



# en breve

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## POVERTY IN MEXICO AN ASSESSMENT OF CONDITIONS, TRENDS AND GOVERNMENT STRATEGY

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In July 2004, in the first phase of a three-year work program on poverty reduction in Mexico and after extensive collaboration with government and Mexican specialists working on poverty, the World Bank published a report assessing poverty conditions in Mexico and government strategies to reduce poverty.<sup>1</sup>

close to the (high) Latin America average. Recently, progress has been much weaker in Mexico and Latin America than in East Asia, but Mexico has performed better than the regional average since 1998 (see Figures 1a & b - Tendencias in poverty incidence in Mexico, Latin America and East Asia using international poverty lines - using 1993 purchasing power parities.<sup>2</sup>)

### Poverty conditions and recent trends

In 2002, half of Mexico's population lived in poverty and one fifth in extreme poverty, slightly lower than before the 1994-1995 crisis. Mexico has made major progress in some poverty dimensions —health, nutrition and education outcomes, access to basic health and education services, electricity, water and (to a lesser extent) sanitation. Large increases in government spending enabled key social programs to expand. Programs also became more pro-poor, with new demand-side measures using cash transfers as incentives for poor households to send their children to school and attend health clinics.

Slow economic growth and Mexico's high income inequality have inhibited progress in income poverty. The recent pattern of poverty changes has closely followed macroeconomic and labor market cycles. The significant decline in extreme poverty in 2000-02 despite stagnant average incomes, is attributed to substantial income growth in rural areas, and declining inequality in rural and urban areas. Rising unskilled wages, and substantial remittances and transfers to the rural extreme poor (including through the OPORTUNIDADES program) boosted rural incomes.

Mexico has generally had slightly less poverty than the Latin American average, and inequality

Figure 1a - Percentage of People Living Below \$2 per Day

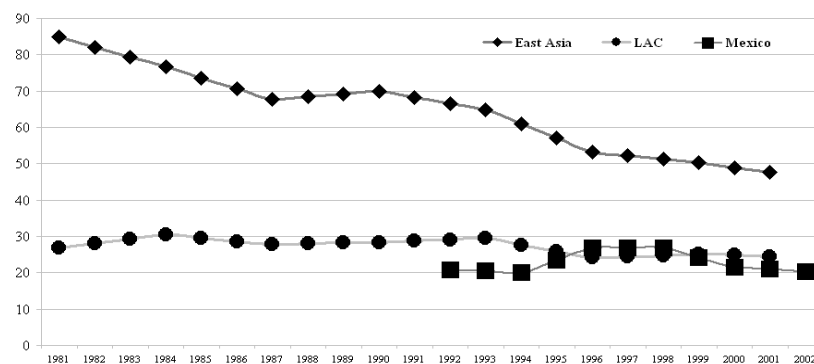
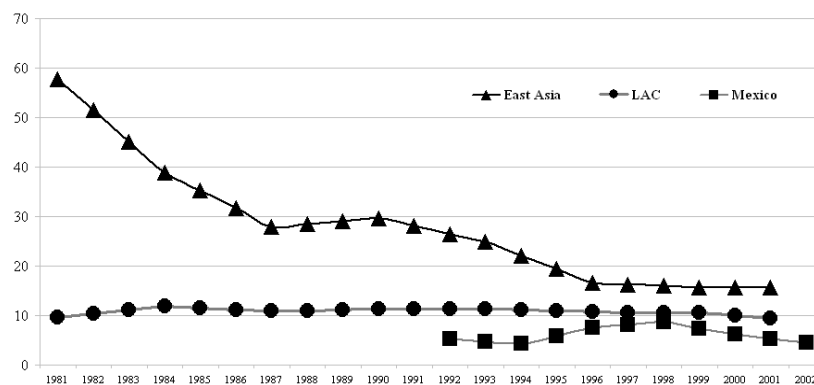


Figure 1b - Percentage of People Living Below \$1 per Day



Mexico's recent improvement in income inequality relative to the (very high) Latin American average may be partly cyclical, but also appears related to longer-term structural changes: falling returns to tertiary education in the labor market; falling wage differentials between rural and urban areas reinforced by remittance flows to rural areas; and a reversal since 2000 of the earlier rise in rural inequality, with more rapid growth in higher-productivity agriculture and non-farm rural incomes in areas closer to manufacturing and service centers.

