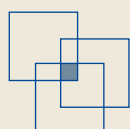


## NOTES ON FORMALIZATION

# Informal employment in Mexico: Current situation, policies and challenges

Nearly 60% of Mexican workers have informal jobs. Some states have implemented practices that have reduced informality. A national employment formalization programme also has been launched. In the framework of stable, robust economic growth, these initiatives, together with the development of unemployment insurance and a universal pension plan, can drive the creation of formal, productive jobs and discourage continued informality.



## TABLE OF CONTENTS

<b>Foreword</b>	<b>3</b>
<b>1. High and persistent informal employment</b>	<b>4</b>
<b>2. Initiatives to formalize employment</b>	<b>6</b>
2.1 2013 programme for the formalization of employment	7
2.2 Unemployment insurance and a universal pension	7
2.3 Good state practices	8
<b>3. Conclusions</b>	<b>10</b>

## Foreword

Informal employment is a persistent problem in Latin America and the Caribbean. Following a decade of economic growth and decline in unemployment rates, there are still 130 million workers holding informal jobs, deprived of social protection and labour rights.

This does not mean, however, that there has not been any progress made on the issue of formalization.

Formal employment, wage labour and social protection coverage have increased in Latin America and the Caribbean. Now, it is important to speed up this process to confront the long-time growth and consolidation of informality in the region.

We cannot forget that the reduction of informality is a key component of the efforts to reduce inequality and social exclusion.

The experience of the last few years confirms that economic growth is essential for the generation of more and better jobs, but it is not enough. To reduce informality, it is necessary to implement deliberate and integrated economic, social and labour policies and actions that complement economic growth, in the framework of sustainable development.

In fact, the policies implemented in several countries were key components of the progress achieved on the subject of formalization. This formalization process has not been uniform. In some countries, processes were faster and took a relatively short time. In others, progress has been slower.

In 2013, the ILO Regional Office for Latin America and the Caribbean launched the **Programme for the Promotion of Formalization in Latin America and the Caribbean, FORLAC**. The programme has three components: a) generation and dissemination of knowledge on formalization policies, b) technical assistance to specific countries, and c) capacity-building of workers' and employers' organizations in formalization issues.

The ILO FORLAC Notes presented here are part of the first component. We analyze public policy experiences trying to identify the most remarkable ones according to the academic or political discussion.

Formalization strategies require a favourable economic context, as well as articulated policies that allow us to address a multidimensional and highly heterogeneous phenomenon.

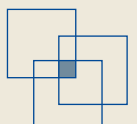
The persistence of high levels of informality is a major challenge requiring the implementation of measures that produce sustainable results.

The ILO expects that the dissemination of these experiences will help promote broader discussion on the strategies that countries may use to facilitate the transition to formality in the region.

Elizabeth Tinoco  
ADG

Regional Director of the ILO  
for Latin America and the Caribbean

Regional Office  
for Latin America  
and the Caribbean



## 1. High and persistent informal employment

The Mexican economy has recorded relatively low economic growth given that in the past 20 years, the economy expanded at an annual average rate of 2.6%, which was insufficient to absorb the growth in the labour supply.

The sluggish growth worsened during the recent global economic-financial crisis, leading to a -6% decline in GDP in 2009. This was followed by relatively rapid recovery and growth, at an annual average rate of 4.4% between 2010 and 2012, doubling that recorded in the years before the crisis. The Mexican economy is expected to continue growing in 2014 and 2015, but more slowly, at estimated annual rates of 1.2% and 3.5%, respectively.

Despite the economic slowdown during the years mentioned, the Mexican labour market was characterized by a low rate of open unemployment. Nevertheless, this co-existed with high, persistent informal employment.

Following the methodology recommended by the ILO, the National Statistics and Geography Institute (INEGI) reported that informal employment accounted for an estimated 60% of total employment in both the last quarter of 2011 and the third quarter of 2012, and 59.1% in the second quarter of 2013.<sup>1</sup> The medium-term decline in informal employment is a strategic objective of the current government administration. The latest available information (January 2014) shows that the informality rate was 58.79% of total employment, 1.69 percentage points lower than in the same month of the previous year.<sup>2</sup>

Statistics on labour informality were generated by the INEGI from an integral or expanded perspective beginning with the National Survey on Occupation and Employment (ENOE).<sup>3</sup> To this end, the ILO and international experts reached a consensus with respect to the concept of informality in its two dimensions.

