

## **URBAN POVERTY IN MEXICO**

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In 2004, some 11 percent of Mexico's urban population was estimated to be extremely poor and around 42 percent moderately poor. Poverty incidence is substantially lower than in rural areas, where poverty incidence reached 28 and 57 percent, respectively. Poverty measures improved in the early 1990s but increased sharply during the 1994-95 macroeconomic crisis. In recent years, urban poverty rates have improved at a slow pace, as opposed to rural rates, which have seen a significant decline.

**Table 1. Share of Population in Poverty**

	1996	1998	2000	2002	2004
<i>National</i>					
Food Poverty	37.1%	34.1%	24.2%	20.3%	17.6%
Capacities Poverty	46.4%	42.8%	32.0%	27.4%	25.0%
Assets Poverty	69.0%	64.3%	53.8%	50.6%	47.7%
<i>Rural</i>					
Food Poverty	52.4%	52.5%	42.4%	34.8%	27.9%
Capacities Poverty	61.7%	60.3%	50.1%	43.9%	36.1%
Assets Poverty	81.0%	76.6%	69.3%	65.4%	57.4%
<i>Urban</i>					
Food Poverty	26.5%	21.3%	12.6%	11.4%	11.3%
Capacities Poverty	35.9%	30.7%	20.3%	17.4%	18.1%
Assets Poverty	60.7%	55.8%	43.8%	41.5%	41.7%

Source: WB staff estimates based on ENIGH.

**Location matters for poverty causes and consequences.** This report has argued that although the urban poor share many characteristics with their rural counterparts, location is a key component for understanding the structure and trends in deprivation, as well as the policy interventions needed to abate poverty. Nevertheless, urban areas are highly heterogeneous, both within and across cities, and regional differences may matter more than rural/urban ones. As such, care should be taken not to rely too strongly on a rural/urban dichotomy.

### The specificity of urban poverty

**Urban and rural poverty differ in many important aspects.** Urban poor share many household characteristics with rural poor – they have larger families, less education and less access to services than the rich. However there are some notable differences. In terms of consumption patterns they spend relatively more on housing (twice the share), transport and education, but relatively less on food, clothing and health. They are much more dependent on the labor market for income. The most remarkable difference is the surprisingly low share of urban income that is derived from

transfers. In fact, this is the only dimension on which the situation of urban poor in Mexico is substantially different from in the rest of Latin America. This is clearly not due to low overall expenditure on social safety nets, since the rural poor's share of income derived from transfers is actually higher than the regional average. Instead, it may be due to the fact that *Oportunidades* had not yet expanded into urban areas at the time of the survey.

**While urban poor have greater access to public services, quality and overcrowding remain a problem.** Another notable difference from the situation of rural poor is the urban poor's greater access to infrastructure and other public services. But here again there are some worrisome caveats. First, despite much higher access to infrastructure and health services in urban areas, infectious diseases such as diarrhea and acute respiratory infections are equally common among urban and rural poor children. This suggests that water and sanitation systems are of remarkably poor quality. While much attention is being paid to expanding coverage, quality is not keeping up, making the improved access only nominal. It also implies that using access to services as a targeting instrument may lead to misleading conclusions about well-being in urban areas. Second, school enrollment rates are equally low among urban and rural poor. This may reflect the positive impact of *Oportunidades* in rural areas, but it does also show the urgent need for assessing the educational situation of urban areas.

### **Urban areas, not more unequal, but highly heterogeneous**

**There is still great heterogeneity in welfare levels between and within cities, which has important implications for social protection interventions.** Over the last decade, urban inequality has declined so that today urban areas are somewhat less unequal than rural areas. However, they are characterized by very high heterogeneity, both within cities and even within poor neighborhoods. This is true for income, whether measured in pesos or through an asset index. Heterogeneity in terms of access to services is however greater than in terms of household characteristics such as wage levels or house quality. The analysis of heterogeneity reveals that the incidence and manifestation of poverty varies enormously between and within different urban areas, and even within particular neighborhoods. This has important implications for the targeting mechanisms of social safety-net programs: in particular that geographic targeting is likely to involve high error rates for both inclusion and exclusion.

