II

A History of Pension Systems in Mexico: Pre-Hispanic to Present

> The third and last duty of the sovereign or commonwealth is that of erecting and maintaining those public institutions and those public works, which, though they may be in the highest degree advantageous to a great society, are, however, of such a nature that the profit could never repay the expense to any individual or small number of individuals, and which it therefore cannot be expected that any individual or small number of individuals should erect or maintain. The performance of this duty requires, too, very different degrees of expense in the different periods of society. Adam Smith: *Wealth of Nations,* Book 5, Chapter I, Part 3.

2.1 Social Security in Mexico

In pre-Hispanic Mexico, land belonged to the community. Most saving was in the form of community saving (*la caja de comunidad*). However, it did not necessarily mean that all saving was shared equally.

When the Spanish *conquistadores* came to rule Mexico (1519), the community of indigenous people was devastated by disease and war (Crosby, 1979). Along with depopulation, social customs such as *la caja de comunidad* also rapidly disappeared. In the end, a few white Spaniards owned most of the land and minerals; the mixed race (creole) owned some; and the indigenous were dispossessed. The resulting inequality created a volatile economic and political mix in the eighteenth century. This volatility erupted in violence in the early part of the Nineteenth Century. In 1810, under the leadership of Miguel Hidalgo y Costilla (a creole priest), a group of revolutionaries declared the abolition of slavery and servitude (called *peonaje*). They also declared all forms of tributes paid to the Spanish Crown illegal. These principles were enshrined in the first Constitution of 1814. After Spain decided to grant independence to Mexico in 1821, political and economic stability remained elusive.

One of the first acts of the new government, after independence (in 1821), was to grant a pension to officials in the executive, judiciary, and treasury offices. Ever since the Spaniards conquered Mexico, the military enjoyed pension benefits (called *montepío militar*). Both of these programs (for the military and the bureaucrats) remained in the (mostly) white minority of the population.

The people of native origin and mixed race, the vast majority, remained outside of the system. In 1858, Benito Juárez (the first, and so far the only, president of Indian origin) became the president of the republic. He enacted reform laws that took lands away from the church and sold them.

Unfortunately, the land was not redistributed evenly. A small group of landowners became more powerful. They set up agricultural production through large landholdings called *haciendas.* Workers in the haciendas became indebted to the landowners through high interest loans. The situation changed slowly at the turn of the century. During the regime of Porfirio Díaz (1876–1910), rapid industrialization took place (in urban areas). This process replaced agriculture with industry. Many workers from the rural areas moved to urban areas to accept jobs in the factories. This did not improve the working conditions very much. These jobs did not pay retirement pensions. Thus, retired workers went back to the life of abject poverty.

In 1906, a labor movement started among miners and textile workers demanding an eight-hour workday, child labor prohibition, workers' compensation and retirement pension. This movement was brutally suppressed by Díaz. After Díaz was deposed in 1910, civil war broke out. Chaos reigned for the next eight years. During the eight years of civil war, more than a million people died.

Venustiano Carranza became the president of Mexico in 1914. With the help of General Alvaro Obregón, he enacted a new Constitution in 1917. This Constitution became the basic model for many Latin American countries in subsequent years. To formulate the labor laws, he sent José Natividad Macías to Baltimore, Chicago, New York and Philadelphia to study labor laws in more advanced countries. Macías was tremendously influenced by what he saw; thus, his formulation of labor law followed the line taken by other advanced nations. His work culminated in Article 123 of the Constitution. It legalized labor rights, such as equal wages for equal work, an eight-hour workday, one-day holiday every week, child labor prohibition, minimum wages, and the right to strike. In the field of insurance, subsections XIV, XXV and XXIX stated that: (1) the employers would be held responsible for death and disability caused by occupational accidents; (2) there should be no contribution required from the workers; and (3) government should organize social security. On the face of it, Article 123 is a model piece of legislation.

However, Article 123 became more notorious for two reasons: (1) it was long on rhetoric and short on implementation; and (2) it did not mention retirement benefits explicitly. During the presidency of Alvaro Obregón (1920–1924), a commission set up by the government recommended payroll tax on the employers to pay for workers' compensation, old-age pension and life insurance. The commission recommended a 10% payroll tax on the employers. It recommended that management of the money from payroll taxes should be handled by the State. However, with tremendous opposition from the employers, these ideas were quietly shelved.

The next president, Plutarco Elías Calles (1924–1928) expanded the coverage of old-age insurance of federal government employees and that of the military. He also extended survivors' benefits and funeral aid to teachers (Seguro Federal del Maestro, 1928).

In 1928, Alvaro Obregón ran for the presidency one more time. He found the cause for social security to be so popular that he helped organize a new party called the Social Security Party (Partido Previsión Social). In his reelection bid, he went on to declare: "No more promises. Our nation knows our platform. In social matters, we have talked about insurance for workers. This will cover not only accident insurance but also cover retirement benefits for all workers. The coverage that the working class will have is the best in the world" (García Cruz, 1962, p. 85–86, translation mine). Alvaro Obregón won the election in a landslide. Unfortunately, before he could take office, he was fatally shot.

In 1929, a new party called Partido Nacional Revolucionario (PNR) was set up incorporating diverging groups. The party included former revolutionaries and labor leaders, as well as agricultural workers. This was a remarkable coalition. Even though the party changed its name to Partido Revolutionario Institutional (PRI) in 1946, PRI was to rule Mexico for the rest of the twentieth century.

The next set of social changes came during the regime of Lázaro Cárdenas (1934–1940). He nationalized a number of industries and helped set up the most powerful union in the country (CTM), which is still very politically powerful in Mexico today. During this period, Cárdenas promised to introduce social security *for all workers* several times (1935, 1938 and 1940), but these drafts were never enacted into law. His promise in 1935 was vague. In 1938, he sent a draft proposing a National Institute of Social Security (Instituto Nacional de Seguros Social). Unfortunately, the entire project was *devoid of any actuarial calculation.*

In 1941, the Labor Secretary, Ignacio García Téllez, under the presidency of Manuel Avila Camacho (1940–1946), undertook the task of formulating the laws of social security. He created a separate Department of Social Security. The department set about studying the specific systems that were in existence in Mexico, such as social security for the military, the bureaucracy and teachers.

