

## Chapter 1. Boosting inclusive growth

*Mexico's GDP per capita levels remain the lowest in the OECD, reflecting low growth rates stemming mainly from poor labour productivity performance. To allow convergence towards higher living standards and well-being, Mexico needs structural policy reforms that can deliver robust, sustainable and inclusive growth. This chapter, therefore, focuses on win-win policies to boost productivity and reduce inequalities in order to deliver prosperity for all Mexicans.*

*Reducing high informality is a priority area and will require coordinated actions in taxation, business and labour regulations and the social safety net to better align incentives to formalise and drive resources towards more productive (formal) firms. Increasing educational outcomes will set the foundations for quality, formal jobs and higher value-added production and exports. While access to education has improved, more efforts are needed to raise quality, especially in early childhood education and care, shift resources towards lower education levels and prioritise schools in poor areas and students from disadvantaged backgrounds. Improvements in urban planning and transport would help raise the productivity potential of Mexico's cities and improve environmental outcomes. The creation of joint metropolitan governance arrangements to deliver integrated public services would also increase the efficiency of public spending and improve the well-being of citizens.*

*Women's skills remain a source of untapped potential to lift growth, inclusion and reduce poverty. Inequalities start early, as the high share of young women not in education, employment, or training (NEETs) prevents them from accessing good quality formal jobs later in life. Current policies to reduce the high share of NEETs should have a focus on women. Expanding early childhood education and care would increase both women's labour market participation as well as enhance educational outcomes.*

## Boosting productivity and sharing the benefits of growth more widely to raise prosperity for all

Mexico's GDP per capita levels remain the lowest in the OECD, reflecting low growth rates stemming mainly from poor labour productivity performance. After losing ground, Mexico's GDP per capita has been slowly converging towards the OECD average over the last decade. However, this recent improvement has been driven by relatively large increases in labour utilisation, while labour productivity growth has not been strong enough to drive convergence towards other OECD countries (Figure 1.1). Boosting productivity is therefore of crucial importance to raising the living standards of all Mexicans.

Moreover, the role of productivity will be increasingly important as Mexico's demographic dividend fades. The old-age dependency ratio is set to increase from 9.8 in 2015 to 29.2 in 2050. In short, productivity gains are needed in order to achieve more robust growth. Furthermore, it will be important to share these gains more widely in order to bring down the very high levels of inequality (Figure 1.2a).

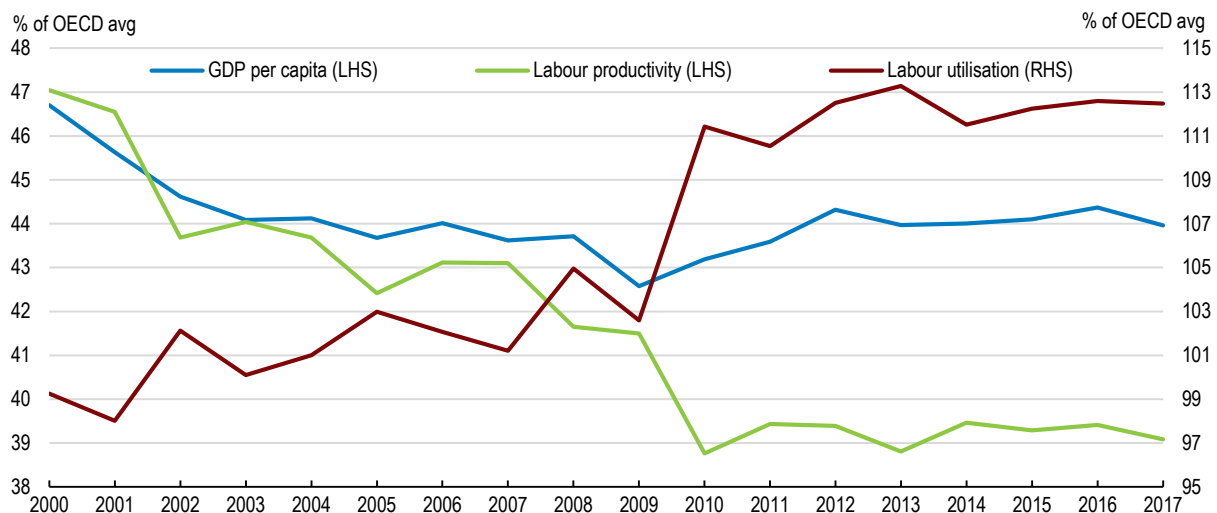
There is, however, room to raise growth by also increasing women labour force participation. Some progress has been made over the years as women's participation rate has risen from 36% in 1990 to 47% in 2017. Still, it remains the second lowest among OECD countries, and significantly lower than men's participation rate of 82% (Figure 1.2b). Many barriers prevent Mexican women from engaging in the labour force. Inequalities start early as young people not in education, employment or training (NEET) are predominantly women. Policies to reduce high dropout rates should be particularly geared towards women (see the section "Raising educational outcomes to combat informality and boost human capital"). The plan should include expanding early childhood education and care (ECEC), as motherhood is a key driver of NEET status and Mexico's teen pregnancy rate remains the highest among OECD countries (OECD, 2017<sup>[1]</sup>). Reducing high levels of insecurity could also help improve school attendance and labour market participation (Figure 1.3).

Another hurdle women face in the labour market is the still low supply of ECEC services. Mexico has made significant progress in expanding access to ECEC but demand still far outstrips supply (OECD, 2017<sup>[1]</sup>). Enrolment rates for children under four years of age are particularly low. Expanding good quality ECEC services is a priority. This is a win-win policy, conducive to higher growth via the inclusion of women in the labour market, lower gender inequalities and reduced poverty rates (including among children, as maternal employment is strongly correlated with child poverty across countries), as well as boosting educational outcomes and reducing income inequalities in the future (see education section). The length of the pre-school day for three- to five-year olds also needs to be increased, as most programmes are currently only half-a-day long. Against this background, the halving of the government budget line for *Estancias Infantiles* - a programme to finance the care of children of mothers working in the informal sector - is particularly worrying. The budget cuts were motivated by detected abuse in the use of funds by the Supreme Audit Institution (ASF) and corruption in some facilities. The government intends to move to a unified ECEC system delinked from parent's labour market status, increase coverage in marginalised areas and raise participation of disabled and indigenous children, which is welcome. However, the budgetary cut is very likely to reduce women's participation in the labour market, further reducing the incomes of the most vulnerable households and leaving some children without educational care.

Culture norms also matter. Women are traditionally seen as caregivers. Mexican women perform over three-quarters of all unpaid housework and childcare in their homes – one of the highest burdens of unpaid work in the OECD – and these hours in unpaid work restrict the time that could be spent in paid work. The culture of long working hours reinforces the traditional gender roles as fathers are more likely than mothers to be able to spend long days at work (OECD, 2017<sup>[1]</sup>).

Going forward, the government could also move to a more gender-equitable use of parental leave as recommended in the 2017 OECD Economic Survey of Mexico (OECD, 2017<sup>[2]</sup>). Eligible mothers in formal jobs are entitled to 12 weeks of publicly-funded paid maternity leave, while eligible fathers are entitled to five days of employer-sponsored paternity leave. These are among the lowest entitlements in the OECD, and the fact that paternity leave is paid for by employers rather than the government likely reduces fathers' take-up. More OECD countries are moving towards reserving non-transferable periods of paid parental leave exclusively for use by fathers (OECD, 2016<sup>[3]</sup>). This would also help reduce the traditional role of women as caregivers. Mexico could also strengthen enforcement of recent changes in legislation that discourage gender discrimination in the workplace, as recommended in the 2017 OECD Economic Survey of Mexico (OECD, 2017<sup>[2]</sup>).

**Figure 1.1. Growth has not been strong enough to allow for convergence to higher living standards**

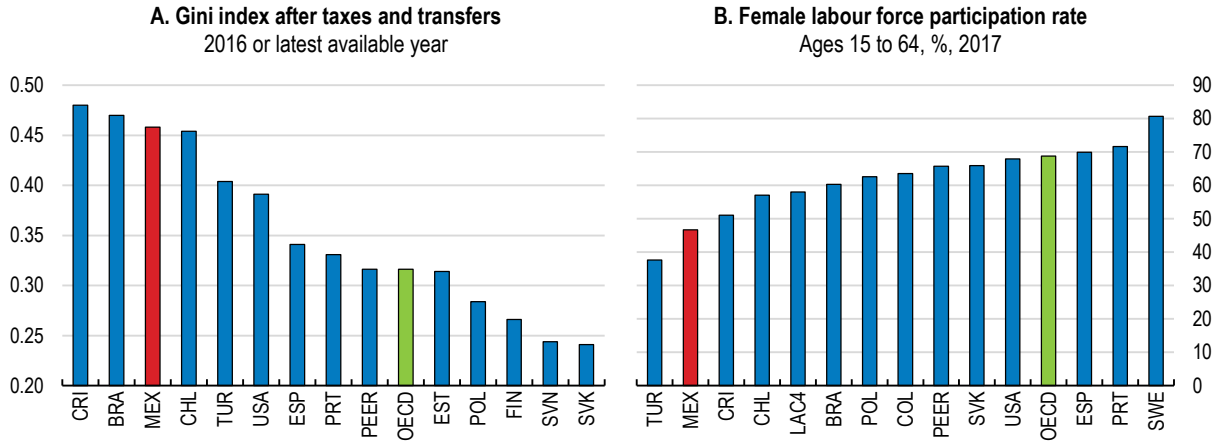


*Note:* GDP per capita and labour productivity relative to the OECD average in constant PPP-adjusted USD terms. Labour productivity is GDP per hour worked. Labour utilisation is hours worked per capita.

*Source:* OECD Productivity Database.

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**Figure 1.2. Inequality is high and the labour market could be more inclusive**



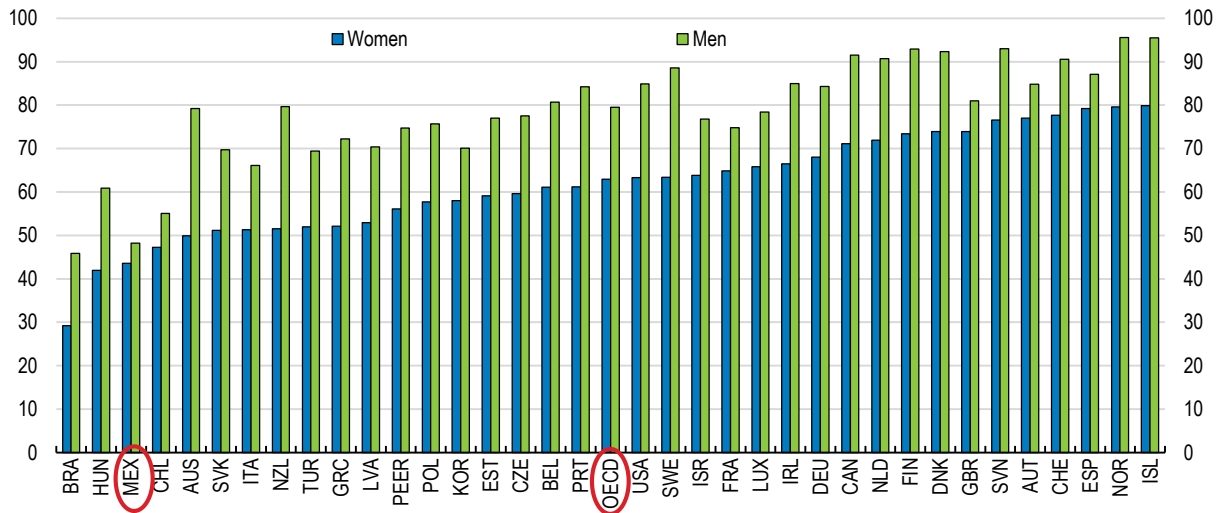
*Note:* OECD refers to the simple average across all OECD countries for the latest year with available data. LAC4 refers to the simple average of Brazil, Chile, Colombia and Costa Rica. PEER refers to the simple average of the 10 non-Latin American OECD countries with the lowest PPP-adjusted GDP per capita: Estonia, Greece, Hungary, Latvia, Lithuania, Poland, Portugal, Slovak Republic, Slovenia and Turkey.

*Source:* OECD Income Distribution and Poverty Database; and OECD Social Protection and Well-being Database.

