Is Grandma Ready for This?

Mexico Kills Cash-based Pensions and Welfare by 2012

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Abstract

Between 1997 and 2011, the Government of Mexico moved to conduct the bulk of it financial activity electronically. This process, spearheaded by the Treasury department, was aimed at increasing transparency on government payments, streamlining bureaucratic processes, and cutting government costs. The transition to electronic payments has, however, also accelerated the drive by some government agencies and social welfare programs to extend financial access to millions of the poorest families. While it is too early to tell if the program will succeed, the process through which the Mexican Government arrived at this point illustrates the sometimes surprising results of seemingly straightforward government initiatives.

The experience of Mexico raises interesting policy challenges that this case study will seek to explore further. Firstly, how much ex-ante cost/benefit analysis necessary in order to effectively move the agenda forward towards implementation? Secondly, the government has mandated a large cash transfer distribution program to be implemented over a relatively short time period. The operational challenges not withstanding, how does one measure the success of the project? In turn, how does the Treasury use this information to expedite implementation as it nears the 2012 deadline?

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Glossary

Bansefi	– A government microsavings bank
Banxico	– Central Bank
Diconsa	– Agency managing a network of community-owned stores
Tesorería de la Federación	– Treasury Department
Oportunidades	– Conditional Cash Transfer Program
PROCAMPO	– Agricultural Social Welfare Program
Secretaría de la *Función Pública*	– *Ministry of Public Administration*
Secretaría de Hacienda y Crédito Público	– *Ministry of Finance*
Servicio de Administración Tributaria	– *Internal Revenue Service*
Telecomm	– Public telecommunications service company
SPEUA	– *Extended Use Electronic Payments System*
SIAF	– *Integrated Financial Management System- -*

Introduction

On December 7th 2010, the Federal Government Mexico released its budget for 2011, which directed all government agencies, or *Dependencias*, to coordinate with the Ministry of Finance (MoF) in updating their work plans in order to make all government to person (G2P) disbursements electronically. December 2012 was set as the deadline for full implementation. The deadline of December 2012 coincides with the end of the term of the President Felipe Calderón, and reflects a desire to establish this program as a legacy of his presidency.

According to the MoF, 66% of G2P disbursements budgeted for in 2010 are eligible to become electronic. This applies to 32 programs run by 7 *Dependencias* and supervised by the MoF, their selection based upon importance in the budget, number of beneficiaries served, and stability of payment streams. This translates to accommodating payments of about USD $12 billion.[*] While the initial impetus for the movement into electronic payments was to streamline basic government operations, financial inclusion and promotion of socio-economic welfare have now become key focuses of this program.

Much progress has been made in setting up the necessary infrastructure and obtaining buy-in from various stakeholders, but work still needs to be done to scope out the expected vs actual costs and savings associated with the initiative, as well as setting up an agent network to serve the beneficiaries after the transition.

Background

Motivation Behind Going Electronic

The government mandate requiring electronic disbursements is the latest in a long progression of developments in G2P transactions in Mexico. The genesis of the program can be traced back to 1997, when a separate mandate required all government agencies to receive payments electronically through a national system managed by Mexico*'s* tax authority.[†] Electronic payments are one element of the National Program for Reduction of Public Expenses instituted in March 2010. The National Program emerged from a process initiated in December 2006, when President Vicente Fox signed a decree establishing measures for increasing austerity, discipline and a reduction in the public administration's expenses. The goal for annual savings for the Federal Government is 5% of current total administrative and operational expenses. This initiative is being implemented through a medium-term program developed and implemented by MoF and the Ministry of Public Administration[‡], by means of an inter-agency agreement published in February 2009. However, the champion of the process is Mexico's

[*] 141.7 billion pesos (Currency conversion accurate as of 4/14/2011)
[†] Servicio de Administración Tributaria
[‡] Secretaría de la Función Pública

Department of Treasury[§], which had developed both the technological platforms and had driven the collation of data necessary to make the initiative work. The Presidential Decree setting 2012 as a deadline had the effect of instilling a sense of urgency of the project, and gave both MOF and Treasury to accelerate this transition.