Vulnerability to adverse shocks remains widespread, affecting rural and urban poor and non-poor. Adverse shocks from ill health, unemployment, meager harvests and natural disasters deepen poverty, and push some of the non-poor into poverty. Rural and urban workers appear to experience similar patterns of income fluctuations, though self-employed and informal sector workers experience higher income variability, especially in rural areas. The large size of the informal sector, associated with the regulatory and tax burden of formalization, leaves much of the population uncovered by formal mechanisms provisioning against risks. Recently, weak labor market conditions were reflected more in higher unemployment than lower wages than was the case before. If future shocks are associated with more long-term unemployment, better mechanisms will be needed to deal with unemployment risk.

With respect to "social poverty" (Incorporación social), a tentative qualitative assessment is that social exclusion and the weak accountability of public institutions to poor groups remain problematic, despite recent progress. The position of indigenous groups is of particular importance because of historical patterns of social exclusion and deeper levels of poverty.

Large, long-standing differences in income poverty and other indicators of well-being across different regions remain, with a generalized gradient from North to South. There has been some long-term special convergence in most indicators of services and social conditions. However, income and wages seem to have diverged in the 1990's, with areas closer to the border, or to urban centers, growing faster.

There is considerable heterogeneity *within* states in poverty levels and trends. Across Mexico, conditions tend to be best in more developed urban areas, less good in peri-urban areas and smaller towns, and worst in remote rural areas. A high fraction of people who are self-identified as indigenous, or speak an indigenous language at home live in poorer states, and in relatively small rural villages, with low levels of services.

## Government strategy

The Government has developed an explicit conceptual framework and set of programs for reducing poverty called CONTIGO. The excellent conceptual framework recognizes multiple dimensions of poverty and complementary domains of public action, across the life cycle. Two areas could be articulated further: complex issues of social inclusion and accountability; and the supply side of social policy, particularly the determinants of coverage and quality of public services that affect the lives of the poor, and how the federal government can influence service coverage and quality at subnational levels in light of Mexico's decentralization.

Some programs within CONTIGO — OPORTUNIDADES, MICRORREGIONES and HÁBITAT — reflect CONTIGO's integrated conceptual framework, but it is unclear how many other programs relate to the framework, and programs vary in the extent to which they reach the poor. The social cabinet, under which CONTIGO falls, is concerned primarily with social programs. But there are powerful complementarities between social and economic development, and a poverty reduction strategy must include both. Sensible changes are being made, placing the coordinating function under the Presidency and exploring ways to focus on fewer, higher priority programs.



The Law on Social Development recently passed is an important step in institutionalizing a state policy for social development. It states that municipalities will be the principal (though not exclusive) executors of some social development programs, and requires that social development spending not be reduced in real terms in any year, introducing problematic additional budget inflexibility.

Implementation will be challenging.

## Public finance for poverty reduction programs

Expenditure on programs specifically targeted to the poor now represents 1.3% of GDP compared to 0.7 % in 1990. Programs involving transfers to the poor, led by OPORTUNIDADES since it was created, grew by an average of 8.4% per year during the 90's, and 9.8% per year after 2000. But growth of social security spending not targeted to the poor is even more striking—35.2% per year since 1990. Social spending growth was achieved through large reductions in "economic sector"<sup>3</sup> spending, which could be problematic from a poverty reduction viewpoint because of the potential impact on aggregate growth and

inclusion of the poor within the growth process. The fairly weak gains in income poverty heighten this concern.

The likely need to increase economic sector spending, continued demands for social development spending, and the transitional costs of pension reform, will make the fiscal position for spending affecting poverty reduction very tight without tax reform. A tax-increasing reform could be one of the most poverty-reducing actions the state could take, *provided increased resources are used effectively*. There is also great potential for more effective use of public spending. On *average*, public spending appears to be much more equal than incomes, and is becoming more equal and pro-poor, but there remain large areas of spending with very unequal incidence, and some with rising inequalities in incidence, for example ISSSTE pensions, tertiary education and IMSS benefits for active workers. Figure 2 illustrates this using a summary measure of spending incidence across income groups: the concentration coefficient (similar to the Gini coefficient) is  $-1$  if all spending goes to the poorest,  $0$  if everyone receives the same spending, and  $+1$  when all spending goes to the richest.

