

Policies to Promote Growth and Economic Efficiency in Mexico

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- Diversity, heterogeneity, and the pursuit of comparative advantage are central features of modern economies.
- Institutions that were once functional in organizing society are no longer appropriate in a world of diversity and heterogeneity.
- Institutions that induce efficient responses to unique situations and unique people produce the greatest value in the new economy.

- Mexico operates under a burden of rigid laws and social institutions.
- Rigidity and regulation produce static and dynamic inefficiency that retard growth.
- Noncompetitive labor markets and product markets in oil, telecommunications, and many other sectors that are monopolies or virtual monopolies.

- Mandated uniformity suppresses the exploitation of the distinctive opportunities produced by the modern economy. It also destroys the incentive of participants in diverse employment and production decisions to foster and use their knowledge.

- Monopolies that prevent innovators from entering industries raise costs and retard growth.
- Mexico has built into its political culture a fear and even loathing of incentives and markets.
- It has created a legal and cultural edifice that restricts its ability to adapt to the new economy.

- The antimarket bias in the Mexican labor market and the economic culture of the country is embodied in two laws that date to the 1917 Revolution.
 - Article 123 of the Mexican Constitution:
“Every person has the right to a dignifying and socially useful job; for that purpose, the creation of jobs and the social organization of labor will be promoted, in agreement with the Law.”
 - Article 3 of the Federal Labor Law, which regulates issues regarding hiring, firing, unions, etc., states:
“The labor is a right and social duty. It is not an item subject to trade, it demands respect to the liberties and dignity of whomever offers it, and it must be carried out in conditions that ensure the life, health and a decent economic level for the worker and their family.”
Here “labor” means “productive” work (“trabajo”).

Main Points of Today's Lecture

- (a) Mexican economy is sluggish and, if anything, is losing its competitive edge.
 - (i) A major problem is the slow or even negative growth of labor productivity.
- (b) Mexican economy is highly regulated
 - (i) Labor markets
 - (ii) Product markets

- (c) Mexican skill formation slow
 - (i) Partly as a consequence of rigidity of unions in the teaching sector and inefficiency of the school system
 - (ii) Mexican family is under stress and this likely has major implications for child development and skill development
- (d) Mexican economic infrastructure weak
 - (i) Partly as a consequence of weak public finances
 - (ii) Partly a matter of monopoly and lack of competition
- (e) Mexican inequality in incomes and public expenditure is high
 - (i) Overall
 - (ii) By region
 - (iii) The inequality in public sector expenditure is *engineered* by public policy from the center. States have little responsibility over revenue and no transparency of public spending in Mexico.

(f) Informality: The Recent Discussion

- (i) Some facts
 - (I) Large informal sector
 - (II) Very heterogeneous
 - (III) Overall declining but informal salaried share is increasing
- (ii) Some interpretations
- (iii) How important is Seguro Popular promoting illegal salaried work?
- (iv) Focus on Seguro Popular is diverting.
- (v) The principle cause of informality is regulation, taxation, and inefficient provision of publicly provided goods.

Mexico Has to Improve Its Economic and Social Institutions in Order to Compete in the World Economy

- Two basic driving forces operate in the same direction in economies participating in the world economy.
- When these forces collide with the institutional structure of the Mexican economy, they create structural problems that go a long way toward explaining Mexico's sluggish economic performance.

(I) The technology of production has changed and continues to change.

(II) The world economy has opened up and Mexico is an active participant in it.

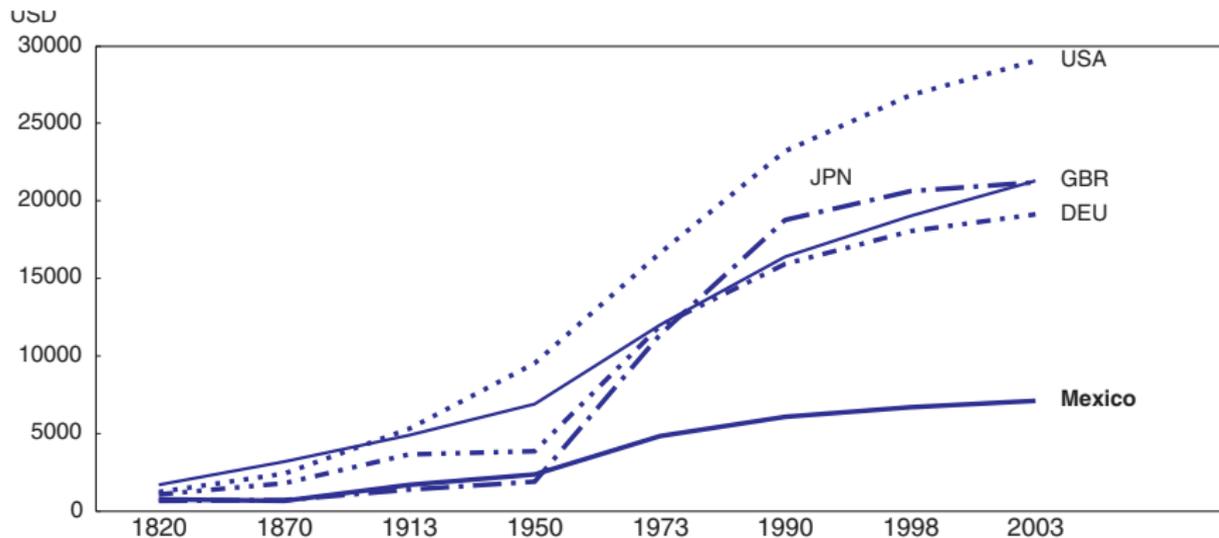
- This has created fresh opportunities for trade and the creation of wealth but at the same time it has created fresh challenges to entrepreneurs to respond to these opportunities.
- The time is over when a rigid way of doing business in the product market or in the labor market can be successful.
- One of the best-established empirical regularities in modern economics is that more educated people and more able people and people less encumbered by regulations and restrictions are better at adapting to change.
- Mexico has to accelerate its skill base in order to compete.

- The returns to adaptability and the skill bias in technology are the major factors in the rise in wage inequality between less educated and the more educated persons that has happened in all modern economies around the world.
- It also has to free up its economy to respond to the challenges of the world economy.

The Performance of the Mexican Economy

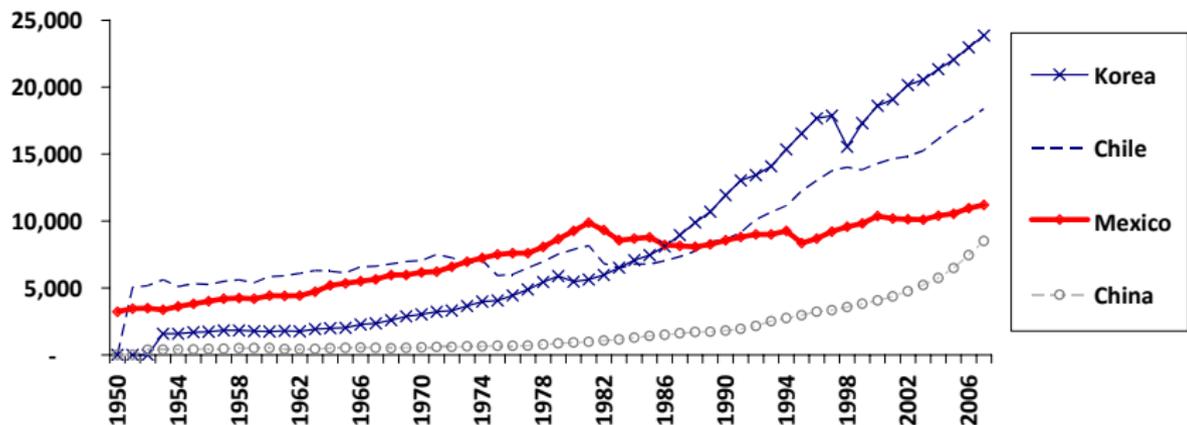
- Performance of the Mexican economy has been weak.

Figure 1: GDP per capita: 1990 USD PPP's



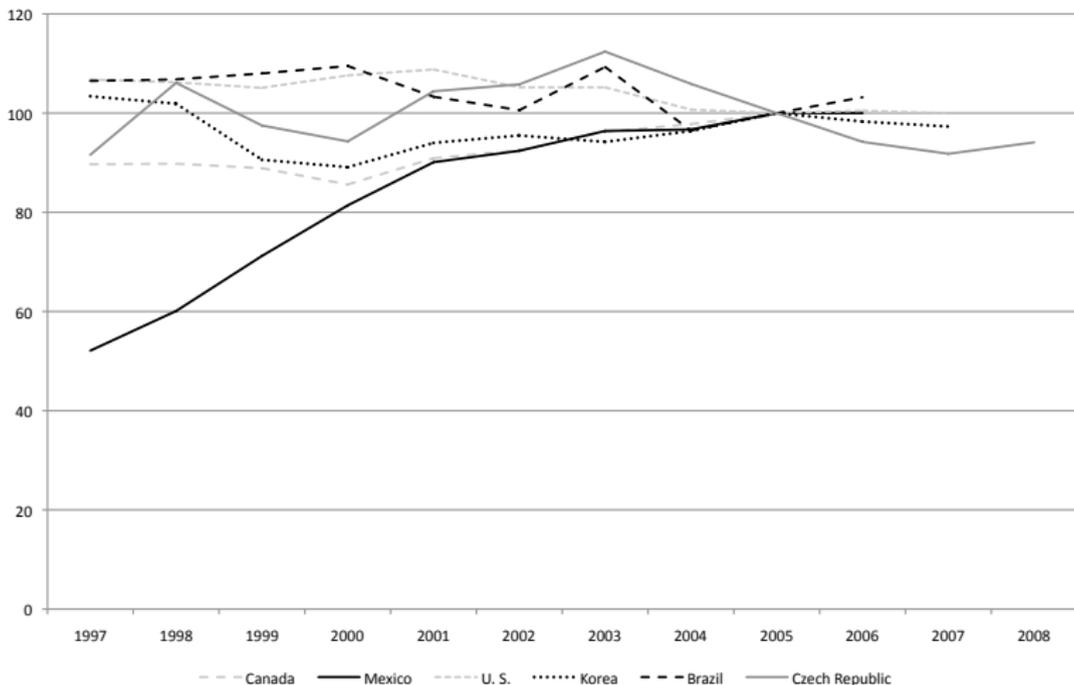
Source: Angus Madison (2003), The World Economy: Historical Statistics.

Figure 2: Real GDP Per Capita in US Dollars



Source: World Penn Tables, 1999. <http://pwt.econ.upenn.edu>

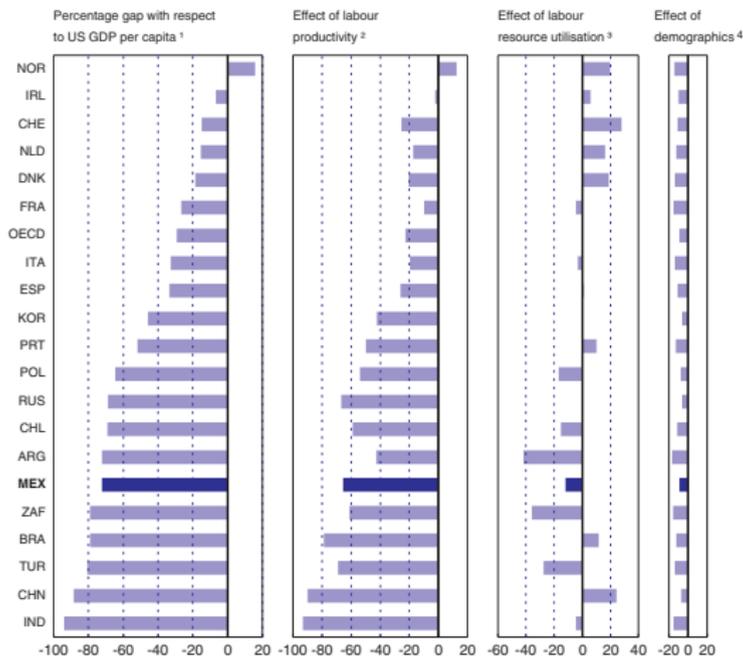
Figure 3: Unit Labor Costs in Manufacturing, Index OECD



Source: OECD (2009)

- In virtually all sectors the level of labor productivity is low compared to other economies.

