ILO NOTES

International Labour Organization

FACING THE CRISIS IN EUROPE: REFLECTIONS ON THE CASE OF MEXICO

I. CRISIS IN EUROPE AND ITS EFFECTS ON MEXICO

The crisis in Europe, especially the Eurozone, affected expansion of the world economy in 2012 with a 2.2% rise in GDP –an increase below the 2.7% recorded in 2011– in spite of the improvements shown by the US and Japanese economies. Slow growth of the world economy and continued uncertainty is expected for 2013, including recession in the Eurozone, thus representing one of the main risk factors at global level and for the economies of Latin America and the Caribbean.

The absence of consensus with regard to ways out of the crisis, and not discarding episodes of uncertainty in world financial markets, although with slightly greater growth in the US and Japan and maintained dynamism in China, once again means developing countries will lead world growth in 2013.

Partial recovery is foreseen in 2013 for Latin America, 3.5% of GDP, as shown in Table 1, driven by Brazil and Argentina, due to the recovery of farming activities and investment in comparison to 2012, and maintaining very dynamic domestic demand. In this context, Mexico would benefit from the greater drive of the US economy, since roughly 80% of its exports are destined to the North American economy.

Available growth estimates for Mexico have tended to converge around 3.5% for the current year, and the most recent estimate anticipates 3.4% growth for 2014. If these forecasts are confirmed, the Mexican economy will approach its potential level, supported by relevant dynamism in domestic demand and increases in consumption, with the creation of jobs, low inflation, and favourable credit conditions.

TABLE 1: Mexico: GDP trends and forecasts for 2011 and 2014
(annual GDP percentage variations)

Institution	2011	2012	2013	2014
Latin America and the Caribbean	**4.6**	**3.0**		
- International Monetary Fund (IMF)[a]			3.4	3.9
- Economic Comission for Latin America and the Caribbean (ECLAC)[b]			3.5	
United States[a]	1.8	2.2	1.9	3.0
Mexico[c]	**3.9**	**3.9**		
- Bank of Mexico[d]			3.6	4.0
- International Monetary Fund (IMF)[a]			3.4	3.4
- Economic Comission for Latin America and the Caribbean (ECLAC[b]			3.5	

Source: Bank of Mexico, ECLAC, INEGI and IMF

a) IMF (2013) *World Economic Outlook. Hopes, realities, risk* (Washington D. C., IMF)
b) ECLAC (2013) *Balance económico actualizado de América Latina y el Caribe 2012* (Santiago, ECLAC)
c) Instituto Nacional de Estadística y Geografía (2013)
d) Bank of Mexico (2013) *Encuesta de expectativas de especialistas en economía del sector privado* (Mexico, D. F., Bank of Mexico), January

As to the labour market, a rise in formal employment was observed in 2012, by considering workers insured with the Mexican Social Security Institute (IMSS) increased by more than 711 thousand 4.6% for the year.

In 2009, and product of the international financial crisis, the unemployment rate increased from 3.97% in 2008 to 5.47% in 2009, then tending to stabilize around 5%. In any case, the main trait of the labour market is informality. In fact, estimates for informal employment, following the methodology recommended by the ILO, report informality represented 60% of total occupation in 2013[1] and its reduction in the medium term is a strategic objective of the current administration.

II. MAIN TRENDS IN THE CURRENT SITUATION IN MEXICO

After a 6.0% drop in GDP in 2009, the Mexican economy resumed growth from 2010 to 2012 at an average annual rate of 4.4%, duplicating the rates recorded in years preceding the last crisis. Nevertheless, a marked downward trend can be seen after the 5.3% increase in 2010, and which would continue during 2013 and 2014.

For its part, monetary policy has focused on achieving an inflation target of 3% per annum.[2] In spite of months of high inflation in 2012 and early 2013, mainly explained by a low benchmark for the price of fruit and vegetables and the rise in other products on account of the frosts last March, the trend is expected to converge with the medium-term target.