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**Figure 1.3. Security is low, hurting women in particular**

Percentage of people who report feeling safe walking alone at night



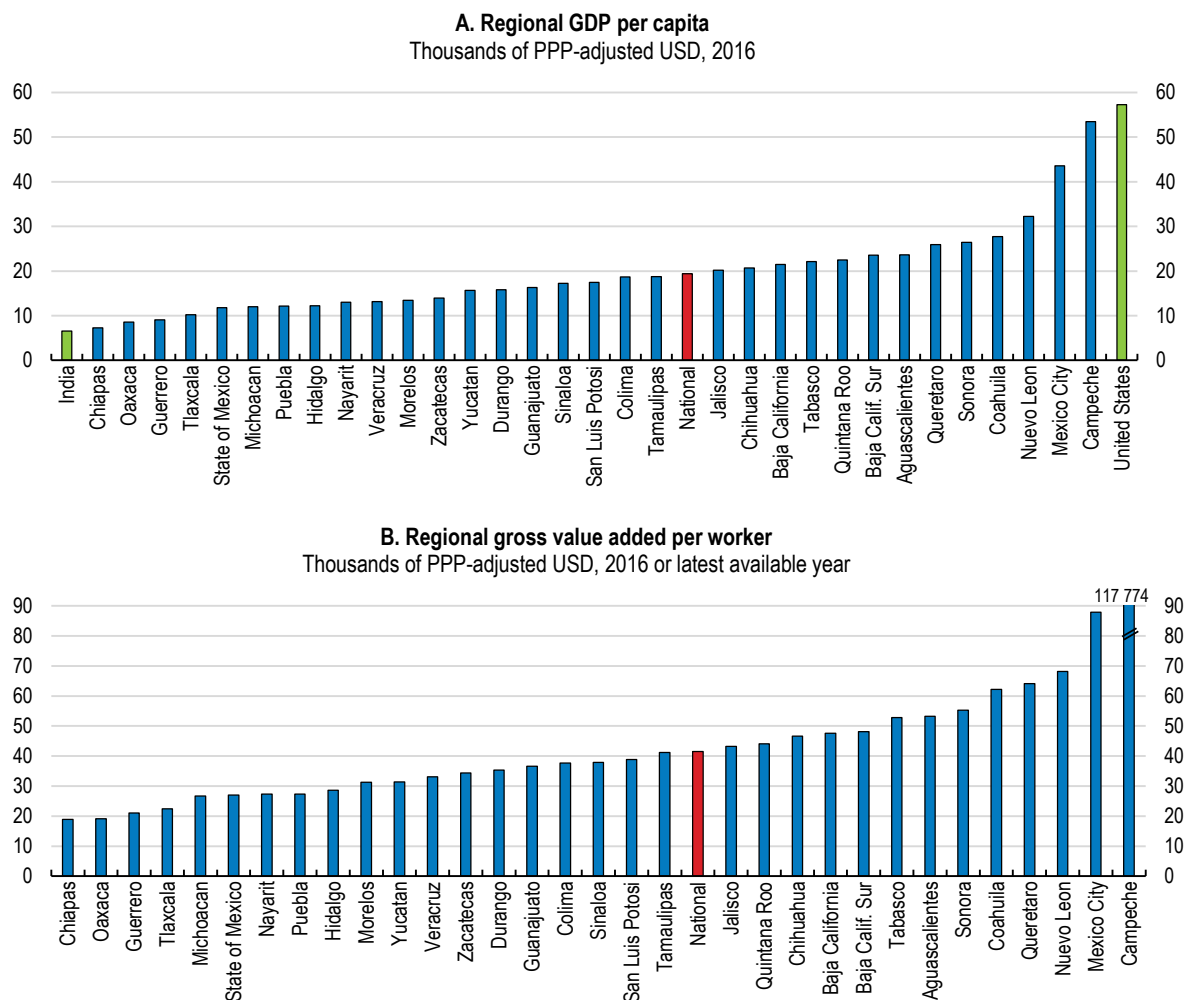
*Note:* PEER is an unweighted average of the 10 non-Latin American OECD countries with the lowest PPP-adjusted GDP per capita: Estonia, Greece, Hungary, Latvia, Lithuania, Poland, Portugal, Slovak Republic, Slovenia and Turkey. The reference period is the 3-year average 2014-2016 for all countries.

*Source:* OECD Better Life Index.

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The stark diversity of GDP per capita and productivity performance across regions is also contributing to Mexico's high levels of inequality. Campeche's levels are almost as high as those of the United States, and more than six times those of Chiapas (Figure 1.4). This partly reflects differences in industrial structures. States with capital-intensive, non-renewable resource sectors, such as Campeche, tend to have high levels of income and productivity. Some states, particularly those in the north, have also tended to benefit disproportionately from trade and investment ties with the United States, whereas southern states tend to be less developed and more reliant on traditional activities and economic structures.

**Figure 1.4. Regional GDP per capita and productivity differences are large**



Source: OECD Regional Statistics and Productivity databases.

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Unequal access to opportunities for Mexico's indigenous people is another obstacle to more inclusive growth. Indigenous people represent a significant share of the population, with 21.5% self-identifying as indigenous (about 28 million people) and 6.5% of Mexicans aged three or over speaking an indigenous language (over 8 million people) (OECD, 2019<sub>[4]</sub>).

Over three-quarters of indigenous people live in poverty, compared with 41% of non-indigenous people, and the rate of extreme poverty is about six times higher among indigenous people (CONEVAL, 2017<sup>[5]</sup>). Indigenous people have much lower educational outcomes than the non-indigenous population. Almost a fifth of indigenous people aged over 15 are illiterate compared with 6% of non-indigenous people (OECD, 2018<sup>[6]</sup>). Despite improvements, indigenous 15-year-old students who speak a language other than Spanish at home have a language assessment score that is 64 points lower than other students according to the OECD's Programme for International Student Assessment (PISA). Among indigenous 25-64 year olds in 2015, only 6.6% had completed tertiary education and only 9.7% had completed upper secondary, compared with 18.7% and 19.6% respectively for the rest of the population (OECD, 2019<sup>[4]</sup>). Labour market outcomes are also poorer among indigenous people. The national activity rate was 50.3% in 2015, while it was 43.9% among indigenous people (CDI, 2015<sup>[7]</sup>). About 53% of the employed population earn over twice the minimum wage, while only 30% of indigenous people earn this amount (OECD, 2019<sup>[4]</sup>). The new government has a strong commitment to boost the inclusion of the indigenous people and future policy initiatives should be assessed against specific outcome targets.

Structural policy reforms are needed to avoid poverty traps whereby individuals with low skills and poor access to opportunities are confined to low-productivity and low-wage jobs, which in turn reduces aggregate productivity and further worsens inequality. Setting in motion a "virtuous cycle" will require co-ordinated and concerted reforms across a range of policy areas that provide win-win opportunities for both productivity and inclusion. This chapter focuses on two policy areas that will help individuals fulfil their potential and lay the foundations for stronger future productivity growth: making labour markets more inclusive, particularly by reducing informality, and improving outcomes and equity in education. Moreover, it discusses how urban policies can be improved to bolster sustainable development and productivity while improving environmental outcomes and the well-being of citizens.

### Informality is a major driver of resource misallocation

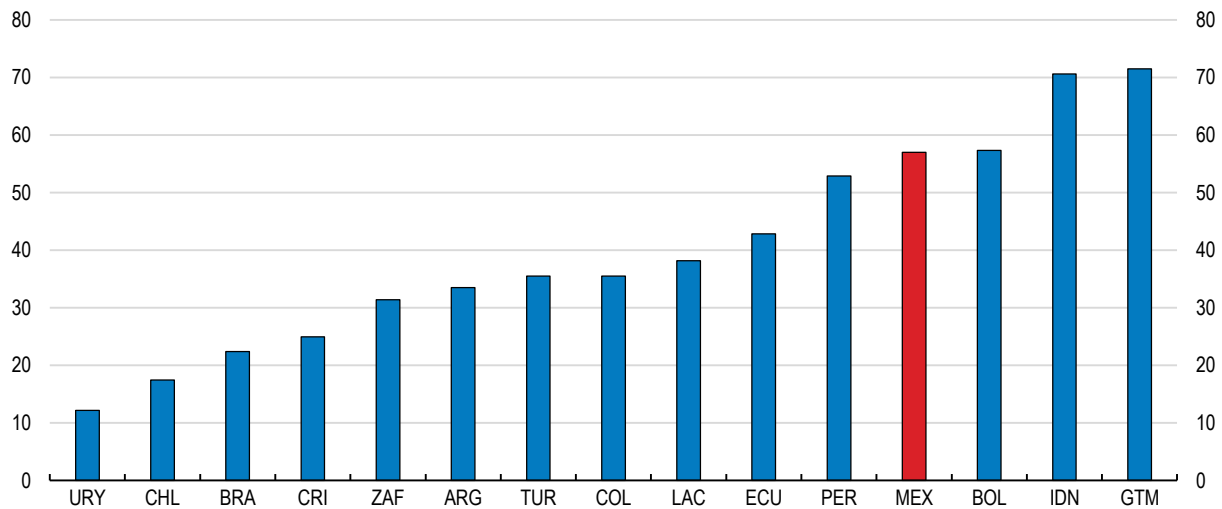
At 60% of workers, informality remains high by international standards despite gradual improvements over time (Figure 1.5, Figure 1.6) and the informal economy represents almost one quarter of Mexico's GDP. Although informality is widespread, it is particularly high among low-skilled workers and other vulnerable groups such as part-time and older workers. Structural transformation from agriculture to industry and then services has not reduced informality (Aranda and Araújo, 2019<sup>[8]</sup>). There are also significant inter-state variations in the share and characteristics of informal workers ranging from 30% in northern states to nearly 90% in the south. This persistently high level of informality is hindering worker mobility, productivity-enhancing resource allocation and workers' access to quality jobs (López-Calva and Lustig, 2010<sup>[9]</sup>; Busso, Fazio and Levy, 2012<sup>[10]</sup>; Hoeller et al., 2012<sup>[11]</sup>; Hsieh, 2015<sup>[12]</sup>; OECD, 2018<sup>[13]</sup>; Dougherty and Escobar, 2019<sup>[14]</sup>; OECD, 2019<sup>[15]</sup>).

Informality limits productivity-enhancing resource allocation, whereby resources flow to firms with high productivity and away from those with low productivity (Hsieh, 2015<sup>[12]</sup>). Productivity losses from resource misallocation in Mexico are high compared not only with other OECD countries, but also other emerging markets and Latin American countries (Busso, Madrigal and Pagés, 2013<sup>[16]</sup>; IMF, 2017<sup>[17]</sup>). This resource misallocation among Mexican firms also has a regional dimension with strikingly large variation across states in

the degree of potential productivity gains from improving allocation (Misch and Saborowski, 2018<sup>[18]</sup>). Misallocation is higher in poorer, southern states, and is linked to higher levels of informality, crime, corruption, ineffective legal systems and market concentration as well as insufficient access to financial and digital infrastructure (Dougherty, 2014<sup>[19]</sup>; Gann, 2016<sup>[20]</sup>; IMF, 2017<sup>[17]</sup>; Misch and Saborowski, 2018<sup>[18]</sup>).

**Figure 1.5. Informality is high by international standards**

% of workers, 2017 or latest available year

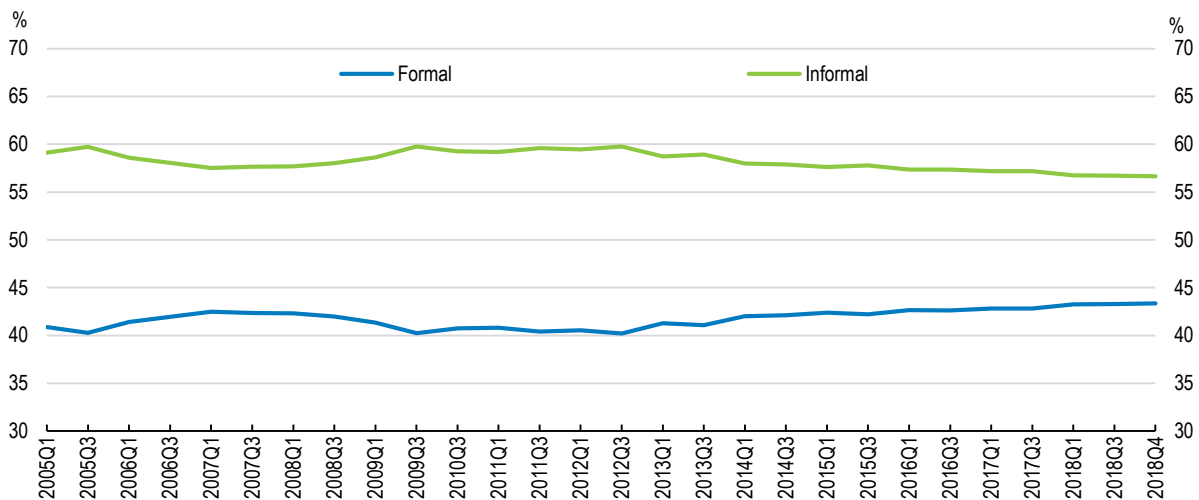


Source: SEDLAC and INEGI.

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**Figure 1.6. Informality remains stubbornly high**

As a share of the total working population



Note: There is a break in the informality data for Q1 2010.

Source: OECD calculations based on INEGI data (ENOE).

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Improvements in productivity will also reduce informality as more firms will be able to survive while bearing the additional costs of formality in terms of taxation and regulation. This highlights the importance of the broader, complementary policy settings that are conducive to productivity growth. However, given the strong regulatory incentives to stay informal in Mexico, and that some forms of informality are legal, the channel from informality to low-productivity is important.

The different forms of informality in Mexico further underscores the complexity of the issue and the need for a multi-pronged policy approach. There are three general types of workers in Mexico: formal workers, informal but legal workers and workers who are both informal and illegal. Salaried workers who have a contract with a firm that complies with labour regulation and tax obligations are formal. Salaried workers hired by firms that do not comply with these obligations are informal and illegal. Non-salaried workers are informal, either because they are self-employed or because they have a contract type that does not oblige the firm they work for to comply with regulations that apply only to salaried workers (Levy, 2018<sup>[21]</sup>).

In turn, there are four types of firms: those that hire only formal workers (fully formal), those that employ a mix of salaried and non-salaried contracts (mixed), those that hire all non-salaried workers (informal and legal) and those that hire all salaried workers but do not comply with their obligations (informal and illegal). Informal but legal firms account for almost three-quarters of firms, although employ only about 40% of workers due to their small average size (Figure 1.7a). Even though the workers of these firms enjoy no labour rights nor social protections, the firms are not breaking any legal obligations in this respect. These firms also have extremely low productivity compared with other firms (Figure 1.7b), suggesting that they would not survive if they were competing on a level playing field with formal firms and highlighting the issue of resource misallocation that stems from informality. A further worrying sign is that, on average, workers and capital in these firms have grown faster than in other types of firms, suggesting that this resource misallocation has worsened over time (Figure 1.8).