### **Places of the poor – an analysis of urban poor *barrios***

**A recent survey of urban Mexico's poor neighborhoods (*barrios*) confirms this great diversity.** What emerges is a picture of great diversity: while the poor are indeed concentrated in poor neighborhoods, not all poor live there, and, most importantly for the topic at hand, poor neighborhoods include both poor and non-poor. Indeed, the incidence of poverty across the *barrios* in the sample varies from 18 percent to 55 percent,

for an average of about 36 percent. And income inequality is much greater within poor *barrios*, than across them. There are pockets of concentrated poverty within poor neighborhoods.

**Average income levels in *barrios* is negatively correlated to distance from centers of employment, the settlement age, lower access to public services and propensity to natural disasters.** The characteristics of the city to which the *barrio* belongs – such as the structure of the local economy, public expenditure per capita, city size and growth – are also found to matter. The gradual way in which poor acquire housing shows up in a positive correlation between the age of a settlement on one hand, and access to services and quality of housing on the other.

**Access to the city and infrastructure services are the most pressing needs for *barrio* inhabitants.** An analysis of the needs expressed by the residents of poor neighborhoods shows that they feel physically isolated from the city they live in – access to the city is by far the most frequently mentioned need. Other high priority needs that emerge are water and sanitation, as well as education infrastructure and public safety.

**Social capital is found to be fairly high in these poor *barrios*,** as measured through a variety of indicators of individuals' level of social connections and of neighborhood level organizations. However, these are found to vary significantly across *barrios*. Greater social connections are found to be positively associated with employment, suggesting that social capital does indeed play a role in the economic well-being of poor households.

**The incidence of crime and violence is high in these poor neighborhoods, much more so than in the rest of Mexico.** Greater social capital appears to reduce crime and violence, however. Other factors that appear significantly associated with crime include higher income per capita (which is a proxy for the amount of transferable assets) and local amenities (with public lights in particular acting as a deterrent). Policing is positively associated with crime.

**What then are the implications of this work on “places of the poor”?** First, where people live matters in determining their opportunities, as well as the challenge facing them. This implies that the spatial focus of *Hábitat*, the new urban poverty program developed by the Mexican government, is appropriate. Second, poor neighborhoods are tremendously varied in their structure and composition, which argues in favor of programs that leave room for self-determination. Finally, social capital and social structures are important in these neighborhoods – indeed *Hábitat* seeks to build on local social structures. It is known from other studies that the benefits of social networks, particularly in terms of procuring employment and securing benefits, are greater when these social networks can span social groups and geographic areas (Woolcock, 2004). This suggest that a role for public intervention, whether through

*Hábitat* (discussed below), or through other programs active in poor urban *barrios* such as *Oportunidades*, could be to help these networks reach out.

**Finally, there are also negative externalities from clustering low-income families together.** Our analysis suggests that people are poor because they locate in low-income areas. But conversely, these neighborhoods also stay poor because poor people live there, resulting in social stigma, lower property rights enforcement, etc. These neighborhood effects have implications for housing and urban planning policies more broadly.

### Vulnerability and coping mechanisms

**Labor markets are at the core of the urban poor's coping strategies, but are also the source of much vulnerability.** Indeed it is through job losses and pay cuts that poor urban households are exposed to macroshocks. But it is also to labor markets that the poor turn most for their coping strategy. Indeed the “added worker effect”, whereby households tend to send additional household members to work when confronted with a shock is an urban phenomenon.

**Urban poverty is more responsive to growth – but for the same reason, the urban poor are very vulnerable to macroeconomic crisis.** Household characteristics condition income vulnerability – in particular self-employment or employment in the informal sector, and a younger household head are associated with greater variations in income. The recent macroeconomic crisis did not change the risk distribution for the poor, although it certainly led to a massive increase in the number of urban extreme poor, which tripled between 1994 and 1996.

**Efforts to improve job growth need to be accompanied by safety nets for those unable to take advantage of employment opportunities.** Growth is key, urban poverty will decrease if Mexico grows and jobs are created in urban centers. But safety nets are needed. As such the recent expansion of *Oportunidades* to urban areas is opportune. The program is struggling somewhat with the need to adapt to urban reality, although evaluations suggest it is having a positive, although somewhat unexpected effect. There is no evidence of an impact on education (unlike in rural areas); on the other hand, beneficiary households appear to have used the resources granted through the program to improve their housing condition. One key challenge confronting it concerns increasing coverage while keeping targeting costs to a reasonable share of overall program costs: currently it is estimated that the targeting approach used only captures 65 percent of eligible households. Another challenge concerns the need to adapt co-responsibilities (attendance at lectures on health and education issues, as well as regular visits to health clinics) to the schedule of urban working parents.

