

International Forum on Public Policies for the Development of Mexico

Reforms to Health and Pensions Systems in Mexico: Where We Are and What Remains to Be Done

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Introduction

The system of social protection in Mexico differs from that in most other OECD countries. As in many Latin American countries, social protection is unequal: the social security system most often excludes the poorest part of the active population – essentially those who are not employed in the formal sector. In fact most of social expenditure benefits people at the higher end of the income distribution. The bottom 20% of the population gets less than 10% of public transfers. These disadvantaged groups tend to be served by safety-nets or social assistance type programmes that are often fragmented and poorly funded. As a consequence, poorer population groups have limited access to social protection, are vulnerable to catastrophic health care costs, and more likely to face poverty in old age. Despite major improvements in recent years, if the longer-term goal of policy is to offer social protection to all Mexicans on an equal basis – as is the case in most other OECD countries -- Mexico will need to undertake further reforms. Today, I would like to focus my intervention on two key areas of social protection, namely health care and pensions.

Health care

- **Mexico has seen dramatic improvements in health outcomes.** Mortality and morbidity patterns are no longer dominated by communicable diseases and the share of chronic diseases and life-style related illnesses has increased even if an important epidemiological backlog remains in poor states and rural areas. **This transition is putting great pressure on Mexico's health system.**

- **Mexico is one of the few OECD countries that have not yet achieved universal or near-universal health insurance coverage.** The System of Social Protection in Health (SPSS) reform introduced in 2004 is aiming at changing this situation. Taking into account expectations of increased financing for Seguro Popular for 2007, public spending devoted to health will increase and the share of total families with coverage for most health care expenditure might expand to around 75 to 80 per cent by the end of this year. This would represent a major policy achievement.
- **In addition the SPSS is injecting new resources into the health-care system** at the state level by increasing State and federal support for each new insuree joining the Seguro Popular. This contributes to expand the State Health System and to re-balance the (unequal) financial transfers for health from the Federal government to the States by increasing resources for the poorer states that have been under-funded in the past.
- **Efforts are also being made to improve the infrastructure** by increasing the number of hospitals, particularly in those areas where supply is low. Quality issues are also being addressed, for example, through hospital accreditation and certification procedures. Governance and supervision from the Ministry of Health and the State authorities are also being strengthened.

What next for health policy?

- The SPSS has been widely considered to be a carefully designed programme aimed at tackling many inequities and shortcomings of the existing health system. It is moving Mexico towards full coverage of health risks. However, **the programme and associated government policy have not thus far addressed important weaknesses in the system.** Let me mention a few that appear to be particularly important.

- **First, today, Mexico spends less publicly on health care than other OECD countries** (Figure 1) 3 percent of GDP compared with about 7 per cent on average in the OECD. Expanding the SP programme will require additional funding from the public purse of the order of $\frac{1}{2}$ to $\frac{3}{4}$ percentage points of GDP. The heavy reliance of the budget on oil revenues makes the financing of recurrent social services such as health care very vulnerable to changes in oil prices. This calls for an urgent tax reform permitting increased tax revenue to ensure a more sustainable and more predictable funding for health care.
- **Second, there is a longer-term need to break down the current fragmentation of the health care system.**
 - The Seguro Popular is increasing health insurance coverage for poor households outside the social insurance systems where vertically integrated institutions serve their own insurees and are not linked. **But it has maintained – and perhaps even reinforced -- the existing fragmentation of the health insurance system.** Over the longer term **a single insurance system with equal benefits for the whole population should be put in place**, as is the case in most OECD countries.
 - The present "silo" approach to health provision, where insurers own the health-care facilities targeted only to their own insurees, has resulted in **duplication and waste** of scarce resources. Over the longer term, **it would be best if money were to follow the patient, not any particular institution.** This is provided for in the SPSS reform and should be **implemented. It would require carving out the medical part of IMSS:**
 - **Third, more attention needs to be given to increasing the overall efficiency of the health-system.**

Areas for particular attention are:

- Partly due to the system fragmentation, **administrative costs -- at close to 10 per cent of total health spending, -- are much higher relative to other OECD countries.** These resources need to be re-invested in the supply of health –care services where they are most needed.
- **A clearer split between insurers and providers is needed** and should be accompanied by contractual arrangements between insurers and providers over the price, quantity and quality of health services. Incentives to increase productivity are low. There should be more emphasis on activity-based financing for hospitals and clinics rather than on historical budgets.
- Consideration should be given to **linking the remunerations of public-sector health personnel to performance goals.**
- **Competition and benchmarking between institutions should be encouraged.**

Finally, there is a need to **better assess and evaluate existing programmes**, in particular whether the new funds transferred to the States under the SPSS are being used in an efficient and effective manner in the State Health Systems. This may require strengthening the overall system governance, notably through investing in managerial capacity -- especially at the State level -- and through the development of common information systems and the introduction of reporting and accountability frameworks for all institutions.

Pensions

The Mexican pension arrangements are also fragmented and provide very unequal coverage to the population. While private sector workers in the formal labour market are now covered by a unified privately managed pension system, introduced in 1997, public sector workers are still covered by a more generous public pay-as-you-go scheme (mainly ISSSTE) and

a large segment of the population (mainly the poor) are not covered at all. The existing schemes differ strongly in the generosity of their pension benefits and some of them are already under strong financial pressures; these pressures will intensify as the Mexican population ages.

Since the 1997 reforms, new entrants into formal private-sector employment are obliged to join the new funded and privately managed, defined-contribution scheme. Self-employed workers can also join the system through voluntary contributions to their pension accounts. By the end of 2006, the private pension system had assets just under 14% of GDP.

Are further pension reforms needed?

Despite the far-reaching reform of the largest pension scheme there remain a number of important problems to address.

First, overall coverage remains a problem: only about 35% of the labour force and less than a quarter of the working-age population appear to be reached by the private sector pension system. The new system based on individual accounts risks reproducing existing income inequality in old age. Currently more than half of public transfers to the elderly go to the richest 20% and only 4% go to the poorest 20%. Only 5% of rural elderly receive a pension compared to 2.2% in urban areas. The biggest challenge for the private pension system to widen coverage will be reducing the size of the informal sector which is estimated to account for about 40% of all Mexican employment.

Secondly, many workers who are affiliated with the new pension system fail to contribute regularly to their accounts. At the end of 2005, only 38% of all account holders actually contributed, jeopardizing the effectiveness of the new pension system in providing old age income security, especially for low-income workers where the share of non-contributors is

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the highest. Since access to the minimum pension guarantee requires 25 years of contributions, these workers are unlikely to have adequate income protection in old age.

Third, the management fees of the private pension fund companies are high by international standards, raising the question as to whether the fund management market is functioning efficiently.

Finally, the ISSSTE pension scheme and other sectoral schemes, which cover the workers of the public sector on a pay-as-you-go basis, raise very serious fiscal concerns. The annual deficits, which are absorbed by the government, are growing at a constant and alarming pace, thereby limiting spending in other priority areas.

I would like to make three concluding remarks by way of a summary:

First, as I already mentioned progress in health and social protection will require greater public resources. The current dependence on oil revenues needs to be reduced through a broad **reform of the tax system**. Otherwise, the Mexican authorities will be unable to provide the wide range of social services that the population needs.

Secondly, **any increase in fiscal resources must be spent in the most effective manner**, i.e. the quality of expenditure also matters. In this context, improving the coherence and co-ordination of existing social policies, including policies to reduce poverty, and their financing, and reducing the piecemeal approach should be a top priority for the new government.

Thirdly, while labour market issues are being discussed in another panel, **a key priority is to increase labour market participation in the formal economy**. The high incidence of informal employment reduces the tax base for funding health and social protection. Efforts to increase formal employment need to consider whether the existing social insurance/assistance

system and its financing are providing the right incentives to move into (or remain in) formal employment.