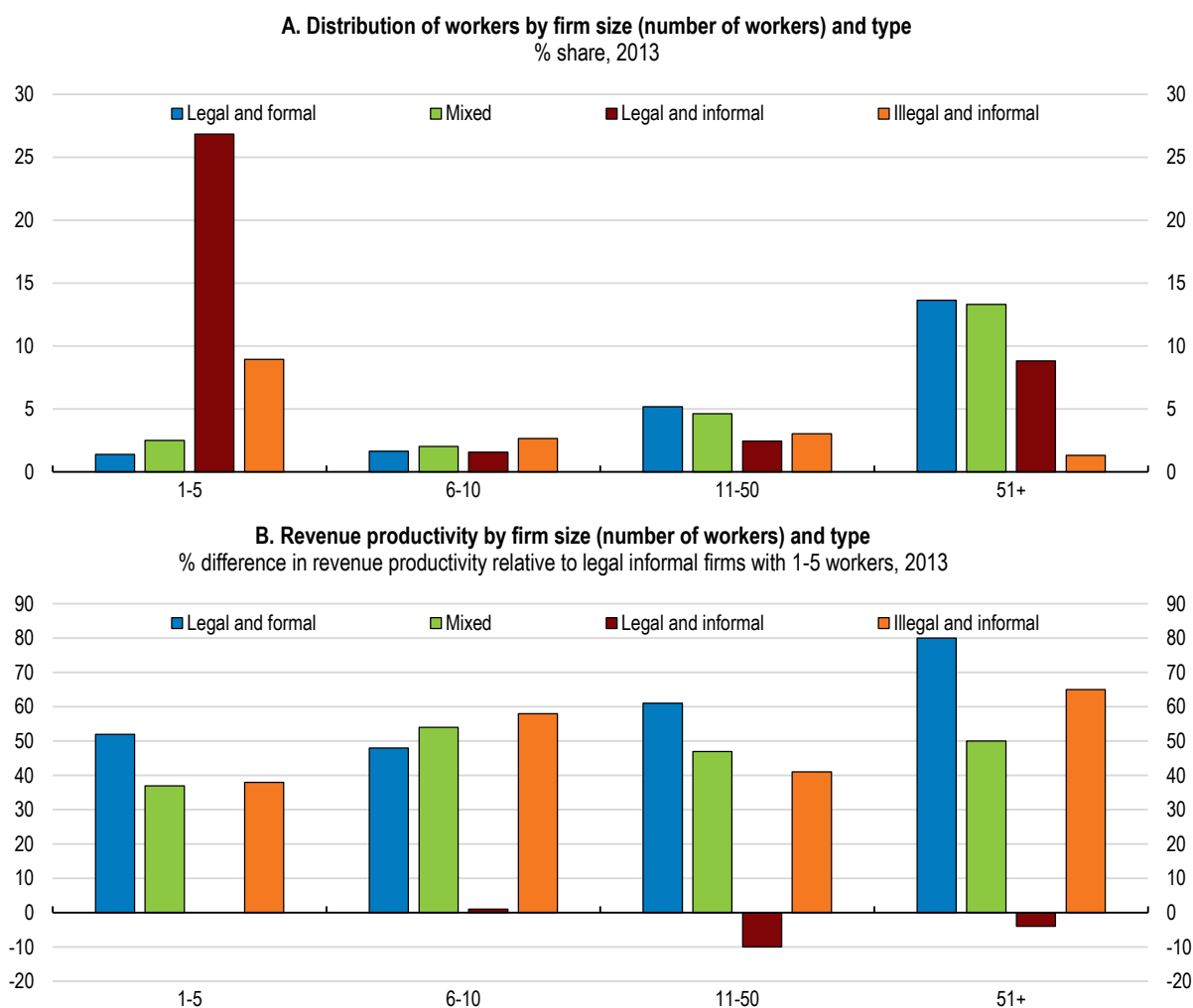
Further highlighting policy interactions, some recent actions may contribute to informality if not complemented by reforms to make formalisation more appealing. Increases in the minimum wage, and intentions to increase social protection with a universal healthcare system, higher universal pensions (*Pensión para Adultos Mayores*, PAM) and other public services currently fragmented according to labour market status, such as early childhood education and care, will increase the relative costs/reduce the relative benefits of formal employment. While these policies aim to improve inclusiveness and reduce inequality, their effectiveness will be undermined if they have the unintended effect of increasing informality.

Making formality more attractive and stepping up enforcement would mitigate these risks. Plans to strengthen the capacity of the tax administration (SAT) are welcome and coordination of existing databases, such as between social security and tax collection agencies would also help (see the Key Policy Insights). Greater coordination between tax and labour inspections would also help, for example, by obliging tax inspectors to report suspected breaches of labour regulations and establishing stronger coordination mechanisms. Reducing informality in the public sector would also set an example for others as 17% of public workers are informal with large differences across states (Aranda and Araújo, 2019<sup>[8]</sup>). As discussed in this section, reducing regulatory burdens for businesses, improving employment protection regulations, lowering taxes on labour and monitoring



and evaluating past efforts to reduce informality should also form part of the comprehensive strategy that is needed to incentivise formalisation.

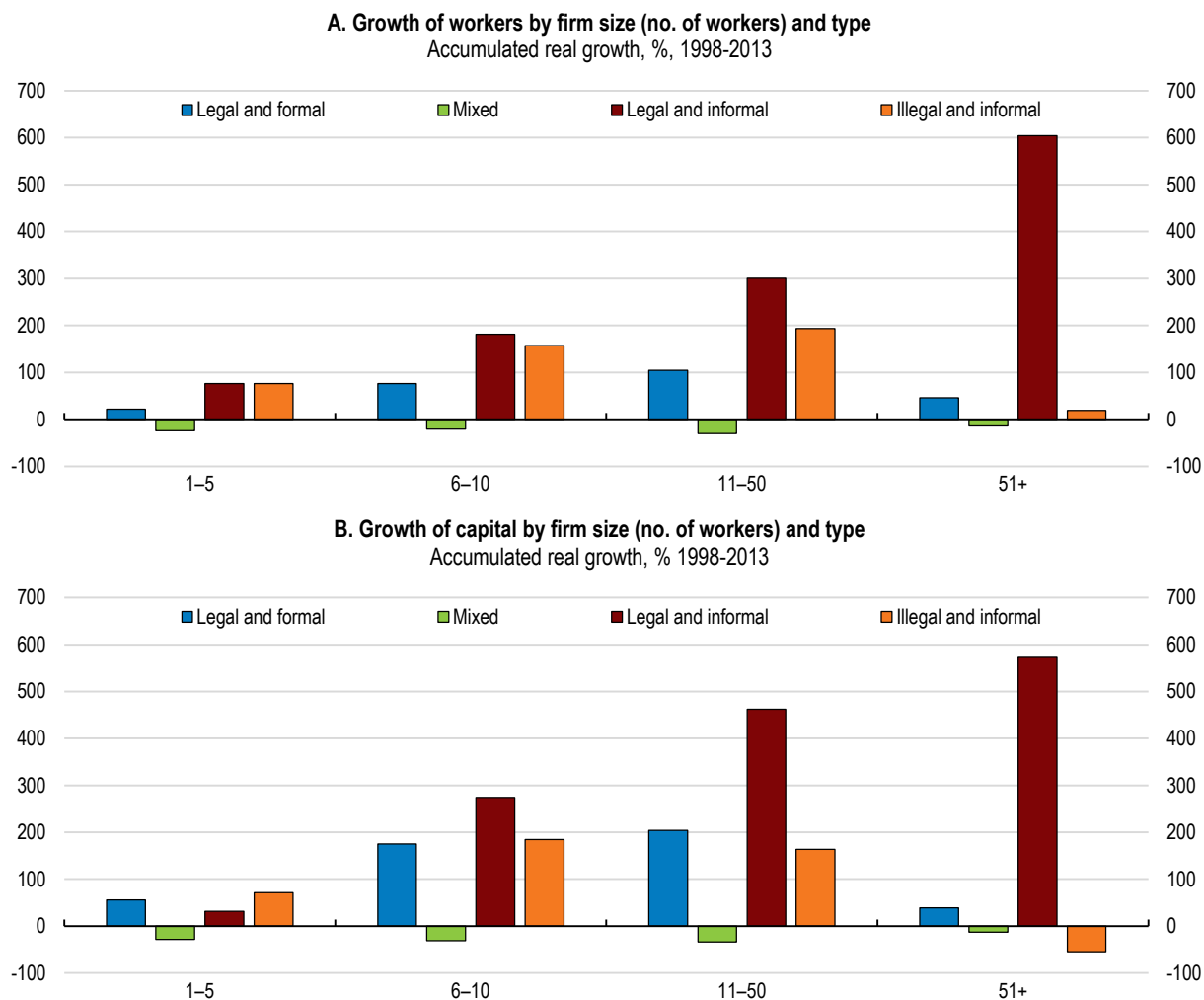
**Figure 1.7. Informal but legal firms account for a large share of resources but have the lowest productivity levels**



*Note:* 'Legal and formal' firms employ only legal, salaried workers. 'Mixed' firms employ some legal, salaried workers and some non-salaried, informal workers. 'Legal and informal' firms employ non-salaried, informal workers. 'Illegal and informal' firms hire illegal salaried workers.

*Source:* Levy (2018<sup>[21]</sup>), *Under-rewarded Efforts: The Elusive Quest for Prosperity in Mexico*.

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**Figure 1.8. Low productivity informal but legal firms have the fastest resource growth**

*Note:* 'Legal and formal' firms employ only legal, salaried workers. 'Mixed' firms employ some legal, salaried workers and some non-salaried, informal workers. 'Legal and informal' firms employ non-salaried, informal workers. 'Illegal and informal' firms hire illegal salaried workers.

*Source:* Levy (2018<sub>[21]</sub>), *Under-rewarded Efforts: The Elusive Quest for Prosperity in Mexico*.

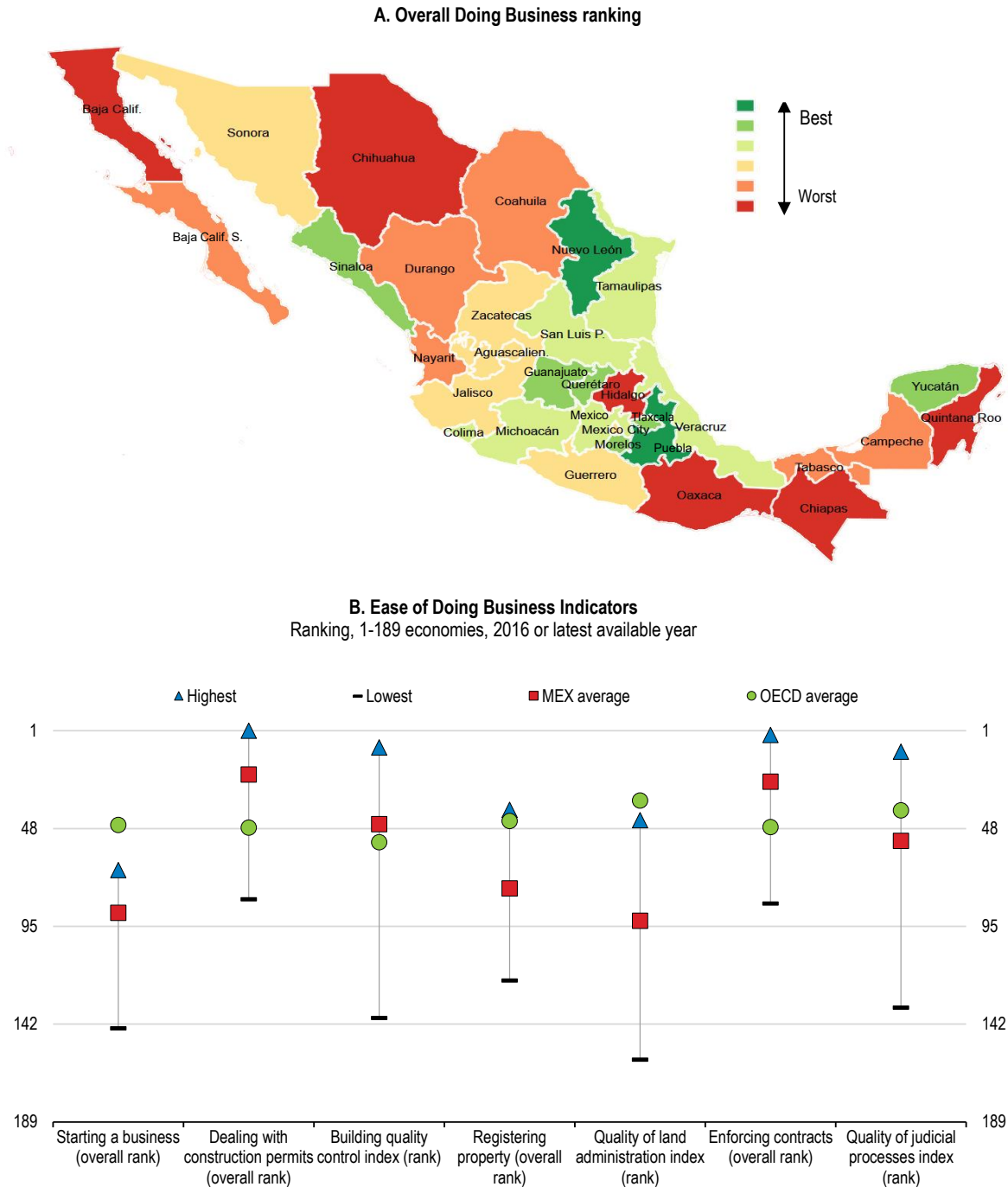
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### ***Reducing informality by reducing barriers to entrepreneurship and streamlining regulatory procedures***

Mexico has taken important steps to reduce barriers to entrepreneurship and streamline regulatory procedures, including by making more use of electronic platforms. Most progress has been at the federal level (COFEMER, 2017<sub>[22]</sub>), while many regulatory burdens remain at the subnational level with large regional variation (Figure 1.9). The recent General Law of Regulatory Improvement will extend reforms to the subnational level, and will include a comprehensive database of business administrative procedures at all levels of government. Implementation of the reform is the next challenge. Going

forward, Mexico could explore harmonisation of regulatory procedures across states and municipalities to reduce compliance costs.

