

Chapter 5

Improving Access to Formal Employment

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The Mexican labour market has recently performed relatively better than those of most other OECD countries. A number of policy initiatives have been taken that should further improve its performance. Nevertheless, there is still much scope for raising Mexico's overall employment rate, in particular that of women and youth, while promoting greater formal employment and providing better social protection. Major reforms are needed for the labour market to contribute more effectively to higher living standards and inclusive growth. It will be important that the provisions of the new labour reform law governing the hiring and firing of permanent workers and the use of temporary contracts are enforced effectively. Further action could also be taken to strengthen training measures and, as envisaged in the Pact for Mexico, adjust and rationalise Mexico's social security schemes to encourage formal employment.

A properly functioning labour market is crucial for achieving better economic and social outcomes, and especially for tackling poverty and social exclusion. The Mexican labour market has weathered the global economic and financial crisis better than most other OECD countries. A number of policy initiatives have also been taken recently that should further improve the functioning of Mexico's labour market and stimulate greater job creation in the formal sector. Nevertheless, there is still much scope for raising Mexico's overall employment rate, in particular that of women and youth, while reducing informal employment and providing better social protection.

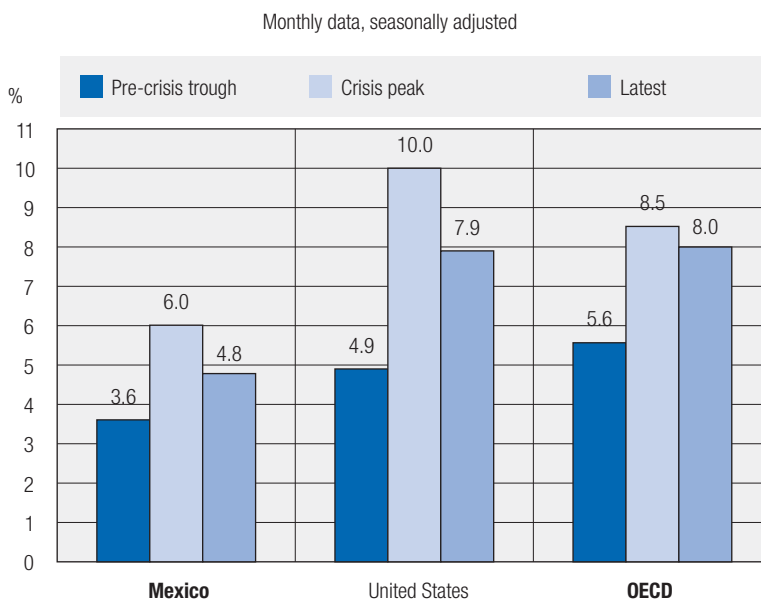
This chapter begins with an overview of the current labour market situation and underscores the main structural challenges facing Mexico. This is followed by an overview of recent policy initiatives to stimulate job creation, promote formal employment, and provide greater social protection for labour force participants. (See also Chapter 2 on combating poverty and inequality.) The recent labour reform law, for example, contains several major measures which, along with several of the decisions announced by President Peña Nieto in his Message to the Nation, and envisaged in the Pact for Mexico, are in line with policy recommendations advocated by the OECD for some time. A final section lists a set of recommendations to further strengthen and complement those measures.

Recent labour market developments and key challenges

A strengthening labour market but much scope for further improvement

The Mexican labour market has, by comparison with the experiences of most OECD countries, performed well in the aftermath of the economic and financial crisis. Total employment grew by 4.6% in the year to the third quarter of 2012 – the third largest increase in the OECD after Luxembourg and Israel. And Mexico's unemployment rate, at 4.8% in October 2012, remains well below the OECD average of 8.0% (Figure 5.1). However, there is much scope for improving Mexico's labour market performance in a number of respects.