There is also a mixed picture in how well programs reach the poor. Some basic services —education, water, electricity— have near-universal coverage and reach most of the poor. But programs that are highly targeted to the poor tend to have relatively modest reach, in Mexico and elsewhere. OPORTUNIDADES is an important exception, reaching 60% of the rural extreme poor (2002 household survey) and an estimated total 80% reach in 2003. Gaps remain in basic service provision, especially for the extreme poor, and incomplete coverage of the social protection system —for

health, old age, and unemployment. These are particularly marked for those amongst the moderate poor who have neither access to the formal social security nor to OPORTUNIDADES.

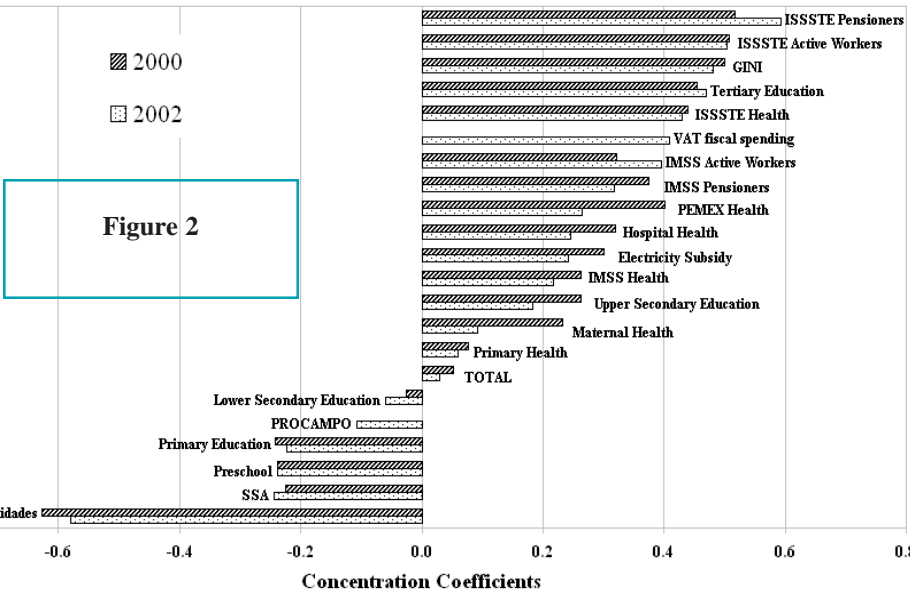
The analysis of incidence and reach indicates considerable scope for redistribution within the budget for greater impact on the poor. For example, reducing the electricity subsidy or removing exemptions under the VAT and reallocating the funds to expand OPORTUNIDADES could have substantial net benefits for the poor.

### Key issues in design of social services and social protection

A continued push on access and quality for secondary education, and mechanisms for giving bright poor children access to tertiary education will be key to future progress in building human capital. Low and variable education quality, especially for poor and indigenous groups, is a central but complex issue (and also appears to apply to health and other services).

Most existing social protection programs are oriented to the formal sector, including pensions, health and unemployment benefits. There is a clear need to expand social protection to poorer and informal households. The Government has recently taken promising measures to extend health insurance for the uncovered population through SEGURO POPULAR, which covered 625,000 families in 24 of the 32 states by the end of 2003. Tracking households' and service providers' behavior is crucial to ensure that the program achieves the intended benefits.

The main poverty-targeted transfer programs, especially OPORTUNIDADES and PROCAMPO, have good to very good targeting, and help reduce risk for recipients, since transfers are not generally subject to shocks. However, coverage of vulnerable groups is incomplete. There is scope for extending conditional transfers to groups in extreme poverty not covered by OPORTUNIDADES and strengthening risk-based programs, such as public works, that kick in automatically in response to shocks.



Note: GINI refers to the distribution of private income. PROCAMPO is not reported in 2000 because the 2000 survey is not representative. VAT fiscal spending refers to exemptions and the zero VAT rate. Source: Background work for World Bank (2004) and SHCP (2004) for the VAT fiscal spending.