**Figure 1.9. The ease of doing business varies greatly across Mexican states**

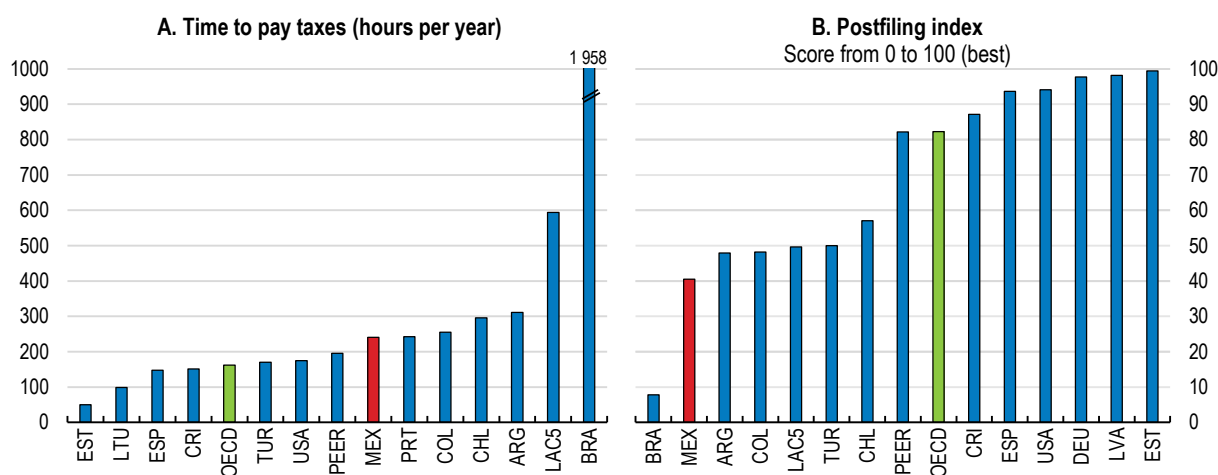


*Note:* "Highest" and "lowest" refer to rankings for Mexican states. Data for Mexican states are for 2016.  
*Source:* World Bank Doing Business Indicators; and World Bank Doing Business in Mexico 2016.

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A particular area where there is significant scope for improvement is tax compliance. According to the World Bank's Doing Business indicators, it takes about 241 hours a year for a medium-sized Mexican business to prepare, file and pay taxes and social security contributions (Figure 1.10a). Post-filing compliance costs are also high, covering the time to comply with a VAT refund, obtain a VAT refund, comply with a corporate income tax correction and complete a corporate income tax correction (Figure 1.10b). For example, it takes 42 weeks to obtain a VAT refund. Making it easier for businesses to comply with their tax obligations would lower one of the administrative barriers to formalisation.

**Figure 1.10. Tax compliance costs are high**



*Note:* LAC5 is an unweighted average of Argentina, Brazil, Chile, Colombia, and Costa Rica. PEER is an unweighted average of the 10 non-Latin American OECD countries with the lowest PPP-adjusted GDP per capita: Estonia, Greece, Hungary, Latvia, Lithuania, Poland, Portugal, Slovak Republic, Slovenia, and Turkey.  
*Source:* World Bank Doing Business 2019.

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### *Improving employment protection regulations*

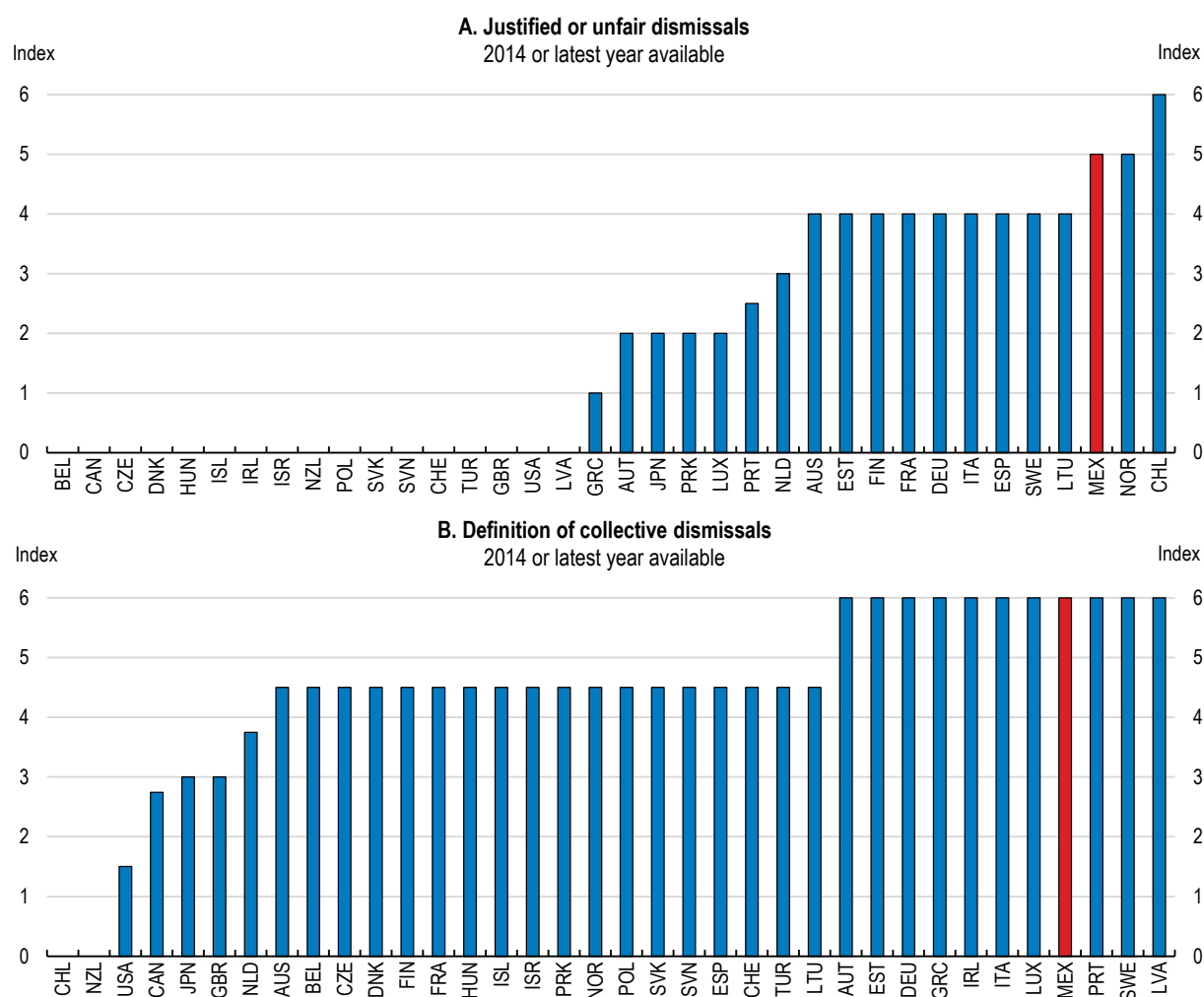
There is a large regulatory gap between non-salaried workers, a legal form of informality, who have no labour protections such as dismissal restrictions and minimum wage regulations, and formal workers. This is a widely used form of employment, and firms employing these workers have low average productivity levels (Figure 1.7). Similarly, outsourcing is used at a high and growing rate in Mexico, which is also likely to avoid the high costs of hiring formal workers. The law is ambiguous about whether the direct employer or the subcontracting firm is obliged to pay social security contributions for outsourced workers (resulting in few contributions being made). The civil nature of outsourced contracts means that these workers are not subject to labour regulations, including severance payment entitlements. They are also not entitled to profit-sharing arrangements that are obligatory for formal workers, nor to seniority rights that many formal workers receive. They cannot organise into trade unions, and are not even subject to basic health and safety standards. There are some legal provisions to prevent the abuse of outsourcing; however, these are not enforced in practice.

Moreover, a more effective way to address the issue of the high cost of hiring formal workers relative to non-salaried and subcontracted workers would be to reduce the

regulatory gap among these groups. For example, this could involve reforms to the labour contracts system to allow for non-salary forms of remuneration (such as commissions) with tax and minimum wage obligations that are more consistent with those of salaried workers. It could also involve further improving the ability of firms to use fixed term contracts to boost flexibility, although careful design would be needed to minimise regulatory differences between fixed-term and permanent contracts.

Broader reforms, including to employment protection regulations, will also be needed as otherwise illegal informality would simply replace this legal form. The costs of dismissing a formal worker are high (Figure 1.11). Workers can only be dismissed for performance reasons, not for economic ones, discouraging employers from hiring formal workers in the first place. The judicial processes for claiming compensation or reinstatement are also lengthy and the outcomes very uncertain and inconsistent, which is costly for both workers and employers (Levy, 2018<sup>[21]</sup>).

**Figure 1.11. High dismissal costs discourage formal job creation**



Note: Scale: 0 (least stringent regulation) to 6 (most stringent).

Source: OECD/IAB Employment Protection Database.

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Reducing high dismissal costs while introducing unemployment insurance would reduce the personal costs of job loss and improve skills matching by providing displaced workers with the opportunity to find suitable employment. Extending just dismissals to incorporate economic reasons would encourage firms to create formal jobs, expand their operations and innovate. Implementing labour resolution procedures that are efficient and enforced, including alternative dispute resolution mechanisms such as arbitration would reduce the time, costs and uncertainty of dismissals.

Raising the employment protections for informal workers would also reduce the regulatory gap between formal and informal workers. As a first step, health and safety regulations should apply to all workers. To be effective, this would need to be coupled with stronger enforcement.

### *Reducing taxes on labour*

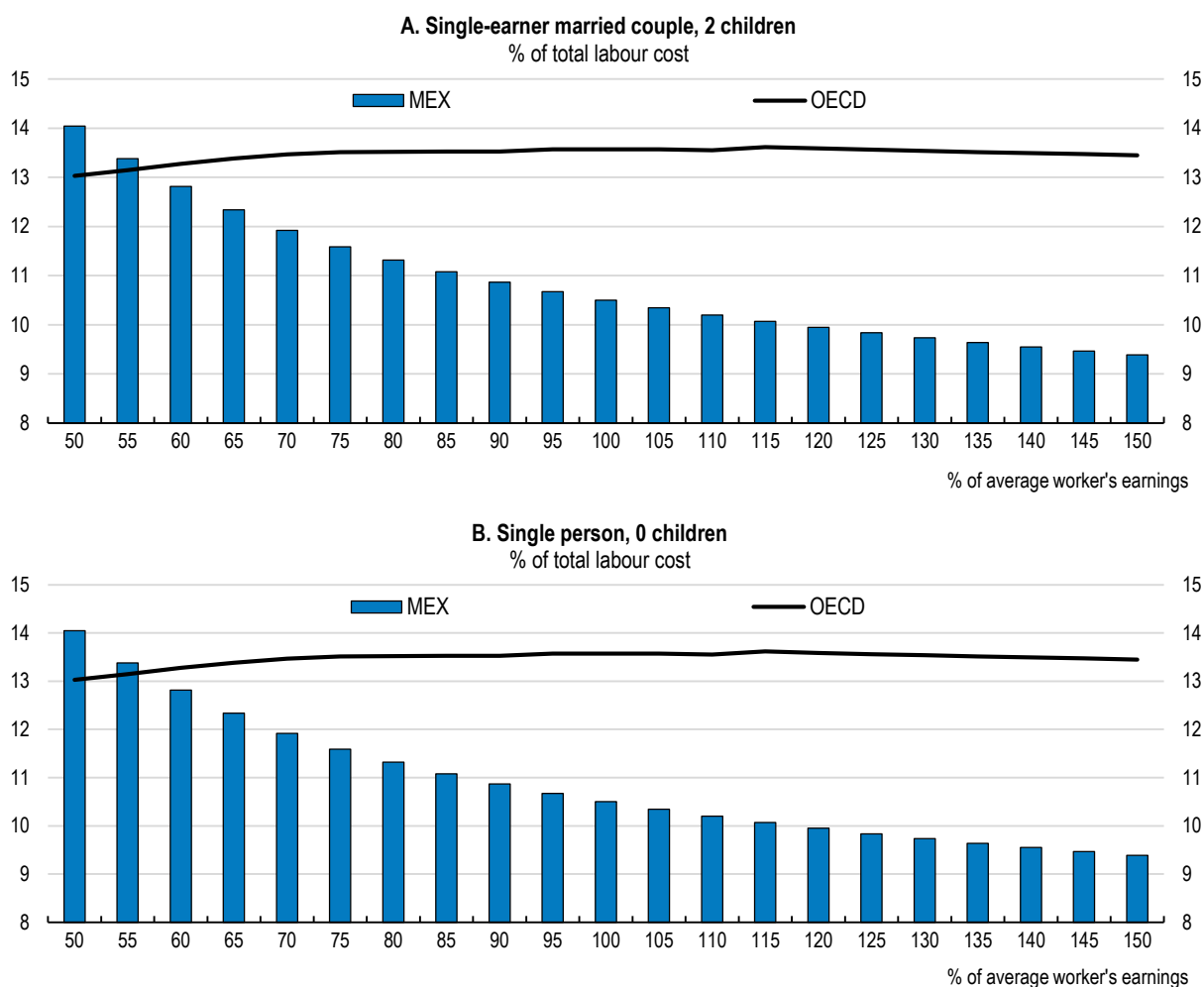
Relatively high taxes on labour for low-wage earners can be a disincentive to job formalisation. In Mexico, social security contributions (SSCs) are a high share of total labour costs. The costs of formalisation are particularly high for second-income earners as formal worker social security benefits are extended to spouses, with the exception of pension rights. As replacement rates are low (see the Key Policy Insights), this does not constitute a powerful incentive to second-earner job formalisation. Increasing replacement rates and reducing the minimum contribution period to enjoy pension rights would strengthen formalisation incentives.

Mexican firms hiring low-income earners face high social-security contributions (SSCs) compared with the OECD average (Figure 1.12). The low skills of many workers and associated low productivity may not compensate for existing labour costs and firms may opt to hire informal workers legally instead. Furthermore, SSCs also decline as a share of total labour costs as earnings increase, resulting in a regressive system and further disincentivising the hiring of formal low-skilled workers relative to those with higher skills. The employer SSC base contribution rate is 20.4% of the minimum wage, resulting in a total employer SSC rate of about 26.9% of earnings for worker on the minimum wage (and employed in a sector with an average workplace risk classification). In comparison, for a worker earning 50% of average earnings (almost three times the minimum wage), employer SSCs account for 14.0% of total labour costs, and for workers earning more than 120% of the average, they account for less than 10% of labour costs (Figure 1.12). This concurs to explain the high levels of informality, given the high share of low-skilled workers (see below). Lowering SSCs for low-wage earners would reduce regressivity and disincentives to hiring formal, low-wage earners. Moreover, as discussed above, in the case of outsourcing, it should be clarified who is liable to pay SSCs (the direct employer or the subcontracting firm). These steps should be complemented in tandem with stronger enforcement.