Figure 5.1. **Recent changes in the harmonised unemployment rate in Mexico and the OECD area**

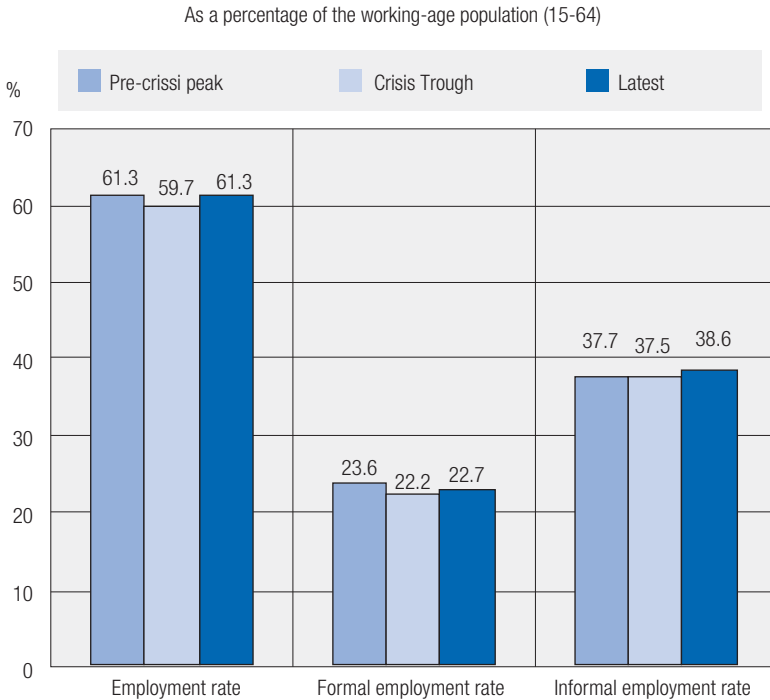


Source: OECD Short-Term Labour Market Statistics database.

First, while there have been some recent declines recorded in the unemployment rate, it still remains above its pre-crisis level. Moreover, according to the latest available OECD projections (November 2012), this gap may persist for some time to come, especially in light of the recent weakening of the economic recovery in the OECD area. In addition, the difficulties that Mexico's workers face in the labour market are greater than what is suggested by Mexico's relatively low unemployment rate in comparison with other countries. In particular, the absence of a public system of unemployment benefits in Mexico means that many job losers cannot afford a lengthy search for a suitable new job and must take up the first option available.

Tackling informal employment

A second key employment challenge for Mexico is to tackle a highly segmented labour market, with many Mexican workers employed in informal jobs with little social protection. While there has been a resumption of robust employment growth after the recession triggered in 2008-09 by the global economic and financial crisis, much of this growth has been in informal jobs. Consequently, the share of the working-age population in informal employment

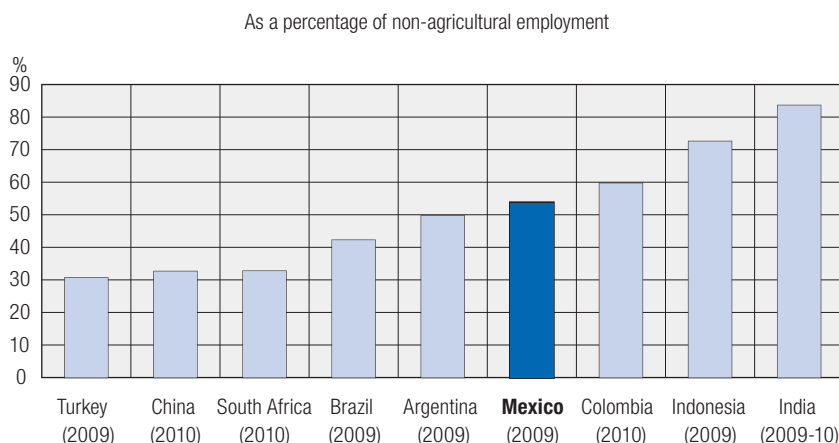
Figure 5.2. **Employment rate of formal and informal workers since the crisis**

Note: Formal and informal employment are not seasonally adjusted but smoothed using three-quarter moving averages and adjusted to total employment (seasonally adjusted) and then divided by the working-age population (aged 15-64). Formal employment refers to workers enrolled in Social Security (IMSS/ISSSTE) through their job.