Figure 4: The sources of real GDP per capita differences, 2007

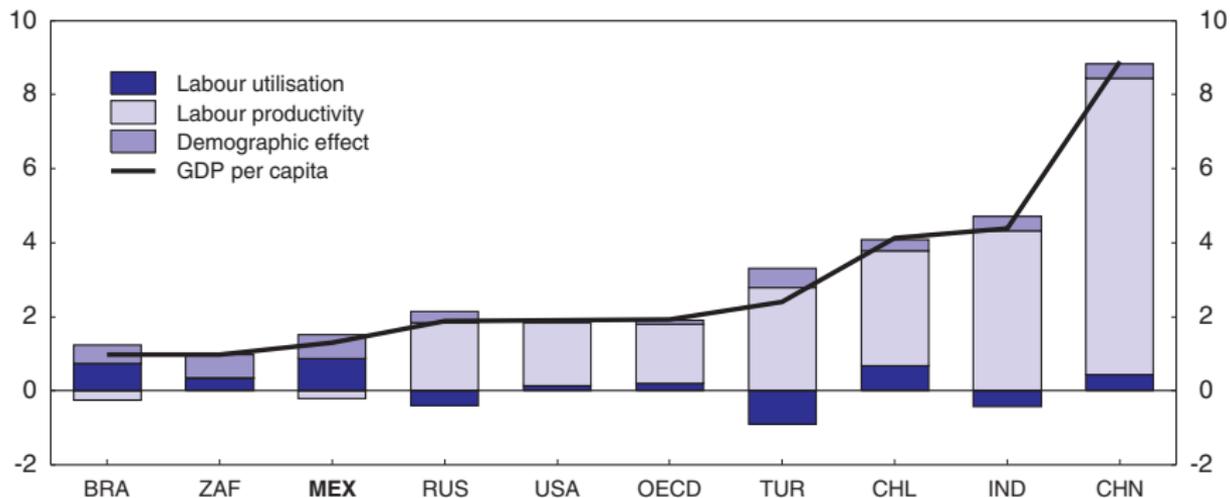


1. Based on 2005 purchasing power parities (PPPs).
2. Labour productivity is measured as GDP per person employed.
3. Labour resource utilisation is measured as the ratio of those employed to the persons of working age.
4. Measures the change in the ratio of persons of working age (15-64 years) to the total population.

Source: OECD, National Accounts; World Bank, WDI; International Monetary Fund, WEO; United Nations, UNSD.

- Labor Productivity Growth in Mexico is *negative*, in sharp contrast to the performance of other economies in the past decade.

Figure 5: Sources of growth: Average growth, 1987-2007



Source: OECD, National Accounts; World Bank, WDI; International Monetary Fund, WEO; United Nations, UNSD.

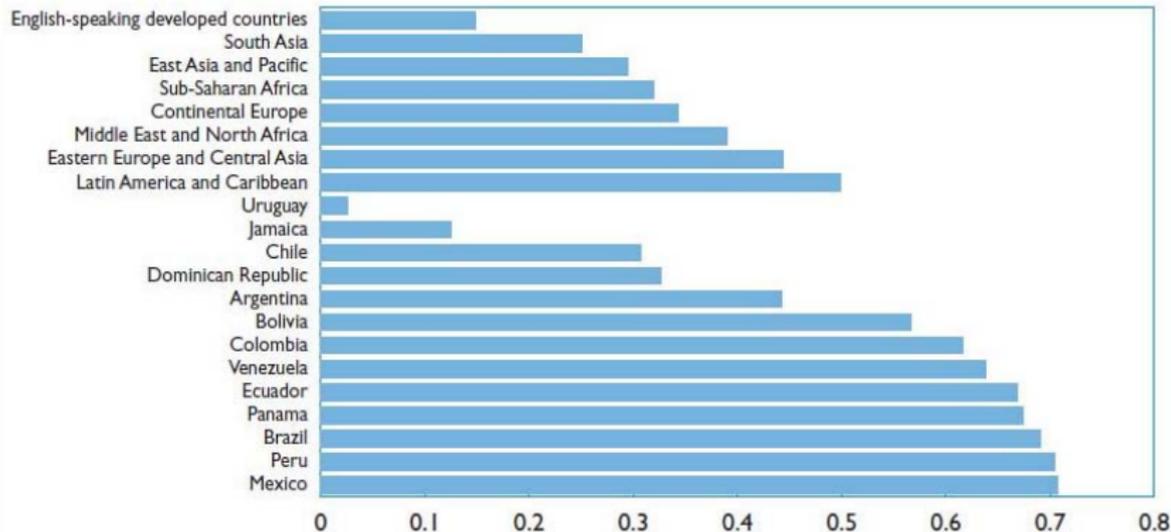
What Explains These Adverse Trends?

- Rigidity and weak incentives in the Mexican economy inhibit its performance.
- Whatever reforms have been implemented are too small to keep the Mexican economy competitive.
- The rigidity and anti-competitive elements in the Mexican economy are well known.
- They are an aspect of a political and economic culture that has accommodated itself to special interest groups.
- This culture has been called “Crony Capitalism”—special interest groups get special favors which lead to monopoly and inefficiency.
- The persistent inequality in regional allocations in education and health are indicative of this phenomenon.

Level of Competitiveness Low

- 1 Very non-competitive economy in many sectors.
- 2 Highly regulated in labor markets and product markets.

Figure 6: International Comparison: Index of Labor Market Rigidity (0=low, 1=high)¹



Source: Botero and others (2003).

¹The higher the index, the higher is the level of labor market rigidities.

Monopoly and Economic Performance

- Low levels of competition cause Mexico to lack vital infrastructure in communications.
- Evidence on telecommunications and oil (lack of investment).
- High and rising unit costs make Mexican products less competitive.
- Consider the performance of the heavily monopolized communications structure (Telmex), e.g., 14¢ per 3 minutes in Mexico, but 2¢ per 3 minutes in Korea.

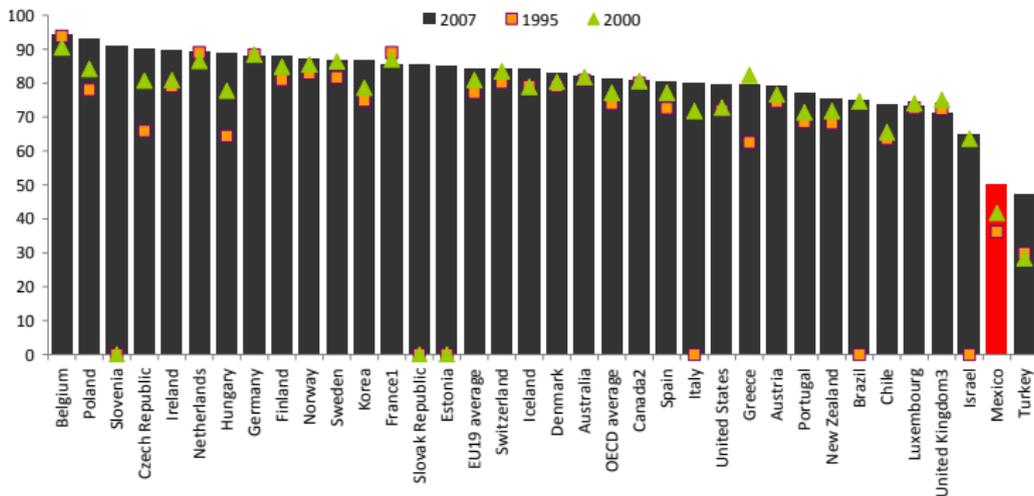
Skill Formation in Mexico

- School system is well-supported by OECD standards (6% of GDP).
- Enrollments low.
- Yet most of the expenditure on salaries, little infrastructure investment.

- It produces a sub-optimally high labor intensity in the education sector and low levels of infrastructure.
- It prevents educational innovations.
- Retards the growth of human capital and helps to explain the low labor productivity in Mexico.

Figure 7: Enrolment rates of 15–19 year-olds (1995, 2000 and 2007)

Full-time and part-time students in public and private institutions



1. Excludes overseas departments for 1995 and 2000.

2. Reference year 2006 instead of 2007.

3. Break in time series following methodological change from 2006.

Countries are ranked in descending order of the enrolment rates of 15-19 year-olds in 2007.

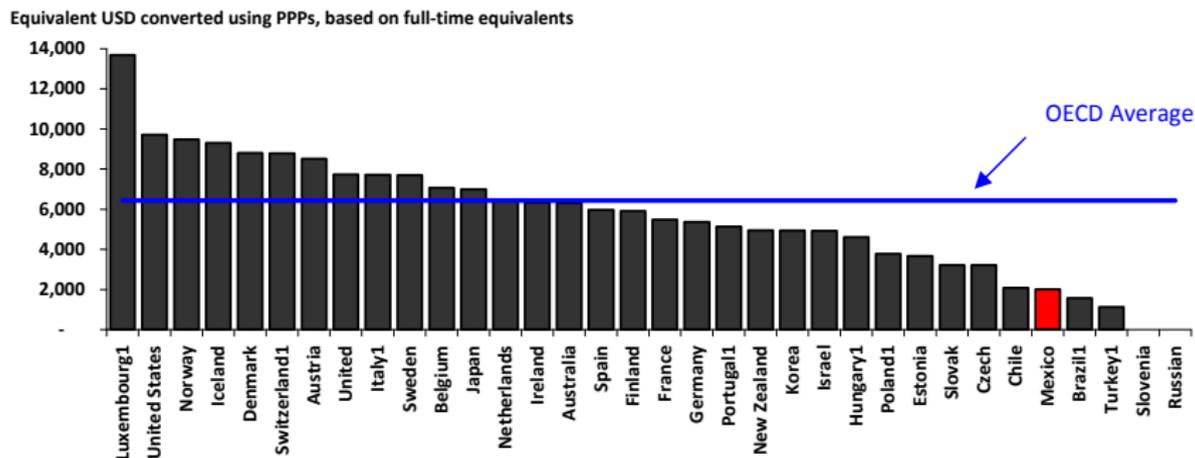
Source: Education at a Glance 2009: OECD Indicators - OECD copyright 2009 - ISBN

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Skill Formation in Mexico

- Yet its performance poor.
- Unionism retards excellence in schools; protects mediocre teachers.

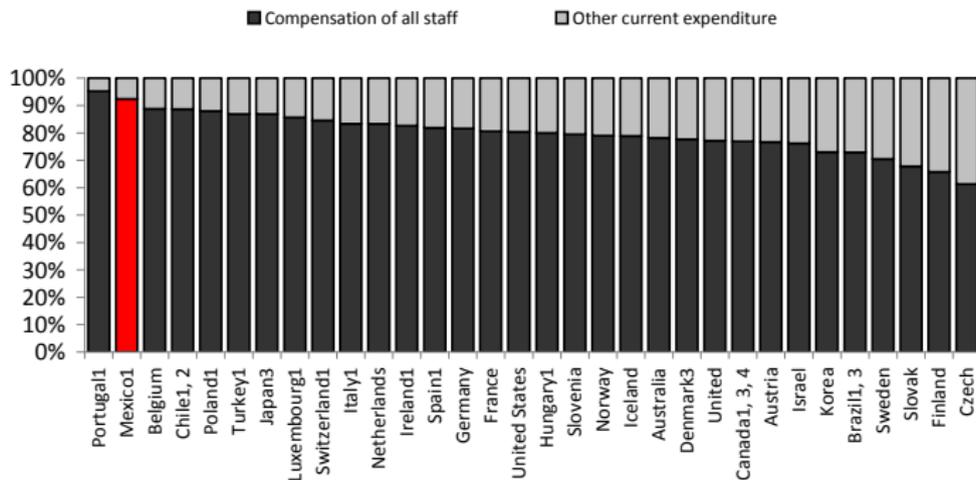
Figure 8: Annual expenditure on educational institutions per student for all services
Primary Education (2006)



Source: Education at a Glance 2009: OECD Indicators - OECD copyright 2009 - ISBN

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Figure 9: Distribution of current expenditure on educational institutions for primary, secondary and post-secondary non-tertiary education (2006)



1. Public institutions only.

2. Year of reference 2007.

3. Some levels of education are included with others. Refer to "x" code in Table B1.1a for details.

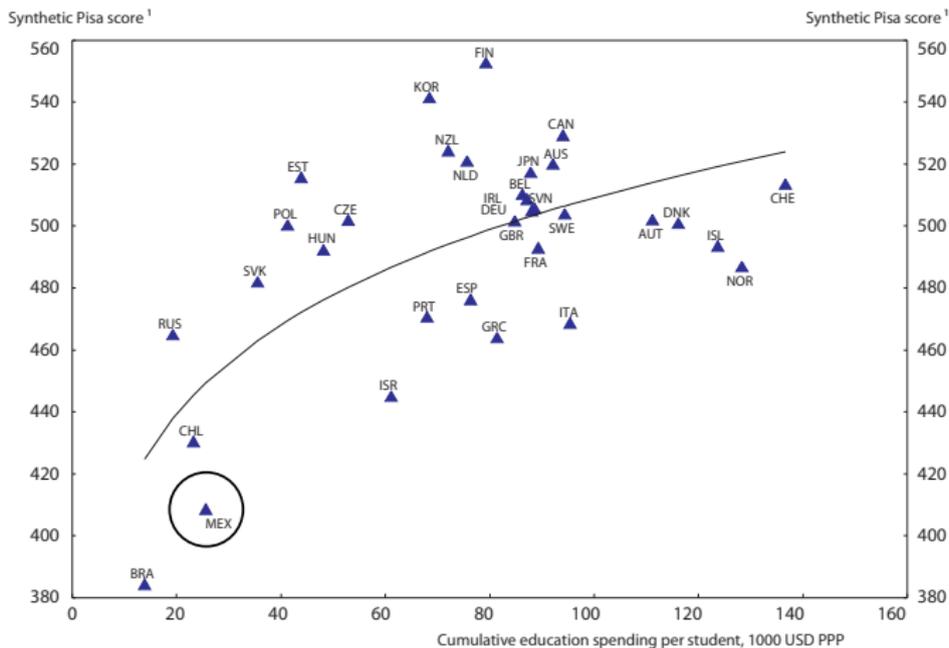
4. Year of reference 2005.

Countries are ranked in descending order of the share of compensation of all staff in primary, secondary and post-secondary non-tertiary education.

Source: Education at a Glance 2009: OECD Indicators - OECD copyright 2009 - ISBN 9789264024755

- Low level of efficiency in education and health.
- Large expenditure on salaries little in infrastructure.