The Department of Social Security also took note of what was going on in the rest of the world. In 1942, the Beveridge Report came out. Collaborators of Sir William Beveridge, such as Oswald Stein (who was then the head of the Social Security Division of the International Labor Organization) had pushed for universal social security in Mexico (Arce Cano, 1972).

Stein was also instrumental in drafting the "Declaration of Philadelphia." In 1944, the International Labor Conference recognized that the right to economic security should be one that's shared by all people. This is part of a human rights declaration that has become known as the "Declaration of Philadelphia." Essentially, the Declaration of Philadelphia sets out human rights conditions, mostly concerning fairness in different aspects of human labor. Social security was one of these conditions.

In December 1942, a draft proposal was sent out to the Mexican Congress for approval. It put the Instituto Mexicano del Seguro Social (IMSS), a federally administered autonomous agency, in charge of social security. Ignacio García Téllez, the Labor Secretary, drafted the proposal. The following risks were to be covered for all workers by law: (1) accidents at work and sickness caused by work; (2) sickness unrelated to work and maternity; (3) incapacity and life insurance; and (4) old age pension (at the age of 60).

In a curious twist of history, the actuarial basis of the IMSS was greatly influenced by three Jewish refugees living in Montreal: Albert Stein (from Holland), Carlos Tixier (from France), and Emilio Schoembaum (from Czechoslovakia). They were the actuaries who happened to have been in Canada when García Téllez went there looking for technical assistance (Instituto Mexicano del Seguro Social, 1968, p. 59).

It is worth noting that the retirement age was set at 60 in 1942. This was remarkable given that even in 1960, male (female) life expectancy at birth was 56.2 (59.4). Obviously, life expectancy of 56.2 does not mean no one is alive at age 60. It *did* mean that there were very few people alive over age 60 (less than 5% of the population even in 1960).

In one of the technical notes, the actuaries remarked that the retirement age should not be considered fixed. They suggested that, with rising life expectancy, the retirement age should be revised upwards. This part of their recommendation was completely ignored in the final formulation of the law.

Social Security became *compulsory* in Mexico on December 31, 1942, at least by law. It was a long way away from providing any significant coverage of the population. It started with very low coverage of the labor force (less than 3% in 1946). Even in 1952, the coverage of the IMSS was less than 5% of the labor force. In 1958, it was still languishing in single digits; it covered 9% of the population. By 1964, the coverage had reached 18% of the labor force. In 1970, the coverage exceeded 25% of the labor force. By the turn of the century, IMSS was still far short of covering half of the labor force in Mexico (with about 30% of the labor force). An additional 8% of the labor force is covered as government employees of various institutions (they are ISSSTE, L&F and PEMEX).

This stands in sharp contrast with coverage in more developed countries. In the United States, between 1935 and 1940, the coverage of Social Security went from zero to 63.7%. By 1951, the coverage was 93.7% of the labor force (Myers, 1993, p. 232).

Federal employees' accounts are managed by the Instituto de Seguridad y Servicios Sociales de los Trabajadores del Estado (ISSSTE). There is a special fund for the state-owned petroleum-related monopoly, PEMEX. Details of all these systems are in Chapter 3.

It is important to keep in mind that the expansion of the IMSS came from the inclusion of additional groups of workers into the system. For example, in 1948, railroad workers joined the IMSS. In 1963, workers in sugar production became part of it, and so on. Probably the most inclusive law came into effect in 1973 when domestic workers, self-employed people (both rural and urban), were brought under IMSS. Although law includes them, the *actual coverage* of domestic workers and the self-employed remains extremely low (less than 10% of the respective sectors).

2.2 Economic and Demographic Changes in Mexico

Changes in social security are a product of three important factors: (1) political (discussed earlier), (2) economic, and (3) demographic. In the following sections, demographic and economic histories are set out (see appendix A for a list of basic facts about Mexico).

