>
</tr>
<tr>
<td>Low human capital development Low income</td>
<td>Receives scholarship to attend school (ages 18–24)</td>
<td>19.0%</td>
<td>11.4%</td>
<td>6.1%</td>
<td>5.0%</td>
<td>24.1%</td>
<td>19.5%</td>
<td>20.2%</td>
<td>15.2%</td>
</tr>
<tr>
<td>Ages 25–64: Has attended training program</td>
<td>4.7%</td>
<td>5.7%</td>
<td>10.7%</td>
<td>25.9%</td>
<td>0.6%</td>
<td>0.6%</td>
<td>2.9%</td>
<td>8.4%</td>
<td></td>
</tr>
<tr>
<td>Low income</td>
<td>Has access to social security system</td>
<td>20.9%</td>
<td>21.8%</td>
<td>32.9%</td>
<td>45.7%</td>
<td>2.6%</td>
<td>3.6%</td>
<td>7.9%</td>
<td>15.8%</td>
</tr>
<tr>
<td>General population: Receives ‘ayuda alimentaria a dispensa’</td>
<td>3.4%</td>
<td>4.4%</td>
<td>9.1%</td>
<td>16.4%</td>
<td>0.9%</td>
<td>0.8%</td>
<td>1.8%</td>
<td>5.2%</td>
<td></td>
</tr>
<tr>
<td>Ages 65+: Receives pension</td>
<td>6.7%</td>
<td>8.4%</td>
<td>15.2%</td>
<td>22.1%</td>
<td>0.8%</td>
<td>0.8%</td>
<td>2.9%</td>
<td>5.3%</td>
<td></td>
</tr>
<tr>
<td>General population: Access to housing credit</td>
<td>8.2%</td>
<td>9.3%</td>
<td>16.6%</td>
<td>29.5%</td>
<td>0.8%</td>
<td>1.1%</td>
<td>2.8%</td>
<td>8.5%</td>
<td></td>
</tr>
</tbody>
</table>

Source: INEGI household survey, ENIGH 2002
<table>
<thead>
<tr>
<th>Program</th>
<th>Agency</th>
<th>Year</th>
<th>Elderly Beneficiaries</th>
<th>Definition of Elderly</th>
<th>Amount of Support</th>
<th>Description</th>
</tr>
</thead>
<tbody>
<tr>
<td>PROCAMPO</td>
<td>SAGARPA</td>
<td>2003</td>
<td>674,894</td>
<td>Ages 65 and over</td>
<td>1030 MXP per Ha for one semester</td>
<td>Cash transfer program (launched in 1994) to compensate grain farmers from the price effect of increased competition brought by NAFTA. The subsidy is given to the user, not the owner, of the land, and is seasonal, such that double cropping farmers receive it twice a year.</td>
</tr>
<tr>
<td>OPORTUNIDADES</td>
<td>OPORTUNIDADES/SEDESOL</td>
<td>2004</td>
<td>554,189</td>
<td>Ages 65 and over</td>
<td>1120 MXP per Ha for the first semester</td>
<td>It has over 5 million beneficiary households, of which in 600,000 an elderly person receives the support. This may be because the mother works and therefore the grandmother takes care of the children. So she receives the transfer. There is another case in which the elderly person does not have either children or grandchildren and still receives the support.</td>
</tr>
<tr>
<td>Programa para Adulos Mayores</td>
<td>GDF</td>
<td>2002</td>
<td>328,000 (98% of the elderly in Mexico City)</td>
<td>Ages 70 and over</td>
<td>700 MXP monthly</td>
<td>Cash transfers for food expenses to the elderly in order to improve food security. All the elderly living in Mexico City are eligible.</td>
</tr>
<tr>
<td>Acuerdo Nacional para el Campo: Atención a Adultos Mayores en Zonas Rurales Provisional*</td>
<td>SEDESOL</td>
<td>2003</td>
<td>211,307</td>
<td>Ages 60 and over</td>
<td>2,100 MXP annually</td>
<td>This program was created because it was one of the terms of the Acuerdo Nacional para el Campo. In 2003, 500 million pesos were destined to this purpose and rules of operation were quickly created in order to provide the support. In 2004, the program was formally launched; however, the rules of operation were not published until August and support has only begun. The objective is to improve living conditions of elderly adults over 60 years old in situation of extreme poverty in rural areas (less than 2,500 people) of high and very high marginality conditions. One condition is that these people do not participate in any other similar government program, unless its objectives are different and complementary.</td>
</tr>
<tr>
<td>Atención a Adultos Mayores en Zonas Rurales</td>
<td>SEDESOL</td>
<td>2004</td>
<td>109,542 up to August, but support will increase to probably 714,000</td>
<td>Ages 60 and over</td>
<td>2,100 MXP annually</td>
<td></td>
</tr>
<tr>
<td>Programa de Empleo Temporal</td>
<td>SAGARPA, SEMARNAT, SCT, SEDESOL</td>
<td>No data on the age of beneficiaries</td>
<td></td>
<td></td>
<td>Workfare program</td>
<td></td>
</tr>
<tr>
<td>LICONSA</td>
<td>SEDESOL</td>
<td>2003</td>
<td>411,217</td>
<td>Ages 60 and over</td>
<td>Buy milk at 3.50 MXP per liter</td>
<td>This program was created for providing better nutrition for families living in poverty. Specifically, one of their target populations is the elderly in poverty conditions. The households make a commitment to assist to orientation lectures and participate in housing and community improvement actions.</td>
</tr>
<tr>
<td>Programa Alimentario</td>
<td>LICONSA/SEDESOL</td>
<td></td>
<td></td>
<td></td>
<td>Food package with value of 150 MXP that the household receives monthly</td>
<td>Poor households living in rural localities of high and very high marginality that do not receive support from other programs like Oportunidades and LICONSA.</td>
</tr>
</tbody>
</table>
Bibliography