Source: Author's calculations based on the National Employment and Occupation Survey (Encuesta Nacional de Empleo y Ocupación, ENOE) and the OECD Short-Term Labour Market Statistics database

has risen, exceeding its pre-recession level by almost one percentage point in the third quarter of 2012 (Figure 5.2). In the initial phase of the crisis, this was caused by a reduction in formal employment due to faltering export demand. Subsequently, the increase in informal employment largely reflected the employment in informal jobs of workers who had lost their jobs in the formal sector, along with the entry into work of the unemployed looking to make up for the loss of household incomes. In the second half of 2011, formal employment recovered somewhat, but not strongly enough to return to pre-crisis levels as a share of the working-age population.

Informal employment is a challenge in many other emerging economies as well. Available estimates of informal employment are not fully comparable

Figure 5.3. **Informal work in selected G-20 economies**

Note: Countries shown in ascending order of the proportion of workers in informal employment.

Source: ILO/WIEGO *Informal Employment* database.

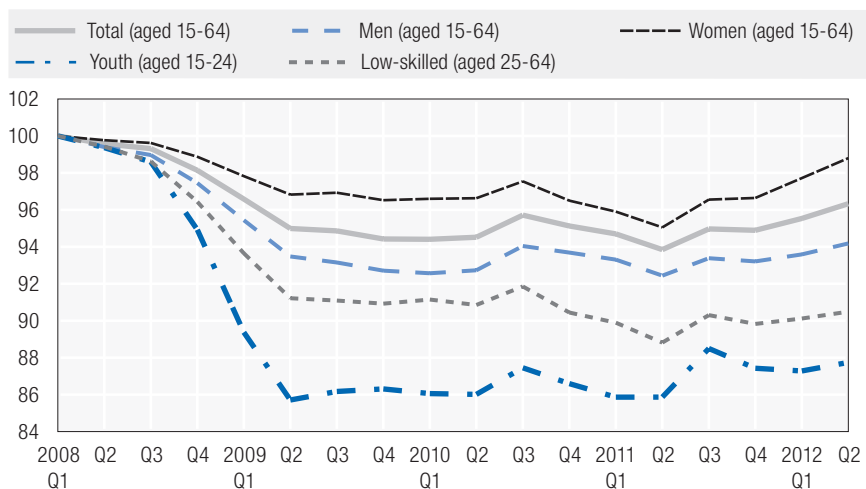
across countries. Nevertheless, among major emerging economies, the incidence of informal employment is relatively high in Mexico, with more than half of its non-farm workers working in informal jobs (Figure 5.3).

Informality is one of the main causes of low productivity, which holds back Mexico's economic growth potential (Chapter 1). Informality also contributes to income and gender inequalities. In 2009, informal employment accounted for around 58% of total non-agricultural employment for women and around 51% for men. It also implies that many workers remain outside the scope of labour market regulations and social protection. Only workers in the formal sector enjoy any protection in the event of dismissal. Even for them, however, the absence of a public system of unemployment benefits means that job loss is likely to result in a move to a new job with worse working conditions, often in the informal sector. Labour reallocation then imposes on workers high welfare costs and inefficient job matching that negatively affects earnings and labour productivity (OECD, 2011a).

Mexico is characterised by higher unemployment rates for individuals with higher educational attainment, reflecting some skills mismatching (see Chapter 6). However, low-skilled workers (mostly men) together with youth were hit especially hard by the 2008-09 recession and the decline in formal employment following the crisis (Figure 5.4). On the other hand, the formal employment rates of women held up over the same period. Although formal employment shrank by about 5% overall, the rate of job loss was two or even three times steeper for unskilled workers and youth. This pattern, which is common to many OECD

Figure 5.4. **Formal employment of selected groups, 2008-2012**

As a share of the working-age population in each group (Index: Q1 2008 = 100)



Note: Quarterly data smoothed using 3-quarter moving averages with base 100 at the peak date (Q1 2008). Formal employment refers to workers enrolled in Social Security (IMSS/ISSSTE) through their job.

Source: Author's calculations based on the National Employment and Occupation Survey (Encuesta Nacional de Empleo y Ocupación, ENOE).