**The recent creation of *Hábitat*, a program focused on urban upgrading, but with a careful emphasis on social issues, is a very positive development.** The program

is innovative, although it could benefit from further action to enhance its impact. In particular, the program would benefit from a greater emphasis on medium term upgrading strategies. This should include encouraging multi-year program support for eligible families (where the need is justified) to ensure resources are sufficient to actually cover meaningful upgrading.

### **Labor markets development, at the heart of urban poverty policies**

**Over the last decade, Mexico's urban poor appear to have worked more for less pay.** Poor workers are increasingly concentrated in sectors with meager performance and slow growth. Most are in low quality occupations, such as salaried informal employment and low-end self-employment (Self-Employment without Investment or SEWI). In fact, a 40 percent increase between 1991 and 2003 in the share of poor households in this category resulted in significant decline in returns to labor.

**Although wage levels for the poor have increased after 1996, they have not regained 1991 levels.** After 1996, relative demand for low-skilled workers expanded and fell for the high skilled. This change in labor demand, coupled with a large increase in the supply of skilled workers (especially women), resulted in a significant improvement in the relative remuneration of the poor. Wage levels recovered after 1996, but the improvement was not sufficient to regain the levels of 1991, especially for the very poor. However lower wages were partly compensated by an increase in poor workers' participation in the labor market.

**Mexico's low productivity growth is affecting poor workers ability to access better quality jobs and thus improve their labor earnings.** Institutional factors in Mexico's labor market appear to have played an important role in curtailing formal employment opportunities, particularly for the poor. However, the 1997 social-security reform may have relaxed labor-market rigidities somewhat. Nevertheless, the fact that Mexico's labor market seems to be losing its ability to adjust to output shocks through wages combined with Mexico's declining ability to improve factor productivity may seriously hurt the country's competitiveness in international markets, particularly the US. Policies that foster the expansion of export sectors together with targeted interventions to favor productivity growth in small and informal firms could increase poor workers access to better jobs. However, for any such policy to work, it must address issues that constrain productivity growth. Furthermore, because the current low levels of productivity growth are a major hurdle for formal sector expansion, improving productivity would go a long way toward increasing formality and consequently enhancing the access of poor workers to better quality jobs.

**Improving the investment climate would help raise productivity levels.** An important step in this direction would be to raise the quality of institutions and services for business, and simplify regulations and procedures for company registration,

functioning and growth. Deepening the 1997 social security reform in the areas where there is still room for action could further smooth out labor-market rigidities while continuing to facilitate formal employment. In addition, labor provisions that hinder productivity growth, such as hiring modalities and promotion-related provisions, dispute settlement mechanisms, and termination of employment **and severance payments (both individual and collective), should be addressed.**

**The current system of unemployment protection (severance payments) neither protects informal workers nor provides adequate service to formal workers.** As such, a more inclusive labor protection scheme should be developed that covers the most vulnerable and does not distort the functioning of labor market. This could be jointly funded by employers, workers and the government through individual accounts to provide supplemental income during job-search periods, thus facilitating easier labor market adjustments. If eligibility is well defined and costs are reasonable this type of system may encourage employers and employees to register contracts that they might not otherwise.

**Female participation rates remain among the lowest in Latin America,** yet, increasing household-member participation in the labor market effectively improves households' income level. As such, it is urgent to expand or develop programs that foster the integration of female workers into the labor force – whether directly or through the provision of services such as child care. The introduction of training programs for women and childcare facilities in the Women Households (*Mujeres Jefas de Familia*) module of the *Hábitat* program is a welcome initiative. In addition, the root causes of the low female participation rate should be examine as it is possible that some degree of cultural bias, discouraging women's participation in the labor force, is further obstructing progress needed on this front.

**The ability of poor workers to get better jobs is greatly hampered by their limited endowments and inadequate access to labor market information.** Providing poor workers with opportunities to improve their skill levels, as well as facilitating their access to information on job prospects could greatly expand their access to decent jobs. Educational policies need to improve the quality and coverage of secondary schooling, as well as to deepen efforts already underway that promote access by the poor to higher education.

