IX

Conclusions and Recommendations

There are many valuable lessons to learn from the experience of Mexico. The following sections cover conclusions and lessons corresponding to each chapter.

9.1 What Mexico Could Not Do

In chapter 2, we show that despite the 54 years of history, the pay-as-you-go system failed to achieve universal coverage, unlike the pay-as-you-go systems in developed countries. The existence of the ''informal economy'' is quite widespread. In the first tentative move towards private management of funds, Mexico introduced the SAR accounts system to supplement the existing pay-as-you-go system. It was a failure. The main problem was the duplicity of accounts. In the second attempt in 1997, checks and balances were introduced to eliminate this problem, but they did not quite succeed.

9.2 The Problem of the Non-Comprehensive Approach

The pension system, whether pay-as-you-go or privately managed, pervades many different aspects of life. If problems are not tackled simultaneously, they can create havoc in the long run. The first problem that the policy makers in Mexico did not attack is how they were going to fund the promises made under the old system (and the old system is not going to disappear any time soon). In addition to the promises made under the IMSS, there are various other unfunded plans (such as the pension systems of the states). These implicit promises can drain the government budget long into the future. Before the introduction of the new social security law (1996), these promises shrank simply due to inflation (as the benefits were not indexed). Under the new law, this will not happen in the future.

9.3 Some Festering Problems in the New System

Compared with other countries in the region, privately managed funds in Mexico took hold rapidly (at least in the formal sector). But some problems remained. Despite some determined efforts not to have duplicate accounts (this plagued the SAR), the problem of multiple accounts continues to pose serious problems. If the market share limit was intended to restrict the market share of the fund sizes, it has not succeeded. Bancomer continues to be out of the bounds. Over the long run, some other funds will exceed the limit (if the limit is meant to contain market power in terms of the fund size). It would have been better to explicitly set the limit in terms of the size of the fund rather than the number of people affiliated. Some funds have a substantial number of inactive members. Inactive members will spell problems later. They will become a burden to the government and thus drain the system in the future. Quantitative restrictions imposed by CONSAR to limit investment would hurt the affiliates in the long run (see also chapter 8).

9.4 Customer Satisfaction under the New System

A longitudinal study of customer satisfaction of the pension system shows that customer dissatisfaction was high in the beginning and then diminished. This is an expected finding when a completely new (financial) product is introduced. Moreover, our surveys show that, for the majority of workers, the option of choosing a fund did not mean anything; the company they worked for chose the fund for the workers. It would have been a better idea to let the companies choose the funds in the first place. It might have been useful for reducing the high management fees (see chapter 7).

9.5 Private Management Versus Full Funding

Newspaper writers and political commentators tend to confuse private management of funds with full funding. The confusion arises from the fact that government bonds are used to finance the past promise to the affiliates under the old pay-as-you-go system. Mexico is a classic example. Mexico has moved to a privately managed pension system. It has not yet achieved full funding. It simply gets the appearance of one.

9.6 The Problem of Management Fees

The cost of running the privately managed system is high. Recent estimates by CONSAR indicate that the average worker would need to be in the new system for 25 years with at least eight-percent real average return on investment to be better off than the old pay-as-you-go system. If we add the cost of buying annuities on top of this, the situation worsens.

9.7 The Problem of Portfolio Management

CONSAR has imposed a number of quantitative restrictions on the investment regime of the AFOREs. The objective is to reduce risk. We show that such restrictions do not prevent occasional negative real rates of return. Instead of setting quantitative restrictions, it might be better to set risk limits and let the funds choose their own portfolios appropriately. Simulation exercises show that it might increase the annual rates of return one to two percent without increasing the risk. This can add a substantial amount to retirement benefits.

9.8 Unfinished Agenda

There are a number of issues that the privately managed system needed to address but did not.
(1) Retirement Age: The new system did not link retirement age to an increase in longevity. Had this been done, it could have avoided many critical funding problems that will arise over the coming decades.
(2) Portfolio Risk: It would have been better to design a program with maximal risk specified rather than specifying individual components of the portfolio.
(3) INFONAVIT: Along with 6.5% contribution (by the workers earning average wage), each affiliate is also making a 5% contribution to the housing sub-account. Given the bad performance of the INFONAVIT, it would have been far more useful for the average worker to have both contributions under the same account.
(4) Informal Markets: The system continues to operate solely on the formal labor market. For workers in the informal sector, there is no possibility of getting into any retirement scheme. Given that the informal sector continues to be extremely large, reforming the pension system means nothing to the majority of the workers in the labor force.