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## **Congress Approves Controversial Pension Reforms for Public Employees**

*by LADB Staff*

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In a move described as the first major reform of President Felipe Calderon's administration, the Mexican Congress approved comprehensive changes to the health and pension system for government workers (Instituto de Seguridad Social al Servicio de los Trabajadores del Estado, ISSSTE). On the surface, the reforms to the ISSSTE, which manages the pension accounts and health benefits of some 2.8 million active and retired federal employees, are an attempt to save the system from insolvency and to increase retirement-fund options for government workers. But critics question whether the government is abandoning its social responsibilities by espousing the changes.

The ISSSTE-reform legislation gained easy approval in both the Senate and the Chamber of Deputies because of strong support from two of the three major parties in Congress: the governing Partido Accion Nacional (PAN) and the opposition Partido Revolucionario Institucional (PRI). The measure met strong resistance from a coalition of center-left parties (Frente Amplio Progresista, FAP), which announced plans to file a constitutional challenge before Mexico's high court (Suprema Corte de Justicia de la Nacion, SCJN).

The centerpiece of the new law is the creation of individual, private accounts similar to the Administradoras de Fondos de Retiros (AFOREs), which were introduced in 1996 (see SourceMex, 1996-11-13 and 1996-12-11). The new private accounts would replace the communal pool at ISSSTE.

Analysts say, however, that the ISSSTE-reform plan differs from the AFOREs because it offers each worker who migrates to the new system a bond, representing his or her vested rights, which can be rolled over to a new individual account. "This makes the plan closer to the Chilean pension reform than to the previous Mexican reform," said Mary Anastasia O'Grady, a columnist for the Wall Street Journal. "Another similarity to Chile is the fact that new hires will not have the option of joining the old system; through attrition, all government employees will eventually be owners of their pensions."

O'Grady and other analysts say one of the major benefits of the change is portability. In the old system, any worker who left a government position before completing 15 years of service lost his or her acquired pension benefits. The new system allows workers to move to jobs in the private sector and still keep their accrued pension benefits. Under the plan, the government will transfer 50 billion pesos (US\$4.51 billion) of worker pensions that are now managed by banks to a new ISSSTE subsidiary, which will be called PENSIONISSSTE.

The new agency will manage pension assets for both the old system and the new system for three years. Through this maneuver, supporters managed to avoid using the term "privatization." The

Calderon administration agreed to a motion by opposition legislators that the PENSIONISSSTE be directed by an investment professional and not a political appointee or a union leader. Legislators and the government also agreed to direct PENSIONISSSTE's investments toward public projects such as housing and highway construction. The new plan allows current workers to remain with the old system, but they will have to accept gradual increases in the retirement age. The new law raises the minimum age for retirement benefits by 10 years, to 58 for women and 60 for men.

### *Move could save institute from insolvency*

Supporters of the reforms stressed the need to ensure the solvency of the ISSSTE, which is operating at a deficit. Without the reforms, said the Calderon administration, Mexico could run a budget deficit equivalent to 3% of GDP by 2012. "With an average retirement age of 56 and retirees living longer, ISSSTE has obligations that far outstrip its income and every year the deficit grows," said O'Grady. "In 2000, ISSSTE's pension deficit was 10 billion pesos (US\$902 million). This year the government has set aside 42 billion pesos (US\$3.79 billion) to fill the gap. By 2012 the shortfall is forecast to hit 77 billion pesos (US\$6.95 billion)."

The initial cost of changing the government pension program to the new system would force the government to incur new debt to cover the costs. In the long run, said supporters, the measure would save the government the cost of covering the gap between worker contributions and ISSSTE pension costs. "Yes, we are incurring a debt of many millions of pesos," said ISSSTE director Miguel Angel Yunes Linares. "But if we don't take action now, the eventual costs would be substantially higher than what we are spending now."

### *Critics say government abandoning social responsibility*

In the broader context, however, the changes raise concerns about whether the new law is a move by the Mexican government to step back from its social responsibilities. "In the Americas, the question of state social welfare is at the core of the larger debate over the market fundamentalism that has swept through the region over the past three decades," said Fred Rosen, a columnist for the Mexico City English-language daily newspaper The Herald. "[This] fundamentalism...now stands severely challenged in the wake of the continent's continued slow growth and worsening conditions of inequality."

Rosen said the new law has, in effect, privatized the risk for government workers. "In this vision of privatized welfare, an insured worker, in a contract with the AFORE of her choice, agrees to carry the risk of investment on her own shoulders," said Rosen. "The proportion of her income she has elected to place in the private insurance fund, after all, can do very well, very badly, or somewhere in-between when invested in the market. Her social risks have effectively been privatized." "In like manner, the social security savings of some 25 million formal, private-sector workers are now invested in firms that trade on the Bolsa Mexicana de Valores (BMV), the Mexican stock exchange," added Rosen.

In supporting the new law, Calderon called the ISSSTE changes "the country's most important structural reform in a decade." This description, said Rosen, does not refer as much to the changes in the way pensions are managed as to the pro-business policies employed by the administration. "By channeling workers' savings through private funds...the law envisions an important expansion

of the investment capital that can be made available to the country's business community," said Rosen.

