

## ***Chapter 6***

# **Reforming Mexico's labour market and social policies**

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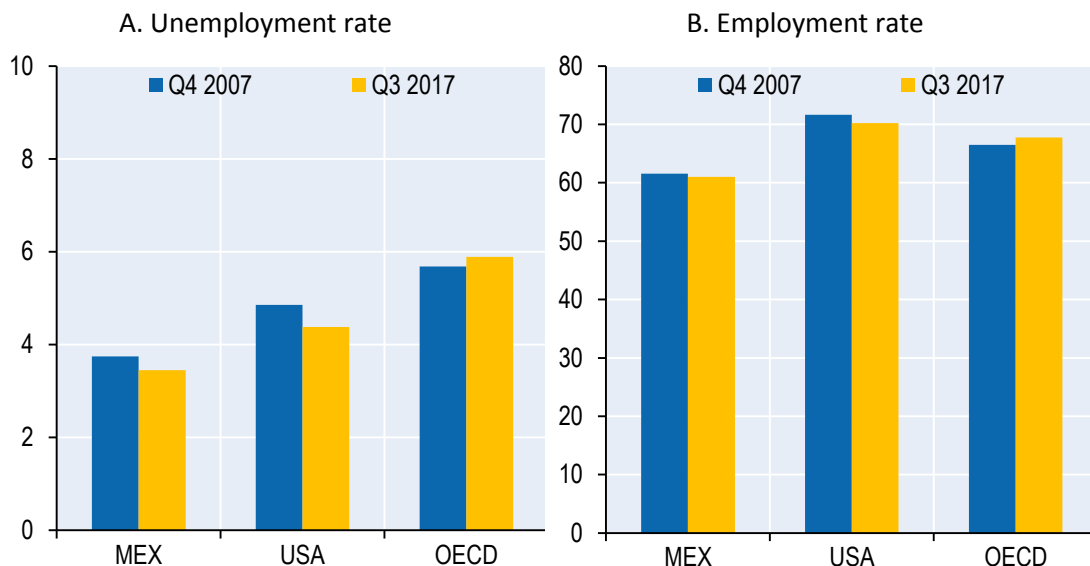
Mexico's labour market has overcome the crisis well, both compared with Mexico's situation in 2007 and the experience of the OECD as a whole. The labour market is, however, marked by pressing structural challenges. High levels of informality, poor quality jobs, an insufficiently developed social protection system and high levels of inequality continue to challenge Mexico. Past policies have begun to correct some of these trends, but much more needs to be done to improve the functioning and inclusiveness of the labour market and the social protection system and to speed up the reform process.

Mexico’s labour market has now moved on from the severe cyclical downturn that followed the global financial and economic crisis. The unemployment rate has fully recovered from the impact of the crisis, standing at 3.4% at its latest reading and therefore somewhat below the rate at the onset of the crisis in 2007 (Figure 6.1). This is 2.5 percentage points lower than in the OECD on average and the fourth lowest rate among the 35 OECD countries. The recovery has been somewhat slower in terms of employment rates, which are still half a percentage point below where they were before the crisis. This reflects a decline in the labour force participation of youth and, to a lesser extent, of older workers. Over the next two years, employment and unemployment are projected to stay broadly stable.

However, the difficulties that workers face in the labour market are greater than what is suggested by Mexico’s relatively low unemployment rate. The absence of a public system of unemployment benefits in Mexico, unique among OECD countries, means that many job losers cannot afford a lengthy search for a suitable new job and must take up the first option available. Spending on active labour market policies is also practically non-existent. Informality remains quite high, and women’s participation low.

Mexico’s overall labour force participation is the second lowest in the OECD after Turkey. This result is largely driven by the low share of women in the labour market, a rate that has remained stable over the past decade while that of men declined. Many barriers prevent women from fully participating in the economy (see Chapter 7).