The Treasury viewed the ability of electronic payments to lower administrative and operational expenses as being its primary value. However, other key actors were motivated to support electronic payments for different reasons. The MoF's Development Bank Unit, alongside the Government's flagship social welfare program *Oportunidades,* believed the drive towards electronic payment would benefit the poor and financially marginalized. Their interest stemmed from a belief that electronic payments would translate into a host of benefits to beneficiaries, such as connecting them with the formal sector, reducing corruption, and being able to offer value-added-services through the same electronic conduit.

Some advocates propose that *Oportunidades* beneficiaries could receive their disbursement electronically, via local stores, savings in travel and other costs could total USD $70 million annually. Because of this, starting in December 2009 the MoF took a proactive role in pushing the *Dependencias* responsible for main subsidies programs[**] to begin to develop a work plan on how to transition to electronic payments. Specifically, the MoF asked each *Dependencia* to collect and provide information on the location of each beneficiary, as well as the value and frequency of subsidies.

Mexico's Social Welfare Programs

The largest of Mexico's social welfare programs, Oportunidades, reaches over 5.8 million households, accounting for roughly a quarter of its households. Oportunidades was founded in 2002 and was based on a previous program called Progresa, which was created in 1997. Both Progresa and Oportunidades broke with traditional poverty alleviation programs, in which goods were directly provided to the poor, and instead provided cash to beneficiaries in exchange for their meeting set of benchmarks that included regular school attendance, regular medical checkups for beneficiary families, and the attendance of health related workshops, amongst others. Oportunidades is one of the most well-studied social programs in the world, and external evaluations have shown that it increases school enrollment, especially in rural areas, improvement in nutrition and health status, gender equality, and economic empowerment. Mexico's largest agriculture program, PROCAMPO ("Programa de Apoyos Directos al Campo," or "Farmers Direct Support Program"), supports 3 million producers and covering an area close to 14 million hectares. Other subsidy programs reach over 3 million recipients, and amount to approximately 24 million pesos.

Developing Infrastructure for E-Payments

[§] La Tesorería de la Federación
[**] Including SAGARPA, SEDESOL, Reforma Agraria, SEMANART

The Office of the President sought to centralize all government payments into a unique government account in order to increase efficiency and transparency, while reducing costs. The challenge for the reformers was to coordinate a plethora of different departments, and identify the bank accounts and payment processes which could be made electronic.

The next major accomplishment for the government's electronic payments drive was the development in 1999 of SPEUA[††], Mexico's first real time gross settlement (RTGS) system. This system was created as part of the reform of the large value payment system in Mexico, to increase efficiency of payments and reduce settlement risk of interbank transactions. It was the first step necessary to allow interbank transfers in real time, and a vital accomplishment in the Government's goals of developing e-payment capacity.

In 2003 the Treasury department developed an in-house information system[‡‡], aimed at automating all government payments. In order to facilitate this automation, the Treasury department asked all government bodies to collect and provide information on their payees/beneficiaries. Just as the development of SPEUA laid the technological framework for e-payments, the collation of information on payees from across government into SIAF allowed the Government to logistically prepare to shift into e-payments.

The shift had the added benefit of forcing the various government bodies to identify both the nature of the different payment systems[§§] as well as their costs. In 2004 the government sought to act on the cost savings and issued a decree requiring all government agencies to receive payments electronically through a national system managed by the internal revenue services.

In 2006 Banxico created a standard for bank transfers.[***] This enabled electronic interbank payments to third parties, and opened the door to e-salary payments, which is today one of the main streams of payments passing through the unique account. This shift to the electronic payment of government wages was facilitated by Banxico's regulation in 2008 that created payroll bank accounts, without fees. In July 2010 Treasury issued an "agreement" with other government entities to promote electronic payments throughout the Mexican Government, all funneled through the unique account.