In turn, domestic interest rates dropped to levels close to their historical lows. Thus, the interbank rate was 4% in April 2013, after rising above 8% in mid-2008. In addition, foreign securities holdings continued to increase and the exchange rate has shown an upward trend.

In this scenario, monetary policy will probably remain conservative in the face of possible risks, either on account of US and Eurozone financial volatility, possible price increases for farm products, and pressure by aggregate demand, especially due to the proximity of the economy to its potential GDP.

As to public finances, the public sector budget balance during 2012, not including Pemex investment expenditure, recorded a deficit of 0.59% of GDP, representing a 0.04 percentage point reduction in comparison to 2011 records. If Pemex investment is taken into account, the figure rises to 2.58% of last year's GDP[3] For this year, total public expenditure approved was 3.9 billion pesos, implying a real growth of 3.1% in comparison to 2012[4] and less than the 3.5% increase foreseen for GDP. Thus, the foreseen trend is toward budget balance.

1 See Instituto Nacional de Estadística y Geografía (INEGI) 2012. Boletín de Prensa Núm. 449/12, December

2 Bank of Mexico 2013. La Economía Mexicana. Comparecencia ante el Senado de la República. Dr. Agustín Carstens, Governor of the Bank of Mexico, April

3 Ministerio de Hacienda y Crédito Público (2013) *Cuenta de la Hacienda Pública Federal 2012*. See at http://www.apartados.hacienda.gob.mx/contabilidad/documentos/informe_cuenta/2012/docs/i01/i01d01.pdf

4 Centro de Análisis de Políticas Públicas, *México evalúa 2013. Los pesos y centavos del Pacto por México. Balance del presupuesto aprobado 2013*. See at http://www.mexicoevalua.org/wp-content/uploads/2013/04/MEX-EVA_DIG-PESOSCENTAVOS.pdf

With regard to the expansion of credit, the Bank of Mexico reported it continues to support economic activity, both by considering real credit increases recorded since 2009 in commercial banking to the private non-financial sector, and Development Banking.

In conclusion, the information presented ratifies macroeconomic stability trends, which contributed to maintaining a sustainable pace of growth, albeit the adverse international context. To aspire reaching higher levels of development, however, it is indispensable to move ahead with reforms that expand the potential for growth, strengthening domestic sources and without neglecting export activities and favouring the allocation of resources for more productive applications.

III. POSSIBLE AREAS FOR INTERVENTION

How the labour market works is a key component for raising the economic growth potential of a country, in the measure it is a source for the creation of decent work. That is, a labour market that respects labour rights, where fair wages are assured, that provides protection against the risks of labour life and social protection for old-age, and where workers can exercise their rights for representation and bargaining their working conditions with freedom.

At present in Mexico there is an opportunity to move ahead in this direction, since there is a better diagnosis of the labour market, because the decision was made to develop institutionality for protection against unemployment and promote increasing productivity among economy sectors. These three dimensions are analysed below.

a) Informal employment

Informal employment in Mexico in the third quarter 2012, according to INEGI[5] estimates, represented 60.1% of total employment. This is an extended measurement of informality that adds the following categories to the previous definition of informal work: unprotected work in farming activities; domestic service workers; and subordinate workers that, although they work for formal economic units, do so under modalities that sidestep social security registration.

The behaviour of the labour market in recent years as appears in Figure 1 shows a low and stable rate of open unemployment, in spite of the fluctuations observed in the pace of economic activity. This stability coexists with an underemployment rate twice its size, also relatively stable, and with a major component of informal employment. When GDP growth is dynamic, informal employment has tended to decline, whereas after the contraction in 2009 it tended to remain stable at a high share of total employment.