**FIGURE 6.1. MEXICO’S LABOUR MARKET HAS RECOVERED RELATIVELY WELL FROM THE CRISIS**



Source: OECD Short-Term Labour Market Statistics (database).

Moreover, economic growth has not been inclusive enough to achieve better living conditions for many families. The Mexican labour market scores poorly compared with other OECD economies in terms of earnings quality – which takes account of the level and distribution of earnings (further discussed below) – as well as different measures of inclusiveness related to income inequality, gender labour income equality and the integration of disadvantaged groups.

For example, one in seven working-age persons live with less than half the typical household income compared with one in ten on average across the OECD (Figure 6.2). These trends in the so-called “low income rate” have further worsened since the global crisis, and women (in particular those with caring responsibilities), youths, migrants, and indigenous people are frequently disadvantaged in the labour market.

## **Enhancing job quality and reducing informal employment**

Poor job quality is a major policy concern throughout the OECD and an especially pressing one in emerging economies such as Mexico. Labour market performance should not be judged solely on the basis of the number of jobs available and the number of people in the labour force, but also on the quality of employment (OECD, 2014).

Overall, Mexico’s levels of job quality present a mixed picture, but a number of important challenges are evident. Earnings quality in Mexico is the lowest in the OECD, due to the relatively low levels of average earnings and the high levels of earnings inequality. Labour market insecurity, as captured by the risk of unemployment, is relatively low. However, when the risk of extreme low pay is also accounted for, insecurity is significantly above the OECD average (OECD, 2015). The incidence of job strain, an indicator of the imbalance between the demands placed upon workers and the resources at their disposal, is slightly below the OECD average. But a relatively high share of workers in Mexico experiences very long working hours (OECD 2017a, 2015). Job quality is especially low for workers from disadvantaged socio-demographic groups (OECD, 2015). In Mexico, young people, and older and low-skilled workers tend to experience poor performance in terms of both job quantity and job quality. These are the groups that face the highest barriers to the best jobs. Young workers, in particular, often struggle to access better employment opportunities due to lack of credentials and prior experience. As a consequence, these groups often fall back into informal jobs, which are of significantly lower quality (see below).

**FIGURE 6.2. LABOUR MARKET PERFORMANCE IN MEXICO IS CHARACTERISED BY LOW EARNINGS QUALITY AND LOW INCLUSIVENESS**



*Note:* An upward ↗ (downward ↘) pointing arrow for an indicator means that higher (lower) values reflect better performance. Earnings quality: Gross hourly earnings in USD adjusted for inequality. Labour market insecurity: Expected monetary loss associated with becoming unemployed as a share of previous earnings. Job strain: Percentage of workers in jobs characterised by a combination of high job demands and few job resources to meet those demands. Low income rate: Share of working-age persons living with less than 50% of median equivalised household disposable income. Gender labour income gap: Difference between average per capita annual earnings of men and women divided by average per capita earnings of men. Employment gap for disadvantaged groups: Average difference in the employment rate for prime-age men and the rates for five disadvantaged groups (mothers with children, youth who are not in full-time education or training, workers aged 55-64, non-natives and persons with disabilities) as a percentage of the employment rate for prime-age men.

