



POLICY NOTE

Poverty Alleviation

by

Directorate for Employment,

Labour and Social Affairs

September 2006

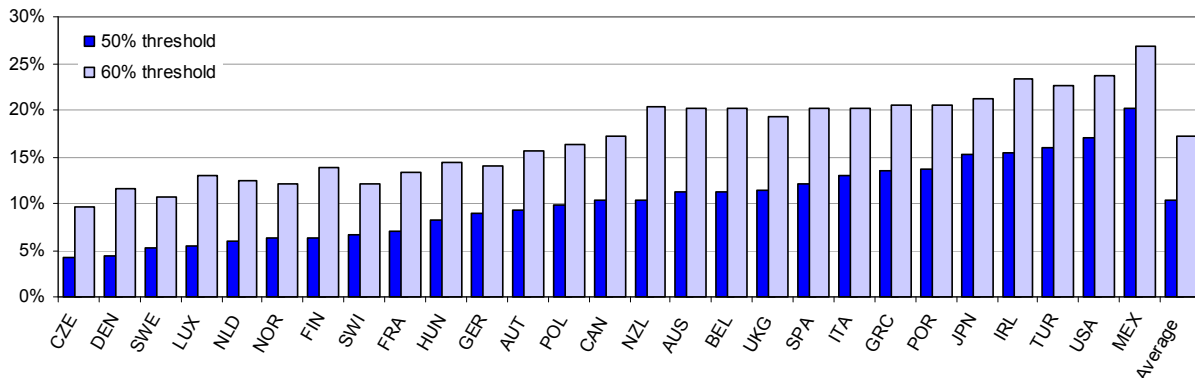
Poverty Alleviation

Facts

1. Poverty alleviation is one of the greatest challenges for Mexico and is a key concern for policies in all areas. According to the World Bank, 4.5% of the Mexican population lived on less than 1 USD per day in 2002, and 20.4% on less than 2 USD. Despite a reduction in the national poverty rate of around 80% since 1996, more than 40% of the Mexican population declared in the early 2000s that they occasionally lacked money to buy food, clothing and health care in the previous year (OECD, 2005). Absolute poverty contributes to other poor social outcomes: infant mortality rates in Mexico are three times higher than the OECD average and (according to OECD/PISA test scores) around 40% of Mexican 15-year-olds in 2003 had literacy skills below the minimum levels required for normal functioning.

2. OECD data on relative income-poverty confirm this gloomy picture.¹ Around 20% of the Mexican population in 2002 had an (equivalised) disposable income of less than half of the median income, and more than 25% had less than 60% of that level (Figure 1). A composite measure of relative income poverty, which combines information on both the frequency and intensity of low income, was highest in Mexico among 25 OECD countries. Children account for around half of all the poor; so poverty is more likely to have lasting consequences in Mexico than in other OECD countries, as the development prospects of children (in terms of their health and human capital investment) are affected by low parental income.

Figure 1. Relative income poverty in OECD countries, early 2000s



Source: OECD income distribution questionnaire.

3. In most OECD countries, most people have incomes fairly close to the mean or median of the income distribution. Mexico, however, has a pattern found in other middle-income countries, especially in Latin America. Most people in the middle class have income that is closer to the bottom than to the top, while the distribution "hollows out" in the middle. This is evidence of a 'dual economy' – people in the more modern part of the economy have incomes which approach those of the rest of the OECD, but most

¹ The OECD data on income distribution and poverty are regularly provided by INEGI, based on the bi-annual *Survey of Household Income and Expenditure*. The OECD is currently collecting data for Mexico referring to 2004.

people remain in the less-developed part of the economy.² While trends since the mid-1990s — gains for the bottom quintile and relative losses in the top one — have lowered income inequalities in Mexico, the policy challenge is to accelerate this tendency in a context of stronger growth in per capita income.

Policies

4. There is no single policy lever which, if pulled, can sustainably reduce poverty. OECD experience suggests a large range of policies are needed. These include growth-oriented macro-economic policies, infrastructural investment, education and health. This brief focuses on what a more narrow range of social policy priorities could do: upgrading welfare programmes targeted to the poor; increasing access to productive employment opportunities for the poor; and improving policy implementation.