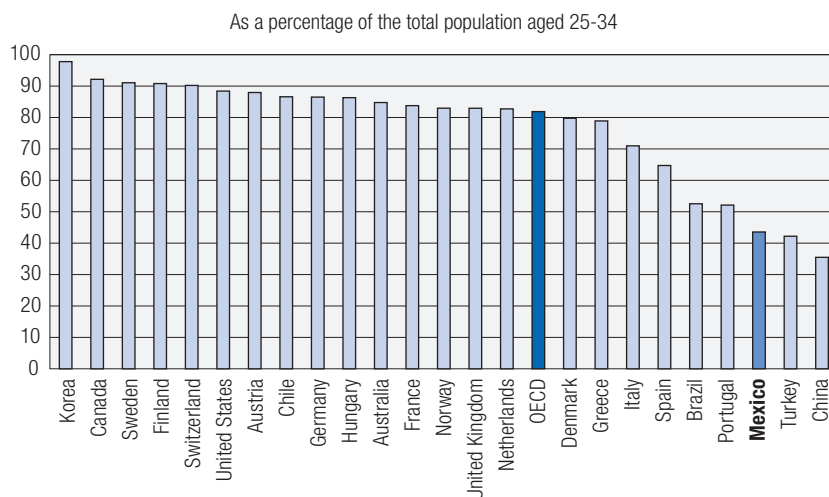
countries, reflects the relative vulnerability to business cycle fluctuations of formal sector workers who have little work experience, low skill levels, and fixed-term or more precarious contracts.

Improving employment and learning opportunities for youth

The third key area where there is scope for further improvement concerns the labour market situation of youth. Many Mexican youth, especially young women, remain outside both the labour market and the education and training system. The share of youth not in employment or education and training (NEET) is the second highest among OECD countries after Turkey. At more than one-third, this share is particularly high for young women, whereas only around one-in-ten young men fall into this category.¹ Although some young women do not seek employment in order to engage in child rearing, this high share for women reflects the difficulties young people face in entering and staying in the

¹ The data reported here refer to youth aged 15-29. The OECD definition of NEET differs from the definition proposed in Mexico, which does not include young mothers who choose to stay detached from the labour market.

Figure 5.5. **Share of young people (aged 25-34) who have completed high school, 2010¹**



Note: 1. The data refer to 2009 for Brazil.

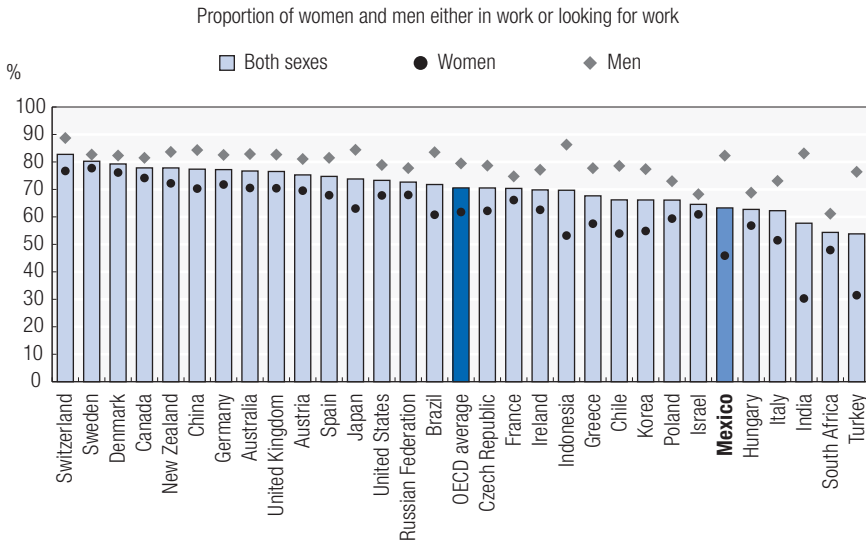
Source: OECD (2012b), *Education at a Glance*, OECD; and for China census data from National Bureau of Statistics of China.

labour market. These difficulties are closely linked to the low level of educational attainment, with less than half of young adults (aged 25-34) having completed upper secondary education in 2010 (Figure 5.5). A lack of education and skills can limit access to formal sector employment. The figures also underscore the challenge that Mexico faces in terms of raising educational attainment among youth and, as stressed in the OECD Skills Strategy (OECD, 2012a), in terms of ensuring that they acquire the skills needed in the labour market (see Chapter 6).