**Increasing access to higher education alone, however, will not improve the situation of the poor, as the benefits of education take time to appear.** Moreover, since the skill premium has fallen since 1996, such initiatives cannot be considered a silver bullet for improving the situation of the poor. On the other hand, occupational training and labor intermediation services can be instrumental in helping the poor in the short to medium terms to access decent jobs. A recent analysis of current government programs (Montes and Santamaría, 2004) suggests that the poor may not be the main beneficiaries of current programs. A staged approach should therefore be adopted, including a more

comprehensive and in depth evaluation of existing programs with an assessment of what works best to help the poor access better jobs in order to help determine which programs have the greatest impact, and therefore should be continued and/or revamped, and which ones are contributing insufficiently, and thus should be reformed.

**Safety nets are needed for the urban poor, especially in times of economywide crisis.** Given that the current unemployment protection system only protects formal employees and that the Mexican labor market may be increasingly absorbing output shocks through employment rates (and consequently higher unemployment rates), it is imperative to develop safety nets that protect the urban poor and help them mitigate risks better, especially when covariate shocks hit. A scheme to protect workers confronted with unemployment mentioned above could be part of this. In addition, programs that particularly target the poor in times of crisis should be designed. Workfare is one approach commonly used – indeed Mexico had one such program operating in rural areas until quite recently Temporary Jobs Program (*Programa de Empleo Temporal* or PET). Chile, Argentina, Thailand and Korea are countries that have successfully relied on workfare programs to cope with the impact of macroeconomic shocks and from whose experience interesting lessons can be drawn.

### Helping the poor build assets

**Assets are at the core of households' strategies to survive, meet future needs, improve their lot, reduce exposure to shocks or minimize their consequences.** And despite being constrained by limited income and few adequate saving mechanisms, the poor do save: prior to the peso crisis, the savings rate of the very poor (as proxied by education) was around 6 percent, increasing by about one percentage point if consumer durables are included<sup>1</sup>. This is clearly much less than better off households with savings rate more than twice that amount, nonetheless, it does confirm that the poor do save even in the face of limited resources and savings instruments. The three main ways in which the poor hold their assets are consumer durables, housing and cash or financial savings. Workfare is one common approach commonly used – indeed Mexico has one such program operating in rural areas (PET).

**Housing is likely to be the most valuable single possession owned by poor.** Home ownership, at 66 percent, is high among Mexico's urban poor, almost as high as for the non-poor (70 percent). Most, however, acquire housing through informal markets. This is due to the fact that in Mexico the purchase of formal finished housing is only affordable to people who earn more than 3 minimum wages – the middle class and above. Housing is likely to be the most valuable single possession owned by poor urban households. In addition to providing shelter, housing also plays a more standard role as

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<sup>1</sup> In 1996, savings rates were around 1 percent to 2 percent, increasing by about one percentage point if consumer durables are added.

an asset, one whose main modality of acquisition for the urban poor offers the opportunity for small incremental investments. In addition, there is evidence on the fact that housing and other residential property act as a substitute for formal retirement systems.

**Key areas for reform include developing resale markets for low income used housing, as well as improving tenure security.** So how then to improve the low income housing market without distorting housing markets or the poor's investment choices? It includes making it more liquid, notably by developing housing finance schemes for the poor that allow for a used housing market to develop (such as the Costa Rican or Chilean ones discussed in Box 5.6). It may also require making it more secure through actions such as titling. Additionally, measures to improve neighborhood quality, whether by improving services or by reducing crime and violence situation of poor neighborhoods, can make a particular neighborhood's housing market more buoyant, although the impact on housing market in general is more limited.

**Housing for the poor is a major focus of the current government as evidenced by the 2001-2006 National Housing Policy's efforts to target low/moderate-income households.** The approach includes developing a unified system of housing subsidies complemented by credit and savings; expanding housing finance by working with financial institutions experienced in serving low/moderate income groups to finance low-cost housing solutions; and strengthening property rights.

**Though important progress has been made, additional efforts may be necessary to fully respond to the housing needs of the 40 percent of the population that earn below 3 minimum wages.** First, a broad land policy is needed. Government efforts to support urban land for low-income housing have focused on building land reserves but those should be short-term solution in the context of a longer-term reform program to address the bottlenecks in land markets. Second, more can be done in terms of micro credit to accompany home improvement and expansion. A pilot program for 2005 shows great promise as it fosters increased private sector lending and appropriately reflects the recent moves of the private sector into this market through consumer and materials loans. Third, there is a need to align subsidies programs to social policy goals and foster private finance to low income households. The expansion of the *Tu Casa* program to include subsidies for home improvement and expansion is a step in the right direction. Last, the institutional and financial framework for property registries needs to be modernized.