Figure 10: PISA score and education spending per student (2007)

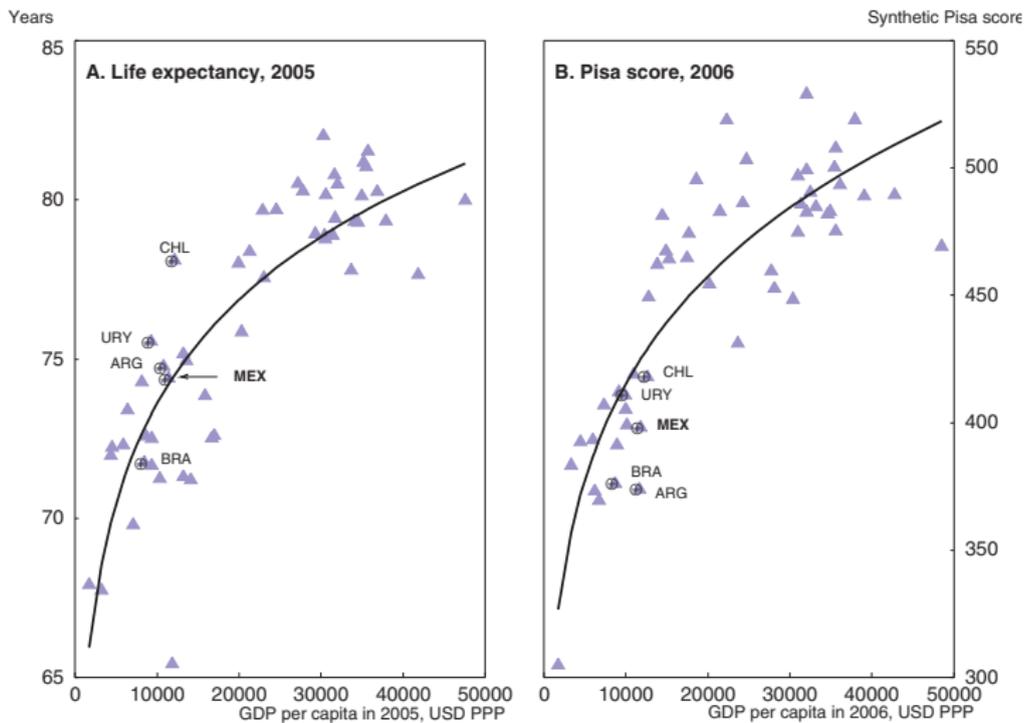


1. The synthetic PISA score combines the scores on the reading, mathematics and science scale through factor analysis.

Source: OECD, PISA Results 2006.

- Similar low performance in health and education given the level of income.

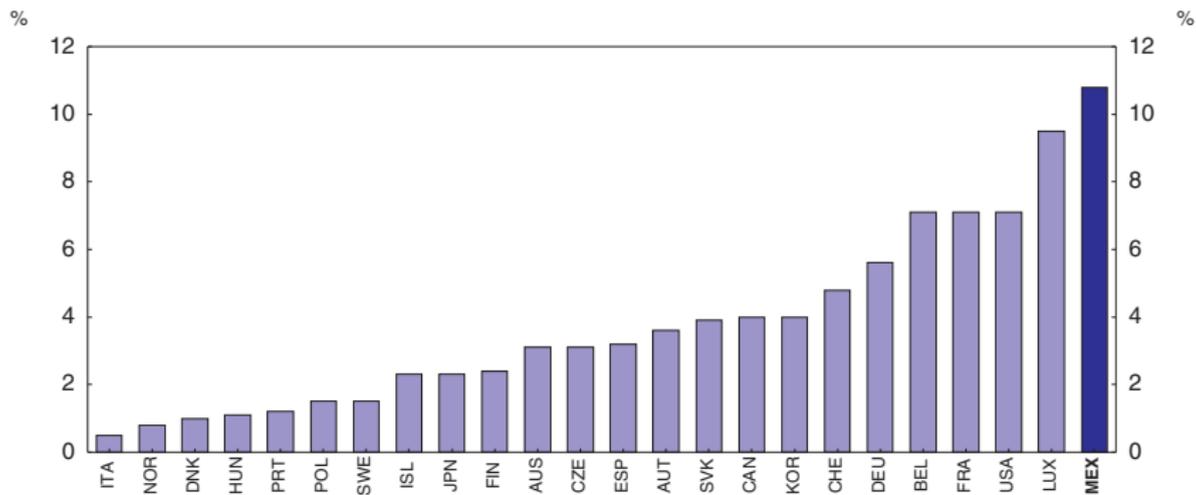
Figure 11: Performance in health and education



Source: World Bank WDI database; OECD PISA Results.

- High level of inefficiency in health care delivery.

Figure 12: Administrative costs
(As a percentage of total health care spending, 2005)

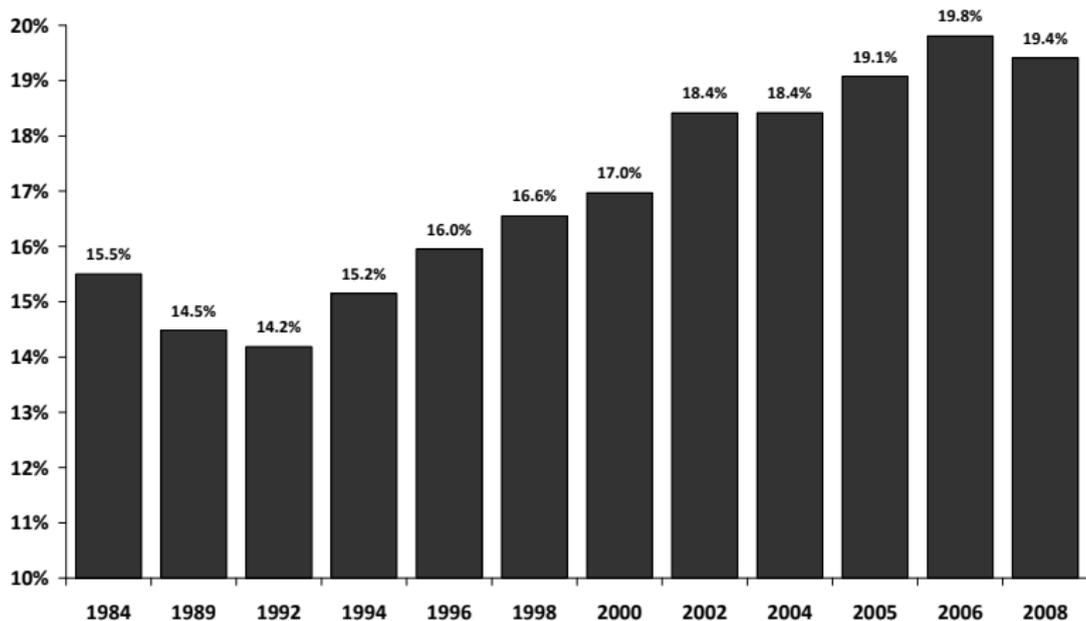


Source: OECD, OECD Health Data 2008.

Families and Children Are Under Stress in Mexico

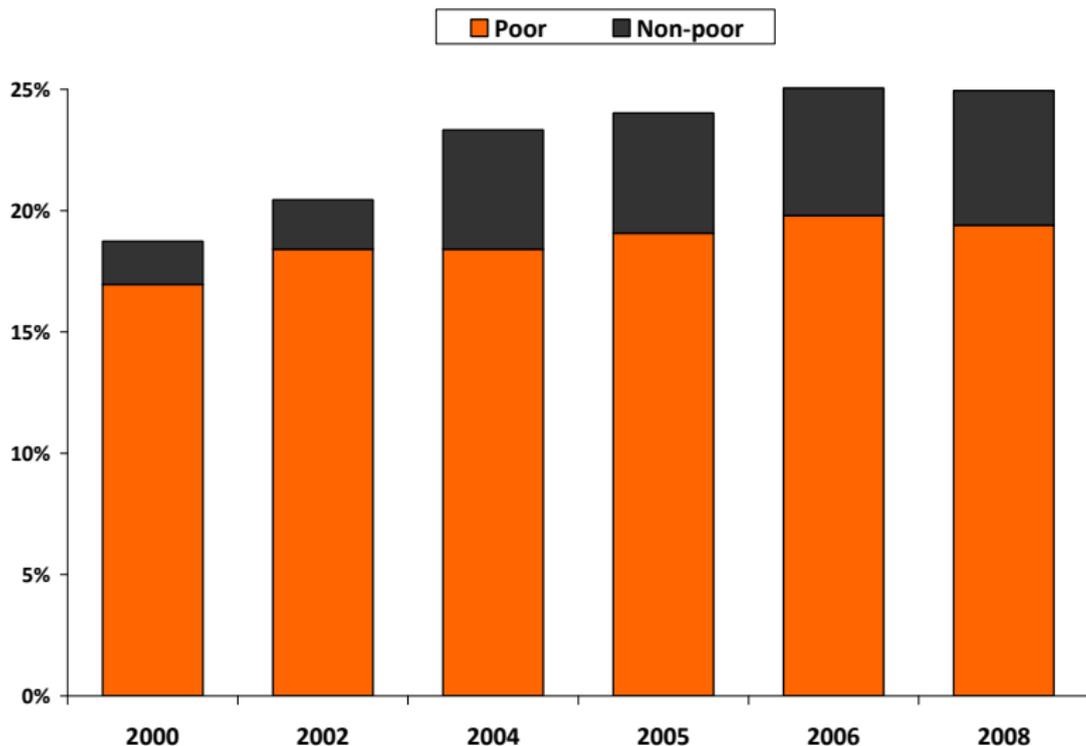
- Percent of all children born out of wedlock is rising.
- These environments have been shown to create adverse child outcomes (data in U.S. and Canada for all demographics).

Figure 13: Percent of Households Headed by Single Females



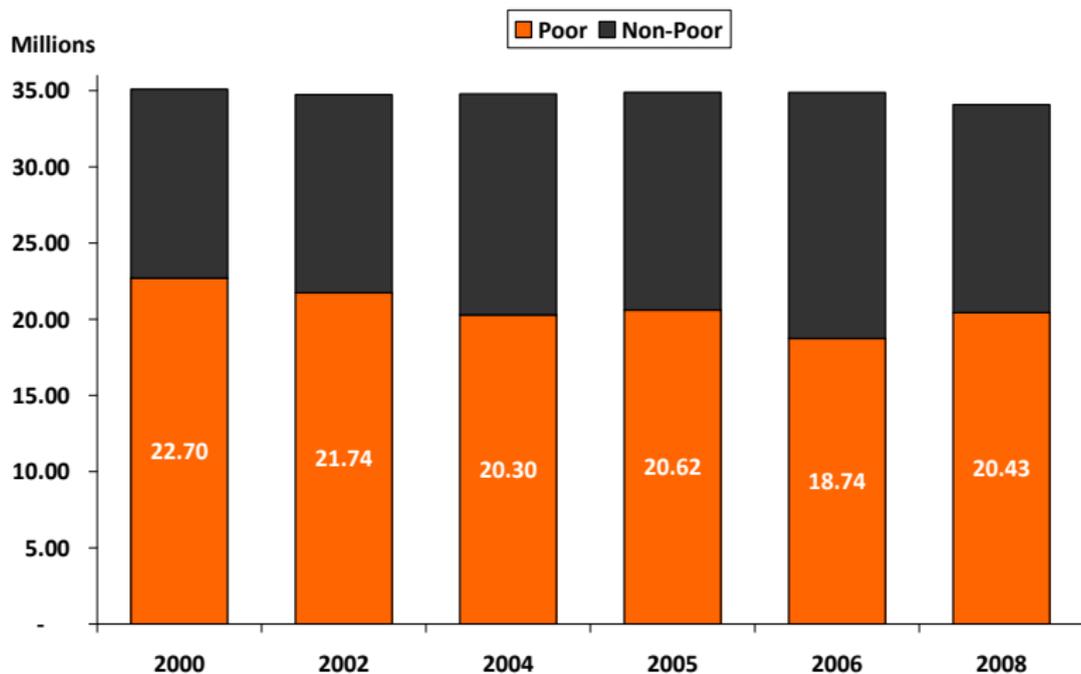
Source: Author's estimations using ENIGHs 1984–2008.