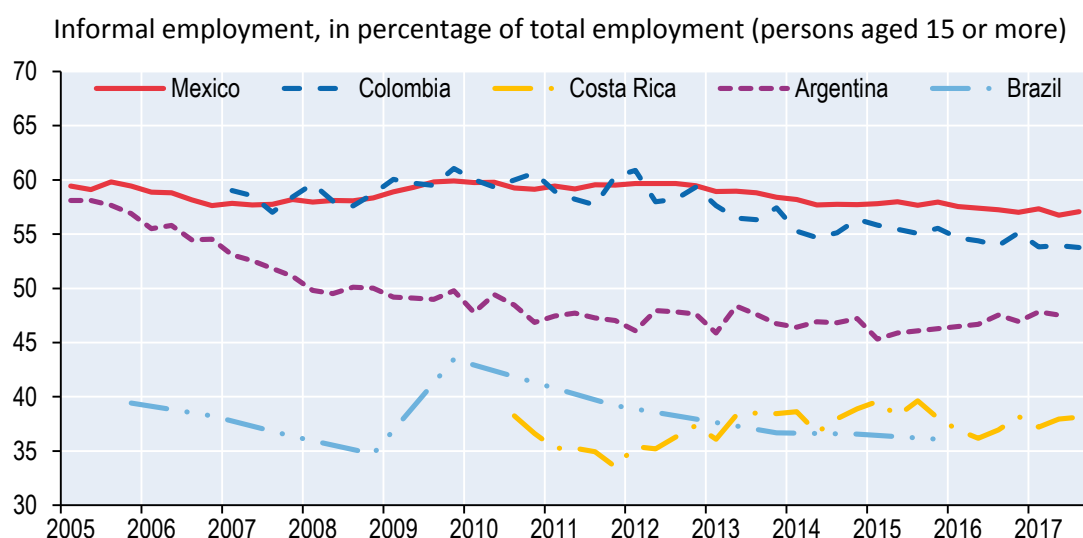
*Source:* OECD calculations using data for 2015 or latest year available from multiple sources. See OECD *Employment Outlook 2017*, Table 1.2. for further details.

A comprehensive strategy to enhance job quality includes a broad range of measures (OECD, 2015). First, more effective social protection systems (discussed below) and labour laws can enhance the quality of existing jobs. Second, given the potential scarring effects of a bad job early in one's career, it is important to help workers find high quality jobs early in their working lives. This is particularly important for low-skilled workers, who face the highest risk of being trapped in undesirable jobs with limited career prospects. Policy interventions in this area are very diverse and include a strengthened academic and vocational education, quality

training and apprenticeship programmes, as well as active labour market programmes. Finally, policies to curb informality will have immediate impacts on job quality in countries with high levels of informality, like Mexico.

Despite recent improvements, informal employment remains high in Mexico. According to the latest available data, the proportion of informal workers in the Mexican labour force was 56.5% in the second quarter of 2017, the highest among OECD countries and one of the highest in Latin America (Figure 6.3). Informality is concentrated in very small informal firms that employ more than half of Mexico’s informal workers, and in the southern states of Mexico.