**Barred from access to formal financial assets, the poor rely on a variety of alternatives to formal banking services.** These include cash savings held at home; loans to and from friends and relatives; and informal savings institutions. The latter take a variety of forms: *tandas*, *cajas de ahorro*, *clubes*, etc., but appear to have a limited reach: in Mexico City only 30 percent of those who did not have access to formal financial mechanisms reported holding some form of financial savings with informal institutions.

**These informal savings or loans systems rely on personal trust and confidence in other people and tend to offer low returns.** Of the various informal savings mechanisms used, only the *cajas* offer positive – and often quite high – returns to the savers, but again, the scarce evidence available suggests that poorer clients do not use or have access to *cajas*. Other mechanisms used offer no opportunities to accumulate financial savings in ways that maintain the purchasing power of those savings.

**The cost of credit, on the other hand, is generally high.** The most common sources of credit for the poor include commercial stores, informal institutions and loans from friends and family. Non-bank credit terms tend to be high, however: grocery stores offering credit for food purchases charge the equivalent of 30 percent monthly interests rates, chain stores consumer loans (typically for consumer durables) charge some 15 percent on a monthly basis. Note that the latter is relevant even for the poor – four-fifth of them owns a television, about half own a fridge and around a third, a washing machine.

**Lack of money, high minimum balances requirements, and general distrust of banks prevent low income people from opening a bank account.** In addition, banks in Mexico do not aggressively pursue low-income clients. Non-bank financial institutions, on the other hand, have increased in number and many have become regulated or at least legally recognized – but coverage in urban areas remains very limited.

**Efforts are also needed to improve the reach of the formal banking sector.** These include approaches to improve the financial infrastructure for financial intermediation (credit information registries, legal and regulatory framework for secured transactions) and approaches that encourage banks to offer low cost financial products to poor households. This entails greater use of information technology (PDAs, smart cards and handheld computers) and encouraging banks to offer “lifeline” accounts with low or no minimum balance requirement. In addition, efforts to reduce the lack of familiarity between poor households and banks include financial literacy programs, publishing information on the profitability of reaching down, programs to encourage large employers to pay through electronic transfers rather than by checks, and relying on banks for direct income transfers to the poor through the formal banking sector (the effort to rely on the Financial Services and National Savings Bank (*Banco del Ahorro Nacional y Servicios Financieros* ,(BANSEFI) – for *Oportunidades* transfers is an excellent such program).

### **Summing up, public policies to fight urban poverty**

**Under the umbrella of *Contigo*, the Mexican government has developed a number of successful initiatives but more efforts are needed to effectively fight urban poverty.** Some programs, like *Oportunidades*, are considered best practice in their kind. Other programs that have recently been developed include *Hábitat*, a new program that

focuses on neighborhood upgrading. However, more is needed to abate urban poverty. First and foremost, social insurance needs to be made accessible to the vast majority of working poor who are not currently covered. However, this requires major reforms as discussed in *Mexico: A review of Social Protection*, the companion report on social safety nets. In the meantime, considerations should be given to developing some type of workfare program that can quickly be rolled out in times of macroeconomic crisis and that does build on the fact that the urban poor often resort to an added worker strategy when confronted with an income shock.

**Fighting urban poverty also requires helping the poor access better jobs.** Growth is certainly important but other measures that can help include education and training. Education is no silver bullet however, since its impact takes time. As to training, there is a need for a thorough and careful evaluation of existing programs. Childcare is an under provided good, which has a doubly positive impact. It allows women to work, and contributes to their accessing better jobs. Quality childcare is also associated with higher subsequent educational performance of children.

***Hábitat* is an important example of policy developments which can help the poor save and hold a better portfolio of assets.** Housing is perhaps the most common form in which the poor store wealth. Urbanization programs such as *Hábitat* as well as recent efforts to improve the poverty effectiveness of housing policy in general are therefore an important avenue for improving the poor's ability to build wealth and protect themselves from income shocks. More could perhaps be done concerning the urban poor's ability to hold financial assets, however. The report suggested some promising avenues to do so.

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