



# The Backdrop

## 1.1 A Decade of Change

Over the past decade, Mexico has gone through the most important historic changes since independence in 1917. In 1991–1992, Mexico re-privatized its banks and relaxed financial regulation, allowing integrated financial operation of financial groups. In 1994, Mexico joined the Organization of Economic Cooperation and Development (OECD), a group of largely developed countries (the only poorer country at the time in the OECD was Turkey). In 1993, it joined the North American Free Trade Agreement (NAFTA) as a first step towards opening up the country to foreign trade and investment. The second phase of NAFTA to open up the financial services industry came into effect on January 1, 2000. From that date, it became possible for American and Canadian companies to own 100% of a Mexican insurance company (AM Best, 2000). In late 2000, the longest running ruling party in the world lost power at the federal level for the first time in its history. Mexico has become sufficiently important for the Society of Actuaries so that in November 2000, a special issue of *The Actuary* was devoted to insurance issues in Mexico (including a brief article on social security in Mexico—see Sinha, 2000).

## 1.2 Past Crises and Consequences

Mexico has gone through several crises within the last three decades. The first crisis hit in 1982. In some ways, two decades later, Mexico has never recovered from it.

For example, wages in the manufacturing sector in Mexico are 30% lower in 1999 than they were in 1981 (see the wage rate dynamics in figure 1.1).

Mexican crises have also followed a six-year cycle: 1982, 1988, and 1994, coinciding with the years when new presidents have assumed office.

The crises have led Mexico to try to change policies. Some of these changes in policies were undertaken voluntarily by the government. Coaxing from international organizations such as the World Bank and the International Monetary Fund has prompted other policies.

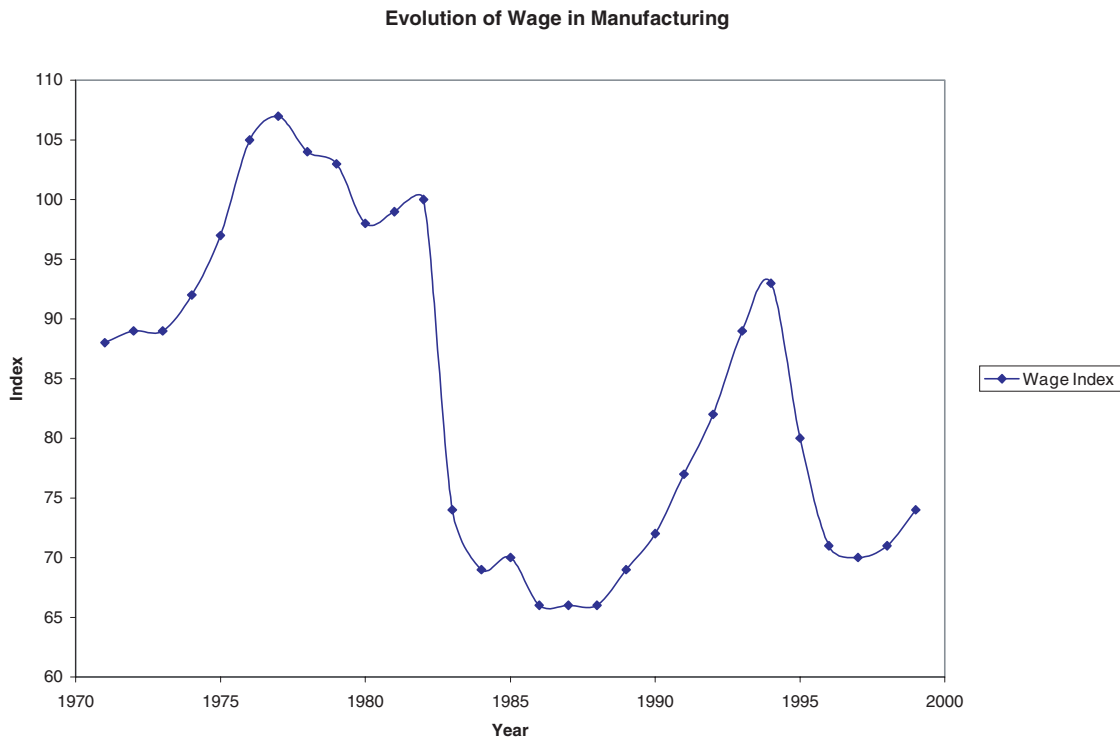
After the crisis of 1982, the falling oil price prompted Mexico to suspend payment of interest of external loans to foreign private banks. Although much of the debt was that of the private banks, the Mexican government took on almost all of it (as did the other governments in the region). The Mexican government was forced to accept austerity measures imposed by the foreign creditors either directly or indirectly (through the World Bank and the International Monetary Fund). These policies worked out very favorably for the lending banks. Some researchers have thus called it the policy of bailing out the lending banks from the developed countries (Dooley, 1994).

Mexico undertook other changes in regulation voluntarily. For example, in 1992 Mexico entered the Organization of Economic Cooperation and Development (OECD) and in 1994 Mexico entered the North American Free Trade Agreement (NAFTA). These actions have had profound impact on insurance markets in Mexico. For example, under NAFTA, starting on January 1, 2000, the Mexican financial markets have been thrown open to investors in the United States and Canada. As a result, a number of companies from the United States/Canada have entered the Mexican markets.

## 1.3 A New Beginning

Mexico also entered a new political era on December 1, 2000. For the first time since 1929, Vicente Fox Quesada, who is not a member of the Institutional Revolutionary Party (Partido Revolucionario Institucional or PRI), was elected president. Fox's party, the

**FIGURE 1.1**  
**EVOLUTION OF WAGE RATE IN THE MANUFACTURING SECTOR IN MEXICO**  
**(1971-1999)**



National Action Party (Partido Accion Nacional or PAN) is friendlier to the business community than PRI has been. PAN had a significant presence as a regional party in the north of the country, but this was the first time they made inroads in national politics.

## 1.4 The Plan of the Monograph

The monograph is organized as follows. In the second chapter, we trace the history of social security in Mexico starting with the pre-colonial era. During the colonial era, the system covered the armed forces, some federal bureaucrats and some specific professions. The “universal” pay-as-you-go social security started in 1943. It was only universal in a notional sense—it did not cover even half the population at the end of the twentieth century. The privately managed system started tentatively with a supplemental program in 1992. The privately managed program to replace the entire “old system” began only in 1997.

Chapter 3 gives in-depth details of the old (which will continue to run for the next half century) and the new systems. Chapter 4 describes the details of the new system and how it has performed during 1997–2000. Chapter 5 looks at the privately operated pension system from the point of view of services marketing. It discusses results of an ongoing longitudinal research project on customer satisfaction with the system. Chapter 6 discusses why private management of pension is not like privatization of other spheres of activities. The problem of replacing the pay-as-you-go system is that it imposes a cost on government that does not arise in other kinds of privatization. Chapter 7 discusses the problem of high management fees of privately managed pension funds that has plagued not just Mexico, but other countries as well. Chapter 8 takes a deep look at fund management by privately managed funds. It shows that quantitative restrictions (as imposed by the current regulator) are of the wrong kind. Chapter 9 concludes with some specific recommendations.