

TC Document

I. Basic Information for TC

▪ Country/Region:	MEXICO
▪ TC Name:	Applying Technology to Create an Integrated and Comprehensive Pension System in Mexico
▪ TC Number:	ME-T1391
▪ Team Leader/Members:	Kaplan, David Scott (SCL/LMK) Team Leader; Azuara Herrera, Oliver (SCL/LMK) Alternate Team Leader; Barragan Crespo, Enrique Ignacio (LEG/SGO); Barrios Nunez, Uriel (CID/CME); De Gyves Sandoval, Alejandro (CID/CME); Garcia Valero, Andrea Carolina (SCL/LMK); Gonzalez Herrera, Beatriz Maria (SCL/LMK); Hernandez-Cartagena, Carolina L. (SCL/LMK); Penaherrera Proano, Sebastian (SCL/LMK) Penaherrera Proano, Sebastian (SCL/LMK)).
▪ Taxonomy:	Research and Dissemination
▪ Operation Supported by the TC:	N/A
▪ Date of TC Abstract authorization:	10 Aug 2020
▪ Beneficiary:	<i>Estados Unidos Mexicanos, through Secretaría de Hacienda y de Crédito Público (SHCP), México</i>
▪ Executing Agency and contact name:	Inter-American Development Bank
▪ Donors providing funding:	OC Strategic Development Program for Social Development(SOC)
▪ IDB Funding Requested:	US\$290,000.00
▪ Local counterpart funding, if any:	US\$0
▪ Disbursement period (which includes Execution period):	36 months
▪ Required start date:	December 2020
▪ Types of consultants:	Consulting Firms
▪ Prepared by Unit:	SCL/LMK-Labor Markets
▪ Unit of Disbursement Responsibility:	CID/CME-Country Office Mexico
▪ TC included in Country Strategy (y/n):	Y
▪ TC included in CPD (y/n):	Y
▪ Alignment to the Update to the Institutional Strategy 2010-2020:	Social inclusion and equality; Productivity and innovation; Economic integration; Gender equality; Diversity

II. Objectives and Justification of the TC

- 2.1 Mexico is still a relatively young country, but it is rapidly aging. Its demographic bonus will end in the next 30 years and the country's social security systems will have to adjust to face this demographic reality.
- 2.2 Mexico's social security systems already have significant structural challenges. First, the costs of Mexico's social security systems are already high and will represent a serious challenge during the next decade. Public spending on pensions in 2018 was around 3.6% of gross domestic product (GDP), or almost all the Value-Added Tax (VAT) collection (estimated at 3.8% of GDP). With current projections, if left unchecked, the deficit from of these systems could reach 5.7% of GDP by the year 2030. Second, low (about 30%) coverage of contributory pension schemes mean that much of the aged population that receives pensions receives non-contributory

pensions that are paid entirely with public funds. Third, the pension system itself is fragmented into over 1,000 different disconnected national and sub-national systems.

- 2.3 These structural challenges to pension systems have identifiable root causes. First and foremost is the high levels of informality within the Mexican labor market, which limits the percentage of the working population that regularly contributes to their future pension. For example, even in formal firms, data from the fourth quarter of show that 28.9% of subordinated workers in private firms do not have access to social security. Second is the lack of portability of pension rights among the different pension regimes which limits labor mobility and therefore productivity in the labor market. These challenges are the more acute because of the lack of connection of the information systems between the myriad pension systems, and the ensuing lack of portability of benefits for workers that wish to move between jobs that offer different types of pension schemes.
- 2.4 Solutions are needed to address these pressing issues. Some key solutions that address these challenges and their root causes are reform designs that consider labor market regulation and incentives, and inter-operable social security systems that support labor market formalization.
- 2.5 On September 25, 2020, the Government of Mexico sent a pension reform proposal to the lower chamber of the congress. One of the crucial issues for the legislative debate is the increased contribution rates contained in the proposal. Another issue that will be important for the debate will be the appropriate methods to evaluate the commissions charged by the fund administrators in order to ensure that workers receive more resources in their accounts while maintaining healthy competition among pension funds.
- 2.6 This TC seeks to use and apply recent technological advances to facilitate and strengthen an integrated and comprehensive pension system in Mexico. Types of new technology under consideration are different types of system interoperability options to support different pension systems and portability of benefits, as well as the potential use of big data in activities like formalization pilots to identify likely cases of labor rights abuse.
- 2.7 Some limited interoperable, accessible, social security systems already exist in Mexico. For example, the federal pensions regulator *Comisión Nacional de Sistema de Ahorro para el Retiro* (CONSAR) has created a public-facing mobile application for accountholders in the Retirement Savings System, which is interoperable with the Retirement Fund Administrators.
- 2.8 There is evidence that big data informed formalization pilots can increase social security coverage in Mexico. For example, the IDB executed a pilot project in 2016-2017 with the Ministry of Finance that merged databases to increase both tax and social security payments, with successful results.
- 2.9 Through this TC, the IDB will collaborate directly with the Insurance, Pensions, and Social Security Unit at the Ministry of Finance to: (i) support the Government of Mexico's work on technical analyses of federal and sub-national reform impacts on

fiscal costs and labor market efficiency; and (ii) support the execution of pilots for social security compliance using technological advances.