**FIGURE 6.3. INFORMALITY REMAINS HIGH**

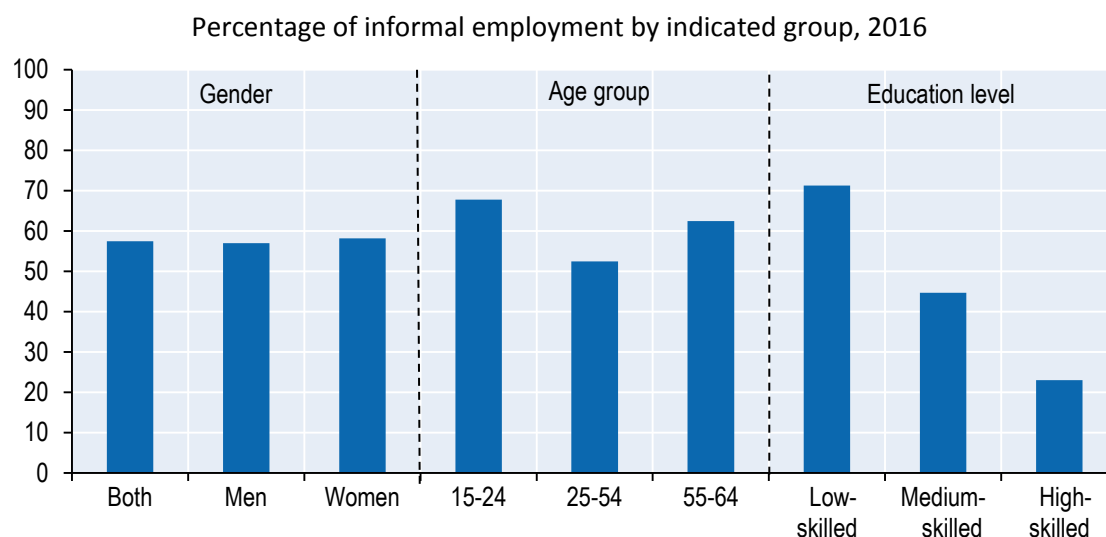


*Note:* Informality for Argentina, Brazil, Colombia, Costa Rica is defined to include: i) employees who do not pay social security contributions; and ii) self-employed whose business is not registered. Figures for Mexico refer to the official indicator of informal employment (TIL1). Annual data for Brazil and seasonally adjusted series only for Mexico. Data for Argentina refer to selected urban areas. According to the National Statistical Authority of Argentina (INDEC), LFS series published after the first quarter of 2007 and until the fourth quarter of 2015 must be considered with caution.

*Source:* INEGI, series based on the ENOE (*Encuesta Nacional de Ocupación y Empleo*) and OECD calculations based on microdata of the *Encuesta Permanente de Hogares (EPH)* for Argentina, the *Pesquisa Nacional por Amostra de Domicílios (PNAD)* for Brazil, the *Gran Encuesta Integrada de Hogares (GEIH)* for Colombia and the *Encuesta Continua de Empleo (ECE)* for Costa Rica.

The risk of informal employment varies considerably according to the socio-demographic background of workers (Figure 6.4). While the share of informality is slightly above 50% in the age group between 25 and 54, it amounts to 62% and 68% among older workers and youth respectively. Low-skilled workers (those with less than high-school) are three times as likely to work informally as workers with tertiary education. Among the former group, the incidence of informal employment is above 70%, while among the latter it is 23%. Men and women face similar rates of informal employment on average, but in specific occupations men and women have different rates of informality. For instance, female workers who are self-employed are more likely to be working informally than men (OECD, 2016a).

**FIGURE 6.4. RISK OF INFORMAL EMPLOYMENT VARIES CONSIDERABLY BY THE SOCIO-DEMOGRAPHIC BACKGROUND OF WORKERS**



*Note:* Includes agricultural and non-agricultural sector workers.

*Source:* OECD estimates based on microdata of the Encuesta Nacional de Ocupación y Empleo (ENOE).

Informality is associated with low productivity, as resources remain trapped in informal activities and are not used in more productive ones, dragging down Mexico’s growth potential. There is also a link between informality and poor job quality along several dimensions, including pay, labour market security and quality of the working environment. Furthermore, workers in informal firms tend to receive less training and are less likely to accumulate human capital.

Addressing labour market informality and job quality is also one of the biggest challenges for the Mexican pension system and it is crucial to ensure adequate pensions. As the contributory pension system only covers formal sector workers, a large part of the working-age population is not reached. Moreover, mobility between the formal and informal sectors is high, which generates significant contribution gaps. As a result, only 25% of the population aged over 65 received an old-age contributory pension in 2010 (Villagómez and Ramírez, 2013). Even workers who are in formal employment will often only contribute little given the prevalence of poor job quality.