SSC payments for high-income earners are also low compared with the OECD average (Figure 1.12), although benefits stemming from SSCs in Mexico are also relatively low. Unlike low-income earners, higher-income earners are more likely to self-select into informality on the basis that the costs of formality outweigh the benefits. Therefore, while increasing SSCs for higher-income earners would reduce regressivity, it would strengthen the incentives for higher-income earners to self-select into informality.

**Figure 1.12. Employers' social security contributions are high for low-income earners**

Employers' social security costs as a share of total labour costs by workers' earning level, 2018



*Note:* OECD refers to simple average across OECD members with available data. For Mexico, the average worker's earnings are calculated using data on IMSS (ie, formal) workers, and amounted to MXN 122 208 in 2018 (OECD, 2019<sup>[23]</sup>), which was about 5½ times the 2018 minimum wage.

*Source:* OECD Public Sector, Taxation and Market Regulation Database.

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### *Monitoring and policy evaluation*

The government implemented important tax and labour reforms to incentivise labour formalisation in 2013 (Box 1.1) with some success at the bottom of the salary scale (two minimum wages or less). However, the informality rate has remained high, which may be related to high transitions in-and-out of informality. It would be useful to evaluate the impact of the recent reforms on creating stable, durable and good quality formal jobs.

**Box 1.1. Mexico's labour and tax reforms to incentivise formalisation**

- Elimination of “Impuesto Empresarial a Tasa Única”, and the “Impuesto a los Depósitos en Efectivo”. The tax base of the new corporate income tax (*Impuesto corporativo*, ISR) was widened to ensure similar tax revenues. The Ministry of Finance estimates that the number of administrative burdens has been cut in half.
- The creation of the RIF (*Régimen de Incorporación Fiscal*), which replaced the REPECO, a size-contingent policy that led to tax evasion. The RIF allows for progressivity in taxation for own-account workers for the first 10 years, after which full personal income taxes apply.
- The creation of the RISS (*Régimen de Incorporación a la Seguridad Social*) to smooth payments to social security by micro-entrepreneurs and their workers. Similarly to the RIF, subsidies are reduced progressively over time until participants join the general regime.

Source: SHCP (2018<sup>[24]</sup>).

## Raising educational outcomes to combat informality and boost human capital

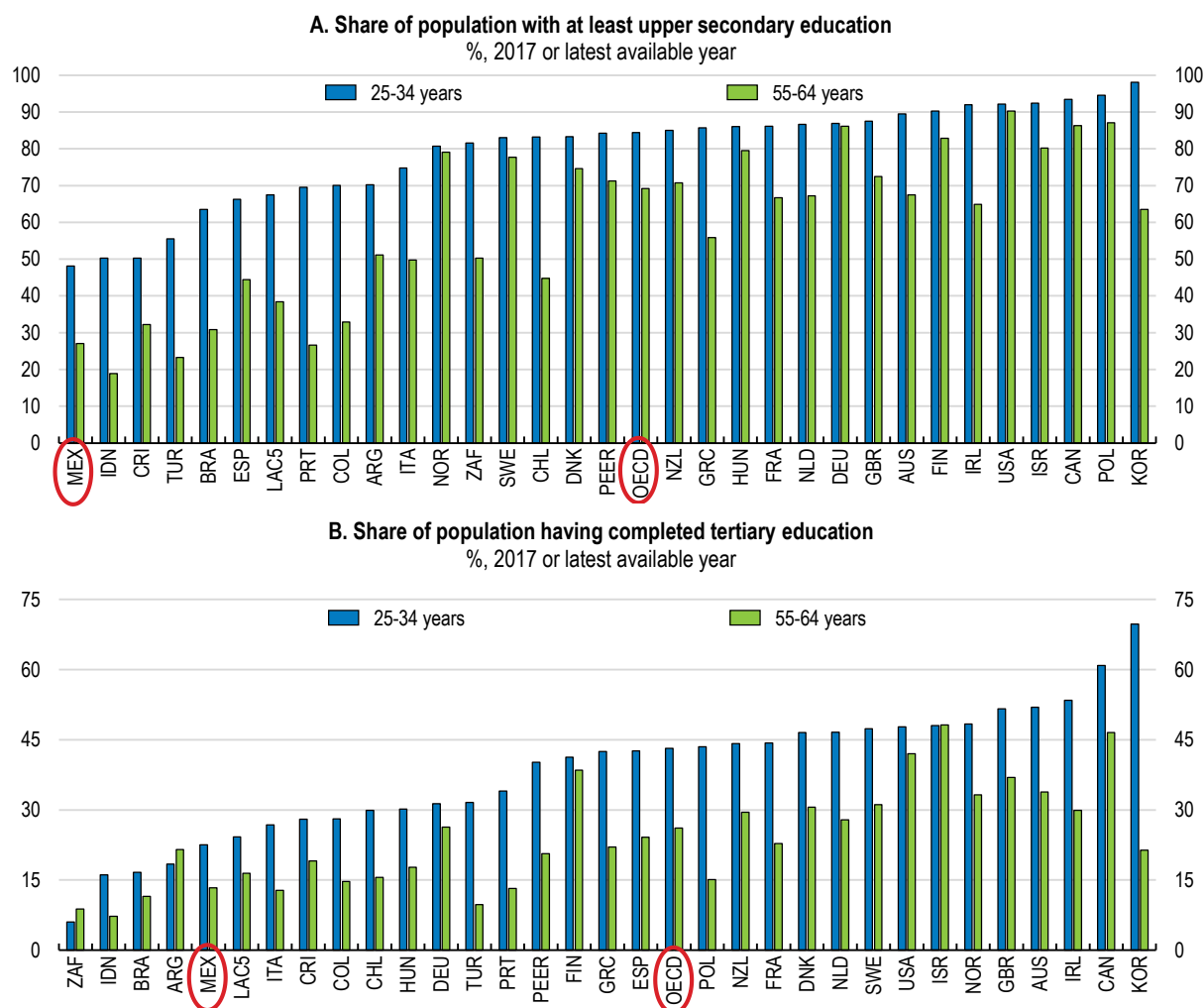
### *Educational attainment and outcomes are low*

Low level of skills are an obstacle to higher productivity and material living standards. Informality disproportionately affects the low skilled leaving them without access to social security, which is one of the main drivers of social deprivation (Figure 4). Investing in skills is also important in addressing potentially rising inequalities related to automation, digitalisation and greater importance of knowledge in work. These trends will raise the returns to skills, potentially leaving the incomes of the low-skilled further behind (Nedelkoska and Quintini, 2018<sup>[25]</sup>; OECD, 2018<sup>[26]</sup>).

In spite of considerable progress, educational attainment and the skills of Mexico's population remain low in international comparison. Only 48% of those aged 25-34 years old has completed secondary education, in sharp contrast with the OECD average of 84%. In addition, only 23% of 25-34 year olds have a tertiary education degree, in contrast with the OECD average of 43% (Figure 1.13).



Figure 1.13. Mexico needs to continue to raise educational attainment

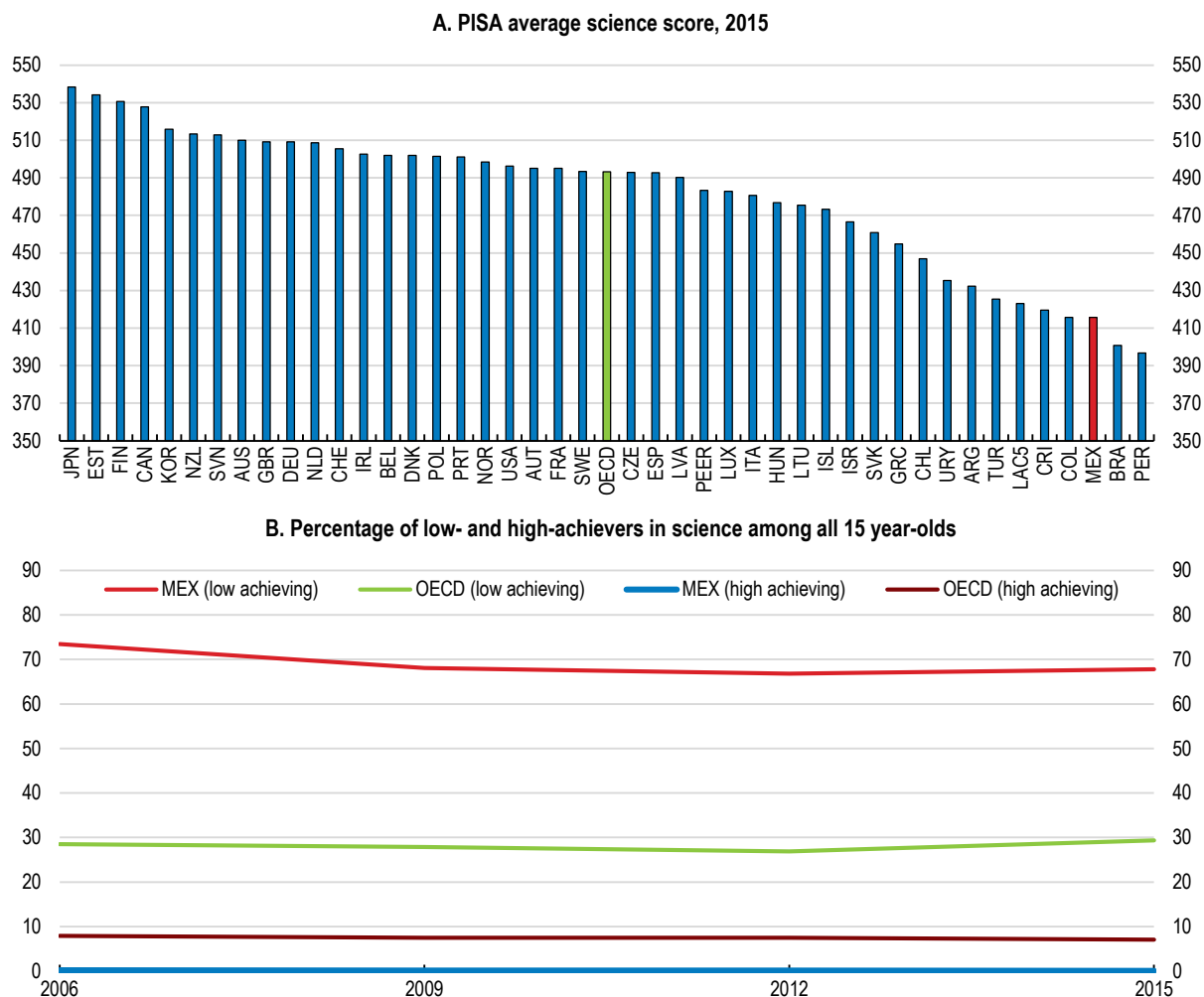


*Note:* PEER is an unweighted average of the 10 non-Latin American OECD countries with the lowest PPP-adjusted GDP per capita: Estonia, Greece, Hungary, Latvia, Lithuania, Poland, Portugal, Slovak Republic, Slovenia, and Turkey. LAC5 is an unweighted average of Argentina, Brazil, Chile, Colombia, and Costa Rica.  
*Source:* OECD Education at a Glance Database.

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Mexico also performs below the OECD average in international tests of educational outcomes such as PISA (Figure 1.14a). Average performance has not changed significantly in recent years. Less than 1% of students are top performers, in contrast to 10% on average in the OECD. The share of low performers is also considerably higher than the OECD average (Figure 1.14b). Although these results are related to the continuous expansion of school enrolment and educational opportunities to students from disadvantaged backgrounds, they illustrate the challenges ahead.

Figure 1.14. PISA scores are low



Note: "Low performers" is defined as those who are not in school, excluded from PISA, or achieving below Level 2 (409.54 points). "Top performers" scored Level 5 or above (633.33 points or higher).

Source: OECD PISA Database.

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The likely effects of raising education attainment are large. Gradually raising education attainment to the average of the top five OECD countries would increase GDP per capita by 10% by 2040 (see the Key Policy Insights). With about half of the population less than 25 years old (INEE, 2018<sub>[27]</sub>), education policies are of prime importance to lift growth and provide better living standards for all Mexicans.

### *Mexico has undertaken important efforts to raise educational attainment and outcomes*

Improving educational outcomes has featured high in the agenda of Mexican authorities in recent years. Mexico made pre-primary education compulsory in 2008-9 and raised the compulsory-school-leaving age to 17 (to the completion of upper-secondary education) in

2012. ECEC has expanded and there has been considerable investment in educational infrastructure across the country.

Mexico also embarked on an ambitious and comprehensive programme of reforms that put student learning and quality at the centre of education system. These reforms included: i) developing and implementing a new curriculum to equip students with the skills needed to succeed in the labour market, ii) improving learning environments, upgrading school infrastructure and upscaling full-time schools, which have proven successful in raising educational outcomes, iii) creating a professional teacher service with a career structure that includes clear entry, permanence and promotion mechanisms and iv) providing constitutional autonomy and responsibility to the National Institute for Education Evaluation (INEE) over the national evaluation system of compulsory education. The development of evaluation and assessment frameworks such as the National Plan for Learning Assessment (PLANEA) meant moving from an inputs-based system to one based on quality and outcomes (OECD, 2018<sub>[28]</sub>) (Key Policy Insights, Annex A).