Encouraging greater labour market participation of women

Finally, there is ample scope for raising Mexico's overall labour force participation rate, which remains low relative to the rate recorded in most other OECD countries and major emerging economies (Figure 5.6). This would help to promote even more rapid economic development in Mexico and reduce the risk of poverty. The low participation rate in Mexico largely reflects the low share of women involved in the labour market. In 2011, the participation rate for women was 46% in Mexico, the lowest rate in the OECD area after Turkey. It was also significantly lower than in other key emerging economies, with the exception of India. While the participation rate of women in Mexico has risen moderately during the past two decades, many women still face major obstacles to participating more fully. One

Figure 5.6. **Labour force participation rate of the population aged 15-64, 2011**



Source: For China, based on census estimates; for India and Indonesia, ILO (2012), “Key Indicators of the Labour Market (KILM)”, 7th Edition, ILO Department of Economic and Labour Market Analysis, Geneva, available at kilm.ilo.org; and, for all other countries, OECD *Employment* database 2012. In the case of China and India, the data refer to 2010.

is the high amount of unpaid work at home: Mexican women spend four hours per day more on unpaid work than men (OECD, 2012c). Another is the traditional gender roles when it comes to work and care. A third is the lack of policies to facilitate women’s employment, especially in terms of child care and family-friendly workplace practices. Some measures have already been taken to tackle these barriers to women’s employment, such as increasing the coverage of child care (*Programa de Estancias Infantiles para Apoyar a Madres Trabajadoras*) and preschool services (enforcing the compulsory nature of preschool education). Nevertheless, further efforts are required that would improve women’s employment opportunities – and Mexico’s economic growth potential more generally.

Promoting formal employment with better social protection policies

For the labour market to contribute more effectively to higher living standards and inclusive growth, major reforms are needed in Mexico to promote formal employment, especially for youth and women. A number of measures have already been taken recently (see Box 5.1) and more comprehensive measures are envisaged under the new labour reform law (see Box 5.2).

Informality is multidimensional and a range of measures is required to tackle it. While high payroll taxes contribute to informality (see Chapter 2), especially for low-wage workers, more general improvements in the business environment are required, such as creating stronger incentives for firms, especially SMEs, to register their activities in the first place (See Chapter 10). Better social policies and labour reforms can also play a major role.

Box 5.1. **Recent labour market measures**

In 2007, a new labour market programme, *Programa Primer Empleo* (PPE), was implemented to foster the creation of permanent jobs in the formal sector. The government subsidised employers' contributions to the social security system during a period of 12 months. However, during its first four years of operation, its impact was low. It did not stimulate formal employment, because of its limited capacity to provide incentives for employers to hire new workers. In late 2011 the programme was reformed to make it more flexible and attractive for employers. However, the number of workers registered in the PPE has not increased substantially as a result. During the first four years of the programme's implementation, 83 000 new workers were registered in the social security system, but in 2011 only 11 000 employees were enrolled (IMSS, 2012).

Another policy adopted by the Mexican government to promote employment among vulnerable groups is the *Programa de Empleo Temporal* (PET). Formerly this intervention had been implemented during natural disasters to provide economic opportunities to those who lost their jobs. However, as a response to the global economic downturn, the federal government increased the budget and coverage of the programme. Although PET has not been subject to any rigorous impact evaluation, it is considered a successful intervention in supporting the unemployed (CONEVAL, 2012). Moreover, its beneficiaries hold a positive perception of the programme, as it improves their living conditions when facing difficult circumstances.

The ministry of labour has also put in place the *Programa de Apoyo al Empleo* (Employment Support Programme), which seeks to increase the participation of the unemployed and underemployed in the formal labour market. This programme, which include grants for vocational training and support in advertising job openings, helps address the difficulties in matching workers with potential employers. According to official evaluations, the programme has had a positive impact and has facilitated beneficiaries' access to paid jobs (CONEVAL, 2010).

Although in theory formal sector job losers with individual pension accounts can draw on their savings in these accounts to provide them with income support, in practice the conditions for doing so are very restrictive. The creation of

a cost-effective unemployment insurance scheme should therefore be a priority of labour market policy. This would improve job matching and reduce the risk of informality after a job loss. Given the pressures on tax revenues to support social protection in Mexico, any such reform would need careful design (See Chapter 3 on fiscal issues). One possibility would be to introduce an individual savings account system, combined with a public insurance component, for job losers who have insufficient savings, as in Chile. The existing system of individual pension accounts could provide a useful starting point for such a reform. However, the introduction of unemployment insurance has fiscal costs, which makes fiscal reform both essential and urgent.