In this regard, it is possible to identify priority areas for intervention that aim toward two complementary objectives: on the one hand, the need to create formal employment, and on the other to promote passage to formality.[6]

5 Instituto Nacional de Estadística y Geografía (INEGI) 2012 *Boletín de Prensa N° 449/12* (Mexico, D.F., INEGI), December

6 Samaniego, N. 2008 *El crecimiento explosivo de la economía informal*, Vol. 5, N° 13 (Mexico, D.F., Facultad de Economía Universidad Nacional Autónoma de México). See at http://www.erevistas.csic.es/ficha_articulo.php?url=oai:ojs.phoenicis.tic.unam.mx:article/2935&oai_iden=oai_revista496

- Enhance the formation of capital, both physical as well as human resources. It is necessary to foster greater dynamism, since over the last 20 years GDP records an annual growth average of 2.6%, insufficient to absorb the growth in labour supply. This should be accompanied by investment in the formation of human resources, aligned with productive system requirements.
- Growth with employment. It is necessary to support exports development and productive chains as well as economic activities destined for domestic consumption, where most smaller-sized enterprises operate. More than half of informal employment is concentrated in tertiary activities.
- Credit and small enterprise. Facing uncertainty and more so in crisis contexts, the financial system tends to react contractively to reduce risk, accentuating the economic cycle, which especially penalizes small enterprises. The main idea is to ensure banks and development institutions place resources in these enterprises and play an active role to maintain liquidity when facing a more restrictive credit context.
- Protect jobs and the unemployed. Establish timely mechanisms for retraining that allow jobs to be kept in cases when productive sectors are transformed. Developing institutionality for protection against unemployment becomes especially relevant, since its absence reduces chances to implement strategies for job seeking and strengthens, even further, the presence of informality in the economy.
- Simplify the registration of enterprises and complying with tax obligations. The aim is to avoid the informality trap. Informality erodes the tax base, which in turn leads to higher tax rates for those who do comply with their fiscal obligations. Higher taxes applied to a smaller tax base, in turn encourages greater tax avoidance and greater shifts from the formal toward the informal sector.[7] Providing quality public services in exchange for taxes becomes relevant in this context, as well as encouraging business development, expanding access to markets and technology, and ensuring labour training reaches the informal economy.
- Ensuring proper operation of cash transfer programmes in order to overcome design or operation aspects that encourage beneficiaries to stay in informality, and provide incentives for beneficiaries to move toward productive employment.

b) Unemployment insurance

The so-called Pact for Mexico[8] was signed on 2 December 2012, making explicit a series of agreements to be implemented during the six years of the current administration. The agreement states: "Unemployment insurance will be established to protect formal sector waged earners when they lose their job to avoid detriment of the living conditions of their families and allowing them to seek better options for professional and capital growth" (Commitment 4). Developing institutionality of this type is crucial, since its absence contributes to adjustment in the labour market that trend to perpetuate low productivity activities, without of social protection, and distances the Mexican economy from the frontiers of efficiency.

In a context of the commercial and financial opening of countries and greater exposure to cyclical fluctuations that have increased the probability of facing episodes of unemployment during working life, protection against possible unemployment has acquired increasing importance since it allows the substitution of income and supports labour reinsertion for those who made their benefit payments while employed and who make the effort to find a new job; prevent poverty among people who face unemployment; and play the role of automatic stabilizer, by offsetting falls in expenditure among beneficiaries during recessive periods.

Although the model to be implemented is not yet known, it is useful to take into account certain design criteria derived from international experience, as well as recommendations agreed with countries within the framework of the International Labour Conference, through ILO Convention 102 about social security minimum standards.

- System structure. Given that the contingency to be protected against is involuntary redundancy, and after determining a benefit programme, its duration and eligibility conditions, among others, the most efficient solution is typically a pay-as-you-go system, with safeguards to avoid over-utilization.
- Relation to severance pay. It is necessary to determine the relation between Unemployment Insurance and severance pay, since both refer to the same contingency.
- Relation to active policies. Although these systems are conceived as passive policies that seek partial compensation for a worker's loss of earnings, it is important to link them to other intermediation and work-training services, in order to support active search for a new job.
- Enhancing the automatic stabilizer role. In addition to operating with a significant coverage of insured workers, recent experience showed the usefulness of having mechanisms for timely activation of an extension to the benefit period facing a rise in the amount and duration of unemployment, and de-activation once the situation has changed.
- Coupling to work sharing programmes. Several countries implemented programmes to facilitate the retention of workers at enterprises undergoing difficulties, by means of work sharing systems whereby the enterprise, the worker, and the State –through a subsidy– partly compensate the drop in earnings.[9]
- In such cases, Unemployment Insurance can play the role of providing benefits that are proportional to work-days, adjusted according to the programme, at enterprises that demonstrate they require temporary support to overcome their difficulties.