Future income gains amongst the poor will depend on overall growth and growth patterns, especially the pattern of job creation. Because job-creation requires private investment, poverty reduction is inseparable from a competitiveness and growth strategy. International evidence suggests that macro

### Promoting income growth amongst the poor

stability, infrastructure provision, tackling private sector protections, and measures to improve logistics are all important.

Economy-wide measures to strengthen competitiveness need to be complemented by strategies specifically oriented to income growth of the extreme poor (mostly in rural areas) and moderate poor (mostly in urban areas). The new IMPULSO strategy, involving measures to increase productivity, security and dynamism in the self-employed and small-enterprise sector, is based on sound diagnosis, but challenges remain in policy design and execution. More infrastructure investment is needed and policy reforms to improve private and public sector efficiency and equity. Electricity subsidies and further land reform are important areas.

The labor market reforms under debate are headed in the right direction of reducing disincentives to formal employment. But the proposed law does not address the main issues affecting the labor market, especially those which increase inflexibility in hiring and firing.

More remains to be done to coordinate and improve rural area programs, and to address specific needs of poor rural indigenous groups.

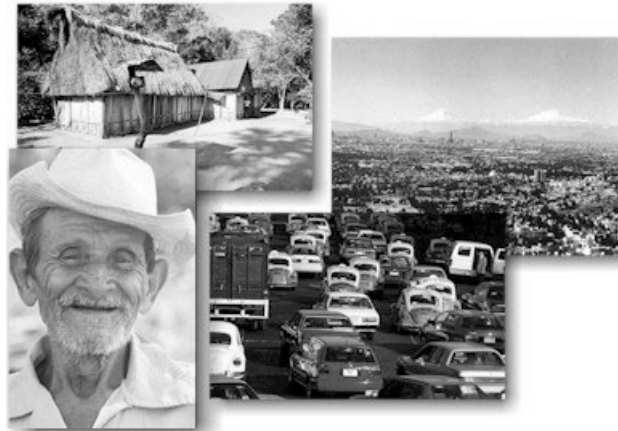
### Cross-cutting institutional issues

- Mexico has had some notable successes in the struggle to reduce clientelistic and patronage-based relations with poor groups. But Mexico's major political, social and institutional transition while deepening democracy is difficult, complex, and long-term.
- A key challenge is further increasing transparency and participation by poorer groups, to improve accountability and reduce capture by local elites.
- Little is known about the impact of decentralization on poverty outcomes, institutional interactions, and program management.
- Indigenous groups remain, on average, much poorer than others. More needs to be done to assess effectiveness and strengthen existing targeted efforts, and to assess the needs of other excluded groups such as poor urban youth and slum dwellers.

Of greatest importance is continued assessment of what does and does not work, building on successes, and pursuing opportunities for integration and complementary action.

Some recent initiatives exemplify best practice, but are confined to only a few areas and ministries. Careful monitoring and evaluation is crucial, to maximize learning, improve program designs, and provide user-friendly information to the public to increase social pressures for accountability.

The World Bank work program includes further work on the characteristics of poverty in urban and rural areas, and structural and institutional influences on income growth, patterns of vulnerability and coping; the effectiveness of current policies and institutions to support risk management; and how to get effective and quality service delivery under decentralization. It is hoped that this work will be useful to government policy formulation and broader debates on strengthening efforts to reduce poverty in Mexico.



### Notes

<sup>1</sup> English version: <http://www.bancomundial.org.mx/pdf/estudiosporsector/povertyinmexico/1.pdf>

Also available in Spanish on <http://www.bancomundial.org.mx> under "Temas y Sectores"

<sup>2</sup>The World Bank's 1993 consumption PPP exchange rate for Mexico is 2.102. The PPP

one dollar per day poverty line is about 68.82 pesos per person per month in 1993 prices. *Source:* Chen and Ravallion (1994) and WB staff calculations.

<sup>3</sup> "Economic sector" spending covers infrastructure, rural development, energy, transport, communication, and other services and economic activities. "Social development" spending includes education, health, social security, social assistance, regional and local development, and labor policy. "Government management" includes legislation, law and order, national security, election processes, governance and environment.

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