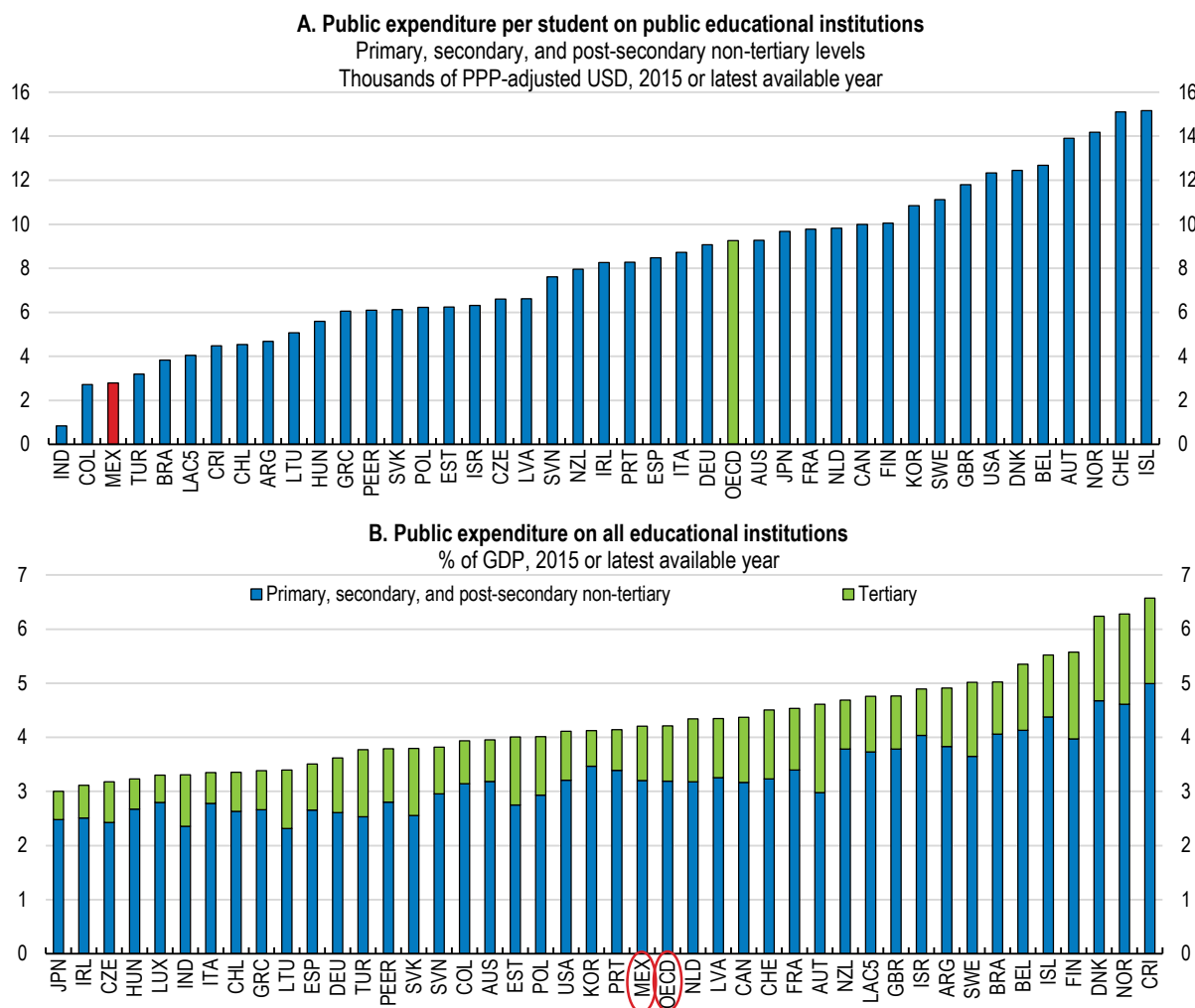
These reforms are in line with international best practices and were developed with the support of the OECD. Despite progress, many of these reforms take time to implement and mature. The government intends to introduce changes to some of these reforms, including reducing the autonomy of INEE and placing greater emphasis on formative elements in teacher evaluation such as observation in the classroom by an evaluator and the production of evidence by teachers of initiatives taken to improve educational outcomes and adopt best learning practices. The new school curriculum, introduced in 2017-18 is also likely to be overhauled but the details are not yet defined. The independence of the INEE acts as a guarantee of the accountability of the education system to monitor and evaluate outcomes of education policies. Its autonomy and ability to contribute to improving education policy should be preserved.

### *The education system needs to do more to reach disadvantaged students and schools*

#### *Shift resources towards compulsory education and ECEC*

Mexico's annual expenditure per student remains low, while education expenditures are a relatively large share of GDP, above the OECD average (Figure 1.15). The structure of spending is biased towards tertiary education, where spending per student is three times higher than in primary education institutions – the highest differential across all countries with available data in the OECD (OECD, 2018<sub>[28]</sub>). With low tax intake and a rigid budget (see the Key Policy Insights), Mexico should refocus spending on compulsory education and expanding access to ECEC, which has the highest returns in terms of skill accumulation, social mobility and reducing inequalities (Cunha et al., 2006<sub>[29]</sub>; Currie and Almond, 2011<sub>[30]</sub>; Heckman, Pinto and Savelyev, 2013<sub>[31]</sub>).

As in other OECD countries, children from disadvantaged backgrounds are overrepresented among low performers (OECD, 2018<sub>[28]</sub>). Disadvantaged schools receive fewer resources than needed for quality education (Luschei and Chudgar, 2015<sub>[32]</sub>; INEE, 2016<sub>[33]</sub>). Mexico had the largest socioeconomic gap among OECD countries in access to education materials in PISA 2015 (OECD, 2016<sub>[34]</sub>). Resources should shift to provide additional support to disadvantaged groups in terms of infrastructure, teaching resources, and educational material.

**Figure 1.15. Public expenditure on education is low**

Source: OECD Education at a Glance Database.

StatLink  <https://doi.org/10.1787/888933957116>

Students in small remote areas also need more attention. Around 20% of the Mexican population live in disperse, remote and small communities of no more than 2 500 inhabitants (INEGI, 2017<sup>[35]</sup>). This is a challenge for the provision of adequate infrastructure services, not only education. Students in small, marginalised areas perform considerably worse in PLANEA tests. They are also more likely to attend schools with multiple deficiencies and challenges, including multi-grade schools with a single teacher (OECD, 2018<sup>[28]</sup>).

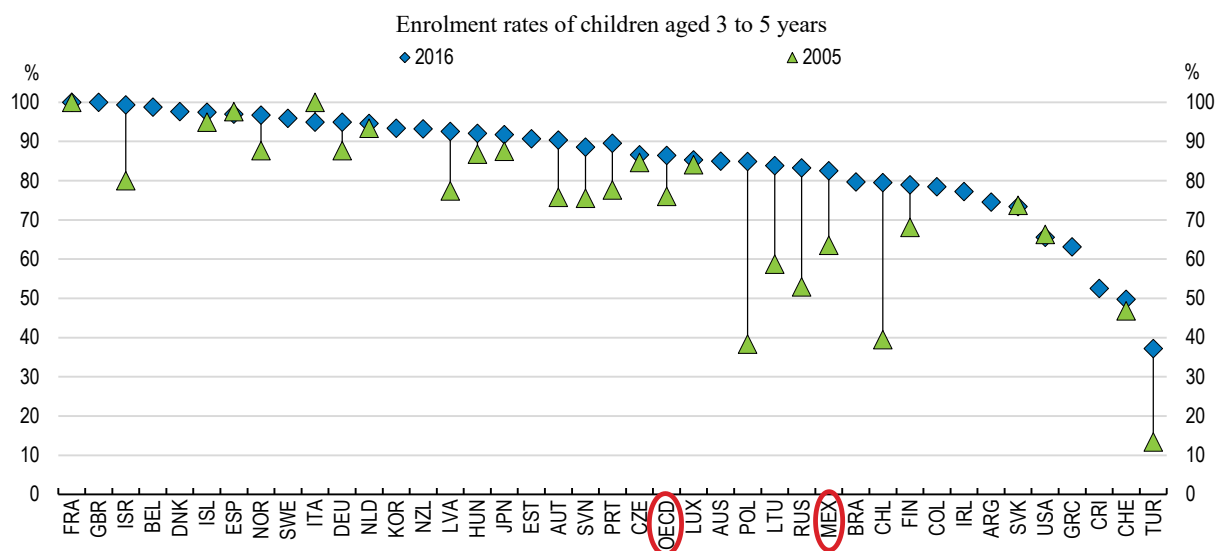
Investment in school infrastructure is another priority. Schools' infrastructure and equipment affects educational quality (Cheng, English and Filardo, 2011<sup>[36]</sup>; OECD, 2014<sup>[37]</sup>). Mexico has invested significantly in renewing school infrastructure, including through the programme *Escuelas al Cien*. Still, many schools are in dire conditions and differences between schools and states reinforce inequalities (OECD, 2018<sup>[28]</sup>). Ensuring that all schools have at least of some minimum facilities such as safe buildings, restrooms and electricity is thus crucial to improve learning opportunities for all students.

Overall, solving discrepancies in school infrastructure, pedagogical material and teaching is a priority and will require a change in the allocation of resources. Schools in disadvantaged contexts usually have less financial resources to operate (Cortés Macías, 2015<sup>[38]</sup>), and infrastructure and equipment are of relatively poor quality (INEE, 2016<sup>[33]</sup>). Allocating resources equitably means that the schools attended by socio-economically disadvantaged students are at least as well-equipped as the schools attended by more privileged students, to compensate for inequalities in the home environment (OECD, 2016<sup>[34]</sup>). There are two broad approaches when designing mechanisms to allocate funding according to different needs across schools. First, including additional funding in the main allocation mechanisms for schools (e.g. including weights in the funding formula to allocate additional resources according to certain categories). The second one consists in providing targeted funding through grants external to the main allocation mechanism. Countries such as Chile have developed effective school funding formulas (Santiago et al., 2017<sup>[39]</sup>).

### *Expand ECEC and increase quality*

Mexico has made significant progress in expanding access to ECEC in recent years. However, enrolment rates remain low (Figure 1.16). Only about half of three-year olds are enrolled versus an OECD average of over three-quarters. The enrolment rate among four-year olds is close to 90%, which is a little above the OECD average. Participation varies widely by region, ranging from over 90% in Tabasco to about 60% in Quintana Roo (OECD, 2018<sup>[6]</sup>).

**Figure 1.16. Early childhood education and care has been expanding but enrolment rates are still low**



Source: OECD Education at a Glance Database.

StatLink  <https://doi.org/10.1787/888933957135>

Overall, children who attended pre-primary education perform better at school and achieve higher PISA results (OECD, 2013<sup>[40]</sup>). However, this is not the case in Mexico (OECD, 2017<sup>[41]</sup>). Equal access to good quality early childhood and care remains a challenge. ECEC is one of the areas where there is the greatest social disparity in Mexico. First, disadvantaged populations are less likely to send their children to pre-primary education.

Second, pre-primary education still receives a small portion of education spending. Third, initial education services are offered according to the labour market status of parents, where discrepancies of care exist and add to inequalities. A worrying development has been the halving of the budget for *Estancias Infantiles*, the government's programme for children of working parents who are not in the formal labour market. Although there were discrepancies in the quality of care, especially when compared to facilities receiving children whose parents work in the formal sector, the cut in the budget, on the grounds of corruption concerns, is likely to leave some children without formal educational care, and it is also likely to lead to lower female labour market participation when gender labour market gaps are already high.

Mexico has taken steps to improve quality in ECEC by aligning guidelines used in initial education with the new school curriculum, and by developing a pedagogical programme for 0-3 year olds (*Programa de educación inicial: un buen comienzo*, Programme for initial education: a good start, 2017) that aims to help young children develop basic skills and slowly get ready for pre-school (SEP, 2013<sup>[42]</sup>). Moving forward, Mexico should adopt this early ECEC programme nationwide and move to a more integrated ECEC system, granting access to good quality education services independently of parents' labour market status.

### *Improving governance of the education system*

As a federal state composed of 32 federal entities (31 states and Mexico City) and 2 457 municipalities, education responsibilities are shared across the different levels of government. However, the decentralisation of education services initiated in 1992 has not evolved into a fully consolidated system and, in practice, federal and state-level institutions overlap or interact in uncoordinated ways while other functions are underprovided (OECD, 2018<sup>[28]</sup>). One result is that there is no common scheme for school funding (OECD, 2018<sup>[28]</sup>). Some schools are financed by state-level authorities, while others receive funds directly from the federal government – including from the Ministry of Public Education (*Secretaría de Educación Pública*, SEP) as well as other ministries and federal agencies – in return for which they are put under federal supervision.

Federal spending on compulsory education (*Gasto Federal Ejercido en Educación Obligatoria*, GFEO) is the largest expenditure (INEE, 2018<sup>[27]</sup>). It is allocated to the states through two main channels: the Federalised Spending Programmes (*Programas de Gasto Federalizado*, or *aportaciones*), which are earmarked to education; and budgetary participations (*participaciones*), which are transferred as part of the states' sovereign budget and can be used partly for education, depending on each state's decision. A third part of federal funds completes the overall budget for education through Federal Programmes (*Programas Federales*), which are directly administered by the central government. As a result of the different subnational authorities (state governments) in charge of implementing education policy at the school level having different resources and capacities, there are asymmetries in the delivery of education services across the territory (OECD, 2018<sup>[28]</sup>).

Each state can decide, each year, if they contribute additional resources to education. Resources may also come to schools through programmes with specific goals and an attached budget. OECD and national evidence show that programme-based funding has been a source of inequity across schools and municipalities (OECD, 2018<sup>[28]</sup>).

Mexico's schools could benefit from a less complex budget allocation, by reducing the number of budget lines and programmes with specific goals. This would lead to greater spending efficiency, release resources to other education areas where they are needed,

introduce more transparency and a better understanding of how much the allocation mechanisms can contribute to equity.

Developing standardised practices for states to disclose their budgets would also improve transparency and allow a better linkage between resources and outcomes. These do not currently exist, which makes it hard to form a detailed picture of how federal and state funding transmits to schools (INEE, 2018<sub>[27]</sub>). This is one of the main information gaps detected in the system as it is very difficult to identify the specific education expenditure from states other than transfers or programmes from the federal authority and then, in turn, how these resources are channelled to schools (OECD, 2018<sub>[28]</sub>).

This calls for more monitoring and evaluation of results. Mexico's PLANEA evaluation tool could be systematically used to improve policies and school practices, identify vulnerable student groups and schools and to inform policies to better support them. At the same time, INEE and the Ministry of Education should continue their efforts to step up monitoring and evaluation capacities at the subnational level, as suggested by the OECD.

### *Expanding and building effective VET systems*

Vocational education and training (VET) often leads to better employment prospects than academic-oriented courses for students not in tertiary education studies. Enrolment in vocational programmes at the upper secondary level in Mexico (38.2% of students) is lower than the average across OECD countries (45.7%). Unlike most countries in PISA, in Mexico, 15-year-olds in pre-vocational or vocational programmes scored 20 points higher in science than those in general or modular programmes (after accounting for student and school socio-economic background).