Figure 14: Percent of Households Headed by Single Females (by Poverty Status)



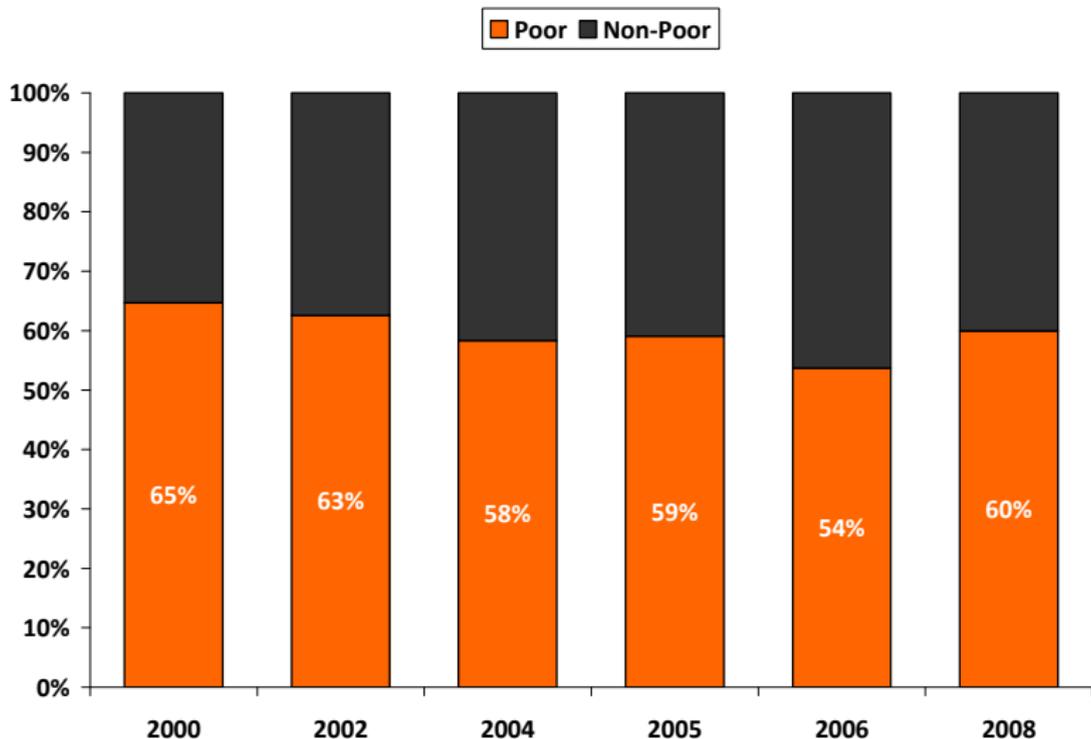
Source: Author's estimations using ENIGHs 2000–2008.

Figure 15: Total Population under Age 15 by Poverty Status



Source: Author's estimations using ENIGHs 2000–2008.

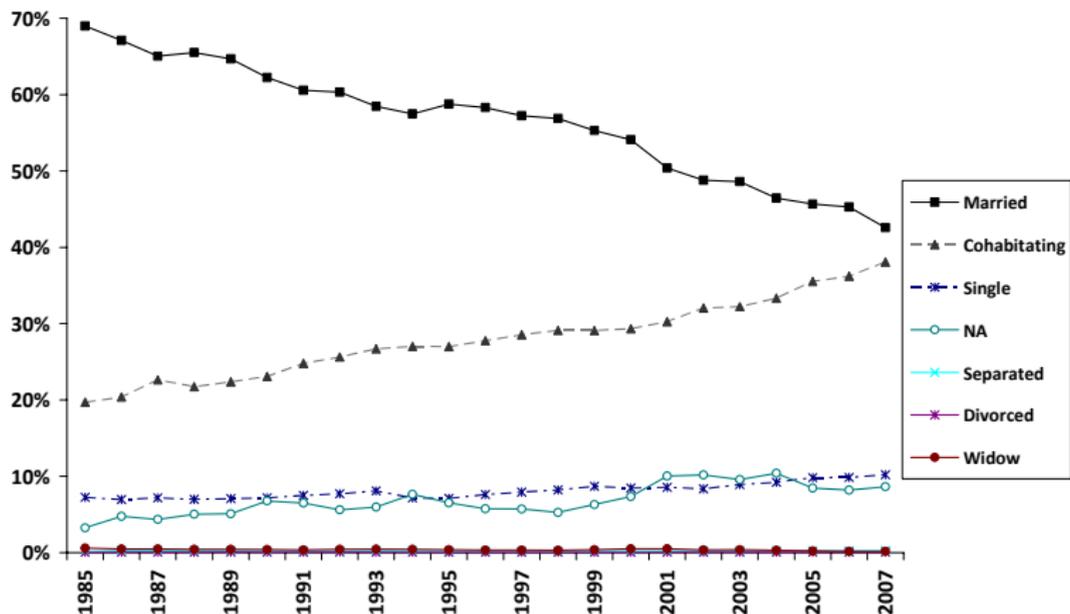
Figure 16: Percentage of Children Living Under Poverty



Source: Author's estimations using ENIGHs 2000–2008.

- Cohabitation in the U.S. and in many countries is a family status with substantial negative implications for child development and the educational attainment of the future Mexican labor force because of greater poverty and lack of resources for the child.
- This slows the growth of human capital.

Figure 17: Registered Births in Mexico
Marital Status of Mothers



Sources: INEGI.

- A large body of evidence shows that the early years before school are important to the success of children in school and in life (Cunha and Heckman, 2009).
- PROGRESA/Oportunidades is a proud achievement.
- But a refocus on the preschool–pre-PROGRESA years to supplement the early family years is an important direction for policy.
- Without quality of schools and teachers, marginal effect of PROGRESA/Oportunidades is low.

- Some current discussions in Mexico favor increasing cash transfers of PROGRESA/Oportunidades as opposed to increasing the quality and efficiency of schools and to fostering early childhood.
- The record in the U.S. is clear.
- Cash transfers do not reduce intergenerational poverty.
- That was why Clinton abolished “welfare as we knew it.”
- A policy that promotes the skills of the young is going to be far more effective promoting.

Inequality

- High levels of regional inequality in
 - 1 Incomes
 - 2 Quality of Education
 - 3 Provision of Health
 - 4 Provision of Social Security
- What is unusual about this inequality is that finance for public services is centralized unlike the U.S.
- Inequality is created from the center.

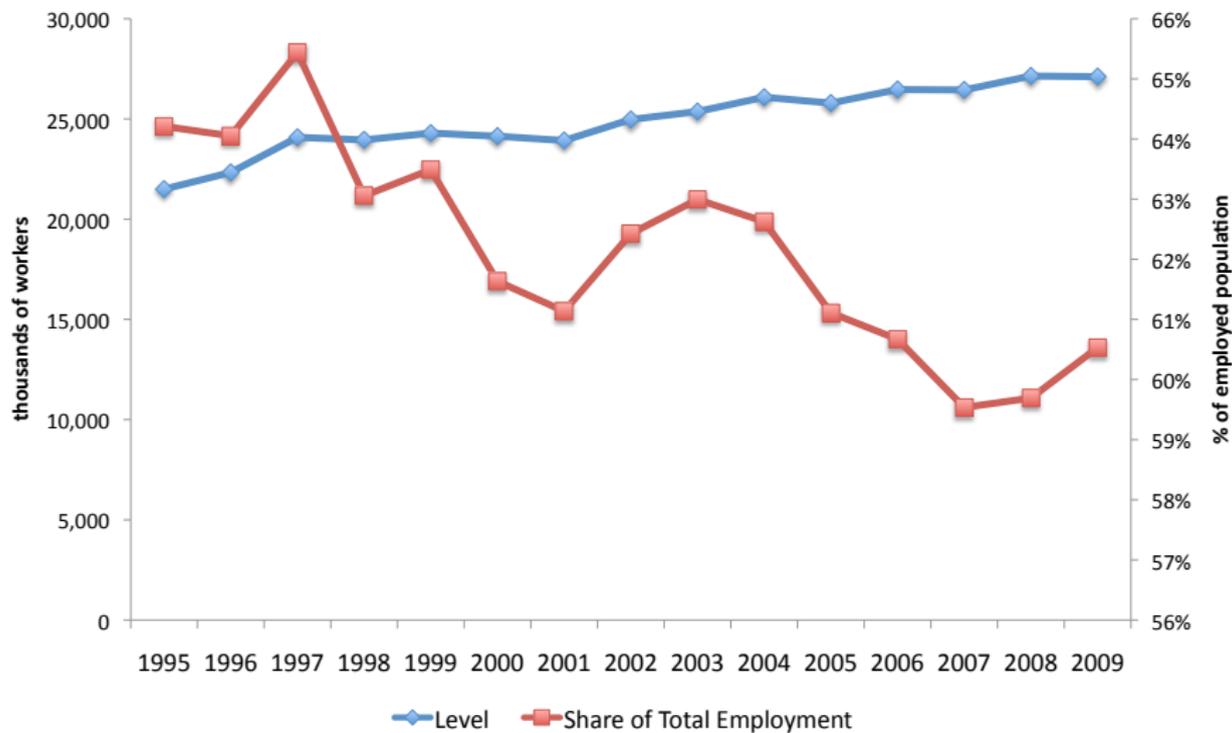
The Informal Sector: Its Origins and its Consequences

- Mexico has a large informal sector.
- It is widely held that the informal sector contributes to static and dynamic inefficiency
- But the evidence on it is surprisingly weak.

Definition of Total Informal Employment

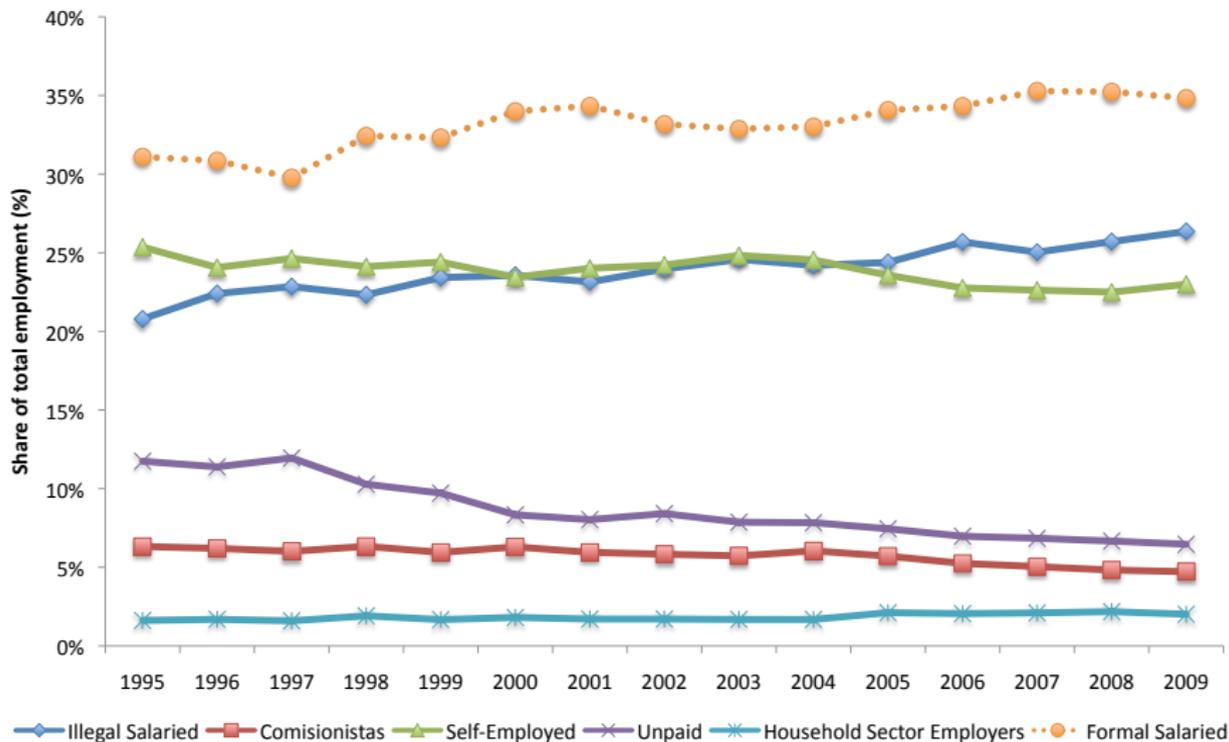
- We define informality to include the following excluding categories:
 - **Illegal salaried worker:** Workers that have a boss and receive a fixed salary on a regular basis and are not covered by any of the social security institutes (IMSS, ISSSTE, PEMEX, and others).
 - **Comisionistas:** Workers that have a boss but do not receive a salary, they might get paid in tips, per work fees, etc. They are NOT required by law to have social security.
 - **Unpaid workers:** Those who do not receive monetary payment for their work.
 - **Self-employed:** Workers with no boss, and work on their own basis.
 - **Household Sector Employers and others:** They are employers in firms that are household based. Firms are classified as household based if they do not have a separate accounting for their business.
 - This category also includes a very small number of workers that were not classified in the previous categories, but are included in the informal sector definition of INEGI.

Figure 18: Labor Force in Informal Sector, 1995–2009



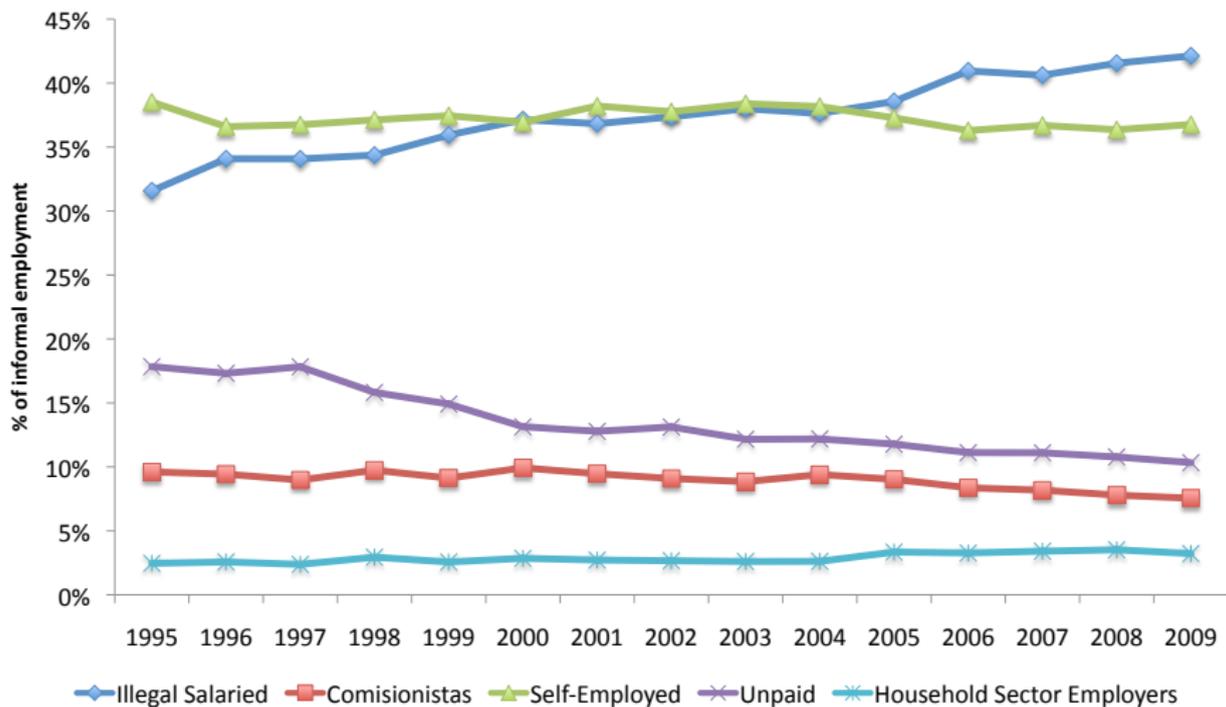
Source: Author's calculations based on data from the second quarter of ENE (1995–2004) and ENOE (2005–2009).