7 Samaniego 2008, *op. cit.*

8 Political agreement signed by the President of the Republic and the presidents of political parties, *Partido Acción Nacional* (PAN), *Partido Revolucionario Institucional* (PRI), *Partido de la Revolución Democrática* (PDR) and the *Partido Verde Ecologista*, that became a signatory of the agreement on 28 January 2013. Considers general time frames for the start and finish of its implementation, and determines the second semester 2018 as the final deadline. See at http://www.presidencia.gob.mx/wp-content/uploads/2012/12/Pacto-Por-M%C3%A9xico-TODOS-los-acuerdos.pdf

9 For further details, see Messenger, J. 2009 "Work sharing: A strategy to preserve jobs during the global jobs crisis", in *TRAVAIL Policy Brief* N°1 (Geneva, International Labour Office), June

- ILO Convention 102 of 1952 on social security minimum standards. This Convention, among other things, determines minimum rates for the substitution of cash benefits in the case unemployment insurance is 45% of the earnings of a typical beneficiary.

c) Inclusive productivity

In the above-mentioned "Pact for Mexico", as well as in the vision of authorities with regard to the strategic challenges facing the Mexican economy, the need to increase the productivity of the economy acquires special relevance.

In this regard, Mexico, as many other countries of Latin America, is at present classified amongst the so-called middle-income countries, and its productive base is characterized by a structural heterogeneity, which has left a significant number of enterprises and the population on the margin of development. Hence, it is possible to identify at least three challenges:

- To continue advancing toward a high-income stratum; this requires continuous improvement of productivity, based on innovation, and the continuous training of staff.
- To advance in terms of more inclusive productive practices, both for the creation of wealth as well as its distribution. The connection between productivity and integral remuneration is the inclusion to be forged.
- To advance in productive practices making a more rational use of environmental resources (water, forestry), reducing toxic pollutants and greenhouse gas emissions, and avoid destroying ecosystems.

To advance in these three areas it is necessary to transform practices that entail sub-optimum levels of productivity, working conditions and of the environment. Hence, social innovation is required at enterprises: inclusive interrelations (Decent Work) among people, in order to mobilize and foster collective intelligence and ambition, based on shared values and competencies.

Participatory practices in the construction of aims, indicators, targets, and learning, to develop integral competencies and improvements, are the backbone of social innovation. The framework is permanent dialogue among production stakeholders: management and organized worker representatives. This is the link that will make it possible to transit from confrontation to collaboration in the workplace.

The ILO has devised a social innovation proposal aiming toward inclusive management at organizations, known as the System for Integrated Measurement and Improvement of Productivity (SIMAPRO) and which is part of the ILO's worldwide Sustainable Enterprise Programme.[10] The SIMAPRO philosophy is 'bottom-up' communication: of problems, opportunities, and integral solutions. It encourages staff motivation based on cooperation among different hierarchical positions for the creation of innovative alternatives. Construction is based on an open learning network among and within organizations, and benefits are shared among everyone involved.

In Mexico, the SIMAPRO experience is applied in the sugar industry at 18 sugar mills and cane farms, and is linked to initiatives to eradicate child labour. It is also applied in other productive sectors such as tourism, the car industry, the small and medium enterprise sector, and in the drafting of competency standards and for staff assessment-certification solutions.

10 See: http://www.ilo.org/wcmsp5/groups/public/---ed_emp/---d_emp_msu/documents/publication/wcms_185282.pdf