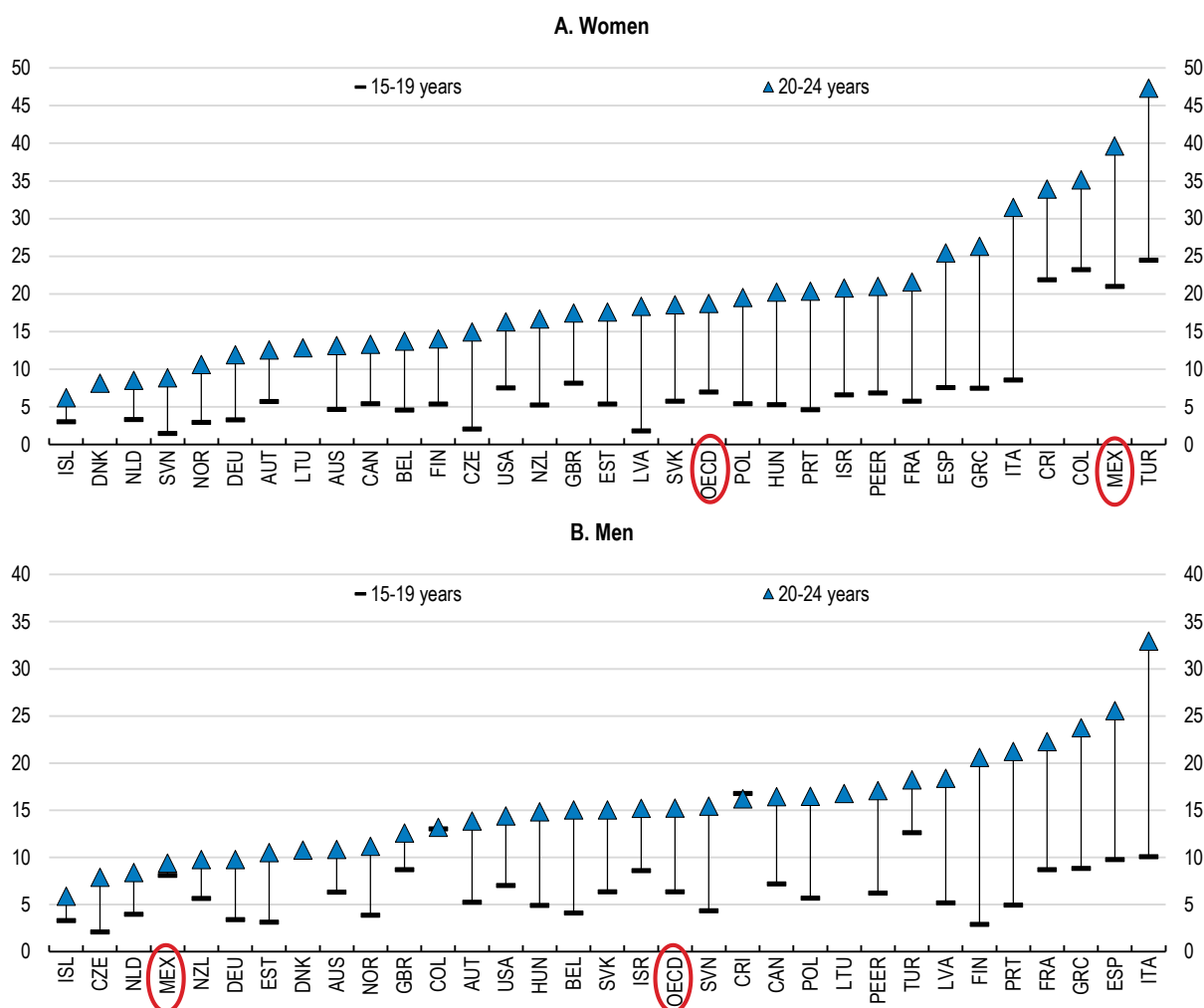
Recent education reforms have aimed to boost technical education, such as through the implementation of the dual training system in 2015, by expanding the private sector's involvement, increasing the number of apprenticeships with on-the-job training, and strengthening the model's vocational component. The VET system at secondary level includes initiatives, such as mobile training units (*unidades móviles*) for remote regions where there are fewer learning opportunities, while at the post-secondary level, VET is provided through short courses in specialised technical professional institutes. The National Productivity Committee has led efforts to facilitate the immersion of students in the labour market and the development of skills required by productive sectors and major clusters, such as the aerospace and automotive industries. These programmes allow young people to simultaneously continue into higher education and work.

The government is seeking to address the high student drop-out rate by implementing a programme of scholarships in upper secondary and tertiary education and internships in companies. The drop-out rate for youth aged 15-19 is 14%, above the OECD average of 6%. Likewise, the drop-out rate for 20-24 year olds is high - 25% compared with the OECD average of 16.5%. However, these rates are driven primarily by high rates among women (Figure 1.17). Motherhood is a key driver of NEET status. Mexico's adolescent pregnancy rate remains the highest among OECD countries (OECD, 2017<sub>[11]</sub>), often leading to young women dropping out of school. Authorities should make sure that women are integrated in initiatives to step-up apprenticeships and VET programmes, not only as a strategy to reduce drop-out rates and boost human capital accumulation but also to reduce the large labour market gender gap (OECD, 2017<sub>[2]</sub>; OECD, 2018<sub>[6]</sub>). This needs to be complemented with additional education services such as expanding ECEC. Going forward, authorities should consider the impact of the scholarship programmes in raising attendance, especially for women, who are about four times more likely to be NEETs than men. On efficiency

grounds, authorities should also consider means testing these subsidies, also given large needs in other areas, such as school infrastructure investment and ECEC, which is receiving much less attention in spite of its potential to raise educational outcomes.

**Figure 1.17. Youth not in education, employment or training are predominantly women**

Percentage of youth not in education, employment or training by gender and age, 2016



Note: PEER is an unweighted average of the 10 non-Latin American OECD countries with the lowest PPP-adjusted GDP per capita: Estonia, Greece, Hungary, Latvia, Lithuania, Poland, Portugal, Slovak Republic, Slovenia, and Turkey.

Source: OECD Education at a Glance Database.

StatLink  <https://doi.org/10.1787/888933957154>

The programme “Youths Building the Future” (*Jóvenes Construyendo el Futuro*), in place since January 2019, seeks to strengthen human capital accumulation by providing internships for 18-29 year olds not working or studying, with placements in firms, NGOs or the public sector. The programme provides a training scholarship of MXN 3 600 per month (slightly higher than the minimum wage) for up to one year. To enhance skills, the programme should be complemented by the acquisition of general skills in school-based



learning, in the same vein as the existing dual VET system. General skills are important in supporting lifelong learning and adapting to new technologies and innovations throughout careers. Strengthening the general education component in apprenticeship programmes does not necessarily require an extensive time for instruction but rather more effective ways of teaching. Teaching of abstract concepts should be combined with practical applications. In this regard, innovative practices should be explored, such as the approach developed in the United States by the National Research Center for Career and Technical Education, which adapted math concepts to the curricula of different VET courses and has proven successful in raising students' ability (Kuczera, 2010<sub>[43]</sub>). Also, the programme needs to ensure that it reaches women and youth not living in urban areas.

Instead of paying interns directly, many OECD countries provide direct subsidies to employers (e.g. the United Kingdom), tax credits or social security rebates (e.g. Canada and France) involved in apprenticeships programmes. Strong evaluation of outcomes would allow the “Youth Building the Future” programme to adapt to labour market needs and ensure it includes an adequate training component. Evaluation should also track the performance of interns in the labour market over time, as is done for instance, in the Czech Republic where a large battery of indicators on labour market outcomes is collected (e.g. job formalisation, duration, job quality indicators, indicators of occupation and skill mismatches). As the government is also introducing scholarships for staying in education at the upper secondary and tertiary education levels but of lower monetary value, it is important to verify that students are not leaving education to qualify for an internship, without pursuing their studies later on. Adding a follow-up strategy for the NEETs involved in the Youth Building the Future programme would further contribute to positive labour market outcomes.

The government is devising a system of alerts to check that the internship program is not abused by, for instance, checking whether private firms are reducing the number of formal job positions and hiring subsidised interns instead. In parallel, it is running periodic surveys of trainees to seek their views on the quality of training. Going forward, and in addition the government should strengthen the quality of training by developing, in cooperation with the private sector, strong guidelines for training and skill acquisition, as in some OECD countries (Box 1.2).

#### **Box 1.2. Guidelines for workplace training in dual VET programmes in OECD countries**

Countries with strong dual VET programmes combine learning of competencies at school with strong work-based learning. To be effective, work-based learning requires a high degree of engagement and ownership by employers and social partners. Strong dual systems also ensure that the short-term needs of employers do not distort broader education and economic goals.

Some OECD countries with strong VET systems have developed, in partnership with the private sector, strong guidelines to ensure good quality training:

- In Germany, a training directive specifies the professional competences in the occupation that should be acquired during in-company training to guarantee uniform national standards irrespective of current enterprise needs. The training enterprise also draws up an in-company training plan for trainees.
- In Switzerland, ordinances require the establishment of a training plan for each occupational field that defines the curriculum and organisation of in-company

training. Training plans are set up by organisations including social partners and approved by the Federal Office for Professional Education and Technology. Cantons license companies and periodically evaluate provided training against national standards. Cantonal inspectors ensure that the training received is up to standard. If a problem is detected, the cantonal staff intervenes through coaching to assist the company. The companies see that this is to their advantage, in that if they train apprentices better, the apprentices do better work for them. A list of 28 criteria of good training, prepared in co-operation with social partners, guides companies in their work with students.

- In Denmark, trade committees with employee and employer representation approve and inspect enterprises that want to take on trainees on the basis of defined criteria. To be approved, an enterprise must have a certain level of technology, and a variety of tasks to be performed to ensure that the trainee carries out a full range of occupation-related activities (Danish Ministry of Education, 2005<sup>[44]</sup>).
- In Austria, the apprenticeship offices (Lehrlingsstellen) that are attached to the chambers of commerce and industry (employer organisations), examine if enterprises are able to offer apprenticeship training with regard to corporate and legal conditions and human resource requirements. They examine and record apprenticeship contracts, and are competent in principle for all issues that are in the interests of the apprentice and training providers. The apprenticeship offices are supported in their work by the apprenticeship and youth welfare units of the chambers of labour (employees' organisations).

Source: Kuczera, M. (2010<sup>[43]</sup>), OECD Reviews of Vocational Education and Training: A Learning for Jobs Review of the Czech Republic 2010, OECD Publishing, Paris.

## Improving well-being, economic and environmental performance with better metropolitan governance

Metropolitan areas can be key drivers of sustainable development (OECD, 2015<sup>[45]</sup>). Good metropolitan policies are an opportunity to reduce pollution and CO<sub>2</sub> emissions. They make cities healthier, more pleasant places to live in, and thereby also more attractive and competitive. They can also improve access to jobs and reduce the costs of exchanging goods and services. Such policies can also reduce the cost of infrastructure deployment. Good metropolitan governance can also make the most of the boost agglomeration benefits bring to productivity. Agglomeration benefits arise because well-managed metropolitan areas can provide more competition, deeper labour markets, a faster spread of ideas and a more diverse intellectual and entrepreneurial environment. Good metropolitan governance can thus unleash a virtuous cycle of better environmental performance, quality of life and economic performance. This applies especially to metropolitan areas of developing countries, as recently shown for Asian cities, for example (Gouldson et al., 2016<sup>[46]</sup>).

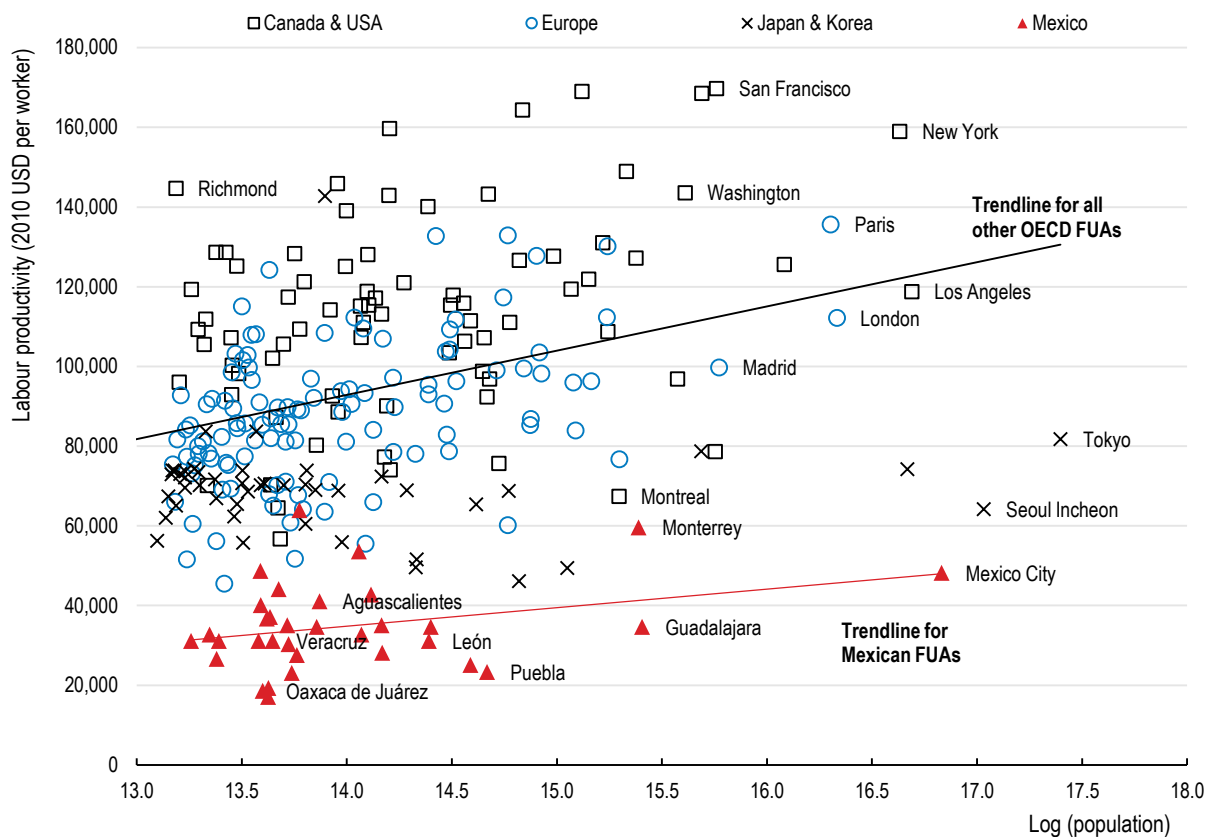
In Mexico, many cities fail to leverage these benefits (Figure 1.18). Mexico's largest metropolitan area, *Valle de México*, which includes Mexico City, is one of the largest in the OECD, but remains among the 10% with the lowest GDP per capita (OECD, 2015<sup>[47]</sup>). What's more, this is purely driven by the high share of highly educated workers in the city, "agglomeration benefits" are low or even completely missing (Ahrend, Gamper and Schumann, 2014<sup>[48]</sup>). Productivity in *Valle de México* has also barely increased since the early 2000s (Figure 1.19). Mexico City suffers from ozone episodes which break national

health protection regulations as well as WHO-recommended limits (International Transport Forum, 2017<sup>[49]</sup>). The impact of air pollution on productivity is generally large, with a 10% reduction boosting labour productivity by roughly 1% (Dechezleprêtre, Stadler and Nicolas, forthcoming<sup>[50]</sup>). This can be explained by health impacts and the impact on cognitive performance.