Figure 19: Employment by type of job, 1995–2009



Source: Author's calculations based on data from the second quarter of ENE (1995–2004) and ENOE (2005–2009).

Figure 20: Informality by type of job, 1995–2009 (% of informal employment)



Source: Author's calculations based on data from second quarter of ENE and ENOE.

- The category “informality” masks a diversity of categories with different trends and different productivities.

- Informality is a world-wide phenomenon.
- True in rich countries and poor (Italy and Peru).
- Related to regulation and level of taxation.

- Three models for informality. There are viewed as trichotomies:
 - (a) “De Soto” – Informal firms are productive firms stifled by regulation.
 - (b) “McKinsey” – Informal firms are parasitic firms stealing from the fisc and also underperforming. They drain fiscal resources and contribute to the low level of infrastructure in Mexico.
 - (c) Informal firms are the inefficient firms that cannot compete except when subsidized.
- La Porta and Shleifer (2008) favor view (c).
- Evidence by Hsieh and Klenow (2009), for Mexico, seems to favor this view.
- All three views are simultaneously consistent with the evidence.

- Policy implications of each polar view are different.
- Under (a), the policy is to reduce the burden of regulation on the Mexican economy.
- Under (b), the policy is to tax the informal sector; bring informal into the fiscal sector.
- Under (c), the informal are the permanently unproductive. They cannot compete with economic development, they will disappear.

Consider the following simple model

- Firms sort into formal/informal sector based on their productivity.
- Less productive firms can only survive in the informal sector (avoiding taxes, lower fixed cost, etc)
- There is no effect of sector type (either formal or informal) into firms' productivity.
- Overall productivity is given by underlying distribution of skills of the economy $\phi(\theta)$

- Distribution of skills $\phi(\theta)$
- Production function $f(\theta, L) = \theta L^\alpha$
- Price of products varies between sectors P_f and P_I
- Gross Revenue of Firms $\rightarrow P_i \theta L^\alpha$ for $i = \text{formal, informal}$

- Cost varies between sectors (i.e. formal firms has to pay taxes τ)

$$C_f = w(1 + \tau)L - c_f$$

$$C_I = wL - c_I$$

- Assumption 1. $c_f > c_I$, fixed cost is higher in formal sector (i.e. time spend in bureaucratic issues, lawyers, accountants, etc)
- Assumption 2. Prices differ between sectors and are higher in the formal sector

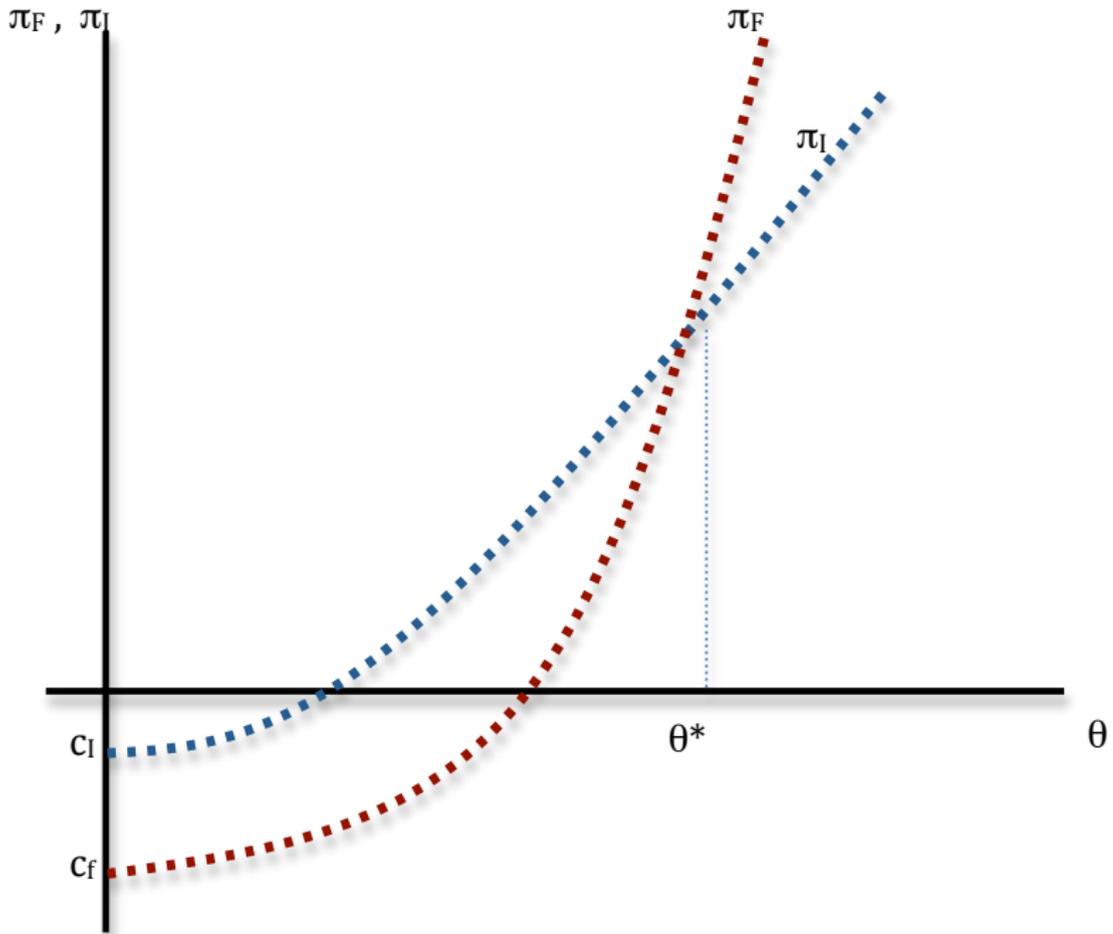
- Firms problem:

$$\max_{\text{formal/informal}} \left\{ \max_L P_f \theta L^\alpha - w(1 + \tau)L - c_f; \max_L P_i \theta L^\alpha - wL - c_i \right\}$$

- Solution implies that there is a level of productivity $\hat{\theta}$ s.t
 - For $\theta > \hat{\theta}$ firm chooses to be formal
 - For $\theta < \hat{\theta}$ firm chooses to be informal
- We can further explore characteristics of distribution of skills $\phi(\theta)$ to study the productivity of economy and within each sector
- It is straightforward to obtain

$$\hat{\theta} = \left[\frac{C_f - C_I}{(\alpha^{\frac{\alpha}{1-\alpha}} - \alpha^{\frac{1}{1-\alpha}}) \left(\frac{1}{w}\right)^{\frac{\alpha}{1-\alpha}} \left\{ \left(\frac{P_f}{1+\tau}\right)^{\frac{\alpha}{1-\alpha}} P_f + P_I^{\frac{1}{1-\alpha}} \right\}} \right]^{1-\alpha}$$

- Graphically the solution implies:



Adding Capital Accumulation

- We introduce capital accumulation in simple model with smooth adjustment cost
- In addition to choose whether to be formal or informal, each period firms choose level of investment such that

$$\min_{K_t} \theta(K_t - K^*)^2 + \beta(K_t - K_{t-1})^2$$

- We assume the cost of investment is the same for all firms (i.e. β). We will relax this assumption.
- Cost of misallocation increases with productivity

- The optimal policy function of capital accumulation is a weighted average of optimal capital and capital chosen in previous period:

$$K_t = \omega K^* + (1 - \omega)K_{t-1}$$

- where $\omega = \frac{\theta}{\theta + \beta}$ \longrightarrow more productive firms invest more
- In this model all firms eventually will reach the frictionless level of capital:

$$K_t = \sum_{i=0}^{t-1} \frac{\theta \beta^i}{(\theta + \beta)^{i+1}} K^* + \left(\frac{\beta}{\theta + \beta}\right)^t K_0$$

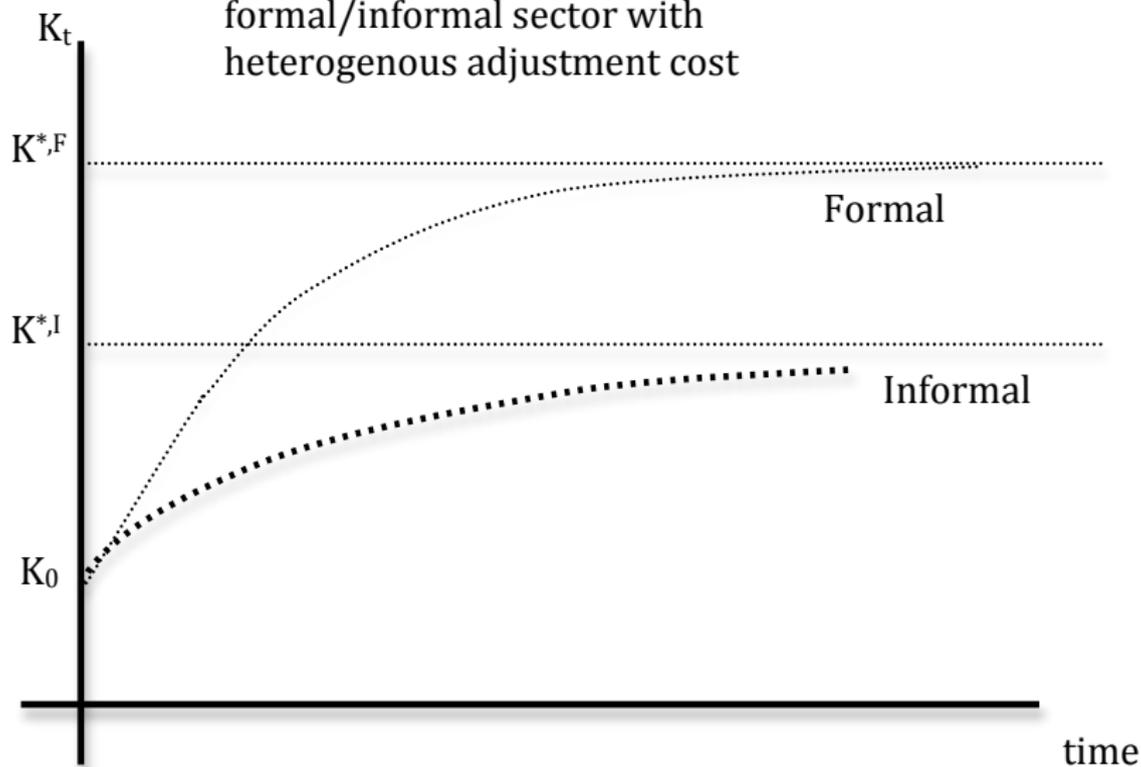
$$\lim_{t \rightarrow \infty} K_t = K^*$$

- Firms in the formal sector grow faster and invest more than firms in the informal sector
- The dynamics of formal/informal entry decision change slightly with the introduction of capital
- For simplicity we exclude labor from the production function
- The threshold level of productivity $\hat{\theta}_t$ is endogenous and decreases over time:
- However, $\lim_{t \rightarrow \infty} \hat{\theta}_t = \hat{\theta}$ where:

$$\hat{\theta} = \left[\frac{c_f - c_l}{\left(\alpha^{\frac{1}{1-\alpha}} - \alpha^{\frac{1}{1-\alpha}}\right) \left(\frac{1}{R}\right)^{\frac{\alpha}{1-\alpha}} \{P_f^{\frac{1}{1-\alpha}} + P_l^{\frac{1}{1-\alpha}}\}} \right]^{1-\alpha}$$

- If we add to the model that borrowing costs and costs of adjustment are higher in the informal sector, then the capital stock is lower in informal sector and steady state growth is diminished.

Capital accumulation in
formal/informal sector with
heterogenous adjustment cost



Dynamic Inefficiency in the Informal Sector Seems Likely

- Restricted access to capital markets in the informal sector reduces capital accumulation. (However, much more research remains to be done to solidify this conclusion.)
- This complements the incentive to remain small to avoid detection.
- In addition, the returns to work experience are lower, suggesting less human capital accumulation in the informal sector.
- Static inefficiency less clear.
- Avoids burdensome regulation and allows units to produce that would otherwise shut down.