The first dimension refers to the type or nature of the economic unit, in other words, when the unit is dedicated to the production of goods and/or services for the market, operates using household resources and does not keep basic accounting records. These are enterprises of the informal sector or unregistered small enterprises and of the employment associated with this sector.

The second dimension is based on a labour perspective and refers to all employment that is not subject to labour law or an institutional framework, regardless of whether the economic units employing the workers are unregistered enterprises or formal enterprises. This is informal employment.

These dimensions have been integrated and made complementary. Thus, the economic unit focus applies to independent employment (employers and own-account workers) whereas the labour focus applies to the categories of dependent employment, such as wage employment.

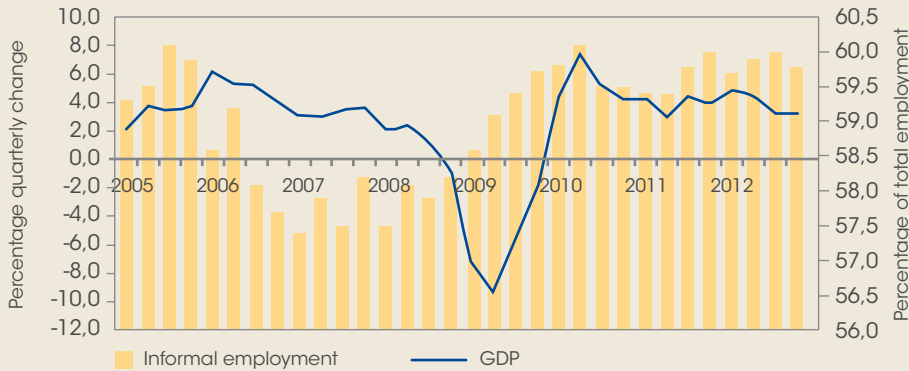
Figure 1 shows that informal employment normally declines in years of economic growth and increases during crisis periods. However, following the 2009 crisis, informal employment as a percentage of total employment remained high.

<sup>1</sup> According to the ILO's SIALC, estimated informal employment increased as a percentage of total non-agricultural employment, from 53.7% in 2009 to 54.6% in 2012.

<sup>2</sup> INEGI 2014. Press release N° 87/14.

<sup>3</sup> INEGI (2013). "Nuevas estadísticas de informalidad laboral." Presentation. See: <http://www.inegi.org.mx/est/contenidos/Proyectos/encuestas/hogares/regulares/enoe/Default.aspx>

**Figure 1: Mexico, GDP and informal employment, 2005 – 2012**  
(% quarterly change and % of total employment)

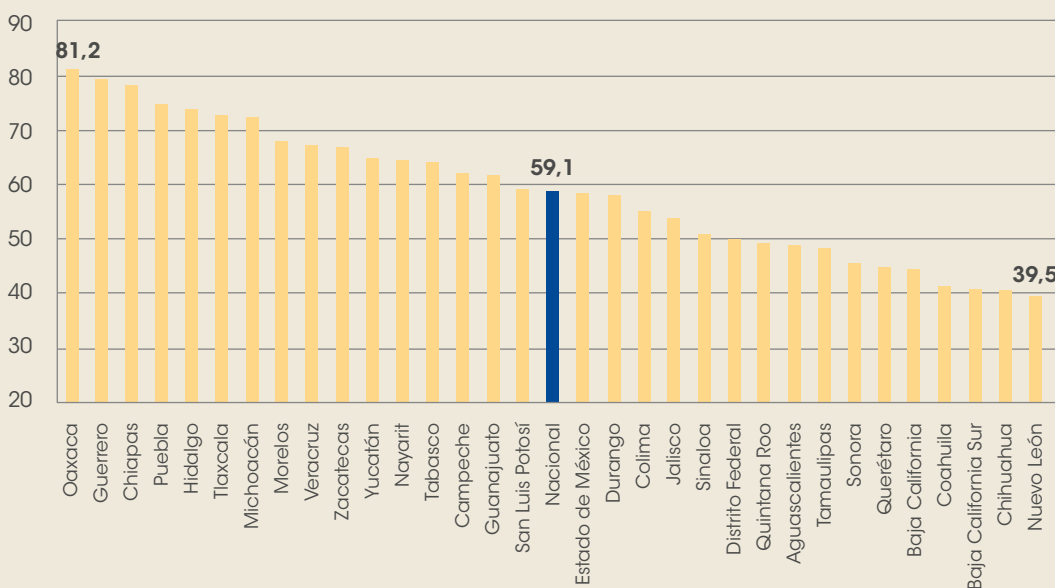


Source: INEGI (2013).