Expanding welfare programmes targeted to the poor

5. Despite progress, the social protection system in Mexico continues to be limited and inequitable, leaving most of its vulnerable citizens unprotected. Gross public social spending, as a share of GDP, has risen from less than 2% in 1985 to 6.3% in 2003 (Figure 2) but is only 1/3 of the OECD average. The share of Mexico's public expenditure on social programmes in GDP is low not only in absolute terms but also in the light of the per capita GDP of the country, especially for non-health expenditures. More critically, most of this expenditure benefits people at the higher end of the distribution. The bottom 20% of the population get less than 10% of the income distribution (Table 1). As a result, social transfers in Mexico achieve little in reducing income poverty (Table 2). The social security system needs to become less regressive and this requires it to have a broader coverage. The main obstacles in meeting this goal are represented by Mexico's limited tax base and by the high contingent liabilities on existing public pensions.³

Table 1. Distribution of public social transfers across quintile groups, working-age and elderly population

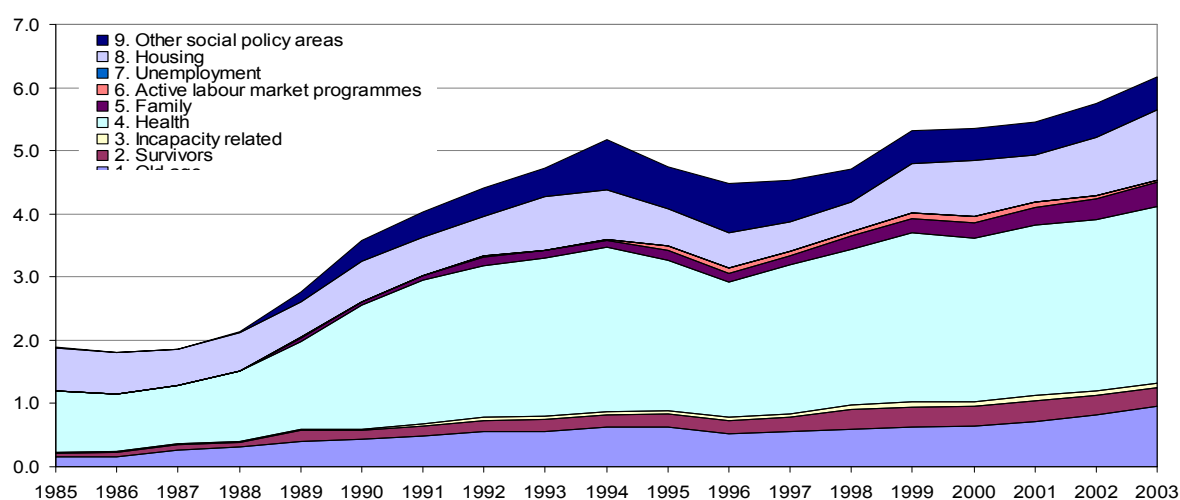
	Working-age population			Elderly population		
	Bottom quintile	Six middle quintiles	Top quintile	Bottom quintile	Six middle quintiles	Top quintile
Mexico 1984	0.9	31.6	67.5	0.2	25.7	74.0
Mexico 1994	7.6	46.0	46.4	3.0	50.4	46.6
Mexico 2002	9.1	33.3	57.7	3.8	43.6	52.7
OECD average 2000	24.7	57.2	18.1	13.9	60.0	26.0

Source: OECD Income Distribution Questionnaire.

2. Source: Sala-i-Martin X and S. Mohapatra, (2002) "Poverty, Inequality and the Distribution of Income in the G20", Columbia University, Discussion Paper No. 0203-10, New York

3. Similar recommendations are put forward by the World Bank in its 2006 report *Income Generation and Social Protection for the Poor*. According to this study, contingent liabilities of existing old-age programmes (run by the IMSS and ISSSTE) represent around 80% of Mexico's GDP.