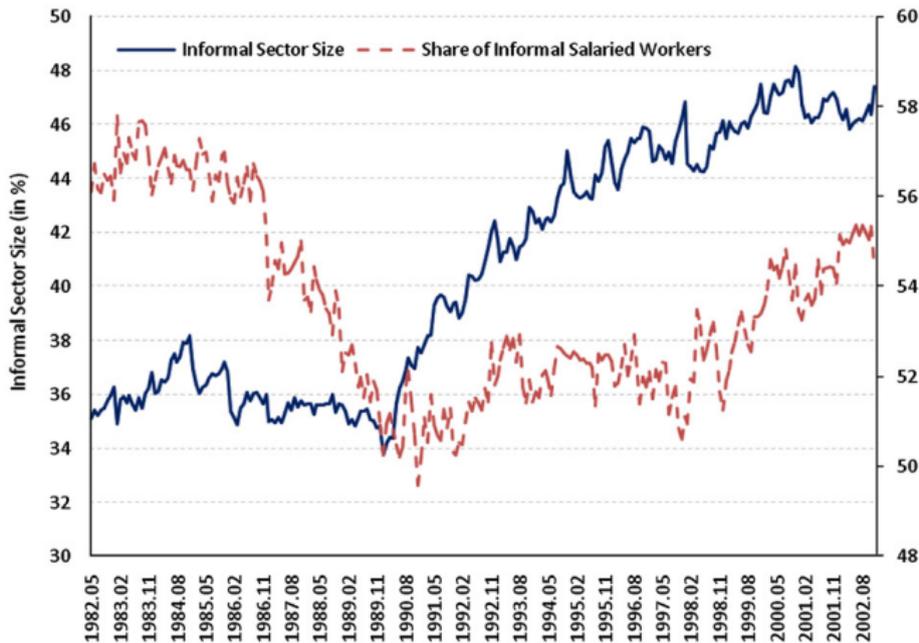
- This model is consistent with all three views of informality.
- Formal firms are more productive (through selection).
- Informal firms evade taxes and lower the fiscal base of Mexico contributing to weak public infrastructure.
- Informal firms less productive (again, selection).
- But notice that, contrary to the World Bank (2007) view, informality does not *cause* low productivity, it *selects* low productivity firms.

- **The cause of the selection is the burden of regulation and the greater cost of doing business.**
- They avoid severance costs and other costs of adjustment that are large, partly due to regulation.

- Remove this burden and Mexico would attract more firms into formality and raise the public resources to invest in infrastructure.
- Raising revenue collection on informal firms would just drive firms out of the informal sector altogether.

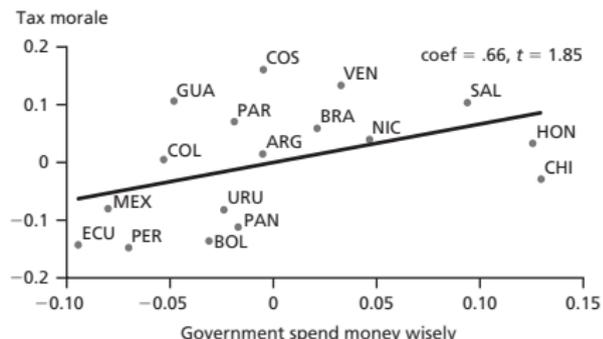
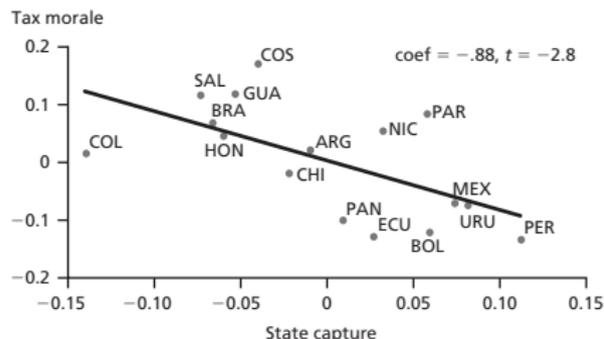
- Evidence from Brazil's increase in the cost of labor regulation is informative.
- Constitutional reform in 1988 that made it much harder to fire workers.
- Dramatic increase in the share of labor in the informal sector.

Figure 21: Informal sector evolution in Brazil. Source: Monthly Employment Survey (PME). Secondary y-axis: Informal salaried employees as a share of total informal employment (in %).



- More generally, ineffective public expenditure programs and a mistrust of government raise the incentives to enter the informal sector.
- Little pass-through of benefits in the form of lower wages and raises the burden on formal sector firms.
- Marrufo (2003): only 46-50% pass-through of benefits in wages.

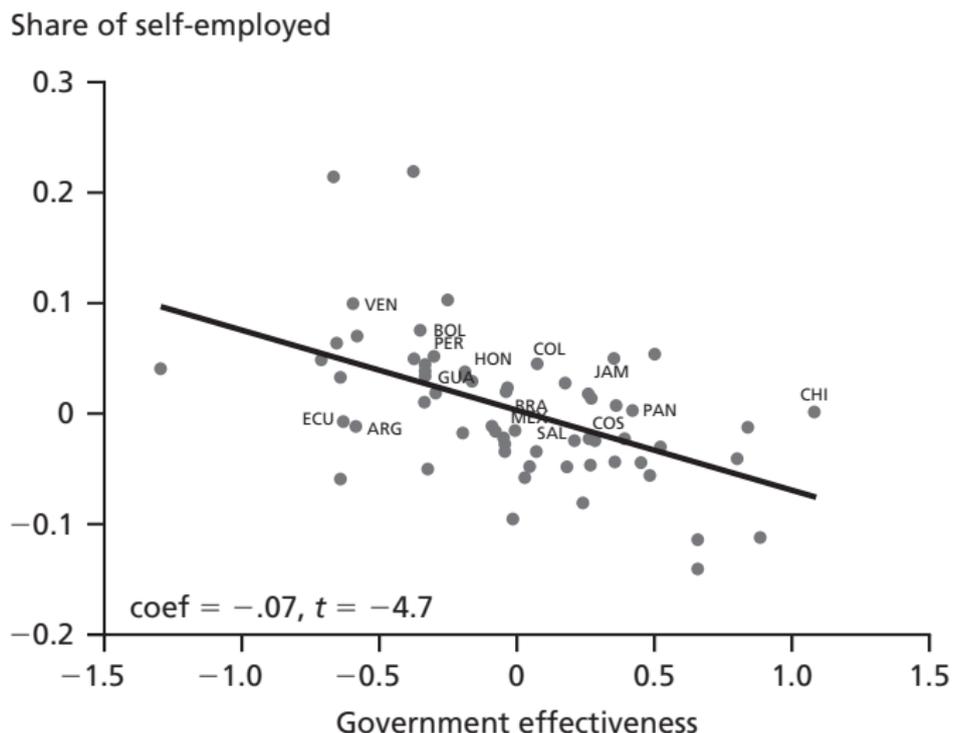
Tax morale, state capture, and perception that the government spends taxpayers' money wisely



World Bank (2007).

Note: Figure shows partial correlations controlling for GDP per capita at PPP. State capture is proxied by an indicator of the perception about the economy being run according to the interests of a few. To construct the indicator we ask: "In general terms, would you consider that the country is governed according to the interests of a few or is governed for the benefit of the country?"

Self-employment and quality of institutions (governance)

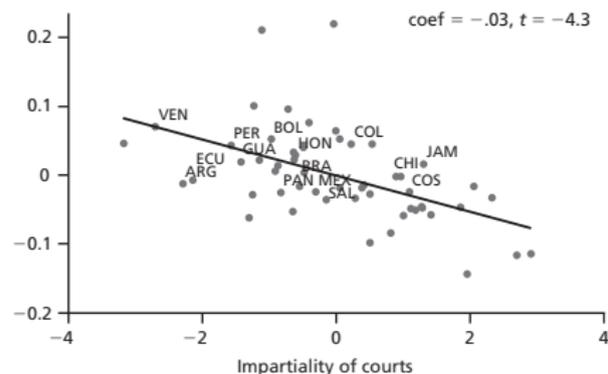


World Bank (2007).

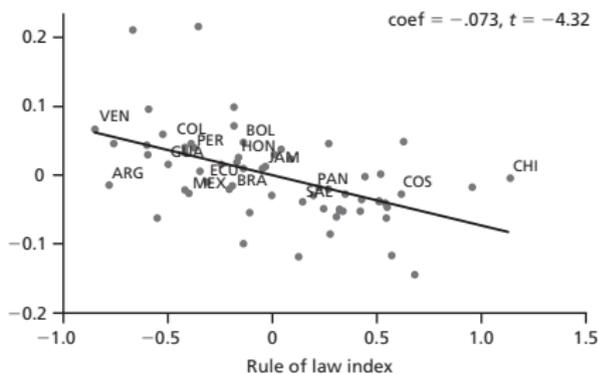
Note: Partial correlations controlling for GDP per capita at PPP. Government effectiveness index measures the quality of public service provision, the bureaucracy, the competence of civil servants, the independence of the civil service from political pressures, and the credibility of the governments commitment to policies. Higher values correspond to a more effective government.

Informality and state competence indicators

Share of self-employed



Share of self-employed



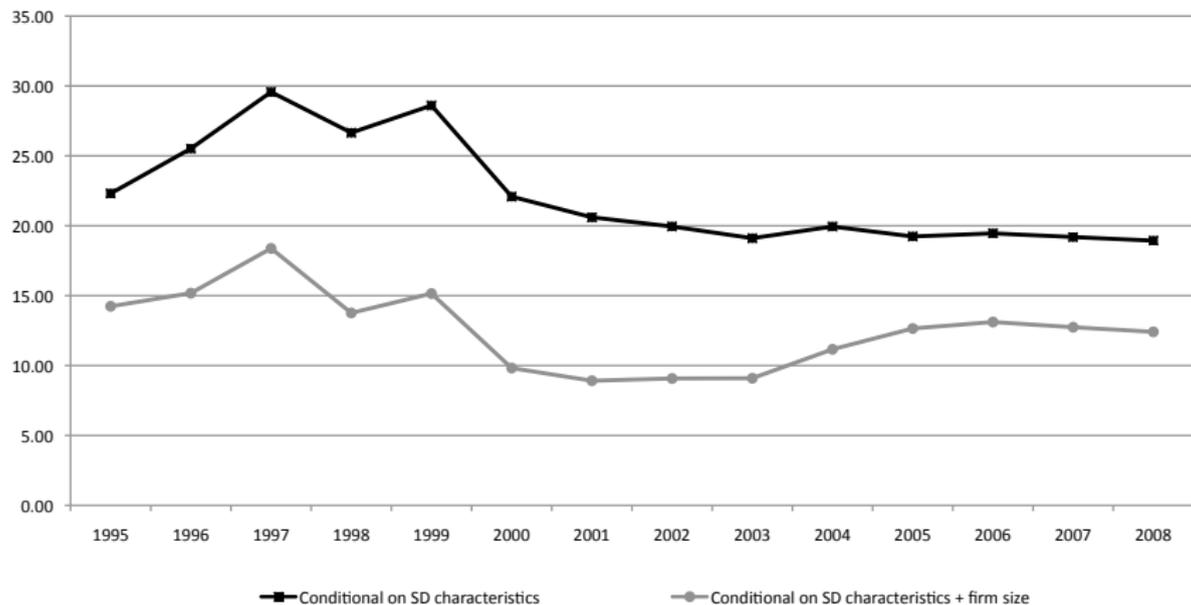
World Bank (2007).

Note: Figure shows partial correlations controlling for GDP per capita at PPP. Impartiality of courts is defined as the degree to which a trusted legal framework exists for private business to challenge the legality of government actions or regulation. The rule of law index measures, in broad terms, the respect of citizens and the state for the institutions that govern their interactions.

Understanding the Informal Sector in Mexico

- Some recent analysts have argued that the wages for the same bundle of characteristics is the same in informal and formal sectors (Levy, 2008).
- Much evidence against this point of view: There is evidence of rents earned by formal sector workers.
 - ① Union wage premium of 20-50%.
 - ② Wages for fixed characteristics much higher in formal sector, even not accounting for unions.