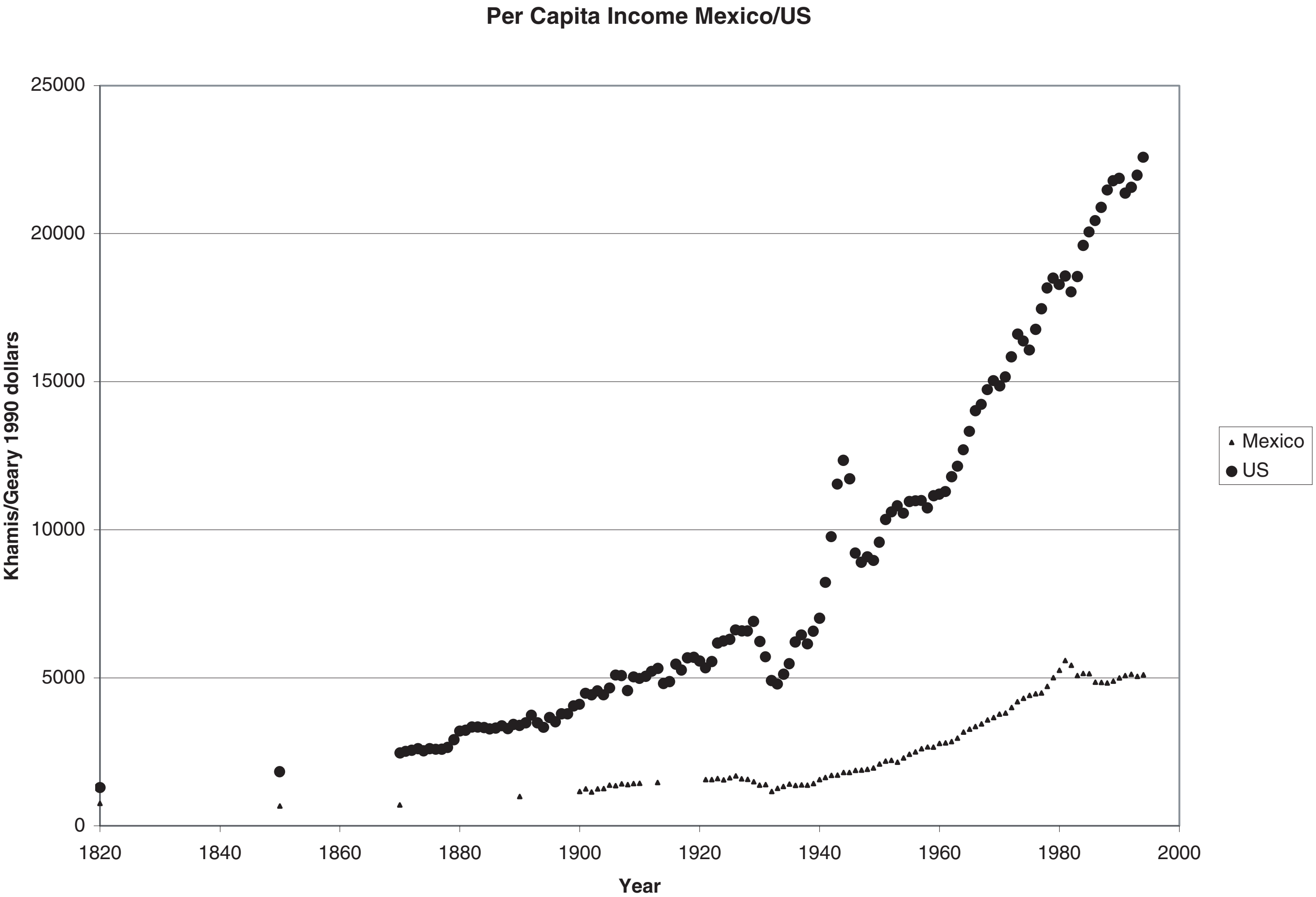
2.2.1 Economic Conditions in Mexico (1820–1995)

In figure 2.1, per capita income in the United States and Mexico is plotted.

Comparison of per capita income is difficult across countries and across time. Within the same country, per capita income could rise simply as a result of inflation with no change in purchasing power. The obvious way to correct it is to deflate the figure by the rate of price rise. Figure 2.1 reflects this adjustment. Comparing across countries poses another challenge. One dollar in one country does not buy the same amount of goods and services across countries if it is converted at the current rate of exchange. Therefore, we need to adjust per capita income (to make it comparable across countries) to reflect differing purchasing power (the so-called purchasing power parity adjustment). In figure 2.1, this adjustment of purchasing power has also been performed. Therefore, here we can compare per capita income between Mexico and the United States with some degree of confidence.

The first striking feature of the figure is that they are following divergent paths in the last half century. Mexico's growth in per capita income has been stalled

FIGURE 2.1
PER CAPITA INCOME IN MEXICO AND US
1820–1994



since 1982. For Mexico (and much of Latin America), the 1980s have become known as the ''lost decade.'' In fact, in 1982 Mexico suffered its first economic recession since 1932. If we look back at the history of the United States, we find a similar lost decade in the 1930s. The other striking feature of this figure is the variability of per capita income in the United States. Mexican per capita income has not gone through similar volatility.

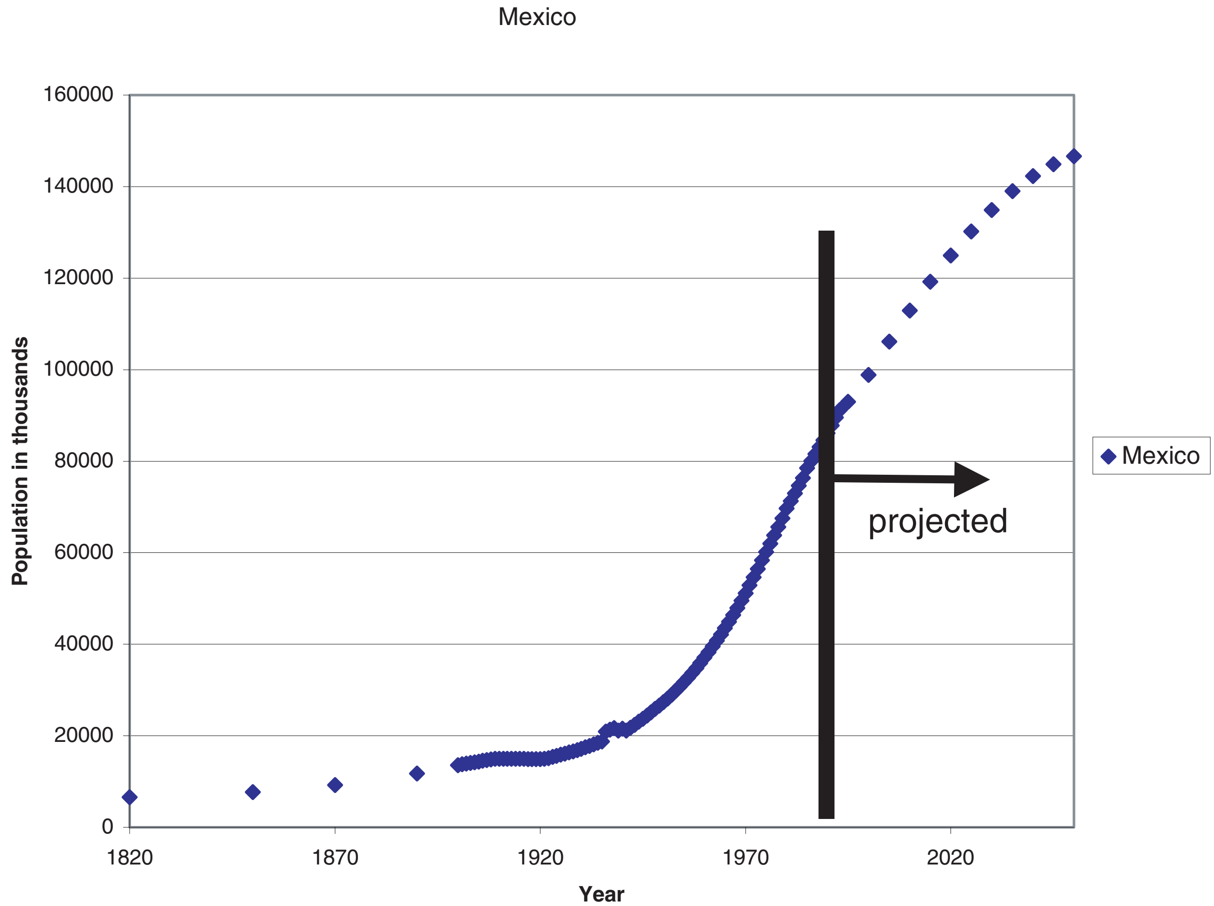
2.2.2 Population Dynamics in Mexico (1820–2050)