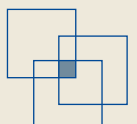
This high rate of informal employment was recorded in a context of a relatively low open unemployment rate. In 2009, for example, during the financial crisis, informal employment rose to 5.47% of the labour force –from 3.97% in 2008–, and then stabilized at around 5%. This suggests that for a large share of people who lose their jobs, employment in informal jobs is the main alternative for earning income. This occurs as a consequence of slow productive job creation and the absence of mechanisms to support dismissed workers who are looking for new jobs.

Additionally, INEGI information shows that informal employment varies considerably by state. Figure 2 shows that percentage of informal employment as a share of total employment surpasses the national average in 16 states. Oaxaca has the highest percentage at 81.2% whereas in states with a more developed labour market, this figure falls below the average. Nuevo León has the lowest informal employment rate at 39.5%.

**Figure 2: Informal employment rates by states, 2013**  
(% informal employment with respect to total employment)



Source: INEGI (2013) op cit.



## NOTES ON FORMALIZATION

The diversity mentioned is also reflected in the fact that other states recovered more rapidly when informal employment declined following the 2009 crisis. These included the states of Chihuahua, Tlaxcala and Tabasco. However, others, which were relatively less affected by the crisis, have been recording declines since 2005: Sonora, San Luis de Potosí, Querétaro, Zacatecas and the Federal District.

### 2. Initiatives to formalize employment

An effective strategy for addressing informal employment requires taking at least two complementary intervention areas into account. These are the need to create formal jobs and the need to align incentives to promote the transition to formality.

The promotion of economic growth with job creation is a necessary requirement, where the development of exports and value chains are crucial, as are economic activities for domestic consumption, where the majority of smaller enterprises operate. More than half of informal jobs are concentrated in tertiary activities.

In the framework of a national growth strategy that prioritizes the development of exports, there is evidence that focus has resulted in the increased importance of exports in the composition of final demand in Mexico, to the detriment of domestic demand. Similarly, the weight of imports in total supply has increased – especially of intermediate goods–, with negative consequences for the productive structure. It is crucial to address this characteristic to increase productivity of the economy –especially of small and medium-sized enterprises– and, consequently, to promote growth of formal, productive jobs linked to the most dynamic sectors.

In terms of enterprise development, measures designed to simplify the registration of enterprises and compliance with tax obligations help stem informality. Informality reduces the tax base and, consequently, results in higher tax rates for those who do fulfill their tax obligations. Higher taxes applied on a smaller base also encourage higher rates of evasion and increased transition of the formal sector to the informal sector.

In this context, in situations of uncertainty– and of crisis even more so—, the financial system tends to react in a counteractive way to reduce risk, which accentuates the economic cycle, making small enterprises even more vulnerable. Therefore, it is necessary to ensure that banks and development institutions disburse resources to these enterprises and play an active role to maintain their liquidity when the lending environment becomes more restrictive.

Additionally, it is essential to develop institutions that offer unemployment protection since the lack of protection affects strategies for searching for employment– for productive jobs–, which tends to further reinforce the relevance of informality in the economy.

In terms of social protection, conditional cash transfer programmes must function properly to eliminate potential incentives for beneficiaries to remain informal. Likewise, it is necessary to establish incentives for the transitioning of beneficiaries to productive employment.

Finally, it is important to strengthen capital formation, both physical and of human resources, in keeping with national production requirements.

Currently, Mexico has an opportunity to advance in the dimensions mentioned, both through the application of a specific programme for employment formalization as well as through upcoming

reforms designed to improve protection during unemployment and retirement. The successful experiences identified by the ILO in some states can contribute to this effort.

## 2.1 2013 programme for the formalization of employment

This programme was signed by the state governments and the Federal District with the national government on 22 July 2013. The programme seeks to facilitate the transition of informal jobs to formal ones.

The proposed target is to formalize 200,000 informal workers by the second half of 2014.

The programme operates through agreements whose objective is to ensure that all workplaces comply with the provisions of the Federal Law on Employment and the social security law in an effort to uphold workers' right to receive all social security benefits.