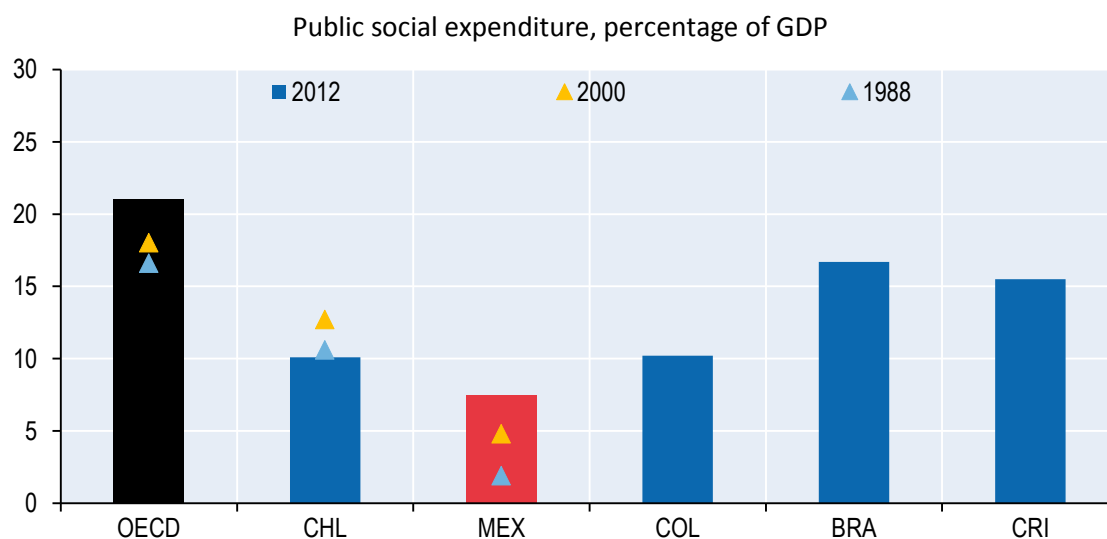
A comprehensive strategy to fight informality should be based on three pillars: increasing the benefits of formality, decreasing the costs of formalisation and improving enforcement methods (OECD, 2015). In recent years, Mexico has put in place several reforms to tackle informality from different angles (OECD, 2017a). It stepped-up enforcement measures for firms with 50 or more employees. It introduced tax reforms – via the Régimen de Incorporación Fiscal (RIF) – that have induced 1.5 million informal firms to join the tax system since 2014. The government also put in place labour market reforms that strengthen incentives to join the formal sector. Addressing the remaining implementation gaps will help fulfil the benefits of these reforms. For instance, it could increase awareness of the social security regime for incorporation (Régimen de Incorporación a la Seguridad Social, RISS) which offers reduced contribution rates for workers joining the national social security system IMSS. These are welcome steps in the right direction.

## Strengthening social protection

In Mexico, social protection policies function in an environment characterized by high levels of informality and widespread poverty. The long-standing challenge of a large informal sector led over time to the creation and expansion of non-contributory social protection programmes, as social security programmes designed for formal workers miss about half of the working population.

Mexico's public social expenditure as a share of gross domestic product (GDP) is still comparatively low, despite significant increases in past decades. Mexico spent almost three times more on social programmes in 2016 than in 1988. However, this still amounts to only one-third of the OECD average, and Mexico's social spending is lower than that of Chile, Colombia, Brazil or Costa Rica (Figure 6.5). Tax evasion and avoidance (see Chapter 2) and the high levels of informality result in lower government revenue, which makes it difficult to increase social spending. Relative poverty reduction through cash transfers is still smaller in Mexico than in most OECD countries. Mexico's tax revenues as a share of GDP are the lowest among OECD Members. According to the OECD Revenue Statistics, in 2016 Mexico had a tax-to-GDP ratio of 17.2%, compared with the OECD average of 34.3%. The resulting low public budget, together with structural issues such as inefficiency in public spending and corruption, result in a relatively low leverage from the Mexican State in financing the necessary higher public social spending and investment.

FIGURE 6.5. SOCIAL SPENDING IN MEXICO REMAINS INADEQUATE TO TACKLE POVERTY



*Note:* Public social expenditure refers to benefits with a social purpose including the following policy areas: old age, survivors, incapacity-related benefits, health, family, active labour market programmes, unemployment, housing and other social policy areas. This does not include education related expenditure. Estimates for 2016. Data for Mexico, Chile refer to 2015, 2014 for Costa Rica, 2013 for Colombia, 2010 for Brazil. Latest data for Mexico and Costa Rica are based on ECLAC. Data for Chile are not comparable overtime due to a break in series in 2005.