A number of other measures could be taken to encourage formal employment. For example, health service coverage has grown sharply during the past decade as a result of the establishment of *Seguro Popular*, a new non-contributory public health system (see Chapter 7). The analysis presented in the OECD's 2011 *Employment Outlook* shows that the introduction of non-contributory programmes in Mexico alongside contributory ones has not necessarily increased incentives for informal work (by reducing the relative benefits of the current contributory system). Nevertheless, better integration of the various health systems, as well as making eligibility for the *Seguro Popular* dependent on each individual's income, would be a useful measure to improve incentives to enter into formal employment.

The labour reform law and the Pact for Mexico

Comprehensive reform of labour legislation is required to promote formal employment and boost productivity growth. An important step in this direction is the new labour reform law. It aims to improve the functioning of the labour market and in particular the employment situation of women, youth and vulnerable groups, such as unskilled and disabled workers (Box 5.2). The reform promotes formal employment through changes in contractual arrangements, extending probationary periods and facilitating hiring in temporary and part-time jobs. Moreover, it will reduce dismissal costs and uncertainty by capping severance payments; link promotion more closely to skills and competences rather than seniority; increase penalties for breaches of labour laws; establish mechanisms to expedite justice in labour disputes; and streamline and modernise the labour court system.

Box 5.2. Main initiatives of the new labour reform law

The comprehensive labour reform law contains several initiatives aimed at providing incentives for creating formal employment. These include adding new types of contracts, such as fixed-term contracts for seasonal workers, initial training and probationary periods, all of which will provide access to

social security and other benefits. The new contracts will be regulated in terms of duration and compensation. For example, probationary periods will last up to six months and employees will not be entitled to compensation when the period is over. There are also provisions to reduce dismissal costs – limiting back pay due to workers in the event of unjustified dismissal to 12 months – and dismissal procedures have been simplified. These changes should reduce the costs associated with workforce adjustment in formal sector firms and encourage job creation in the formal sector. At the same time, these measures will reduce workers' uncertainty, increase access to social security, and create incentives for employees to be more productive.

The reform also aims to encourage more women to take up and stay in work. These measures include reducing discriminatory hiring and firing practices; outlawing workplace harassment; allowing more flexible use of maternity leave; reducing working time after childbirth for breastfeeding purposes; and introducing the right to request family-friendly arrangements such as part-time work and other forms of work more compatible with family responsibilities, such as teleworking. Moreover, the introduction of paid paternity leave is a step towards a more gender-equal distribution of work and care. Recent OECD work shows that fathers' leave-taking facilitates childcare involvement when leave-taking is of two or more weeks' duration (Huerta *et al.*, forthcoming).

The introduction of initial training contracts and probationary periods should improve the hiring prospects of young, inexperienced and low-skilled workers. It will also contribute to reducing the high number of young people that are neither in employment nor in education or training. Similarly, the possibility of part-time jobs will facilitate young people's access to the labour market.

Linking promotions to skills and competence rather than seniority is an important step to increase firm-level productivity. This initiative should improve incentives for workers to take part in training that in turn may contribute to higher productivity and economic growth. This is in line with past OECD recommendations to Mexico regarding the need for a stronger education and training system to allow individuals to reach their full potential and improve overall productivity performance.

The labour reform should improve the protection of vulnerable and disadvantaged groups, including children, domestic workers, farm workers, mine workers, disabled workers and those working for subcontractors. More specifically, recruitment of children under 14 years of age outside the family circle will become illegal, and employment of children aged between 14 and 16 will be regulated and restricted to certain occupations. The working conditions of domestic workers will also be regulated: the length of their

working day will have a limit, and they will be granted periods of daily and weekly rest. Farm workers will be granted free transportation and adequate water and sanitation services by their employers; they will be registered with the social security system; and, the use of interpreters should be facilitated for them if needed. There are also provisions for easier access to specific services for workers with disabilities in firms with more than 50 employees. Subcontracting and outsourcing practices will be better regulated in favour of workers to tackle abuse and protect their rights, such as having access to social security benefits.