Figure: Formal-Informal salaried labor wage gap

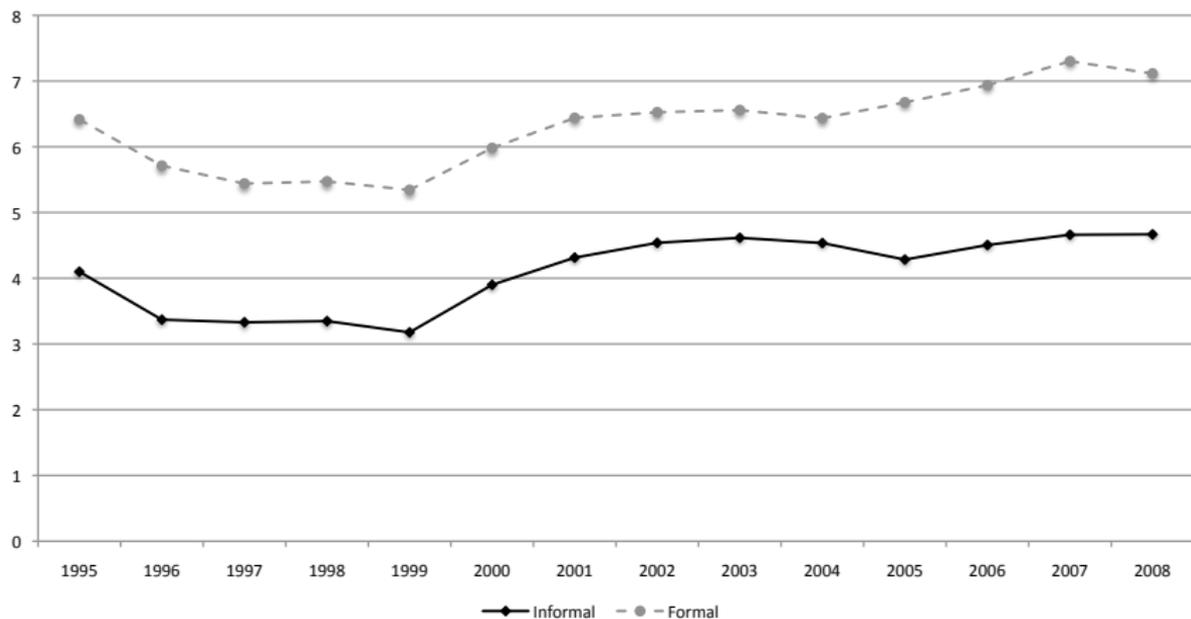


Note: formal workers are those receiving the bundle health coverage, pension and housing loan through their job.

Source: own calculations with data from the National Survey of Employment (ENE) and the National Survey of Occupation and Employment (ENOE).

Sample: Individuals 15 to 65 years old who worked between 35 and 98 hours per week in exchange for a salary.

Figure: Salaried workers' hourly wages



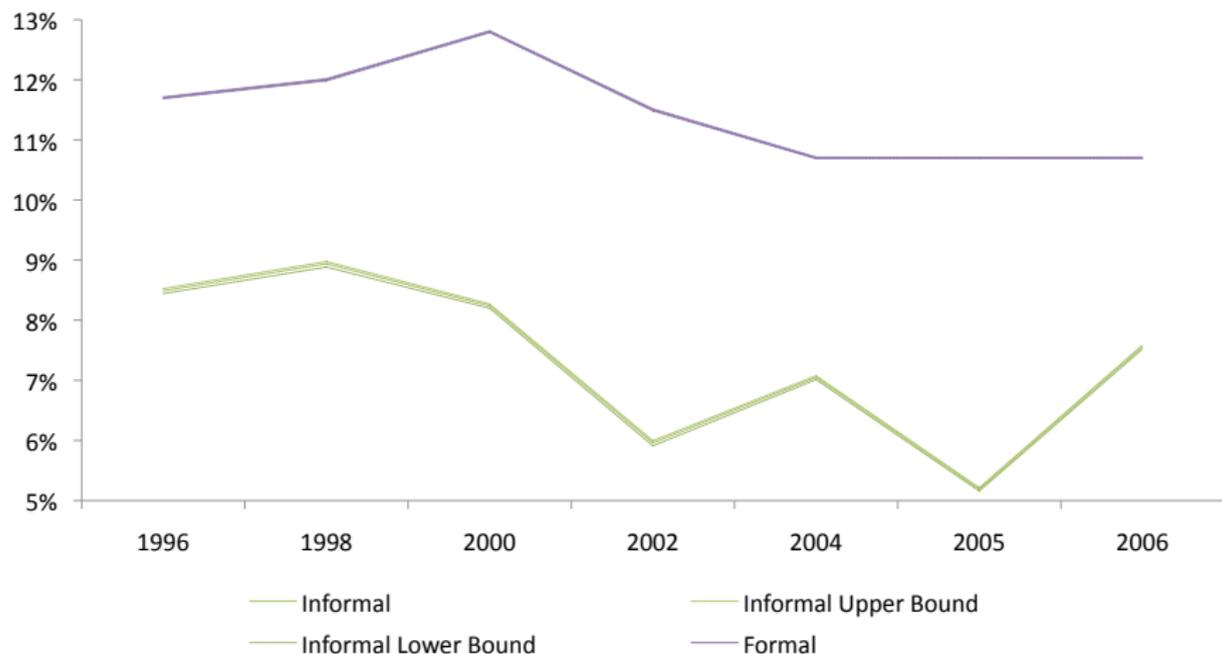
Note 1: wages in constant 1995 pesos.

Note 2: Formal workers are those who receive the bundle of benefits health coverage, pension and housing loan through their job.

Source: own calculations with data from the National Survey of Employment (1995 - 2004) and the National Survey of Occupation and Employment (2005 - 2008).

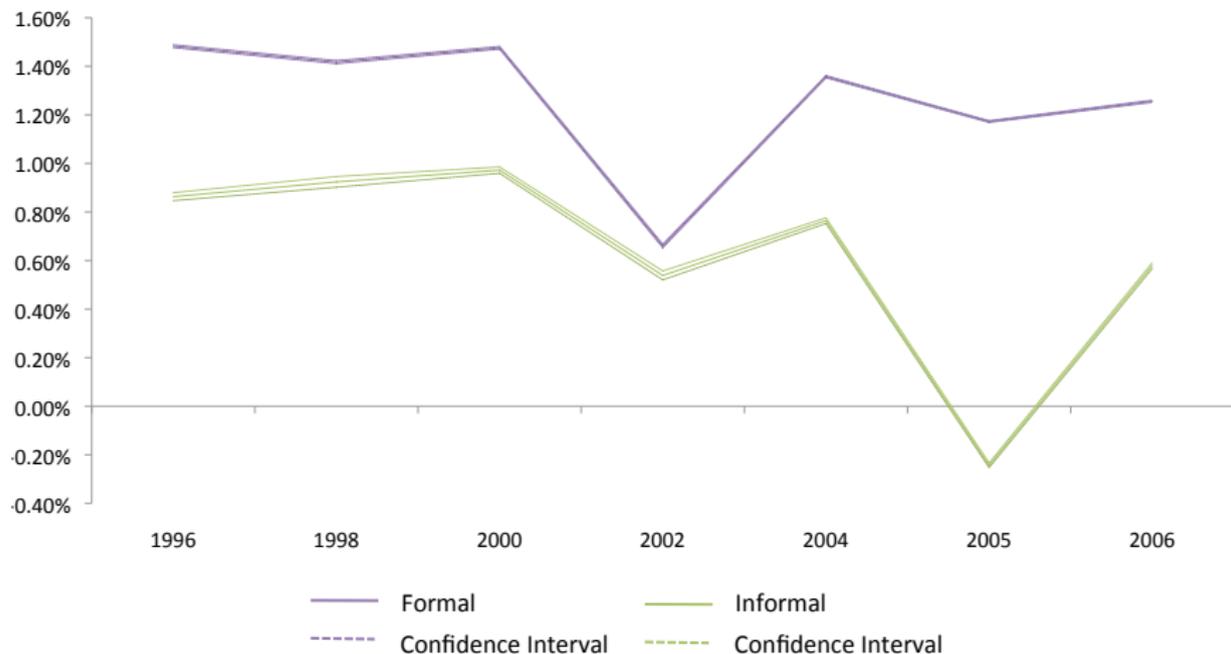
Sample: individuals 15 to 65 years old who worked between 35 and 98 hours per week in exchange for a salary.

Returns to Schooling of Salaried Workers by Formality Status



Source: Author's calculations using ENIGH. The returns to schooling are obtained from an OLS regression controlling for experience, experience squared, marital status, gender, union status, size of firm and state and industry effects. Formality status is defined as having access to social security institutions (IMSS, ISSSTE, PEMEX and others). Bounds are obtained with robust standard errors on a 95 percent confidence interval.

Mean returns to experience of salaried workers by formality status



Source: Author's calculations using ENIGH. The returns to schooling are obtained from an OLS regression controlling for experience, experience squared, marital status, gender, union status, size of firm and state and industry effects. Formality status is defined as having access to social security institutions (IMSS, ISSSTE, PEMEX and others). Bounds are obtained with robust standard errors on a 95 percent confidence interval. The effect is estimated at the mean values of experience for each group.

The Premium for Being Unionized and in the Following Sectors Relative to Being Nonunionized in Other Sectors, Selected Years (percent)

<i>Sector</i>	2000	2002	2004	2005
Petroleum	104	76	67	73
Telecommunications	43	77	75	34
Manufacturing	39	31	27	30
Teaching	47	54	58	54

Source: Lopez-Calva, Guerrero, and Waldon (2009), World Bank.

- It is argued that high turnover rates between formal and informal sectors are evidence of lack of segmentation of the Mexican labor market.
- This argument is not clear.
- Each sector is heterogeneous and firms in each subject to shocks.
- This can create large turnover among firms within and across sectors, even though there are substantial rents and barriers to mobility in the aggregate.

Social Protection Programs and the Growth of the Informal Sector

- Recently *Seguro Popular*, a program designed to cover the informal sector with social services currently supplied only to formal sector workers, has been introduced.

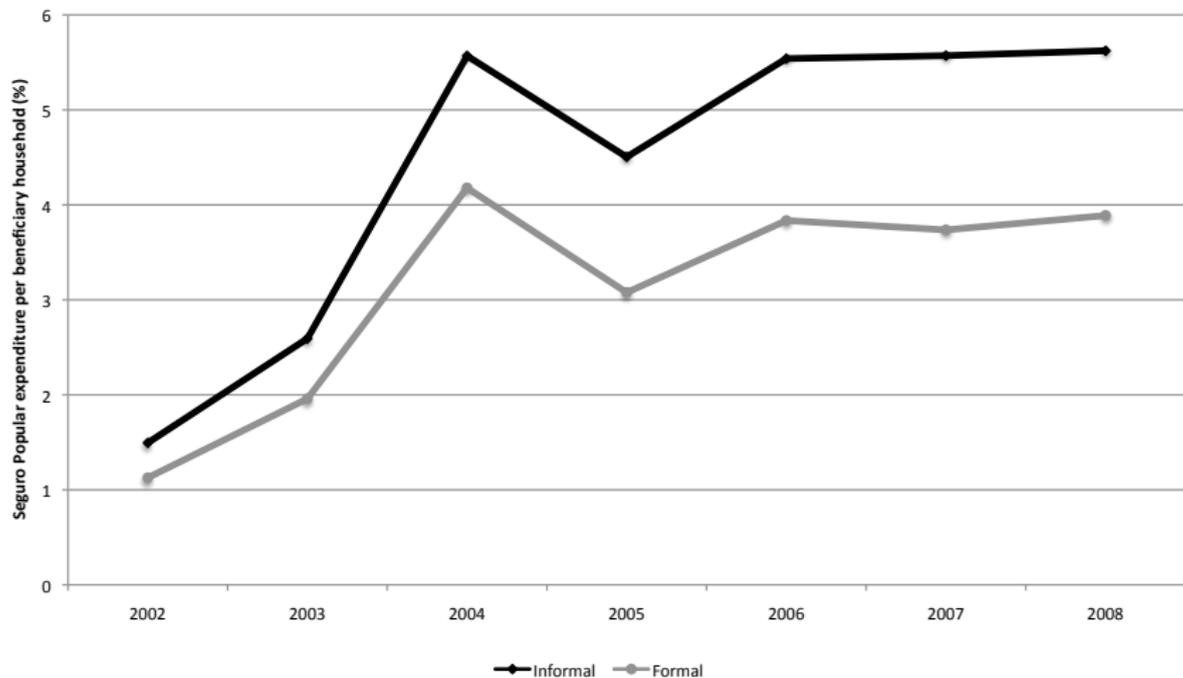
Seguro Popular

- Provides coverage of health services through public voluntary insurance
- Conditioned on no-formal job, being self-employed and not being covered by any of the social security institutions (IMSS, ISSSTE)
- It covers all members of the household.
- Basic coverage:
 1. Basic health service
 2. Provision of medicines
 3. Third level surgeries
- Introduction of Seguro Popular did not involve a reform of the contributive Social Security systems
- This facilitated political and legal challenges of reforming the social security institutions
- The benefit in current pesos of 2008 for covered households was equivalent to 4,877 pesos.

Targeted to the most disadvantaged groups.

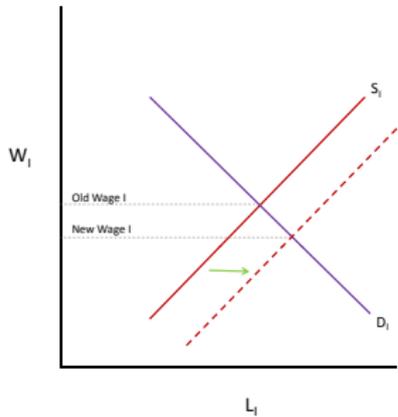
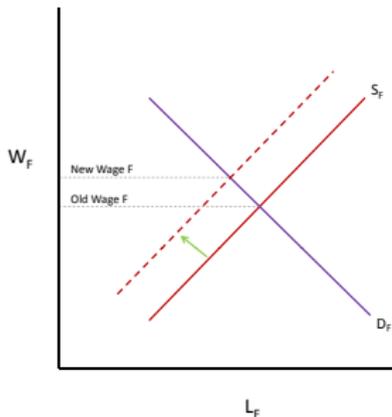
- It has been argued that Seguro Popular has shifted workers toward informality and raised the wages in the formal sector.
- It increased real incomes of the people in the informal sector.