A key factor for the underperformance of Mexican cities is their fragmented governance. Taking the *Valle de México* as example, the OECD definition of the metropolitan area spans across 51 municipalities in Mexico City and the State of Mexico, but many policies are limited to the boundaries of the individual municipality, e.g. land use planning, or by the border between Mexico City and the State of Mexico, e.g. public transport.

**Figure 1.18. Agglomeration benefits are limited in Mexico**

Labour productivity in OECD metropolitan areas, 2014 or latest available year

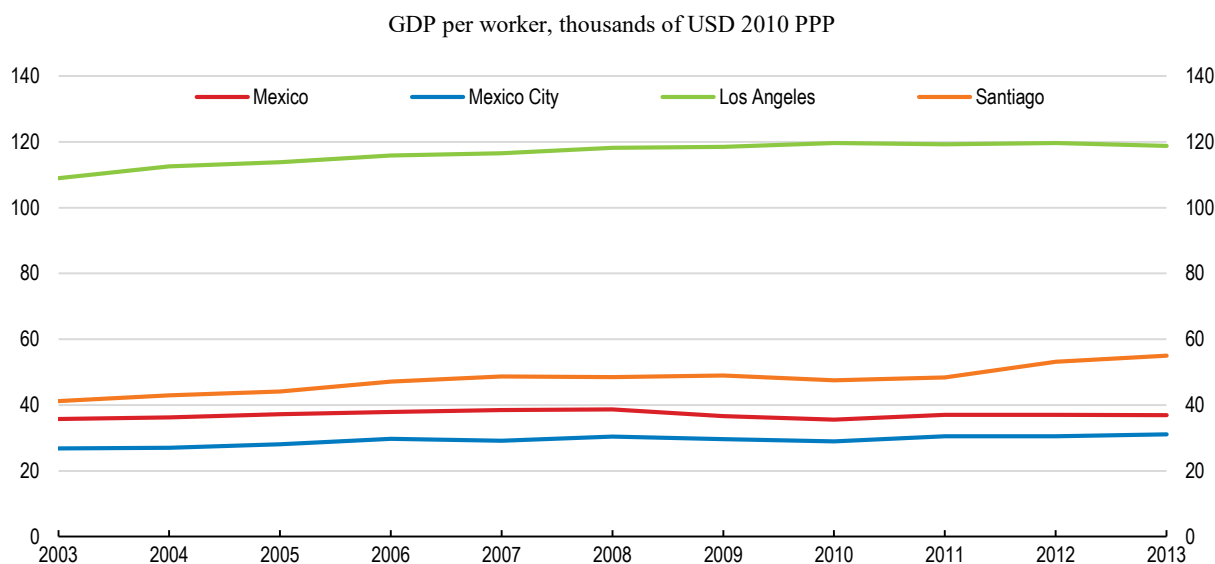


Note: FUA: Functional Urban Area.

Source: OECD Regions and Cities Database.

StatLink  <https://doi.org/10.1787/888933957173>

**Figure 1.19. Productivity has grown little in the metropolitan area of Mexico City (*Valle de México*)**



Source: OECD Metropolitan Database.

StatLink  <https://doi.org/10.1787/888933957192>

Transport and urban planning are key for the growing population to live in a healthy environment and for economic agglomeration benefits to materialise. Intensive car use and road congestion are key drivers of pollution, reducing productivity. Mexico City's road traffic congestion in the metropolitan zone ranks among the highest in the world. Congestion is estimated to cause an annual loss of 3.1% of GDP in *Valle de México* (OECD, 2015<sup>[47]</sup>). Reducing congestion would substantially lower prices of goods and services and improve access to jobs, with a substantial positive impact also on long-term employment. Car drivers have been estimated to face only two-thirds of the costs of driving in large cities even in less congested cities of high-income countries (Arnold (2013<sup>[51]</sup>), for the example of Vancouver, Canada). Air pollution, greenhouse gases, noise, adverse health impacts, and congestion account for the remaining third.

Near-term action to reduce pollution and congestion includes improving the mandatory vehicle inspection programme, adopting state-of-the-art emissions standards and extending speed limits (International Transport Forum, 2017<sup>[49]</sup>). The local authorities could improve incentives to use low-emission vehicles by aligning driving restrictions for vehicles more closely with their emission performance. Raising parking fees in areas well-served by public transport would reduce congestion, favour the use of mass transit, and take better account of the opportunity cost of urban public space. Taxing car ownership depending on their emission performance could also help curb purchases of high-emissions cars. Ideally, this measure would be targeted to highly-polluted metropolitan areas. All of these measures would raise the cost of operating or owning a car. Low-income households typically do not own cars, so these measures would be consistent with inclusive policy-making. Moreover, evidence from the United States suggests that, within metropolitan areas, low-income households are the most exposed to air pollution and suffer the worst health consequences. They would therefore gain the most from reduced pollution (Hsiang, Oliva and Walker, 2017<sup>[52]</sup>).

In the longer term, strategic urban planning, integrating the planning of housing, transport and commercial development (OECD, 2015<sup>[47]</sup>), is necessary to ensure the metropolitan area provides access to jobs and services to its citizens. Effective metropolitan governance is key for achieving these objectives. Across the OECD, good metropolitan governance has contributed to lower air pollution, lower CO<sub>2</sub> emissions, higher productivity, durably higher wages and better quality of life (Ahrend, Gamper and Schumann, 2014<sup>[48]</sup>; OECD, 2015<sup>[45]</sup>). Integrated planning of housing, commercial development and transport also helps to improve access to jobs and key social services, such as health and education, especially for low-income households, helping to overcome poverty traps (OECD, 2019<sup>[53]</sup>). It therefore offers opportunities to reduce CO<sub>2</sub> emissions and air pollution while improving well-being and performance along several sustainable development indicators.

Metropolitan areas and their governance need to be defined to match the daily realities of its residents and powers assigned at the right scale. Some countries have used municipal mergers to ensure that administration covers the right scale, other use metropolitan governance bodies. Governance needs to ensure co-ordination across municipalities within the metropolitan area as well as across policy areas, notably transport and land use. This should include creating a metropolitan transport authority in charge of the whole metro area (International Transport Forum, 2017<sup>[49]</sup>). Transport authorities that plan and regulate mobility across the whole of a metropolitan area and have authority over different transport modes tend to be more successful. This is the case of Curitiba, London, Paris and Singapore. Transport authorities can strengthen combined use of different transport modes, which tends to encourage mass transit use. For example, investment to improve safe walking and cycling is often cheap and may not only reduce mortality but also encourage the use of mass transit.

Mexican metropolitan zones are not managed as an integrated economic urban area, but rather at the municipal level in an uncoordinated fashion (OECD, 2015<sup>[54]</sup>). In *Valle de México*, for example, the area in which its businesses and residents live and work and the administrative boundaries of jurisdictions do not match (OECD, 2015<sup>[47]</sup>). Often, these municipalities are heterogeneous in terms of technical and financial capacities, priorities and regulatory instruments which makes coordination more difficult. For example, legislation for Mexico City prescribes priorities for allocating investment and road space in favour of pedestrians, cyclists and public transport, then freight delivery and lastly private vehicles (International Transport Forum, 2017<sup>[49]</sup>). Indeed, prioritising soft and public transport modes in transport investment can reduce long-term investment costs, especially in the light of long-term decarbonisation needs (OECD, 2017<sup>[55]</sup>). However, legislation in other municipalities of the metropolitan area does not establish these priorities.

There is generally no legal provision to allow municipalities to create a metropolitan governance structure, so collaboration must be achieved through the federal government. (OECD, 2015<sup>[47]</sup>). While municipalities have powers to take land-use decisions, for example to decide on housing development, they are not involved in large urban transport projects (such as inter-urban trains, metros and rapid bus transit systems, for instance). These involve the federal and state governments. The problem is exacerbated by separate legal frameworks for housing and urban development.

The fragmented local governance generates fragmented settlement patterns in Mexico's metropolitan areas (OECD, 2018<sup>[56]</sup>). The resulting urban sprawl lengthens distances to jobs and services and makes it harder and more expensive to meet transport demand with mass transit. In addition, doubling the density of urban development has been shown to

reduce energy demand by around 25%. Cities which sprawl less emit substantially less CO<sub>2</sub> (OECD, 2017<sup>[55]</sup>).

To foster inter-municipal co-operation, Mexico, like many other OECD countries, could adopt arrangements that allow local jurisdictions to work together for certain common services or investments (OECD, 2015<sup>[54]</sup>). A strategy for the creation of metropolitan structures would help ensure that public service delivery and urban planning occur at the metropolitan level. State and federal transport authorities should involve municipal land-use planning authorities (OECD, 2015<sup>[54]</sup>). Experience across OECD countries also shows that co-ordination seems to occur when legal mechanisms are implemented to force policy sectors to address the interests of another sector at the metropolitan level (OECD, 2015<sup>[54]</sup>).

Metropolitan governance institutions would be well placed to adopt policies reducing congestion, pollution and urban sprawl. This could include integrated mass transit systems, deploying more urban space for walking and cycling, and developing time- and location-contingent road use charging systems. Policies to integrate land use with transport could include making building permits contingent on developers contributing to providing access to public transport. Developing accessibility indicators can improve the integrated planning of transport and housing. For example, location accessibility indicators measure the average time or monetary cost that is needed to access key locations, such as job locations and education and health services. Transport for London, for instance, has developed a number of accessibility-based indicators which have helped to double public transport's modal share between 1995 and 2012 (OECD, 2019<sup>[53]</sup>).

## Recommendations to boost sustainable development and inclusive growth

MAIN CHALLENGES	KEY RECOMMENDATIONS
<b>Reducing informality</b>	
Informality is high, leading to severe resource misallocation, low productivity and access to social services.	<p><b>Lower social security contributions for low wage earners. Step up enforcement.</b></p> <p><b>Implement a coordinated approach to reduce informality, comprising lower administrative burdens to doing business, including tax compliance costs, and reduced dismissal costs while stepping up social protection. Lead by example and progressively reduce the number of informal workers in the public sector.</b></p> <p>Ensure the implementation of the General Law of Regulatory Improvement at the subnational level to reduce compliance costs.</p> <p><b>Link the tax administration (SAT) and the social security databases to improve tax surveillance and compliance.</b></p> <p>Set minimum protection standards for all type of labour relationships.</p> <p>Improve the efficiency of the judicial system to accelerate the implementation of labour resolution procedures.</p>
<b>Increasing female labour market participation</b>	
Female labour market participation is low.	<p><b>Expand access to good quality, affordable childcare. Increase the length of the pre-school day for three- to five-year olds.</b></p> <p><b>Reduce high female drop-out rates in education.</b></p>
<b>Improving access to and the quality of education</b>	
<p>Education outcomes are low contributing to high and persistent inequalities and holding back productivity growth.</p> <p>Resources to education are limited and underprivileged schools received lower resources.</p> <p>The governance of the education system is complex, with overlapping functions and un-coordination across levels of government.</p> <p>Drop-out rates are high.</p>	<p><b>Raise the quality and coverage of early childhood education and care programmes and delink them from parents' labour market status.</b></p> <p>Ensure that funding resources are distributed equitably among schools.</p> <p>Provide additional support to students from lower socio-economic backgrounds.</p> <p>Clarify fiscal federal relationships in the delivery of education services, simplify funding mechanisms and increase transparency in the allocation of resources at the state level.</p> <p>Continue efforts to step up monitoring and evaluation at the subnational level.</p> <p><b>Continue to expand VET coverage, assess the results of the internship programmes and encourage female participation.</b></p>
<b>Getting more out of agglomeration</b>	
High pollution in metropolitan areas raises sickness and mortality, especially among the poor, and reduces productivity and is strongly related to car use.	<p><b>Invest in integrated public transport systems focusing on improving access in low-income areas.</b></p> <p><b>Allow and encourage municipalities to create joint metropolitan governance arrangements on their own initiative, in particular metropolitan transport authorities.</b></p> <p>Take near-term action to reduce pollution and congestion, by improving the mandatory vehicle inspection programme, adopting state-of-the-art emissions standards, and extending lower speed limits.</p> <p>Create a metropolitan transport authority responsible for all transport policy in every metropolitan area.</p> <p>Foster integrated planning of housing, transport and urban planning by requiring policy makers in each sector to take into account the views of policy makers in other sectors, integrating legal frameworks and involving local governments in the planning of large urban mass transit infrastructure.</p> <p>Develop accessibility indicators for all metropolitan areas and use them to integrate housing and transport planning.</p>

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