Mexican population growth shows the classic pattern of a Gompertz distribution. In the nineteenth century, the population in Mexico did not rise rapidly. Even though the birth rate was high, a high death rate checked the growth rate in population.

There are two important breaks in the pattern. Between 1910 and 1920, the population actually fell in absolute number. This drop can be directly attributed to the civil war that raged in Mexico. This process left a deep scar on Mexico, as did the civil war in the United States. The most rapid population growth took place after 1920. Figure 2.2 shows a very clear ''cusp'' during the late 1930s.

First, there was a huge influx of refugees from the Spanish Civil War. This was followed by an outflow of temporary workers to the United States during its involvement in the Second World War. These workers were allowed into the United States to replace the Americans who went to fight in the war. These ''temporary'' workers never came back to Mexico. The population figures used here are from Maddison et al. (1995). Since the census figures are collected every ten years (in more recent times, every five years), the

FIGURE 2.2
POPULATION DYNAMICS IN MEXICO
1820–2050



annual figures are estimates based on interpolation. Moreover, since census figures are underestimates of the population, the figures have been adjusted to account for estimates of undercount.

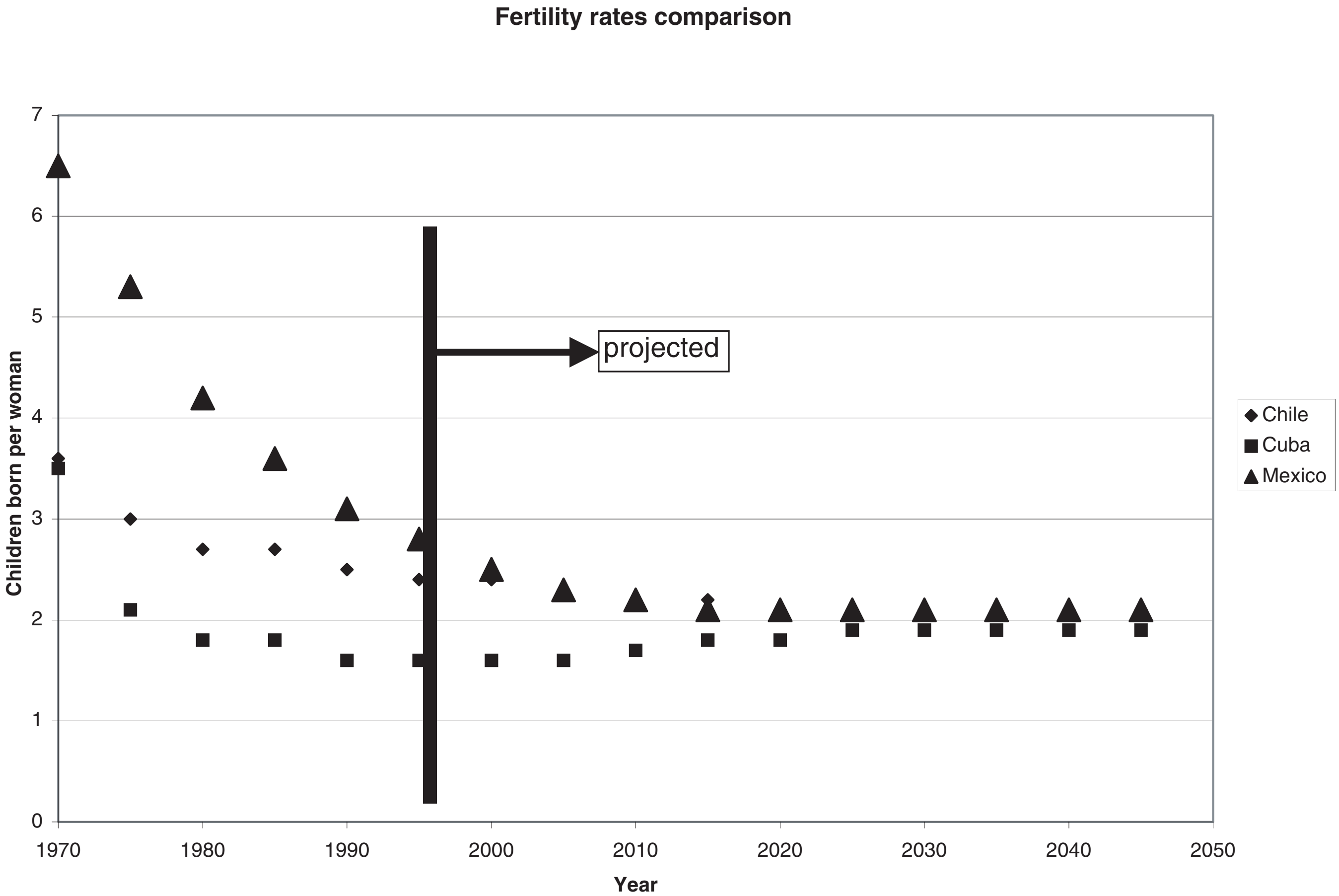
2.2.3 Fertility and its Determinants (1970–2045)

Lifetime fertility rate (number of children born per woman over the period in which she is fertile) has been falling for most countries around the world. In Mexico, the fall in fertility rate has been extremely rapid. Figure 2.3 shows the fertility rate has gone from 6.5 children per woman in 1970, to a projected 2.1 in 2015 (with the census of 2000 numbers now available, it seems that it will fall even more quickly).