Figure 2. Trends in Mexico's social spending, as a share of GDP



Source: OECD Social Expenditure database.

Table 2. Poverty rates before and after considering social transfers, 1984 - 2002

	1984		1994		2002	
	Before transfers	After transfers	Before transfers	After transfers	Before transfers	After transfers
Total	21.2	20.7	24.2	21.7	24.1	20.3
Working-age	20.6	20.2	22.7	20.8	22.8	19.8
Retirement-age	28.7	26.6	39.6	31.4	35.3	24.2

Note: Poverty rate: percentage of persons with incomes below 50% of disposable adjusted income of the entire population.
Source: OECD Income Distribution Questionnaire.

6. The challenges confronting the Mexican administration are daunting, both with respect to the working-age population and to the elderly. With respect to the former, the programme *Oportunidades* is one of the most innovative and successful programmes targeted to those living in extreme poverty or just above this threshold. But it excludes moderately poor households and a range of social risks confronting them. Also, (until recently) its coverage was limited to rural areas. As a result, outlays for this programme — which reaches more than 20 million people — represent only 10% of total public spending on social purposes (based on the OECD classification).

7. Conversely, public spending on active labour market programmes is negligible. While labour market programmes may not have been a major priority in the past — as macroeconomic shocks have traditionally affected the Mexican labour market in the form of lower wages rather than higher unemployment and emigration to the United States — this may be changing, at the same time as Mexico's exposure to external shocks is rising (World Bank, 2006). Housing programmes are quantitatively more important (with public expenditure of more than 1% of GDP), but need to be better targeted to the poor and to the types of products they demand. Invalidation programmes are virtually non-existent.

8. With respect to poverty among the elderly, OECD data suggest that the main problem is among the oldest of the old. In 2002, the poverty rate among people aged 65 to 74 was 24%, with a differential relative to the rate for the total population (around 1/5) that was similar to that of most OECD countries.

Conversely, the poverty rate among people aged 75 and over (at 36%) was almost twice as large as the overall rate. This implies that many more people will be exposed to risks of poverty in old age as the Mexican population ages rapidly.⁴ The move since 1997 to individual pension accounts for private-sector workers has been a success in several respects, but it risks reproducing existing income inequalities in old age. Less than 4% of public transfers paid to the elderly go to people in the bottom quintile of the distribution, and more than half to elderly people in the top quintile (see Table 2 above). This is because the Mexican pension system provides benefits to higher-income groups in the public and formal private sectors while leaving most vulnerable people unprotected. Only around 5% of the rural elderly receives a pension, as compared to 22% in urban areas (Table 3); but, again, the pension system does not reach the poor, with less than 7% of the urban extremely poor (and less than 1% of the rural extremely poor) covered. The lack of old-age income security means that many older people continue to work, particularly in the countryside.

Table 3. Pension receipt among people aged 65 and over by area of residence and poverty status

	Urban		Rural	
	Extreme poor	Overall	Extreme poor	Overall
Receives pension	6.7%	22.1%	0.8%	5.5%
Works, no pension	29.8%	24.9%	57.9%	49.7%

Source: Mexico: an overview of social protection, 2005

9. A range of transfer programmes help some of the elderly poor (*Procampo*, *Oportunidades*, *Liconsa*, *Acuerdo Nacional para el Campo*, and *Programa Alimentario*). A particularly interesting initiative has been the *Programa para Adultos Mayores*, which covers 98% of people aged 70 and over in Mexico City, paying all of them a flat-rate benefit. Proposals to extend this programme to all states have veered from the financially ruinous to its current state: entirely ineffectual. While the legislation currently in Congress would allow social-assistance recipients to save part of their benefit for retirement, with the government matching this peso for peso, take-up of the new programme is unlikely to exceed a handful of people. A national scheme more closely modelled on the *Programa para Adultos Mayores* could be a powerful tool in the fight against poverty; however, because of its fiscal costs, such a measure would require significant reforms of existing pension programmes targeted towards higher earners.