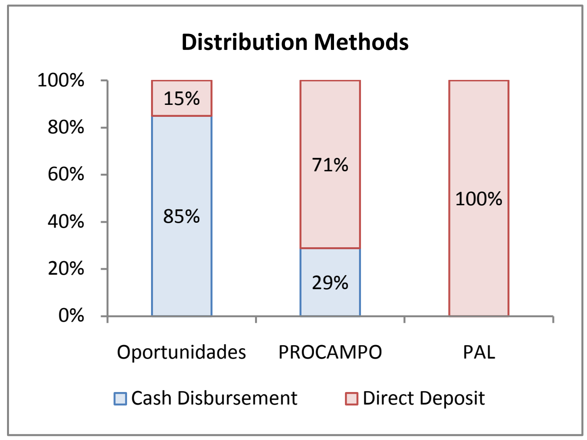
The drive for enacting e-payments was therefore a very gradual and deliberate process undertaken by the Government, intended solely to increase efficiency and transparency in government expenditures, and reduce administrative and operational expenses. During the early stages of this process social impact did not appear to feature prominently on the policy agenda.

[††] Sistemas de Pagos Electronicos de Uso Ampliado
[‡‡] Sistema Interno de Administracion Financiera
[§§] Including cash, checks, and direct deposit.
[***] Clabe Bancaria Unica

The Transition to E-Payments

Status Quo of G2P Payments

The current state of funds disbursements varies greatly from program to program.



It could be argued that *Oportunidades* is a model of efficiency and transparency. No *Oportunidades* employees handle cash, in order to minimize the opportunity for graft, while the minimal infrastructure enables 97% of the program's budget to be delivered to beneficiaries. Payments to its beneficiaries go through two channels, via cash transfer and through direct deposit to a beneficiary's bank account. Cash transfers are handled by Telecomm, a public telecommunications service company that also functions as a remittance provider, by Bansefi[†††], a government microsavings bank, or by *Diconsa*, a government agency that manages a network of more than 22,000 community-owned stores. *Oportunidades* is still primarily based on direct cash disbursement, with the vast majority of beneficiaries receiving benefits in this way.

The second method involves the direct deposit of funds into accounts provided to beneficiaries by Bansefi. Beneficiaries then withdraw funds via the 513 Bansefi branches or, in a minority of cases, via an ATM card. This form of disbursement is favored by *Oportunidades*, not only for its cost savings[‡‡‡], but due to the increased potential for beneficiaries to save some of the transfer. One of the biggest challenges of the current system arises from its lack of service points convenient to beneficiaries, Another challenge is that recipients usually are unbanked, i.e. they do not have bank accounts to deposit cash in.

One 2005 study estimated that "between 15 and 25 percent of the urban population, and as low as 6 percent of the rural population, [have] access to accounts in financial institutions." The vast majority of Bansefi's branches are located in urban areas, making direct deposit disbursements a reality only for the minority of *Oportunidades* beneficiaries. Most *Oportunidades* beneficiaries are located in the country's poorest and most rural areas, in which access to formal financial services is limited.

Transfer mechanisms for other government social welfare programs are not standardized and involve a number of partners, though in general most mix cash-based and direct deposit disbursements. Each

††† Banco del Ahorro Nacional y Servicios Financieros
‡‡‡ The cost is passed on to Bansefi who incur the cost of disbursing at branches and maintaining ATM machines

program has its own account at individual banks through which payments are made. ASERCA[§§§], a component of the ministry of Agriculture, for instance, has accounts in 5 or 6 banks and pays different fees to each to process its payments. Both the Treasury and the MoF are currently focusing on mapping the fund-flow landscape of *Dependencias*, financial institutions and distribution channels by determining who pays whom for what service and through which mechanism. Identifying this web of relationships is crucial to effectively switching over to a centralized payment system, and underlines the need for greater control, transparency and ability to fight cost and corruption.