This rapid decline stands in sharp contrast with other Latin American countries, such as Cuba and Chile. In those countries, the decline in fertility rates has been much slower (see figure 2.3). In the case of Cuba, the rate has gone so low that in the future its population is going to shrink.

What explains the decline in fertility rate? A global study by Behrman et al. (1999) shows that there are three factors that influence fertility rates the most: (1) health improvement of the population (where health improvement is defined as the (conditional) life expectancy at age 1); (2) secondary education of females; (3) tertiary education of females. In the context of Latin America, the health improvement factor accounts for 38% of fertility decline, secondary education 13%, and tertiary education 12%. Perhaps surprisingly, per capita income does not figure prominently and neither does the level of education of males. In the study, approximately 30% of the variability remained unexplained by their model.

FIGURE 2.3
Fertility Rates in Mexico, Chile and Cuba
1950–2045



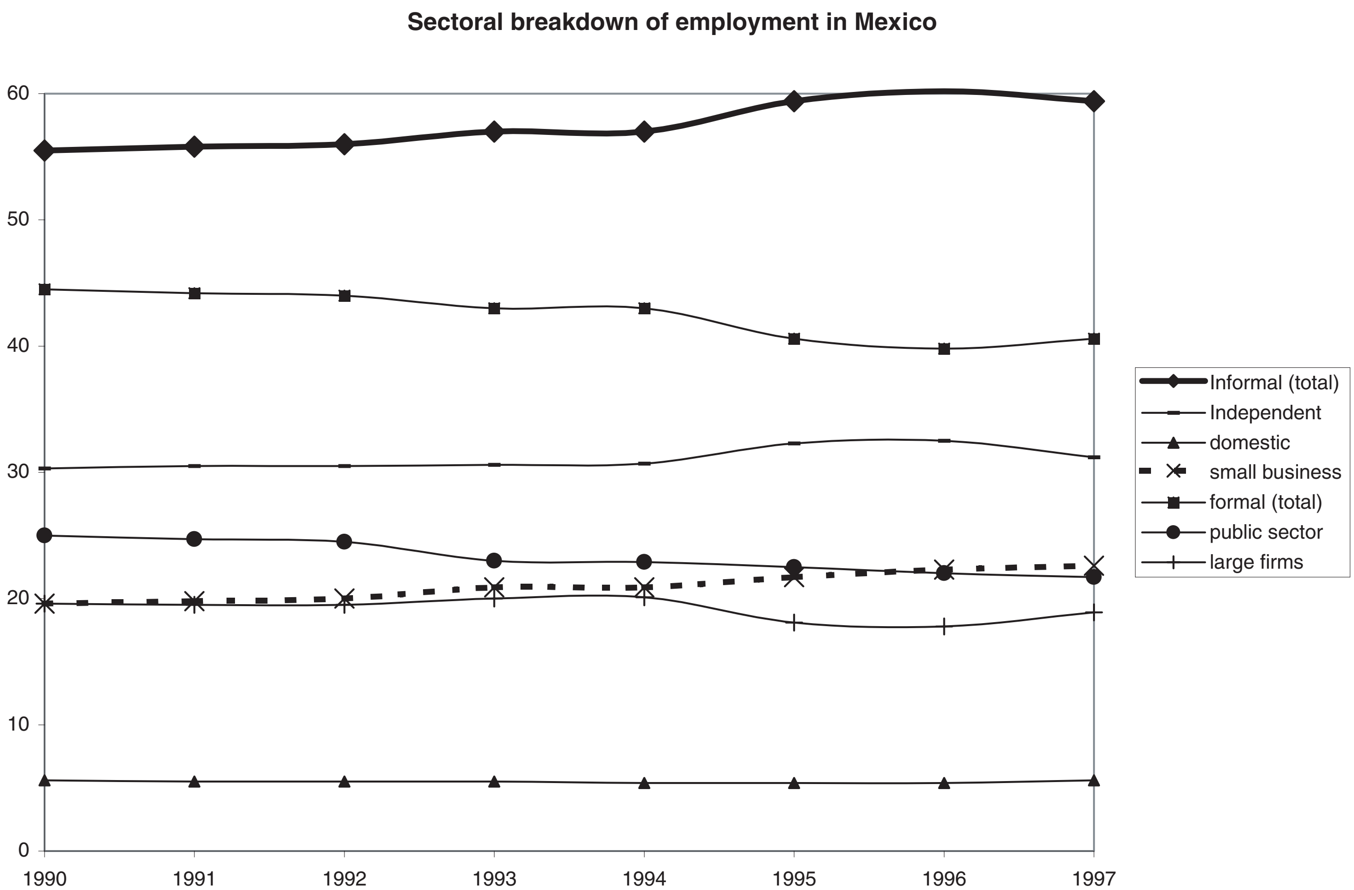
2.3 Who is Covered in Mexico

The majority of an economically active population (which happens to be in the informal sector) is excluded from coverage in Mexico. Figure 2.4 gives a sector breakdown of employment during the 1990s in Mexico.

The following are notable features of this figure. (1) The employment in the informal sector continues to be more important than the employment in the formal sector. The informal sector consists of independent workers, domestic workers and workers in small enterprises. (2) There is no trend towards a reduction in the size of the informal sector. (3) Public sector employment is falling. A (small) reduction in employment in the formal sector is a large reflection of the change in public sector employment. (4) The single largest group of workers are "independent" workers (around 30% of employment). (5) Government remains the second largest employer (around 25% of employment). (6) Small businesses have just about exceeded the level of employment in the government sector (with more than 25% of employment). (7) Large businesses account for around 20% of employment.