*Source:* OECD (2016), *OECD Social Expenditure database (SOCX)* ([www.oecd.org/social/expenditure.htm](http://www.oecd.org/social/expenditure.htm)); OECD (2016) *Society at a Glance*, OECD Publishing, Paris; OECD Social Indicators (database), Economic Commission for Latin America and the Caribbean (ECLAC).

Over the past three decades, Mexico has invested in and implemented many significant social programmes to tackle poverty. Today, Mexico's main social programmes for the poor are large both in coverage and expenditures. PROSPERA, the country's primary anti-poverty programme, covered almost 6.8 million families in 2016, with 28.1 million total beneficiaries benefiting from conditional cash transfers – equal to nearly 23% of Mexico's population. The programme *Pensión para Adultos Mayores* (PAM), Mexico's social pension for individuals aged 65 and above, benefited 5.4 million elderly people in 2017 (equal to just over 60% of the population aged 65 and above), though the benefit level is still below the extreme poverty line. Spending on PROSPERA (formerly *Progresa/Oportunidades*) and PAM amounts to 5.4% of total social public expenditure (0.45% of GDP) and 2.6% of total social public expenditure (0.22% of GDP) respectively. PROSPERA, PAM and other innovative programmes like *Programa de Estancias Infantiles para Apoyar a Madres Trabajadoras* (day-care centres, PEI) have contributed to a reduction in extreme poverty in Mexico, while at the same time encouraging families' take-up of education and health services (OECD, forthcoming).

Despite these achievements, however, coverage gaps remain and the country faces challenges in moving PROSPERA recipients out of benefit receipt and into productive employment. There are few mechanisms for improving “graduation” from PROSPERA and, indeed, it is not often measured (OECD, forthcoming). Although education and health services are a key component of PROSPERA, access to educational and health services is unequally distributed across the country, and remote localities are still regularly underserved by the state. The quality of health and educational services remains a major concern (see Chapters 5 and 8). Improving access to good-quality health and educational services is a necessary condition for conditional cash transfer programmes to work, but improving the quality of services will require greater public investments and more inter-institutional co-operation across ministries and levels of government. Federal ministries and state and local governments face challenges to achieve a whole-of-government approach to poverty reduction. PROSPERA, for example, would benefit from a simplified design and institutional co-ordination. Given the many levels of governance in Mexico, there are also many public assistance programmes that overlap in terms of objectives, benefits accrued, and beneficiaries, although Mexico is starting to build a social beneficiary database to address this issue (OECD, forthcoming).

As in other OECD countries, Mexico has difficulty transitioning cash benefit recipients into jobs – especially formal ones. PROSPERA recently introduced a linkage (*vinculación*) component aimed at connecting cash beneficiaries with labour market opportunities, but in practice this tool is underused. There is no conditionality around this part of PROSPERA, and potentially useful institutional linkages with other ministries and the private sector are missing, which limits PROSPERA's ability to connect beneficiaries with jobs (OECD, forthcoming).

Additional measures could also be taken to reform the housing programme for workers, managed by the Institute of the National Workers' Housing Fund (INFONAVIT). Under this programme, workers contribute on their wages for housing purposes. The system could be made more flexible and allow workers to use such contributions for other purposes, such as unemployment or retirement benefits.



Better fighting poverty in old age is also crucial. Even for those who are in formal employment, contributions to the mandatory pension system are too low to guarantee pension benefits of more than 50% of final salary. According to a recent OECD study (OECD, 2017b), a contribution rate of 6.275% may lead, in the best case scenario, to a replacement rate of only 26% for a full career average earner, the second lowest replacement rate among OECD countries. This low replacement rate is mostly the result of the low mandatory contribution rate. A 50% replacement rate can be achieved with a 75% to 90% probability by contributing on average 13% to 18% over 40 years (OECD, 2016b). Recent legislation, which ensures all remaining funds in the housing account at the point of retirement are transferred to the pension system and annuitised, rather than being taken as a lump-sum, will help increase future pensions. However, as the housing account can be withdrawn during working life, there will be considerable variation in its future value and it will therefore not be beneficial to all.

