2015 Pension Policy Notes

MEXICO

- **Move towards a truly national pension system: make public- and private-sector schemes converge; eliminate special regimes in public firms and universities; condition part of the transfers to local governments to the adoption of the national scheme; raise and unify non-contributory safety nets and integrate them better with the first-tier contributory pension.**
- **Increase the mandatory contribution rate, and ensure that new contributions accrue entitlements to the DC reformed system only.**

The reformed pension system will deliver low replacement rates. In 1997, the mandatory pension system for private-sector workers was transformed from a public PAYG DB into a private funded DC managed by pension funds. The government tops-up workers' contributions with the so-called social quota for wages below 15 times the minimum wage. People older than 65 years having contributed for at least 1,250 weeks are eligible in the new DC scheme for the minimum pension guarantee (PMG, equivalent to about USD 160 per month). Contributions are small because the mandatory contribution rate is low (6.5% of wages), the informal sector is large and many workers do not contribute regularly. Only about 30% of people aged 65 and over received a contributory pension in 2011. Under standard assumptions in the OECD pension models, the mandatory private-sector scheme generates the lowest projected replacement rate for full-career average-wage earners among OECD countries, and the third lowest for low-wage earners. Taking into account the housing sub-account of the Mexican system that can be diverted into old-age pensions improves the situation, but replacement rates remain low. The poverty rate among people over 65 is very high, above 30%. Two thirds of their incomes still comes from both formal and informal work or self-employment.

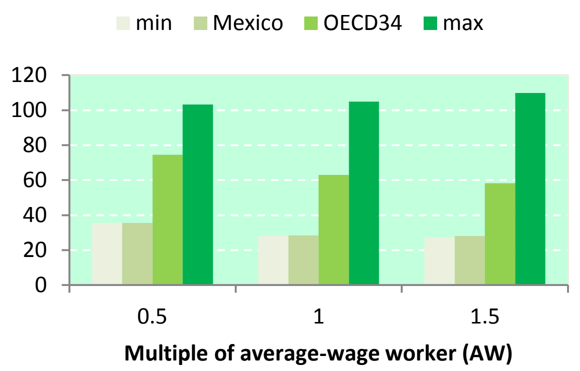
Key indicators: Mexico and OECD average

	Mid-1980s	Mid-1990s	Mid-2000s	latest available	latest OECD	long-term	long-term OECD
Pensionable age for a full-time career starting at the age of 20	65.0	65.0	65.0	65.0		65.0	
Retirement age	65.0	65.0	65.0	65.0	62.9 (61.8)	65.0	64.6 (64.4)
Net replacement rate, avg earner						28.4 (26.2)	63.2 (62.7)
Total mandatory contribution rate			6.5	6.5	19.1		
Total pension spending, % of GDP	0.1	0.8	1.2	1.9	10.3		
Public pension spending, % of GDP	0.1	0.8	1.2	1.9	8.4		
Public debt, % of GDP					115		
Employment rate 55-64, %		75.7 (25.7)	77.3 (30.4)	76.1 (36.3)	66.1 (49.1)		
Labour-market exit age	80.5 (79.2)	72.2 (74.5)	73.7 (73.3)	72.0 (68.1)	64.6 (63.1)		
Old-age poverty rate, %	28.0	32.7	28.0	31.2	12.6		
Life expectancy at 65, years	15.5 (17.3)	16.6 (18.1)	17.6 (19.2)	18.4 (20.2)	18.4 (21.5)	22.8 (24.2)	22.9 (25.9)
Old-age dependency ratio	0.09	0.10	0.10	0.11	0.28	0.42	0.57
Fertility rate	3.8	2.9	2.4	2.1	1.7	1.7	1.8

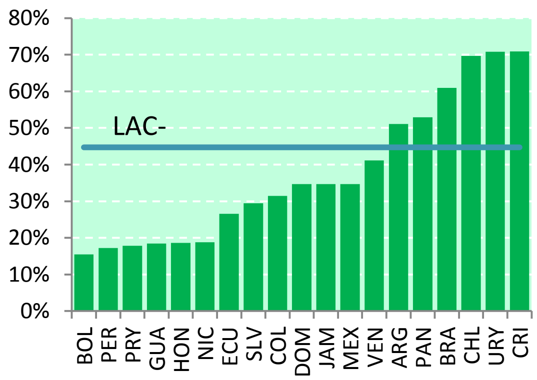
Note. The figures for women appear in parenthesis where they differ from those for men. Long-term: Around 2060 based on all legislated reforms up to mid-2015.

Pension reforms have improved the social and fiscal sustainability of the system but many challenges remain. Several types of non-contributory pensions exist due to the poor coordination between the federal and local programmes, varying in eligibility condition, level and scope. The most important national program (*Pensión Alimentaria para Adultos Mayores*, PAM*)* applies to people who are at least 65 and do not receive another old-age or disability pension above a certain threshold currently equal to about half of the minimum wage. In March 2014, draft legislation ("Universal Pension Law", which remains to be approved by the Senate with no clear plan to do so) would introduce a pension at a higher level than the PAM for an individual having resided in the country for 25 years and with no contributory pension. The same draft legislation contained other important measures to enhance financial sustainability (such as a regular increase in the PAM eligibility age by 87% of the increase in life expectancy at birth). However, there is no plan to reduce the high fragmentation of the system which goes far beyond the different treatment of private- and public-sector workers. Some states, local authorities, public universities, other public entities and various professions run independent pension systems. There is coordination neither across the various plans nor across the federal and local levels, even for non-contributory schemes. This generates opacity, duplication and inefficient management, and is a source of large inequalities. The lack of portability of entitlements between schemes and entities also harms labour mobility.

Long-term net replacement rates (%), by earnings level



Pension coverage, % affiliated DB and DC



Sources: OECD pension models and OECD, Pensions at a Glance 2015; OECD/IDB/The World Bank (2014), Pensions at a Glance: Latin America and the Caribbean, *OECD Publishing, Paris.*

Income adequacy for the elderly is at risk due to low contribution rates, low coverage and high informality. Private-sector workers will have low replacement rates from the DC scheme, even under favourable assumptions on returns. By contrast, "transition workers" who contributed to the system at least once before 1997 can opt to have their pension computed according to the heavily subsidised PAYG DB scheme. A smoother phase-in could guarantee the rights accrued by transitional workers in the old DB system up to now while ensuring that new contributions accrue entitlements in the new DC system. Mandatory contribution rates should also increase to improve income adequacy. Old-age poverty risks are highest for those who rely on the social pension benefit alone as its value is low. People who have limited cumulated contributions but are eligible for the PMG may also have poor incentives to participate further in the formal labour market as additional contributions do not generate more pension entitlements. The disconnection between the non-contributory pension and the PMG creates substantial discontinuities as a function of contribution periods and perverse incentives once eligibility conditions for the PMG are met.

With population ageing, the take-up and cost of non-contributory programmes might increase substantially. The link between the PAM and the PMG should be smoothed by creating a new minimum pension, with the level depending on contributions paid or the contribution period. The new minimum pension should be withdrawn against pension entitlements to help finance a higher pension level, but the withdrawal rate should be relatively low to limit disincentives to contribute. Integrating the two schemes, as Chile did with similar schemes in 2008, is a priority. The coordination of safety net programmes between different levels of government should also be enhanced, for example by making some part of the transfers to local governments conditional on the adoption of the national scheme. To improve pension adequacy, mandatory contributions for the self-employed should also be introduced.

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