In many developed economies, the pay-as-you-go pension system is often used as a means to reduce income inequality. If all workers are covered by social security, income redistribution can be achieved by taxing one group of people to pay for the low income of another group of people. In Mexico (as elsewhere in Latin America), the coverage is far from universal. Even at present, IMSS (or other arrangements) cover less than 40% of the economically active population. Therefore, redistribution affects less than half the labor force. The rest is independent of

FIGURE 2.4
SECTORAL EMPLOYMENT IN MEXICO
1990–1997



old age coverage (as they have been since colonial times).

Coverage in Mexico is highly correlated with income. It has been so since the beginning of the system. To see this clearly, we plotted per capita income in each state (there are 32 including the Federal District of Mexico City as a separate entity) against coverage of the population in 1980 (see figure 2.5). There is a high degree of positive correlation.

2.4 Attempts To Change Social Security

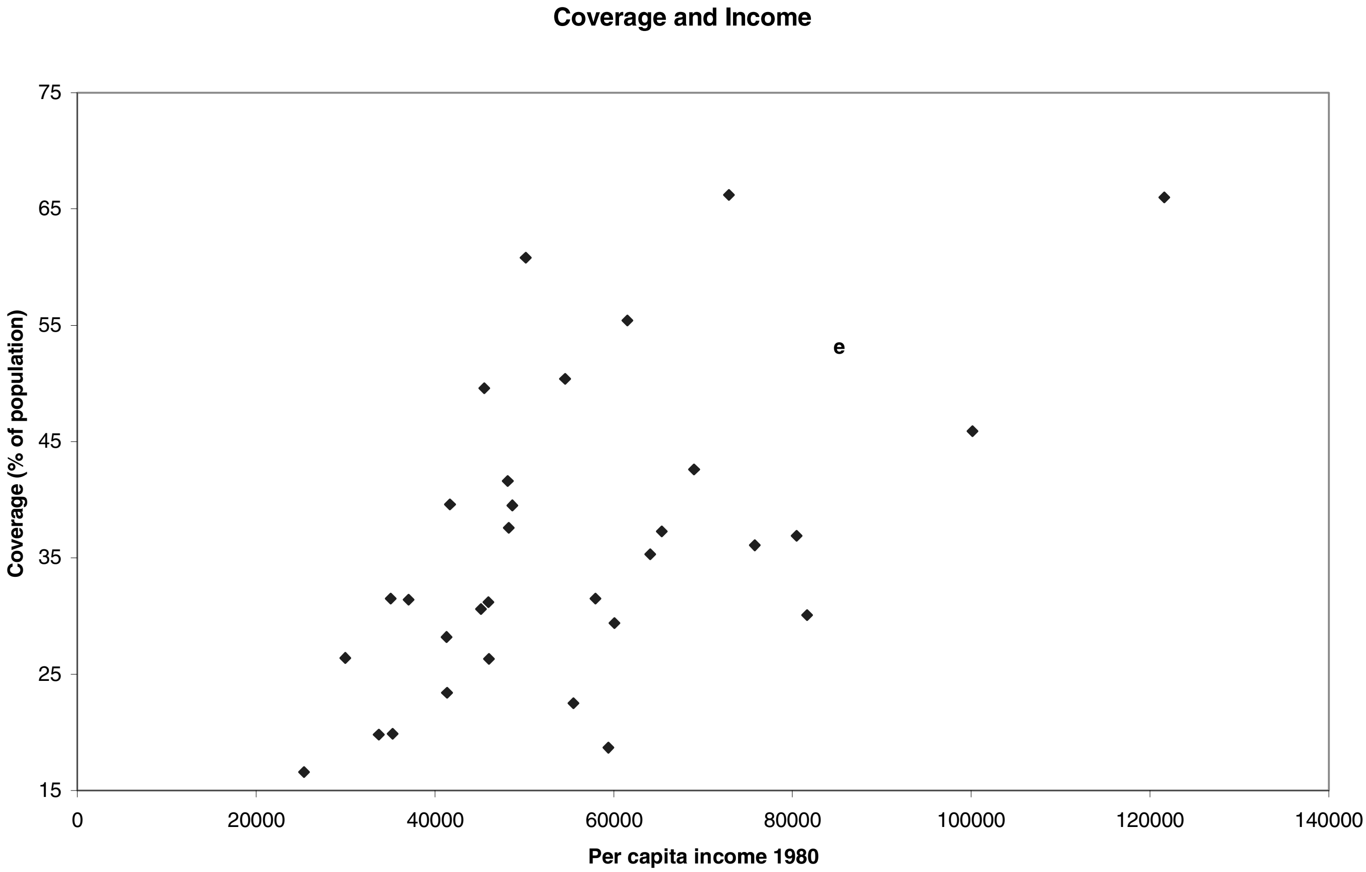
On February 24, 1992, the Mexican Congress passed legislation establishing a new program of individual retirement accounts designed to supplement the statutory social security system administered by the IMSS. There were two sub-accounts.

2.4.1 Sub-account: SAR

Public and private employers contributed a tax deductible 2% of basic wages for retirement (limit of 25 times the daily minimum wage in Mexico City—a ceiling equal to about US$110 in March 1992). This account became known as Saving for Retirement System (el Sistema del Ahorro para el Retiro or SAR).

This was introduced to boost savings and contribution in the system. These accounts were deposited mainly in banks. But, the central bank (Banco de México) was responsible for ensuring that the SAR accounts earned a minimum of 2% real interest rate. Beginning in 1993, employees would be able to choose where to invest contributions. Mutual funds

FIGURE 2.5
Coverage of Social Security in Mexico by State
1980



would be established as an alternative to the Bank of Mexico's pension bonds, which would open fund management to brokerage houses and insurance companies, thus spurring competition.

