

Labour Poverty

Improving social well-being to promote growth

- Mexico's structural changes towards a more opened economy with its growth supported by exports, had had heterogeneous impacts within the country. Gains have been concentrated around industrial clusters in the Centre and Urban North of Mexico, impairing technological transfers and capital accumulation for small and medium-sized enterprises (SMEs).
- Inter-sectoral productivity suffers do to the migration of qualified and no-qualified works from the manufacture sector to services, looking to improve their incomes since salaries have stagnate and are no longer linked to the productivity growth rate in manufacture.
- Since the signing of the North American Trade Agreement (NAFTA), though growth has been assured, poverty and inequalities have increased, and today Mexico know its **highest levels on Labour Poverty**.
- **Inefficient regulatory burdens and taxes** generate negative incentives pushing workers and employers to **informality**, and reduce the State's capacity to properly invest in development programmes.
- Programmes such as **Prospera** have shown to be helpful to reduce inequality opportunities and poverty incidence, however they should be improved and include new **job formation and unemployment support**.

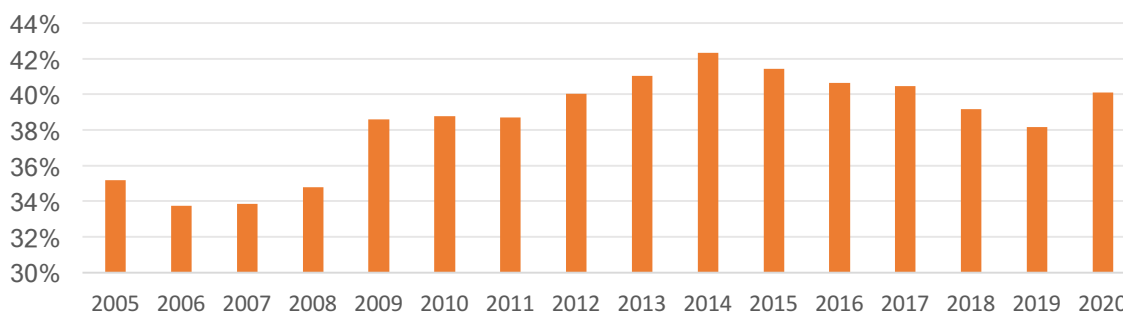
What is the issue?

Over the last three decades, Mexico has undergone structural changes supported by reforms based on economic liberalization and export-led industrialization. However, the gains and the distribution of the Gross Added Value are not homogenous within the economic sectors nor the Mexican territory. In reality, there is a bifurcation of the national economy, with sectors and firms heavily engaged in international trade but without remarkable links to the local demand. This causes a gap in productivity and disrupts technology transfers between the two economic structures, thus hindering the accumulation of productive capital, the modernization of the smaller production systems and exalting the weight of the informal sector.

The low performance of its labour market characterized by high levels of informality, poor quality jobs and underdeveloped social protection systems, pushed nearly 38% of the population in labour poverty by 2019. This means, that more than a third of Mexico's households have labour incomes that don't allow them to afford items of the basic food basket. The uncertainty faced by Mexican households regarding employment and income stability, as well as the lack of proper social protection systems, endanger populations that are already vulnerable (rural and indigenous communities, women, youth, etc.) pushing them into poverty traps, where malnutrition and low access of

➔ Labour poverty levels in Mexico are twice the National Goal (20,5%)

Part of the population in Labour Poverty from 2005 to 2020



Treatment: Authors. Source: México ¿Cómo estamos ?

basic services (health, education, water, energy) persist.

Even though unemployment rates have diminished, **more than 50% of the population is working in Small and Medium Enterprises (SMEs) concentrated in the informal sector, and have seen their purchasing power drop significantly** due to an absence of evolution of real wages and the burden of inefficient taxes. On the one hand, wages, and in particular the minimum wage, are computed based on underestimated inflation rates and aren't following the growth rates of productivity in their respective sector. On the other hand, VTA, which is 16% today, and other taxes such as the ISR (*Impuesto Sobre la Renta*), generate high pressure on the household's available net income. **Thus, to survive and escape poverty, households are now forced to turn to informality and even consider migration** in hopes of better working conditions.

Furthermore, the Mexican popular opinion has lost its trust in the government since there is no noteworthy progress concerning social protection systems neither adjustments to the everlasting unfair fiscal regime. Corruption hinders then the confidence towards the government's actions and spending, uplifting tax evasion practices and generating discomfort among taxpayers who feel that the government's allowances are not proportional to their contributions. **Corruption has then invigorated informality, hamper global productivity levels and reduce the state revenue.**

Why is this important?

Certainly, the economic liberalization allowed the Mexican Economy to develop a more performant industrial sector and to sustain a positive growth rate over the years. However, the new production structure with low public investment generates negative impacts on the quality of employment, causes the stagnation on productivity levels and weakens the progress concerning the reduction of inequalities and the fight against poverty.



Further Reading

BRANDT N. *Informality in Mexico*. OECD Economics Department Working Paper, N° 869, pp1-28, 2011.

CEPAL, 2017. *Políticas Industriales y tecnológicas en América Latina*.

CONEVAL, 2019. *El Progreso-Oportunidades-Prospera, a 20 años de su creación*.

PADILLA P. & VILLAREAL F.G., 2017. *Structural change and productivity growth in Mexico, 1990-2014. Structural Change and Economic Dynamics*.

Mexico Policy Brief: Labour Poverty

What should policy makers do?

Assess Existent Regulatory Burdens and Credit Facilities:

- Facilitate access to credit to SMEs, mainly to improve payment to suppliers, capital accumulation and productivity;
- Alleviate administrative costs and adapt regulatory burdens to small scale business with high rates of informality;
- Modify social security payments attached to salary and which endorse arbitration between formality and informality;

Evaluate and Restructure the Fiscal Policy:

- Introduce the concept of "economic capabilities" when computing rates on income tax, to reduce poverty vulnerabilities;
- Take into account household's structure when paying income taxes to enhance a more just fiscal regime;
- Rethink the weight of VAT in households purchasing power;
- Restructure Public Revenues and Public Spending to boost investment and R&D;

Strengthen Social Protection Networks:

- Protect employees from severe wage changes during major economic downturns;
- Develop a universal social protection and security system;
- Facilitate the access to a higher unemployment insurance;

Enhance Job Formation and Human Capital:

- Eliminate duplicated programmes on education;
- Implement strategies that aim to improve labour productivity with different follow-up stages;
- Broaden the current temporary employment programmes and enhance the formation and access to certificates for individuals stocked in the informal sector or in unemployment.

For Mexico, **eradicate vicious cycles** is key to escape its current **productivity trap and underemployment long-term equilibrium**. To achieve its sustainable development goals, as well as other national objectives in terms of labour poverty and productivity, Mexico has then to disrupt its harmful dynamics where low technological transfers and public investments, insufficient wages, tax evasion, corruption, rent seeking behaviours, informality, and migration seem strongly linked. Otherwise, the expected gains from the Industrialisation by Export Substitution won't be enough to improve the living-standards of the majority, and will be, on the contrary, the root of the main social development issues.