

Border Corollary: The Effect of Demographics and Migration on the Mexican Pension System

LOWER MORTALITY, DECREASING FERTILITY, AND MIGRATION TO THE UNITED STATES of young persons of productive and reproductive age are leading Mexico to a rapidly aging population.

In 1930, the population was 16.9 million with an aging index (AI) of 6.3 persons 65 and over for every 100 younger than 15. The population increased to 99.8 million in 2000 with an AI of 14.5. Intermediate projections estimate a population of 132.8 million by 2040 and a jump in the AI to 116, which will increase to 167 by 2050.

Mexicans aged 90 and older are already common, and centenarians are appearing; thus socioeconomic risks and health vulnerability for the oldest-old will be significant in coming decades. This rapid aging of the population will occur at the same time that lags in education, employment, housing, health, and social security continue to hobble economic development.

Mexico's changing age structures aren't due just to aging. Presently, and for the next few decades, young and adult populations will continue to increase, potentially enabling the country to surpass current productivity levels. Lower birthrates will reduce the dependency ratio in a "demographic window" that will be open at its widest in the years before 2040. As depicted in the graph on page 12, declining demographic dependency ratios will then increase but this time due to population aging.

This demographic window is significant when invoking the concept of demographic dividends. In theory, the first dividend occurs when a favorably low dependency ratio is used to save money and invest resources in constructing a lasting social and economic infrastructure that is capable of supporting the well-being of the entire population, including the increasing elderly sector. The second longer-term dividend kicks in after the demographic window has shut, assuming that the first dividend was utilized to build up social and economic supports in the society. (To read more about this concept, see Barr's article on the economics of pensions and Brown's

discussion of fallacies about pre-funding pensions, listed in the references.) A crucial long-term benefit according to the theory, and very pertinent in the case of Mexico, is the availability of sustainable retirement pensions.

Pensions in Crisis

An international standard and a socioeconomic goal for any country is that its pension system provide protection for the entire population, grant uniform and equitable benefits that are suitable and sufficient, redistribute wealth in a solidarity scheme, and be financially, economically, and socially

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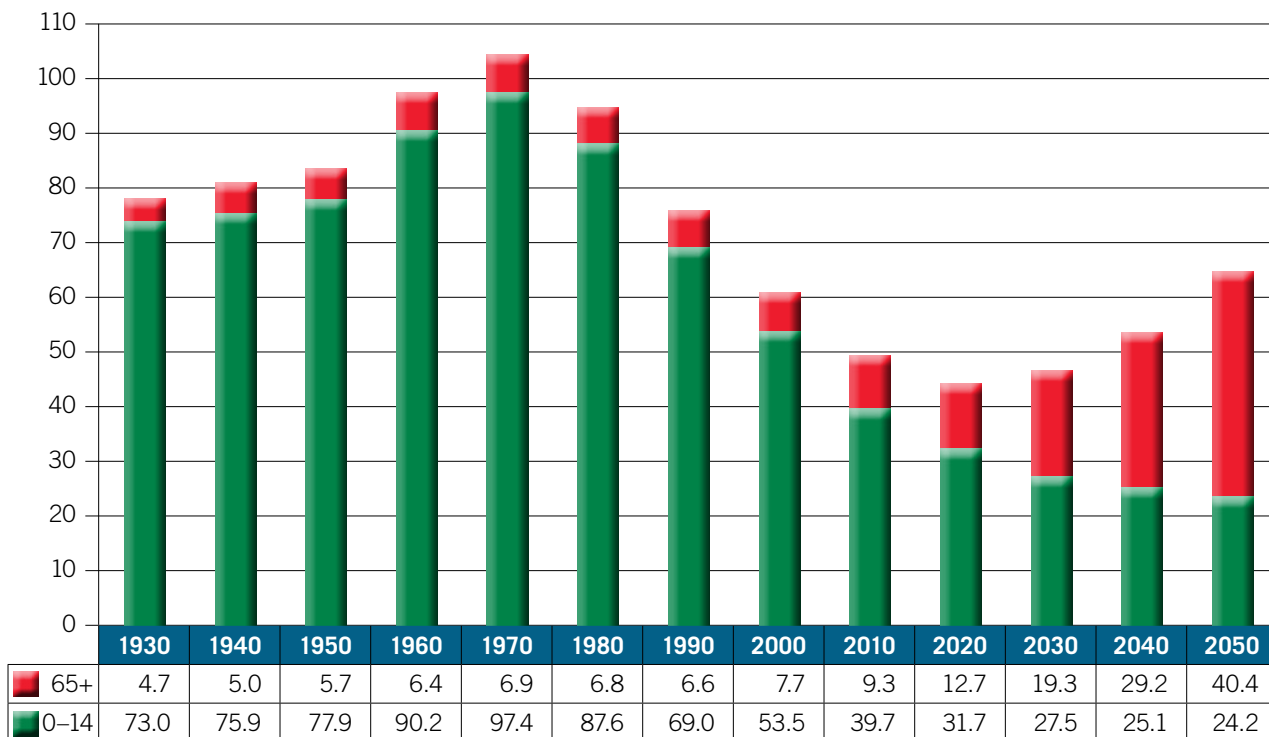


sustainable. Unfortunately, none of the above has ever been met in Mexico. Less than 40 percent of the economically active population is covered by a pension plan. Those who do have some form of pension benefit are mostly urban salaried employees who work for private companies or public institutions with the economic capacity and management structure to offer a pension. There are several Mexican pension agencies, each protecting specific groups and offering different benefits depending on political clout and the negotiating ability of different labor unions. While a large number of Mexican retirees receive an insufficient pension, a minority retire at an earlier age and after a limited work

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DREAMSTIME/BONOTOM STUDIO

Demographic Dependency Ratios for Mexico, 1930-2050



SOURCE: CONAPO, 2005

life to more generous pension incomes.