2.10

2.11 This TC builds on the Bank's previous experience and expertise in the subject matter. The IDB has positioned itself as a recognized actor in the issue of pensions in Mexico during the last few years. The IDB analytical work has supported the Mexican authorities in the design of system improvements, as well as recognized the Bank as a reference in the public debate. This includes:

- a. Since 2016, a regional project that includes several pilots to promote voluntary savings and improve pensions. This work has been mostly with CONSAR, but also with the Insurance and Pension *Unit of Secretaría de Hacienda y de Crédito Público* (SHCP). Voluntary savings is one of the issues addressed in the reform proposal.
- b. In 2017, the IDB worked with *Secretaría de Desarrollo Social* (SEDESOL), SHCP, and CONSAR to estimate the fiscal costs of different non-contributory pension reform scenarios.
- c. In 2018-2019, at the request of the president-elect, the IDB worked to develop a document with a work plan for a deep reform of social security (including the pension system).
- d. In 2019, the document "Diagnosis of the Mexican Pension System and Options for Reform" was published. The document was presented at an event at the CONSAR.
- e. In 2019, the IDB participated in a working group organized by the Aspen Institute that delivered recommendations for a pension reform. This group also included SHCP, CONSAR, *Instituto del Fondo Nacional de la Vivienda para los Trabajadores* (INFONAVIT), Amafore, academics, and unions.
- f. In 2020, the ME-L1289; 5026/OC-ME supported the reduction of Afore commissions, the incorporation of domestic workers into social security, and the prohibition of work arrangements that help evade social security obligations.
- g. In 2019-2020, the IDB worked with Mexican actuaries to deliver the fiscal costs of sub-national pension systems, including the implications of different reform scenarios. The IDB also provide legal analyses of the implications of these reforms.

2.12 The TC is consistent with the Bank's Institutional Strategy Update (UIS) 2010-2020 (AB-3008) and its accompanying Second Revised Version of the Corporate Results Framework (CRF) (GN-2727-6). Thus, this TC contributes to the development challenges of: (i) social inclusion and equality through the regulatory reforms aimed at reducing old-age poverty; (ii) productivity and innovation through contributing the improvement of the Pension System in Mexico; (iii) economic integration through investment of pension resources in foreign financial instruments; and (iv) gender equality and diversity, through the improvements in the pension system, especially with a the reduction of the number of weeks contributed, that will benefit women more since they have lower contribution densities. The TC is aligned with the objectives of the Ordinary Capital Strategic Development Programs for Social Development (GN-2819-1) and, in particular, with its objectives: (iii) support IDB and clients to foster social inclusion, gender equality, and diversity through projects and programs; and (iv) promote social inclusion, gender equality, and diversity in member countries. Finally, the TC is consistent with the priority areas for Bank action in the IDB Mexico Country Strategy 2019-2024 document, specifically aligned with its priority area of "Supporting equitable and sustainable access to social services" within section

II (social policy) related to the strategic objective of “strengthening the labor market”. The TC is aligned with the expected outcomes of “Reduce informality” and “Increased number of people with pensions”.