### *PAN, PRI differ with PRD over reforms*

The difference of opinions regarding the changes was reflected both in the Mexican Congress and among labor organizations. The PAN and the PRI along with the Partido Verde Ecologista Mexicano (PVEM), Partido Alternativa Socialdemocratica (PASC), and Partido Nueva Alianza (PANAL) controlled enough votes in Congress to ensure easy passage of the legislation. The measure was approved 313-146 in the lower house and 85-32 in the Senate. A key to the vote was the PRI's decision to vote uniformly for the changes, even though the party has proposed redefining itself as leftist (see SourceMex, 2007-02-28).

The initiative met strong opposition from the FAP, which voted against the bill even though the PRI and PAN took into account several objections raised by the leftist parties when crafting the final version of the bill. In the end, the FAP comprising the Partido de la Revolucion Democratica (PRD), the Partido del Trabajo (PT), and the Partido Convergencia por la Democracia (PCD) voted against the measure on the premise that it would dilute retirement benefits for Mexico's government workers. "The idea is that everybody will be left to scrape by on their own," said PRD Sen. Carlos Navarrete.

The PRD not only campaigned against individualized accounts but raised concerns that the manipulation of some 160 billion pesos (US\$14.45 billion) of new AFORE funds over the next few years could create an unwanted, uncontrollable volatility on Mexican stock exchange (Bolsa Mexicana de Valores, BMV).

Lacking the numbers to stop the initiative in Congress, the PRD has pledged to bring the issue before the SCJN once the law is published in the federal register (Diario Oficial de la Nacion). The FAP complaint will focus on the government's move to incur debt to make the transition to the new system, which, in effect, would convert pensions into public debt. The constitutional complaint will also address violations of the individual rights of workers, said PRD Deputy Alejandro Sanchez. "Once we complete our examination [of the unconstitutionality of the ISSSTE law], we will bring the issue to our FAP partners so we can file this complaint jointly," Sanchez said in an interview.

### *Unions also divided*

The issue has received mixed reactions among government-worker unions, dividing those that have long been affiliated with the PRI and those that have adopted a more independent course in recent years. Unions like the Sindicato de Trabajadores de la UNAM (STUNAM) and Sindicato Nacional de Trabajadores del Seguro Social (SNTSS), which are affiliated with the Union Nacional de Trabajadores (UNT), have come out strongly against the reforms. The independent unions helped organize massive protests in Mexico City's Zocalo on the days that the Chamber of Deputies and the Senate were each voting on the measure. They have also threatened to call a nationwide strike on May 2, the day after international Labor Day.

UNT president Francisco Hernandez Juarez acknowledged that the pension system for government workers was in deep financial trouble. But he called on the government to display the same

"generosity" in rescuing worker pensions as it did in rescuing the banking system in 1995 (see SourceMex, 1995-03-08) and the highways in 1997 (see SourceMex, 1997-09-03). The bailout for the highways was similar to the pensions (60 billion pesos), while the bank bailout was much larger, although there was also a lot of international money involved.

Conversely, leaders of unions long affiliated with the PRI, such as the Federacion de Sindicatos de Trabajadores al Servicio del Estado (FSTSE) and the Sindicato Nacional de Trabajadores de la Educacion (SNTE), have strongly endorsed the ISSSTE reforms. FSTSE leader Joel Ayala, who is also a PRI deputy, said the reform legislation is much preferable to outright privatization.

Controversial SNTE leader Elba Esther Gordillo also campaigned hard for the reforms. "We consider this a victory, because we proposed some of the changes that Congress eventually incorporated into the measure," said Gordillo. "This is a signal that the [ISSSTE] truly belongs to the workers." Gordillo's strong advocacy for the changes raised some red flags.

Former presidential candidate Andres Manuel Lopez Obrador accused Calderon and the PAN of pushing the changes as a "reward to Gordillo" for delivering the votes of the teachers union in the July 2006 election. Other analysts suggested that Gordillo had a very personal interest in the reforms. "Over the past three years, it appears that SNTE leader Elba Esther Gordillo and her appointed subordinates have worked hard on several rounds of draft proposals of ISSSTE reform, and have helped it along its complicated legislative path," said Rosen.

The columnist pointed to allegations that Gordillo developed a personal financial interest in the reform and that she and a variety of financial groups linked to banks and insurance companies are in line to earn very decent returns on the individualized accounts.

Rosen noted that the PRI, PAN, and PVEM were aware of Gordillo's ambitions and pushed through a parallel reform that would prevent any single union from deciding how the initial outlay of 58 billion pesos (US\$5.23 billion) would be invested. "Such a reform would prevent anyone having an institutional affiliation with ISSSTE [such as the public-sector unions] from acting as a financial adviser to the retirement funds," said Rosen. [Note: Peso-dollar conversions in this article are based on the Interbank rate in effect on March 28, reported at 11.07 pesos per US\$1.00] (Sources: Notimex, 03/20/07, 03/22/07, 03/26/07; Agencia de noticias Proceso, 03/20/07, 03/21/07, 03/26/07, 03/27/07; Reuters, 03/20/07, 03/22/07, 03/27/07; The Wall Street Journal, 03/27/07; The Herald-Mexico City, 03/20/07, 03/21/07, 03/26/07, 03/28/07; Reforma, 03/20/07, 03/21/07, 03/23/07, 03/26-28/07; La Cronica de Hoy, 03/20/07, 03/22/07, 03/27/07, 03/28/07; El Universal, 03/20/07, 03/22/07, 03/23/07, 03/26-28/07; La Jornada, 03/20-23/07, 03/26-28/07; Excelsior, 03/21- 23/07, El Economista, El Financiero, 03/21-23/07, 03/26-28/07; Bloomberg news service, 03/28/07)

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