The Bank of Mexico estimated that the new pension law would immediately add as many as 10 million new bank accounts to the estimated 15 million bank accounts currently in the country. It also projected that the number of pension accounts would reach 35 million by the year 2030 and that the new pension accounts would accumulate capital in excess of US$9 billion by the year 2000, surpassing the US$66 billion mark by the year 2030.

Pensioners would have access to their accounts at age 65, when they became eligible for an IMSS benefit or when they started to receive a non-mandatory private pension provided by an employer. The pensioner may either use the accumulated funds to purchase an annuity or receive a lump sum equal to the account's accrued value. No income tax would be imposed on lump-sum distributions provided distributions did not exceed the amount needed to purchase an annuity yielding nine times the daily minimum wage in Mexico City.

2.4.2 Sub-account: INFONAVIT

A specialized sub-account for housing was introduced. This was managed by Instituto de Fondo Nacional de la Vivienda para los Trabajadores (INFONAVIT). The contribution rate was set at 5% of basic wages (up to a ceiling of 10 times the daily minimum wage). Both of these entries were an integral part of SAR. If an employee who owns a housing sub-account under the new pension plan does not withdraw funds to buy housing, the employee may withdraw the accumulated funds without conditions every 10 years.

INFONAVIT was not new. It began in 1972. It was introduced 55 years after the ratification of Article 123 of the Mexican Constitution. Among other things, it stated: "All business . . . will be obligated to provide comfortable and hygienic worker housing. . . . Businesses will comply with this requirement by contributing to a national housing fund that will constitute deposits for the workers and extend sufficient low cost financing for the workers to buy this housing."

During the first 20 years of existence (1972–1991), INFONAVIT was an utter failure. For example, if a worker had put in 5% of the base wage (of two times the minimum salary) for twenty years, he or she would have received a real rate of return of *negative* 89% over 20 years. Thus, one hundred pesos contributed during 1972–1991 would leave eleven pesos in present value for an affiliate in 1991.

The root of the problem was that, until 1987, INFONAVIT did not index mortgage principal or interest payments to inflation. In 1987 the situation was partially rectified by indexing mortgage principal and interest to the minimum wage. But the drain on resources continued because INFONAVIT assigned construction contracts in a preferential and inefficient manner. Favored contractors produced substandard housing, and if construction costs were unreasonably high (US$25,000 for housing with a market value of US$20,000 was typical) INFONAVIT absorbed them. When INFONAVIT purchased land, it frequently paid inflated prices for poorly located tracts.

2.4.2.1 New and Improved INFONAVIT (since 1992)

In essence, INFONAVIT would act as a fiscally autonomous intermediary that specialized in worker housing. Employers would (still) pay 5 percent of their monthly salary to INFONAVIT, but instead of going directly to an amorphous collective fund, the money would be credited to the workers' individual SAR INFONAVIT sub-accounts in a Mexican bank. The funds would then be transferred to INFONAVIT's account in the Bank of Mexico.

INFONAVIT would be authorized to extend mortgages to qualified workers, make loans to construction companies for worker housing, and loan money to commercial banks to cover the same types of credit. In this last capacity, INFONAVIT would operate as a second tier bank, taking on the minimal credit risk of the lending commercial bank, rather than that of the worker or construction company. Idle funds would be invested in interest-bearing federal government debt. These changes were considered "revolutionary" at the time (Carstens, 1992).

2.5 Why Were These Changes Made in the SAR?

These changes were made in the SAR for several reasons. First, they were expected to boost national saving. Whereas saving in Asia was in the order of 30% of income, saving in Mexico was in the order of 20%. There was a naïve belief that a privatized account would increase national saving (see Chapter 6).

Second, it was believed that individual accounts would make the workers take charge of "their own" accounts. It was also believed that SAR accounts would attract voluntary contributions from workers in the informal sector. Since workers would be able to move their funds around (from one bank to another), it would give banks an incentive to perform.

Third, it was supposed to inject more capital into the under-capitalized banking sector. In 1991, banks were re-privatized. The Bank of Mexico (central bank) perceived that the new banks did not have enough capital. Hence, the additional investment would inject cash into the banking sector.

Fourth, the government wanted to ensure that the retirement of baby boomers did not fall short of their expectations.

2.6 What Happened with the SAR?

Some of these were short-term goals, whereas others were long-term. It is hard to say whether the long-term goals were fulfilled. It is easier to find out what happened in the ensuing five years (before the new laws of social security came into existence in 1997).

One of the predictions of the Bank of Mexico (central bank) was more than fulfilled, but for the wrong reason. By 1997, there were 55 million accounts of SAR. When we contrast this number with the number of workers in the formal sector (10 million in 1994), it becomes amply clear that there were multiple accounts. This problem totally overwhelmed all the benefits. Each person was supposed to have a unique identification number (called RFC, Federal Revenue Code). In reality, people had multiple RFCs. Employers were supposed to contribute on behalf of the workers. Banks were supposed to accept them. Nobody bothered to check the validity of the RFC for each worker. As a result, workers were not able to take charge of their own accounts. Many did not know where their money was. As of July 2000, the regulatory body CONSAR was still trying to sort out this problem.

Boosting national saving by means of a compulsory retirement account is at best a questionable goal. One form of saving simply may substitute another. In addition, if the saving is invested in government bonds, it is unlikely that it would be net wealth to the economy as a whole.

Banks in Mexico had lent recklessly during 1993–1994. Thus, whatever re-capitalization might have occurred through SAR accounts was completely overwhelmed by bad loans.

2.6.1 Lessons

The single biggest problem created by SAR accounts was the multiplicity of accounts. This multiplicity was due to the failure of the government to make affiliates "take charge" of their own money. Neither the banks nor the employers had much incentive to manage this properly. Employers felt their duty was done once they delivered the money to the banks. Banks in turn made no effort to find the appropriate "owner" as long as the money was deposited in the bank.

The response of the government was to create a new regulatory body within the Treasury Department. It was called Comision Nacional de Sistemas de Ahorro para el Retiro (CONSAR). CONSAR was created in July 1994, two years after the introduction of SAR.