Anticipated Set-up Post Transition

Once the transition to electronic payments is complete, all *Oportunidades* beneficiaries will have a debit card. The card can be attached to a transactional savings account at Bansefi though the savings account is not required. The intent is to eventually to ease all beneficiaries into fully transactional savings accounts. Bansefi will open bank accounts for those who don't have accounts today, but who are receiving state subsidies. Withdrawal of G2P payments (payments from the Government to individuals) will occur within the extensive agent network that Bansefi is in the process of setting up. This agent network will include current participants in the process, such as Diconsa and Telecomm. Diconsa, in particular, is key, as roughly half of its stores are within four kilometers of more than one million unbanked beneficiaries. There is no provision to incorporate mobile banking into this ecosystem yet.

Progress Report

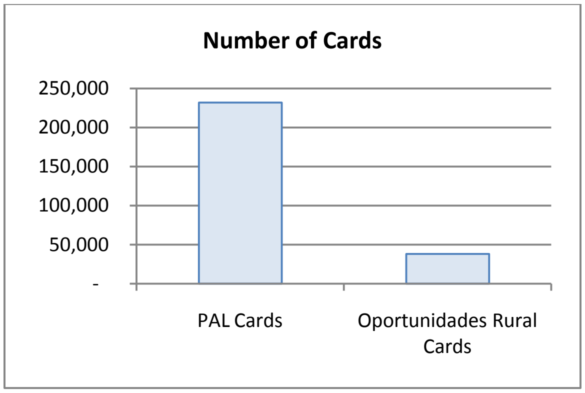
Initial progress was relatively slow due to bureaucratic inertia and hesitance on the part of the *Dependencias*[****]. It took over 2 years for the *Dependencias* to provide MOF and Treasury with information required about the beneficiaries, transfers value and frequency for them to help *Dependencias* to write the work plan to implement electronic payments. Neither Treasury nor MOF have developed reliable estimates as to the costs of payments and the savings they would incur due to this delay, as most all the *Dependencias* are still in the process of designing a plan to implement the transition.

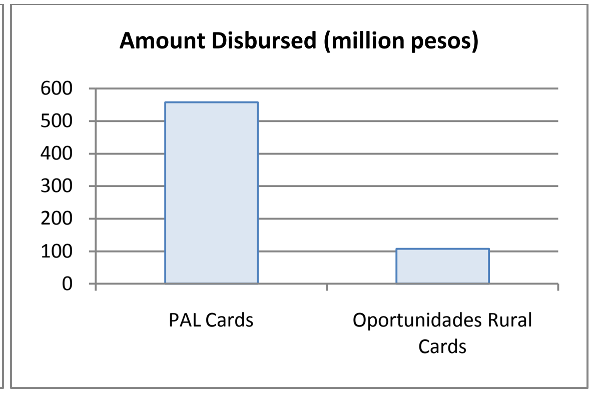
Progress to date is varied in extent. As of May 2010, 71% of PROCAMPO payments are made to bank accounts, 15% of *Oportunidades* payments are made electronically, and 100% of Program for Nutritional Support (PAL) subsidies are made in prepaid smart cards issued by Bansefi. By May 2010, there were 232,172 PAL cards and 38,192 *Oportunidades* Rural cards (Diconsa), amounting to 558 and 108 million

[§§§] Apoyos y Servicios a la Comercialización Agropecuaria

[****] It is worthwhile to note that the other major type of G2P payments, salaries for public employees, are mostly electronic already – about 50% of salaries are made into bank accounts – and are expected to meet the deadline for making these payments completely electronic comfortably.

pesos respectively. By 2007 PROCAMPO paid 26.5% of recipients into their accounts, rising to 54% in 2008 and 57% in 2009.





Oportunidades in particular has made much progress in transitioning to electronic payments, and has developed a specific plan of implementation by November 2011, covering everything from setting up infrastructure to completing negotiations with other implementation partners. Its greatest challenge is figuring out, along with its partners Bansefi, Telecomm and Diconsa, how to get cash to isolated, small communities in an efficient and less costly manner **and** build electronic payments ecosystems. If beneficiaries cannot use the electronic form of money in a payments ecosystem, they will simply withdraw all the funds and transform it into cash, thereby reducing the utility of opening bank accounts and make payments electronically. The existence of points of transactions where beneficiaries can use their cards is crucial to the success of the program.