A number of provisions seek to improve the transparency, democracy and accountability of trade union practices. These include the use of secret ballots for elections by union delegates and transparency audits of union records and finances every six months.

The reform will create more legal certainty for hiring and dismissing workers, and considerably ease the stringency of current employment protection legislation for regular workers (EPL). The reform will raise firms' incentives to hire and invest in workers under formal arrangements, which could in turn lead to higher aggregate productivity and living standards (OECD, 2011c).

The OECD has long recommended that Mexico undertake a comprehensive reform of its labour markets so as to promote the creation of more and better jobs for all. The new labour reform law is an important step in this direction: it should help reduce labour market informality, better protect vulnerable workers, increase the adaptability of the labour market, and improve employment prospects for women and young people. The provisions in the reform for greater transparency and accountability in trade union practices are also an important step towards moving Mexico closer to the same standards that apply in most OECD countries.

The new reform should ensure that provisions governing the hiring and firing of permanent workers and the use of temporary contracts are enforced effectively. Enforcement of these provisions, along with the strengthening of safety nets for formal workers, would provide incentives to formalise jobs and thus help to overcome labour market segmentation. It will be important to bolster this reform with further measures to tackle the root causes of informality, which include not only hiring costs but also the tax wedge on labour and the lack of incentives to formalise business activities. More generally, Mexico should increase the resources devoted to labour inspection, which lag behind international best practices given the country's level of development, and are disproportionately focused on larger businesses. Finally, consideration should be given to introducing an unemployment insurance system.

A number of commitments included in the Pact for Mexico are complementary to the labour reform. In particular, three of the 95 broad proposals for reforming Mexico aim at strengthening formal employment and represent steps in the right direction (Box 5.3). Careful attention should be paid to their implementation and the evaluation of their impact.

Box 5.3. **The Pact for Mexico: Proposals for strengthening formal employment**

On his first day in office, President Enrique Peña Nieto presented a Pact for Mexico containing 95 broad proposals for reforming the country; the document was signed by the leaders of the three main political parties: the ruling PRI, the PAN and the PRD.

The Pact lays an agenda of legislative reforms and administrative action in several areas. Three of the first commitments it contains are aimed at consolidating formal employment by creating a universal social security system that will guarantee the right to health care and other social benefits for all Mexicans (commitments 1, 3 and 4).

Commitment 1 aims at improving the quality and the effective scope of health services, especially for the population without formal jobs living in remote, highly marginalised areas. Insured persons should be able to access any of the public health systems. In addition, the coverage and quality of services should be gradually equalised across regions.

Commitment 3 proposes lowering the pensionable age to 65 years from the current 70 years for seniors without retirement savings or pensions from social security. A major step will consist of payments by the federal government of additional social contributions to the individual accounts of each Mexican. These contributions will be made throughout an individual working life, from age 18 to 65, and each individual account will ensure the portability of pension benefits.

Commitment 4 proposes establishing an unemployment insurance system to protect job losers in the formal sector against income loss, and to provide economic security during the search for jobs.

OECD Key Recommendations

- As envisaged under the Pact for Mexico, *incentives for formal employment should be strengthened by better integrating the various health schemes and other social transfers*. In the first instance, the fees paid by individuals in the

non-contributory scheme (*Seguro Popular*) should be more closely linked with their capacity to pay, in order to smooth the transition towards the contributory scheme.

- *Strengthen measures to ensure tax and social security compliance*, as part of a comprehensive strategy to encourage both informal workers and their employers to register their activity.
- *Introduce a system of unemployment insurance*, as envisaged under the Pact for Mexico. This could take the form of an individual savings account system for workers who lose their jobs, with (as in Chile) a public insurance component for job losers who have insufficient savings. While this would serve an equity objective, it would also increase the incentives for entering into formal employment. Clearly, there are fiscal implications that would have to be considered.
- *Improve enforcement capacity*, especially the resources devoted to labour inspection, so that labour laws can operate effectively.
- *Introduce new types of training arrangements such as apprenticeship contracts*, and make more use of probation periods in order to facilitate the creation of permanent job contracts. Both of these mechanisms should be properly regulated to prevent abuse.
- *Promote training by improving information and guidance on employment opportunities*. The creation of short-term training modules would make it easier for workers to acquire training without leaving their jobs.

Further Reading

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