As a practical matter, the current pension debate in Mexico is predicated on the need to maintain financial stability in the country. One advantage for Mexican pensioners, even those with meager allotments, has been the difference between benefits paid out and relatively low contribution levels. After decades of ignoring actuarial imbalance, budget warnings, and common-sense accounting, Mexico has scant financial resources and less economic capacity to fund currently vested retirement benefits.

From the perspective of demographic dividends, two issues must be stressed. The first is the high cost of pensions in a system with historical actuarial gaps and an increasing benefits/contributions ratio. The other is a rapidly increasing contribution ratio for both employees and employers. These are obstacles to the construction of the first dividend and thus perilous to any realization of the second dividend.

From Defined Benefit to Defined Contribution

In recent years, Mexican pensions have been moving from a pay-as-you-go defined benefit model to a defined contribution system with privatized individual accounts. Promises have been made to seek actuarial balance, to provide universal coverage, to offer better pensions, and to generate investments that would create jobs and income. That is, to work at developing a significant part of the first dividend.

But after more than a decade of social insurance reforms, it's evident that coverage is diminishing, that administrative costs are enormous, and that there's a heavy load on public finances. Future pension benefits will be lower, and actual capital investments that could generate employment are scarce as most of the funds are invested in government bonds to meet current public expenses. From a macroeconomic perspective, resources are being diverted from basic needs such as education and health care. Instead of

building it up, it's clear that the new system is actually eroding the first dividend.

When workers with individual accounts under the defined contribution system retire, government bonds (the main savings instrument) will be cashed in, further depleting public funds. At the same time, most retirees will have accumulated insufficient funding, since contributions are low, returns are almost non-existent, and funds are subject to inflation and devaluation risks. Those who have contributed at least 24 years are entitled to a minimum guaranteed pension. If their resources are insufficient to buy an annuity, they will receive the difference from public revenues.

As this implies, Mexican pensions still keep many pay-as-you-go characteristics, only now in a more expensive system. Since most of the costs rely on public revenues, Mexico's resources are being diverted from social and economic priorities, affecting negatively the first dividend and jeopardizing the second dividend of

In 2006, migrants sent back \$23 billion to Mexico.

long-term sustainability of the pension system.

Mexicans in the United States

The size and dynamics of the population of individuals of Mexican origin residing in the United States are significant for both countries.

In 1930, the U.S. Census registered 600,000 individuals of Mexican origin, equivalent to 0.5 percent of the U.S. population and 3.5 percent of the population in Mexico. In 2006, that population was estimated at 28.3 million by the U.S. Census Bureau's current population survey, comprising 9.6 percent of the U.S. population and comparable to 26.7 percent of the population in Mexico. Of that number, 17.2 million were born in the United States and 11.1 million migrated from Mexico.

Projections about the growth of this group can be made using assumptions of future mortality, fertility, and migration for three categories of individuals: those born in the U.S., those born in Mexico, and future migrants from Mexico. With respect to future migration, the main determinants will be socioeconomic, which will be affected by the rise or fall of employment opportunities in both countries.

Under present trends, the portion of the U.S. population of Mexican origin is projected to be 37.8 million by 2020. That would be 11.3 percent of the total U.S. population and equivalent to as much as 30.9 percent of the population of Mexico. The percentage of that group aged 65 and older would be 6.3 percent, lower than the 8.8 percent expected for Mexico. The numbers for 2040 are larger: 55.4 million, representing 14.1 percent of the total U.S. population and equal to 41.7 percent of the population of Mexico. The percentage of those 65 and older of Mexican origin resident in the United States in 2040 is projected to be 13.1 percent, compared to 18.9 percent in Mexico.

Since migration from Mexico to the United States consists mainly of young males at working and reproductive ages, an immediate question is whether it is affecting the demographic window in Mexico, thus eroding the first dividend, including social insurance.

From a simple demographic analysis, this movement of the labor force from Mexico to the United States appears to be a loss for the demographic window. But it should be remembered that these migrants might not have been employed in Mexico and are sending back a great amount of money. It's possible that migration will have a positive effect for Mexico as it seeks to take advantage of the first dividend.

Remittances from migrants back to Mexico have always occurred. But in recent years, there have been considerable increases. It's estimated that in 1990, Mexico received \$2.5 billion. It was \$6.7 billion in 2000, went up to \$16.6 billion in 2004, and reached \$23 billion in 2006. This last figure is equivalent to 2.6 percent of Mexico's gross domestic product, making it the second most important source of foreign currency, surpassed only by the oil industry.

Some 80 percent of remittances are destined for home consumption, with 16 percent applied to housing improvement and construction, 3.5 percent saved and invested, and 0.5 percent applied to other purposes. Research is still needed to ascertain what portion of expenditures is replacing the existing lack of social insurance, as well as how much is used for health care and to allow children to attend school (key elements of the first dividend).

In any case, any study on sustaining retirement pensions and general well-being for the elderly in the near and distant future in Mexico requires a wider perspective that includes both the causes and consequences of migration. As part of any further analysis of prospective social secu-

rity and demographic dividends in Mexico, pending tasks include a demographic, economic, and actuarial evaluation of cross-border interaction with those of Mexican origin who are residing in the United States. ●

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