Share of salaried workers' annual earnings



Source: Own calculations with data from ENE (2002 - 2004), ENOE (2005 - 2008) and the III Informe de Gobierno

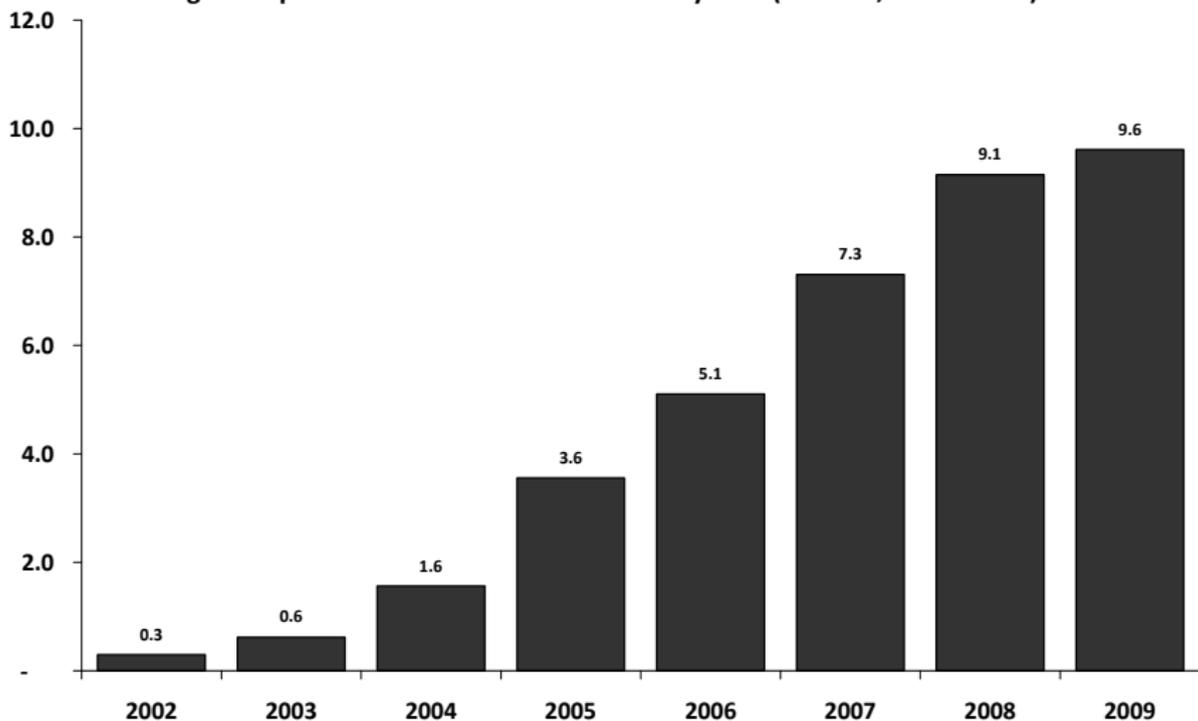
- How important is Seguro Popular in explaining the growth of the informal salaried worker sector?
- If Seguro Popular has shifted workers towards the informal sector, the shift in the supply of workers towards the informal sector should
 - Lower wages in informal sector and quantities employed should increase
 - Raise wages in formal sector and quantities employed should decrease



- Yet the empirical evidence does not support this claim.
- Relative wages (formal/informal) declining, not rising.

- Evidence from many sources.
- Substantial increase in households covered by Seguro Popular.

Seguro Popular. Total Households Covered by Year (Millions, 2002 - 2009)



Source: III Informe de Gobierno. <http://www.informe.gob.mx>

- Is there an effect on employment in the formal sector?
- Difference in difference analysis of Knox and Campos-Vazquez (2008) suggests not.

Figure 22: Formal Employment Rate and Effect of SP

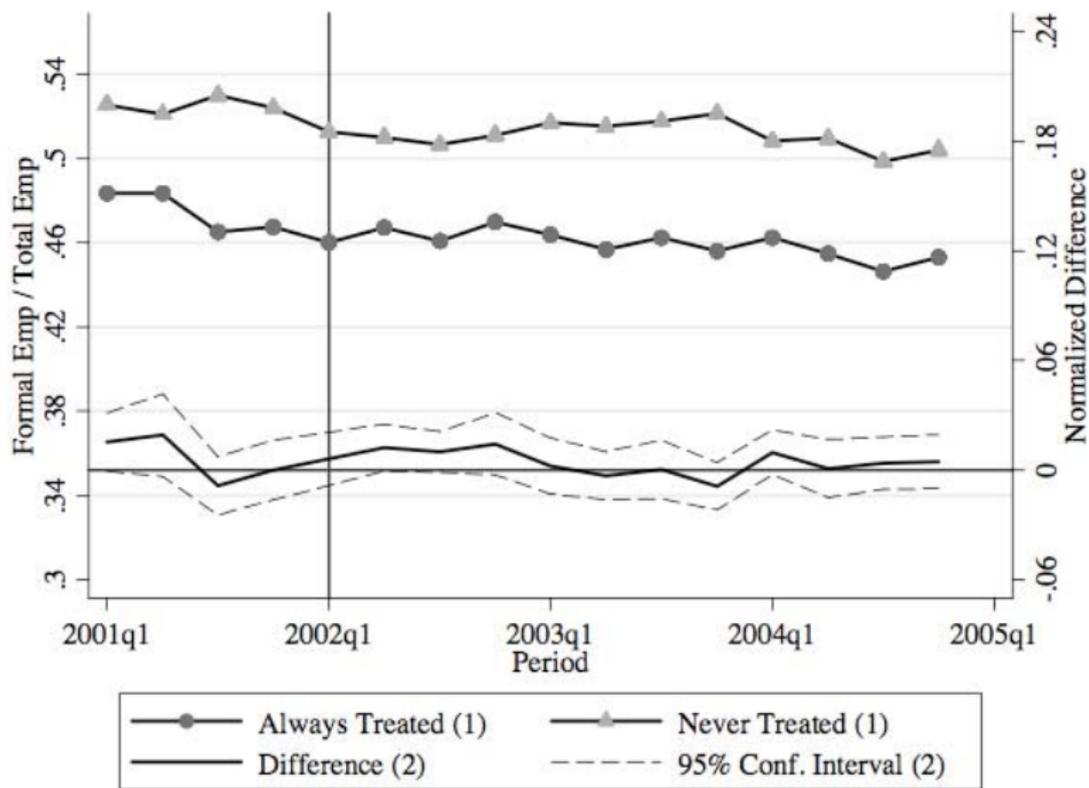
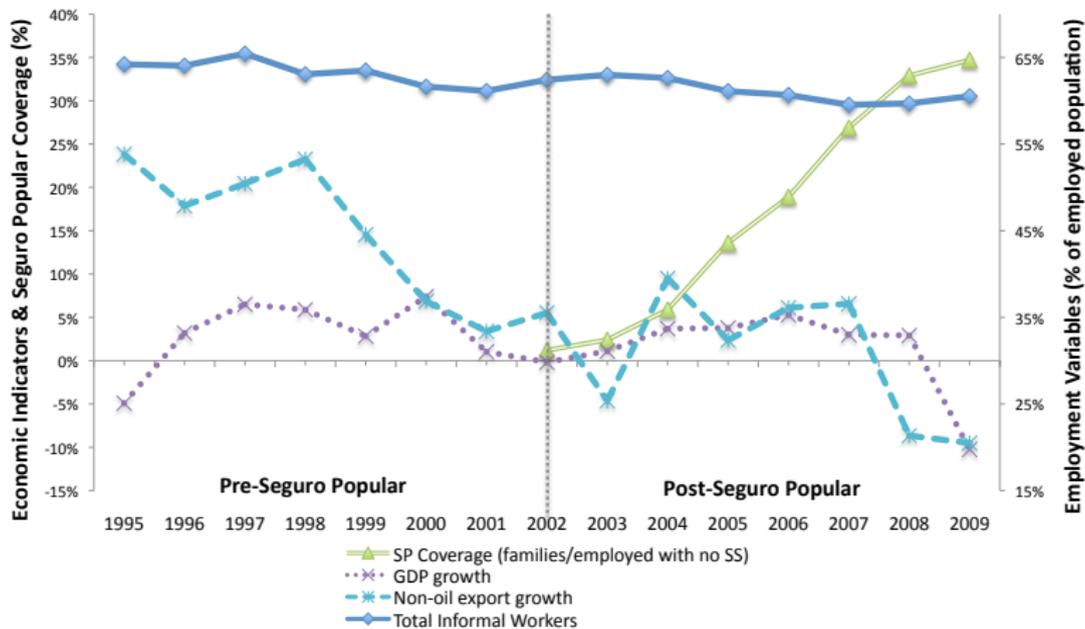
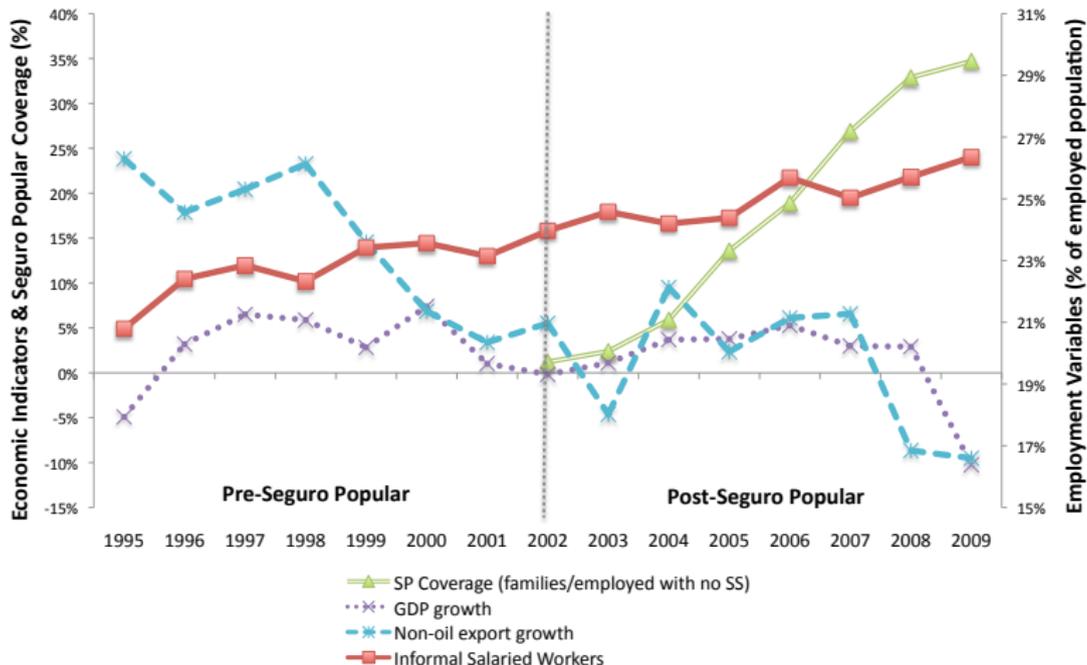


Figure 23: Trends in informal employment, external sector and Seguro Popular coverage



Source: Author's calculations based on data from second quarter of ENE, and ENOE, INEGI, and Office of the President.

Figure 24: Trends in illegal salaried employment, external sector and Seguro Popular coverage



Source: Author's calculations based on data from second quarter of ENE, and ENOE, INEGI, and Office of the President.

Summary of an Extensive Regression Analysis of Informal Sector

- 1 The effect of exports is stronger than that of GDP in all models.
- 2 All measures of SP are significant when no other covariates are added.
- 3 Once economic variables are included as well as SP measures, the effect of SP disappears in most models, and export-related variables remain a strong predictor. Although in a model where all are in growth rates, SP measures are sometimes significant, the effect of exports is greater. In this latter model, SP increases informal employment in about 2% whereas external sector variables are around 7–8%.
- 4 If we add the trend in addition to SP measures and economic variables, most effects disappear, and not even the trend is significant.

Conclusions and Recommendations

- Modern economies require adaptability and flexibility to adjust to the rapidly changing world economy.
- The Mexican economy operates under a heavy burden of regulation and monopoly.
- This produces both static and dynamic inefficiency.
- In some sectors (e.g., oil, telecommunications, education), consequences are dramatic and reduce productivity growth and skill formation.
- Role of teacher's unions in promoting inefficiency in the human capital sector (poor performance of the schools).

- The informal sector is not well understood.
- It is a response to regulation and corruption of the state.
- It is an efficient second best response to a heavy-handed regulatory system and to inefficient governments.
- Recent theoretical arguments about Seguro Popular and the growth of the informal sector are overstated.
- Large informal sector is due in large part to regulation and rigidity and monopoly colliding with structural changes in the economy.
- Policies should focus on this eliminating the burden on firms as a high-order priority.

- Mexico is justly proud of PROGRESA/Oportunidades.
- But it may operate too late in the life cycle of children.
- Families in Mexico are under stress. More out of wedlock births.
- This will undermine the growth of skills in the population.
- Mexico needs to respond flexibly to the recent changes in the composition of the family.
- Needs to develop a family supplemental policy to supplement the early (pre-school) lives of disadvantaged Mexican children.
- Avoid pure transfer programs.
- They reduce poverty in the short run but promote it in the long run.
- Investment programs that promote the capabilities of young children will have much bigger payoffs in the long run.

- Public expenditure on health, education, and social services directed from the center is very inefficiently administered and is unequally distributed by region.
- Need *more* incentives in provision of government services and uniformity in this aspect of Mexican economic and cultural life.
- **Need more basic research on the Mexican labor market and the Mexican family in order to better formulate better economic policy.**