The programme also seeks to affiliate workers to the mandatory social security system managed by the Mexican Social Security Institute (IMSS), and to promote the voluntary affiliation of other workers to the mandatory IMSS system, including domestic workers, non-wage workers, cooperative members, communal landowners and small-scale landowners. Likewise, it promotes and supports the affiliation of state and municipal government workers to the respective social security institutions, or, as pertinent, their voluntary affiliation to the respective social security systems.

To this end, the Labour and Social Protection Secretariat has committed to disseminating these activities among employers and workers, as well as to supporting state governments in meeting targets through linkage activities developed by the National Employment Service.

Agreements were also made to adopt the measures necessary to affiliate all suppliers and contractors of the Federal Public Administration. Activities will also be implemented to advance in the simplification and deregulation of IMSS services in an effort to make them more accessible, flexible and transparent.

Programme results can help continue and improve these activities in the future.

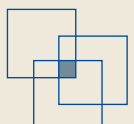
## 2.2 Unemployment insurance and a universal pension

Two social protection initiatives were recently submitted by the executive branch to the Congress. They are designed to include two new rights: that of older adults to have a universal pension to cover their basic expenses in old age; and that of workers to have unemployment insurance to enable them to cover their needs while they search for a new job in the formal labour market.

Without going into detail on these proposals, it is possible to highlight that the creation of a universal pension plan is framed in the ILO recommendation on national social protection floors and has the objective of contributing to mitigating poverty and income inequality. Pensions seek to alleviate the loss of or decrease in income at the end a worker's productive life, which is especially important for population groups vulnerable to adverse market conditions.

The proposal to create unemployment insurance seeks to fulfill commitment N° 4 established in the "Pact for Mexico" of December 2012,<sup>4</sup> which establishes a series of agreements that include the initiative to protect wage workers of the formal sector when they lose their jobs.

<sup>4</sup> Agreement between the President of the Republic and political parties that stipulates beginning and ending dates for implementation. See: <http://www.presidencia.gob.mx/wp-content/uploads/2012/12/Pacto-PorM%C3%A9xico-TODOS-losacuerdos.pdf>



## NOTES ON FORMALIZATION

Institutional measures of this type are crucial since their absence contributes to the tendency of the labour market to continue informal activities of low productivity that do not offer social protection and that affect the efficiency of the Mexican economy.

In a context of trade and financial opening of countries, and of greater exposure to cyclical fluctuations that have increased the probability of episodes of unemployment during a person's productive life, these measures will provide income and support labour re-entry to workers who have registered contributions and who have made efforts to find new employment. Likewise, they will contribute to preventing poverty among unemployed individuals and will automatically stabilize their situation by compensating for beneficiaries' decreased spending during recessive periods.

In this regard, it is important to underscore the close interrelationship between Mexico's economic growth and that of the United States. That country is the destination of 80% of Mexico's exports, which have been growing since the 1990s.<sup>5</sup>

This regional interdependence can be explained by at least five areas of interconnection: migrations; short-term capital flows; foreign direct investment; commodity flows (oil and non-oil); and tourism services.

The combination of trends in these areas explain why changes in the U.S. economy have a greater impact on Mexico than on other economies that also have a close economic relationship with their regional partner. Thus, the implementation of unemployment insurance, among other measures, can contribute to alleviating the impact of volatile growth, as well as compensate for loss of income and wellbeing of workers who lose their jobs.

### 2.3 Good state practices

Informal employment varies significantly among the Mexican states, both in terms of levels of informality and trends.

Recently, the ILO identified experiences in reducing informal employment in states with a relatively low rate of informality in 2013; in those that recorded declines in informal employment between 2010 and 2013; and in states that applied successful programmes to reduce informal employment.

Table 1 presents this information. Programmes differ in their objectives. These include training and job placement of workers; cooperative operations; government actions with suppliers; enterprise promotion; and targeted labour inspections. Some states implemented innovative practices that will require future assessment whereas others carried out activities with a proven track record.

<sup>5</sup> See Ugarteche, O. 2012. "México: tan lejos de Dios, tan cerca de la crisis. Mecanismos de contagio económico en América del Norte." *Revista Nueva Sociedad* N° 237, January-February, ISSN: 0251-3552, <[www.nuso.org](http://www.nuso.org)>.