2.7 Pension Reform in 1997

By the end of 1994, it had become clear that the SAR reform had not produced any changes that were supposed to take place. Moreover, during 1994 the worst economic crisis in Mexican history occurred. The "rescue package" brought in by the World Bank and the International Monetary Fund (along with the Treasury Department of the United States) had strings attached to it. One of the preconditions of the loans was a complete revamp of the pension system along the recommendations made in the document of the World Bank (1994). This pressure was recognized in an article in *Business Week*: "Mexico is facing mounting pressure from the International Monetary Fund, World Bank, and international investors to create privately managed pension funds to pump more savings into the economy. Finance Secretary Guillermo Ortiz is already working on proposals to reform Mexico's social security system." (October 23, 1995)

The government passed the new legislation reforming the social security system and ushered in privatization of fund management in December 1995 in the Lower House of the Mexican Congress. This change was viewed in various quarters in very different lights. For example, the *Wall Street Journal* (December 11, 1995) reported, "Mexico's House passes a broad plan that will free billions of dollars from the federal pension and social security system to help finance Mexico's credit-strapped companies." Thus, the main reason for privatization was seen to be the funding of private companies. However, the restrictions on the regime of investment of the pension system would not allow large-scale investment in the private sector (see chapter 8).

In a summary of the system at the end of 1995 and describing the reason for changes in Mexico, Kritzer (1996) wrote:

> Currently, there are about 1.2 million pensioners, 90 percent of whom receive the minimum benefit. The Mexican Social Security Institute (IMSS) has an annual budget of more than 40 billion pesos. Under the present system, revenues would be lower than pension obligations by the year 2000. The new plan involves partially privatizing the pension and health systems, revamping the workers' compensation program, and expanding the number of child-care facilities throughout the nation. These changes are expected to increase domestic savings from 16 percent to 24 percent of the gross domestic product over a 5-year period.

This was exactly the view promulgated by the Ministry of Finance of Mexico. According to this view, there were two strong reasons for the reform. The first reason was that the existing pay-as-you-go system was going to go bankrupt by 2000. The second reason was that saving was going to be boosted by privatization of pension.

Reporting the approval of the reform in the Senate of Mexico, de Palma noted in the *New York Times*:

> The privately run pension funds approved on April 25, 1996 are a crucial part of President Ernesto Zedillo's sweeping overhaul of the Mexican social security system. To increase domestic savings, President Zedillo revamped the social security system so that retirement funds could be managed by private companies. By offering more efficient management and higher interest rates,

> the privately run pension funds would presumably encourage Mexican workers to save more. Under the bill, which now awaits the President's signature, private companies, banks and the social security system itself will be allowed to manage separate funds. American, Canadian and Chilean companies can have complete control of a fund but companies from other nations that are not principal trading partners will be limited to 49 percent participation. But no fund will be allowed to control more than 17 percent of the entire pension fund market during the first five years, a precaution intended to prevent any company from dominating the field. After five years, the limit will be raised to 20 percent. (April 27, 1996)

After the passage of the law in both houses, there was a long wait for the regulations to be released. At first CONSAR indicated that it would have the new regulations in place within two months. But there was an unexplained delay. In September 1996, CONSAR came up with the promised regulations.

There were several surprises. Many people in the industry expected that the funds would be allowed to invest in stocks and bonds. As a result, many in the mutual fund industry were hopeful that they would be able to participate (Wyss, 1996). Instead, CONSAR issued very tight regulations that made investment in anything other than short-term government bonds virtually impossible. Money managers also expected that they would be allowed to run several funds (simultaneously) from the beginning. Regulations also ruled them out. There were also political battles as to the authority to choose funds, that is, who should choose the funds—the workers or the employers? In the end, individual workers were set free to choose their funds. In reality, however, it was the employers (in most cases) who chose the funds on behalf of their workers (see chapter 5). CONSAR also set out a limit on the market share of funds. No fund was allowed to have more than 17% of the market. The surprise was not the limit itself but the form it took. Market share was not defined in terms of the value, but in terms of the number of accounts. Thus, a fund could have high-income individuals in the portfolio with 30% of the market value and not touch the 17% market share limit in terms of the number of affiliates.

There were 44 applications for setting up pension funds under the regime by December 1996. It became obvious that it was not possible to start the system by January 1, 1997. Thus, the starting date was pushed back to July 1, 1997.

2.7.1 Amazing Overstatements

Out of the initial 44 applicants, 18 passed the first stage. In January 1997, 12 pension funds were approved by CONSAR. Funds began advertising on February 1, 1997. Three days later, Banamex announced that it had already signed up 100,000 customers. Figures published by CONSAR showed that none of the funds had 100,000 affiliates *even by the end* of February 1997. Before July 1, 1997, both Banamex and Bancomer had more than a million affiliates each.

In March 1997, *Best's Review* reported that by 1998, pension funds in Mexico would be managing over US$12 billion or about 3.5% of GDP. Case (1997) also reported the same. However, deposits into the system only brought in about 2.7% of GDP by the end of *July 1999* (see Solis-Soberon, 1999).

2.8 Conclusions

Social security has a long history in Mexico. In the post-Hispanic period, the existence of social security was highly selective. Like many other Latin American countries, well into the twentieth century, social security benefits were provided to a select few. The introduction of a ''universal'' social security system in the form of pay-as-you-go arose only in 1943. With the problems of a mainly informal economy, the universality was never achieved. Even at the end of the twentieth century, no more than 40% of the labor force was covered. However, the main beneficiaries of this coverage remain the high-income workers.

As a response to the economic stagnation of the 1980s, many fundamental policies in the country were changed (not in the least because of coaxing from the World Bank and other international agencies). A trial balloon of privatization was floated for social security with the introduction of SAR accounts in 1992. By all accounts, this was not a success. It did, however, pave the way for private management of social security in 1997. In the following chapter, we explore the old and the new systems in full detail.