Bansefi is tackling one of the more difficult aspects of this program – building an agent network large enough to disburse payments to every intended recipient and offering account-handling services for those with savings accounts. This network, based in large part on the Diconsa network, will be responsible for 91% of the electronic payments once completed. One of the key challenges for Bansefi and Diconsa involves liquidity management, ensuring that enough funds exist at each Diconsa affiliated store to satisfy beneficiary payout. In a pilot project, this challenge was addressed by staggering when beneficiaries could come to the store to receive a full payout. Another challenge is ensuring connectivity in the Diconsa stores, either via fixed line or GPRS. Mobile network operators have also reportedly been working with Diconsa to address the connectivity issue. At present, most stakeholders are waiting for Bansefi to complete building its agent network, which is mostly limited to Diconsa stores.

In preparation for this transition, the government has implemented some changes in the regulations related to agent banking, simplified accounts with lower anti-money laundering (AML) requirements, and payroll accounts to facilitate this transition. Diconsa stores will need 4,806 POS with digital biometric capability[††††]. In addition, Bansefi and *Oportunidades* have designed an education and awareness campaign for recipients to accept and use electronic means.

†††† Biometric POS are materially more expensive than card-only POS', so Diconsa would be saddled with this increased cost should this scenario come to fruition.

Expected Utility and Associated Trade-offs

In order to measure the magnitude of savings expected from the transition to e-payments, Treasury has tasked applicable government agencies with identifying the average cost of bank fees they pay for transfers and other expenses. It is assumed that this is where most of the direct savings will come from, although it is difficult to confirm because the line item in the balance sheet where bank fees are recorded have other items included in it too.[‡‡‡‡]

The electronic G2P will almost certainly lead to savings for the government even though there is the overhead of setting up new working relationships that are nationwide in scale. For example, the contract between Banxico and the Treasury for the payments is based on a fixed fee, regardless of the number and value of transactions processed through SPEI. The advantage is that the Treasury will be signing bulk contracts with the banks, increasing its bargaining power and reducing costs.

To illustrate possible savings, consider the fact that banks charge an average of 4 pesos per payment via Electronic Funds Transfer, depending on the negotiations/agreement between each bank and each *Dependencia*. In contrast, Banxico charges Treasury only 0.4 cents per transactions if at night and 50 cents for transactions during the daytime. Thus, whether the Treasury makes 1 million transactions through SPEI or just one, it pays the same in fees to Banxico.

For social programs, this will reduce inefficient use of funds and allow the social programs to offer a range of products to their beneficiaries. These individuals are often not able to access credit and products such as housing co-finance even when such services are specifically designed by the government to reach the poor because they lack a verifiable steady income. The G2P stream becomes proof of income, thus facilitating access to financial products.

The trade-off for social programs such as *Oportunidades* is that when it disburses in cash, it does so when people gather at one place and time, which makes it easier and cheaper to conduct the other elements of the program, such as training, monitoring of fulfillment of conditions etc. With electronic payments allowing recipients to withdraw the money in the most convenient time and place, the program may face difficulties in gathering beneficiaries for other kinds training.

The MoF notes that while intuitively they knew that recipients of cash transfers would save time and money to get their money, is the MoF has no empirical research supporting this hunch. It estimates that simply by transferring the money directly from Treasury to the payer bank (i.e. without going through a *Dependencia*'s bank account first), there were savings of about 14.5 million pesos between 2008 and 2009. Beneficiaries can save 88% of the transaction costs and 87% of the time in accessing the benefit,

[‡‡‡‡] As of March, 2011, the agencies have conducted the necessary research, and the Treasury is analyzing the information to come up with a global “savings” number.

according to research conducted by the Bill and Melinda Gates Foundation between 2006 and 2008. As for savings for the government, it can only be determined after analysis of the aforementioned work plans to be written by the *Dependencias* with MoF's assistance.

