A model for the pension system in Mexico: diagnosis and recommendations

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Abstract

The reform of the pension system of the Mexican Social Security Institute (IMSS) in 1997, limited the growing fiscal cost of the previous pay-as-you-go scheme. Sixteen years on from its creation, the Retirement Savings System (SAR) has had favourable macroeconomic effects for Mexico, as it has significantly increased financial savings and encouraged the development of local financial markets.

However, the employment and pension coverage has not developed as hoped, due to the high rate of informality in the labour market. In addition, the replacement rates forecast for old-age pensions from the defined contribution scheme will be low, due to problems exogenous to the pension system, such as low contribution rates and low contribution densities.

The main objective of this study is to develop a macroeconomic and actuarial projection model to simulate the expected coverage and replacement rates for the period 2012- 2050, within the framework of a demographic and economic forecast that will allow a detailed diagnosis of the current conditions of the pension system. To do so, the model manages a database of 4 million individuals, classified into 60 types of each age, according to age, gender, level of studies and deciles of income distribution.

The results reveal the unpromising scenario that the pension system has and will continue to have in the long term, with limited improvements in coverage rates. The possibility of obtaining adequate pensions will be restricted to those who have socioeconomic conditions with a long employment history, who can thus make contributions to their individual accounts.

Taking into account this baseline projection scenario, we simulate the expected effects of a applying a set of proposals with the aim of tackling the main problems, such as the low coverage, low replacement rates, and low level of participation by young people in the system.

Key words: defined contribution, pensions, replacement rates

JEL: G23, H55, J11, J26