**Table 1: Mexico. Rate of labour informality, 2010 – 2013 and good practices for formalizing employment (% of total employment and percentage point change)**

Entities	2010	2013	Change	Good practices identified
National	60,1	59,1	-1,0	Government procurements from formal suppliers
Baja California	44,3	44,5	0,2	Formalization of community-based micro and small enterprises
Chihuahua	45,3	40,5	-4,8	Vivebus and university advisors
Distrito Federal	49	49,9	0,9	Employment portal, ICDF and unemployment insurance. La Comuna, Cooperative Promotion
Hidalgo	76,4	73,9	-2,5	Tuzobus, coordinated work with STPSH, STPS and IMSS and Invitation to formal enterprises
Nuevo León	42,8	39,5	-3,3	Specific labour workshops (JALE), Employment for youth, Made in Nuevo León and targeted inspections
Querétaro	49,3	44,9	-4,4	Q network

**Source:** INEGI and ILO (2013). "Mexico: Buenas prácticas para la formalización del empleo." Presentation at the international forum: "Políticas públicas del empleo y protección social," November, Mexico City.

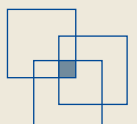
Among the practices focusing on linkage with the labour market and job training, Nuevo León's "Specific Employment Workshops (JALE)" programme is noteworthy. The JALE seeks to increase the job placement rates of workers registered with the State Employment Service as well as to provide training free-of-charge to job seekers to enable them to acquire skills in areas of market demand. In 2013, 133 JALE were organized, and 16,300 workers were placed in jobs in the formal sector.

Another such programme is "Employment for youth," which provides training scholarships to youth ages 16 to 29 without work experience. It even pays the first month's salary to the enterprises that hire the young people. Of the 4,000 graduates in 2013, 2,885 found formal jobs.

In the Federal District, efforts focus on strengthening the linkage between unemployment insurance, the Mexico City Employment Portal and the Federal District Training Institute. This is an innovative experience that should be evaluated in the future.

Among the so-called cooperative practices, the initiative for Cooperative Promotion of the Federal District stands out, as do efforts associated with the restructuring of public transport. In Hidalgo, the Tuzobús service is planning the formalization of 400 direct workers in 2014. The Q Network, which seeks to improve public transport efficiency in Querétaro, has formalized 2,000 drivers, who were registered with the IMSS. For its part, Chihuahua launched the new Vivebús transport system in 2013, with the formalization of 1,056 urban drivers. Previously, none of these workers had a registered contract, wage packet or healthcare coverage and more than 80% lacked social security.

With respect to measures associated with government demand, Hidalgo State mandated compliance with social security obligations as a prerequisite for participating in public bidding for infrastructure and service delivery contracts. That state is also planning to formalize 1,534 municipal workers.



## NOTES ON FORMALIZATION

In terms of enterprise promotion, the programme “Made in Nuevo León,” seeks to promote the commercial potential of micro and small enterprises in the state through business advisory services for exporting to 1,100 member firms. In addition, Baja California has implemented the programme “Formalization of community-based enterprises,” which has led to the formalization of 10,198 enterprises since 2009. It also operates the School for New Entrepreneurs, which has provided business training and advisory services since 2008. To date, 4,988 enterprises have been established.

Finally, in the area of targeted labour inspection, the “Invitation to formal enterprises plan” was implemented in Hidalgo to encourage enterprises to formalize their workers. In Nuevo León, targeted workplace inspections are carried out, during which the benefits of formality are explained. Chihuahua implements the university advisors programme in an effort to support enterprises on labour issues.

### 3. Conclusions

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Mexico has a high, persistent incidence of informal employment, which affects some 60% of all workers in the country. To address this problem, a strategy should be adopted to create formal jobs and that at the same time eliminates incentives for remaining informal.

Currently, conditions exist for implementing efforts to reverse this situation. Three specific interventions are addressing the issue: the implementation of the upcoming reforms in unemployment protection and retirement pensions; a national programme to formalize employment under the leadership of public institutions; and several measures developed by states, which should be analyzed and evaluated as good practices for their subsequent scaling up and replication in other contexts.

Additionally, it is crucial to address structural problems that are reflected in the variations in the productive structure. Conditions should be created to effectively incorporate small and medium-sized enterprises in value chains associated with the most dynamic activities of the export strategy. Furthermore, competitive domestic production should be strengthened to provide the necessary space for the creation of more formal, productive jobs.

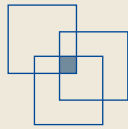




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# FORLAC

PROGRAMME FOR THE PROMOTION OF FORMALIZATION  
IN LATIN AMERICA AND THE CARIBBEAN



NOTES ON FORMALIZATION

Regional Office for Latin America and the Caribbean