Due to its implementation of a randomised experimental design in the initial phase of *Progresa* (subsequently renamed *Oportunidades* and now PROSPERA), Mexico has a strong international reputation for rigorous evaluations of social programmes. Yet Mexico's commitment to embedding rigorous evaluations in the design and reform of programmes has tapered in recent years. Significant recent changes to social programmes – such as the reduction of the pension age for PAM, the introduction of the labour linkage component of PROSPERA and the introduction of PEI (day-care centres) – were not introduced using randomised or quasi-experimental methods. This lack of pre-planning for evaluation has hampered evaluations of programme effectiveness.

A major step towards improved poverty and inequality evaluation and the effectiveness of poverty-reducing measures is Mexico's new social beneficiary database, which is currently being developed and implemented. Mexico's social protection system is fragmented across many individual programmes operating in different contexts and at different levels of government. To better co-ordinate these programmes, the Integrated Social Information System (*Sistema de Información Social Integral*, SISI) is a computing platform that has been put in place with the aim of assembling data from social programmes at the federal, state and municipal level. It will consolidate information to further improve the possibilities of identifying poor and vulnerable households in the country, and to detect overlap and duplications across programmes, thereby laying the groundwork for an integrated national social protection system.

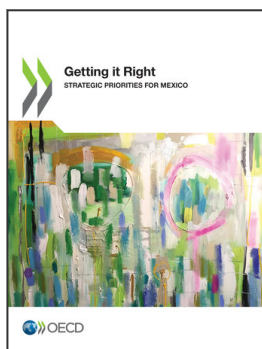
Mexicans' high reliance on informal jobs leaves more than half of all workers outside the traditional, employment-based social protection system. Yet even workers with formal jobs have little security in the event of job loss, as unemployment insurance does not exist in Mexico. While Mexico has made important gains in social and labour market policies, it must continue to expand access to good-quality social protection, facilitate beneficiaries' transition to productive employment, and improve equality of opportunity to ensure inclusive growth.

## Key recommendations

- Reduce informality through a multi-pronged approach that includes i) improving the quality of public services and strengthening the link between contributions and benefits in social protection schemes; ii) simplifying tax and regulatory systems (see Chapters 2 and 9); and iii) giving enforcement agencies, such as the labour inspectorates, sufficient resources to carry out their work effectively.
- Renew efforts to introduce a national system of unemployment insurance.
- Improve the targeting of social benefits (e.g. conditional cash benefits) and expand access to ensure that those individuals most in need receive social protection.
- Increase the quality of and access to social services, particularly education and health, to reduce regional inequalities and ensure comprehensive social protection.
- Facilitate beneficiaries' transition to productive employment, in order to reduce benefit dependence, for example by improving the linkage (*vinculación*) component of PROSPERA.
- Increase the number of contributors to the mandatory pension by reducing informality.
- Increase contribution levels to the mandatory pension system to ensure more funds are ring-fenced within pensions.
- Increase the safety-net benefit to alleviate old-age poverty, but ensure that this does not act as a disincentive to formal employment.
- Strengthen institutional linkages across ministries and levels of government in order to make social protection more effective.
- Recommit to rigorous evaluation in the design and reform of social programmes, in order to assess better programme effectiveness.
- Ensure that resources continue to be invested – and increased – in important social programmes, such as PROSPERA and PEI, under the condition that programme effectiveness and coverage are improved.
- Simplify the administrative procedures for accessing cash transfers.
- Step-up the role of social workers in reaching out to marginalised families to tackle extreme poverty, in particular in remote areas in the South.
- Raise and broaden the minimum pension to expand the old-age safety net.

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