Implementation Challenges

Doing More with Less: Prior to the decree issued in December 2010 which set 2012[§§§§] as the deadline, the Treasury Department was working with the government agencies in order to undertake gradual changes that involved developing in-house systems to implements part of the program. Most of the focus up until that time had been on salaries. Implementation was accelerated precisely when departments were experiencing reduction in personnel or at least a freeze in new hiring as part of a general government policy to rationalize expenses and reduce government expenditure. The unit dealing with this program within Treasury has only five individuals at the moment, including the Director General.

Negotiating with Dependencias: *Dependencias* were concerned that beneficiaries would not accept an electronic proof of payment. For example, *Oportunidades* still makes recipients to sign a paper receipt when receiving their allowances. A recent amendment to the Fiscal Code that explicitly recognizes the legitimacy of the electronic invoice/receipt[*****] helped overcome this objection. Resistance also mounted to the idea of payments being made by an entity other than *Dependencias* themselves, particularly with regards to subsidies.

Accommodating Labor Laws: An obstacle to a universal implementation of G2P salary payments is a provision in the Labor Law that protects the right of employees to receive salaries in cash at their workplace. The labor unions fight for this right and often negotiate with employers to pay in cash or check in the workplace. Solutions to this would be negotiations between each employer (*Dependencia*) and relevant unions, or an amendment to the Labor Law, which has been proposed by the Ministry of Labor, though such arrangements would not be retroactive and would not apply to contracts already in effect.

Pacifying Banks: Banks would be one of the major losers from this program. They would lose an important source of revenue and have much less power to negotiate contracts, since they will now have to deal with the Treasury and not with each *Dependencia*. *Dependencias* would need to close bank accounts, since the Treasury would be making payments directly into accounts of the beneficiaries. They would need to identify the relevant bank accounts and close all agreements and contracts with banks. Banks will lose revenue not only from fees, but also from interest on money sitting in the *Dependencias*'

[§§§§] 2012 is the end of the current governments tenure.

[*****] Factura electronica

accounts before being paid to the payees. Such lags average 3-5 days, and are often pre-determined through negotiations between the bank and the *Dependencia*.

An example of the interplay between these issues is the interactions between *Oportunidades*, Diconsa, Telecomm and Bansefi. All three entities have a contract with *Oportunidades* to disburse the bi-monthly subsidies. To make payments electronically using cards and biometric-enabled POS, *Oportunidades* will have a single contract with Bansefi, and Telecomm and Diconsa would be banking agent of Bansefi. Although the MOF itself does not have a preference for a private or public bank since the defining criteria is a branch network for disbursement, *Oportunidades*, for its part, prefers to partner with Bansefi because it has an extensive network in rural areas, an institutional mandate to serve poor populations, and its business is not attractive to the private sector, which to date, has shown no interest in managing subsidies for government beneficiaries.

Conclusion

Two particular points stand out from this initiative to implement electronic disbursements of social welfare G2P transfers:

Firstly, a program of this scale is arguably being implemented successfully because it has an appeal to the multiple stakeholders involved. What started out as an exercise to attain efficiency gains by the Treasury found purpose within MoF and the *Dependencias* as a way to promote financial inclusion. There is a confluence of interests that gives the program a momentum that each stakeholder would be unable to impart on its own.

Lastly, it is too early to evaluate the success of this program. Eighteen months remain to complete implementation of the program. None of the *Dependencias* have completed the feasibility analysis that outlines savings and costs associated with the program. Bansefi's agent network, on which the distribution of the G2P payments will depend, is incomplete. This may be a reason for concern for some, and as the deadline gets closer, Treasury and/or MOF will look to expedite implementation.

Appendix 1: Timeline

1997
- Treasury begins to centralize all government payments into a unique account.

1999
- Banxico develops Mexico's first RTGS

2003
- Automation of Government Payments states

2006
- National Program for Reduction of Public Expenses Initiated

2010
- Federal Budget requires all government agencies make all disbursements electronically

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