Increasing access to productive employment opportunities for the poor

10. Around 95% of all the income-poor in Mexico live in households with workers, rather than in households where no one works. In other terms, poverty does not reflect a lack of jobs, but of jobs in the formal sector and (in rural regions) outside subsistence agriculture. Informal employment is estimated to account for over 40% of all Mexican employment. Work in the informal sector is part of the coping strategy adopted by poor people, but is associated with social costs (lower opportunities for human capital accumulation, career development, tax evasion, etc.). Furthermore, even among those in the formal sector, evasion of social contributions by low-risk groups reduces the effectiveness of social protection in reducing poverty.⁵

11. Direct policy measures can help reduce informal employment (administrative requirements, tax provisions, temporary reductions in social security contributions and support services for firms and

⁴ According to national demographic projections, the old-age dependency ratio (the ratio of the population aged 65 and over to the population aged 20 to 64) is projected to increase from less than 10% in 2005 to 35% by 2050.

⁵ OECD (2004), "Informal Employment and Promoting the Transition to a Salaried Economy", OECD *Employment Outlook*, OECD, Paris.

workers that emerge from the hidden economy) but evidence of their effectiveness is mixed (OECD, 2004). Expanding job opportunities in the formal economy is a long-term process. Beyond measures to sustain the accumulation of human capital among the poor, this goal requires strengthening local development in those areas where poverty is highest through measures that take into account the heterogeneity of situations and the differences between rural and urban areas. In this respect:

- Around ¼ of Mexico's population lives in sparsely populated communities lacking access to a wide range of basic public services. The *Strategy for micro-regions*, introduced in 2001, has improved ministerial co-ordination to assist a selected number of rural regions characterised by high levels of marginalisation (in around 3 000 *Strategic Community Centres*) to achieve the critical mass necessary for the efficient delivery of public and private services such as health, education, electricity and water. The programme involves a mix of measures that combine social emergency relief and support to the competitiveness of local activities. An OECD assessment of this programme recommended giving more weight to economic competitiveness in the mix of interventions and reinforcing partnerships among the actors involved.⁶
- Poverty in urban areas is lower than elsewhere but trends have been less favourable. About 60% of population in Mexico City's metropolitan area live in poverty, with a trend towards increasing spatial concentration of the poor.⁷ While public transfers represent close to 20% of the income of the bottom quintile in rural areas, they account for less than 5% for those in urban areas. Earnings are the main income source of the urban poor, and evidence suggests that, in 2003, these urban poor worked more hours but earned less than in 1991 (World Bank, 2006). The OECD review of Mexico City, while praising some recent programmes targeted to reduce urban poverty (SODESOL's *Habitat* programme, which now targets around 200 cities), argued for better co-operation among administrations and stronger implementation frameworks, alongside interventions to improve the competitiveness of the whole region.

Improving policy implementation

12. Improving implementation of poverty alleviation programmes calls for a combination of approaches. At the top policy level, the credibility of the government efforts to reduce poverty would be strengthened by the setting of explicit targets for policy reduction. Implementation could be strengthened through the adoption of tools and structures to ensure that all policies are assessed *ex ante* for their effect on poverty — and that different interventions are effectively co-ordinated within the federal government — such as those implemented in other OECD countries (e.g. Ireland). Improvements need to be made in the co-operation between local and federal authorities, so as to allow greater decentralisation in the design and implementation of anti-poverty programmes.

13. Another priority is to upgrade the statistical infrastructure so as to allow greater use of evidence-based policies. This includes regular evaluations of existing programmes but also the development of new tools that would allow assessing the effects of social protection programmes on incentives to work and income adequacy. Also important is to improve existing household surveys to allow a better assessment of changes in the living conditions of those at the bottom of the income distribution.⁸

⁶ "Placed-based Policies for Rural Development – The Micro-Regions Strategy, Mexico Case Study", GOV/TDPC/RUR/PRD(2003)1.

⁷ OECD (2004), *Mexico City – OECD Territorial Reviews*, OECD, Paris.

⁸ The bi-annual INEGI survey covers only around half of household income, as opposed to 70-80% that is typical in most other OECD countries; in addition, this survey does not provide information on tax payments of different households.