III. Description of activities/components and budget

- 3.1 **Component 1: Technical analyses of pension reform impacts.** The impacts of different types of pension reforms currently under consideration by the Ministry of Finance are varied and have implications for social security systems, ongoing labor reform, and on public finances more broadly. The Bank will analyze these impacts and the impacts of other parametric indicators related to pension pay-outs, for private sector pensions, public sector pensions, and state-level pensions. It is anticipated that the analysis of different types of pension reforms could support the Ministry of Finance during the legislative debate regarding the reform proposal already submitted to Congress, and will support future reform initiatives that could potentially involve the regulation for subnational pensions.
- 3.2 These technical outputs will include the following topics:
 - a. Analysis of 2020 pension reform proposal impact and deaccumulation (converting savings into pensions) options;
 - b. Analysis of potential reforms of subnational pension systems; and
 - c. Portability of benefits within different Mexican pension schemes
- 3.3 These outputs can be published as IDB technical notes with the authorization of the Insurance, Pensions, and Social Security Unit at the Ministry of Finance.
- 3.4 **Component 2: Pilots for social security compliance.** This component will fund at least one pilot project supported by the Ministry of Finance to assess interoperability of different federal and subnational pension systems or utilize big data to target enforcement efforts to increase access to social security. The exploitation of the rich data that can be accessed by achieving interoperable information systems can permit the identification of likely abuses of the social security system (lack of social security affiliation or affiliation with a wage lower than the worker actually receives), which can help target enforcement efforts.
- 3.5 The Bank will only hire consulting services that do not entail the development or purchase of software for these pilots.
- 3.6 The results of at least one of these pilots will be published as an IDB technical note with the authorization of the Insurance, Pensions, and Social Security Unit and or the Unit for the Coordination with the Mexican States at the Ministry of Finance.
- 3.7 The total cost of the operation is US\$290,000 and it is financed by the Ordinary Capital Strategic Development Program for Social Development (SOC).

Indicative Budget (US\$)			
Activity/Component	Description	IDB/FUND (SOC)	Total Funding
Component 1. Technical analyses of reform impacts on fiscal costs and labor market efficiency			
Firm and Individual Consultants	Technical notes covering topics to include: - Analysis of 2020 pension reform proposal impact and deaccumulation options; - Reform of subnational pension systems; - Portability of benefits within different Mexican pension schemes;	175,000	175,000
Dissemination and communication	Workshops / Technical Notes/Materials/Meetings	5,000	5,000
Component 2. Pilots for social security compliance			
Firm and individual consultants	Pilot project supported by the Ministry of Finance to assess interoperability of different federal and subnational pension systems or big data informed enforcement.	85,000	85,000
Dissemination and communication	Workshops / Technical Notes/Materials/Meetings	5,000	5,000
Incidentals		20,000	20,000
Total		290,000	290,000

IV. Executing agency and execution structure

- 4.1 This TC will be executed by the Bank through the Labor Markets Division (SCL/LMK), at the request of Mexican authorities. The Labor Markets Division team working in Mexico (LMK/CME) has the relevant background, skills, and technical experience to carry out this TC. Furthermore, the execution of TCs by the Bank is common practice in Mexico due to the national budgeting mechanism, which subtracts the financing of the TC from the beneficiary's budget when the beneficiary executes them. The Bank, through SCL/LMK, has worked for several years in collaboration with the Government of Mexico in general, and with the Ministry of Finance, which will be the counterpart in the design and implementation of effective and efficient solutions, positioning it as a benchmark in the area. In addition, the Bank has specific experience in the execution of the activities foreseen in this TC.
- 4.2 **Procurement and financial management.** The Bank will contract the services of individual consultants, consulting firms and different consulting services, in accordance with the policies and procedures in force in the Bank. All activities to be executed under this TC will be included in the Procurement Plan and will be contracted in accordance with Bank policies as follows: (a) AM-650 for individual consultants; (b) GN-2765-4 and Guidelines OP-1155-4 for Consulting Firms for services of an intellectual nature and; (c) GN-2303-28 for logistics and other related services.
- 4.3 SCL/LMK will be responsible for the direction, supervision, monitoring and coordination of the TC. SCL/LMK will submit annual reports and a final report to the fund. The Official Exchange Rates of the IDB indicated in the SDP will be applied for necessary conversions to local currency. Audits will not be required for this TC.

V. Major issues

- 5.1 **Coronavirus/COVID-19.** The current Global Coronavirus Pandemic and health contingencies have introduced a generalized risk of uncertainty to the success of this Technical Cooperation, as well as all activities planned by the Government of Mexico in the short and potentially medium term. To mitigate this risk, the Bank is in constant communication with counterparts at the Ministry of Finance. The Bank understands that federal and subnational pension reform remains a high-level priority. The Bank will maintain constant communication with the Ministry of Finance to mitigate this risk and adapt accordingly to any changes necessitated by this unique risk and challenge.

VI. Exceptions to Bank policy

- 6.1 None.

VII. Environmental and Social Strategy

- 7.1 Due to the nature of this operation, it is not expected that it will have a significant negative environmental or social impact. See safeguards SPF and SSF. This TC does not include activities that would have significant negative environmental and/or social impacts and is therefore classified as a category “C” operation, according to the policy OP-703.

Required Annexes:

[Request from the Client - ME-T1391](#)

[Results Matrix - ME-T1391](#)

[Terms of Reference - ME-T1391](#)

[Procurement Plan - ME-T1391](#)