

LABOR MARKETS FOR INCLUSIVE GROWTH

EXECUTIVE SUMMARY

Message 1: Mexico has low unemployment rates (by global standards), its most skilled labor force ever, and has streamlined procedures to facilitate business development. Nonetheless, the country has a history of low labor force productivity that constrains economic growth and the well-being of its population.

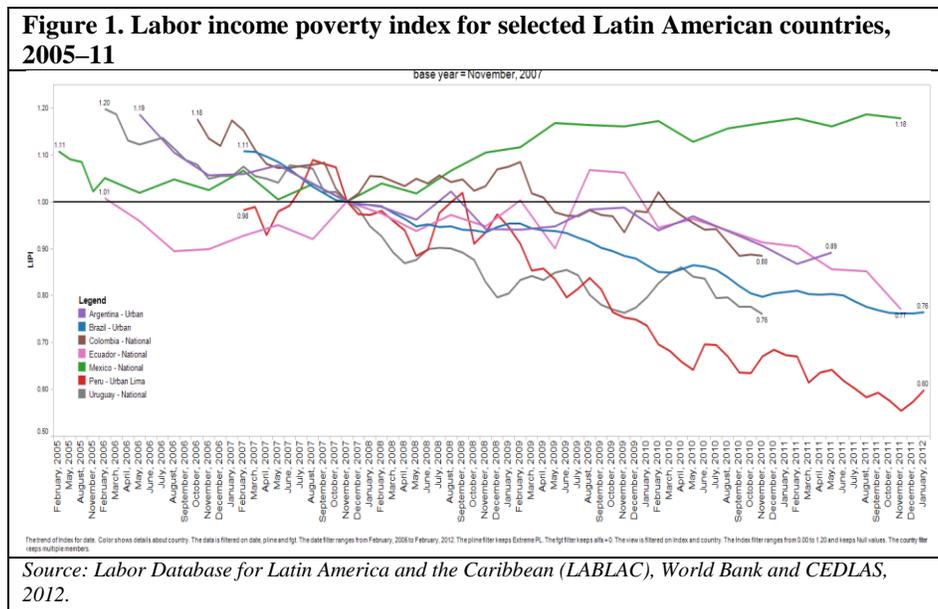
Message 2: Macro-economic policies in place helped mitigate the impact of the crises of 2008. However, economic recovery is occurring with limited job creation and persistently higher unemployment and underemployment, raising concerns of new joblessness and limited poverty reduction.

Message 3: Policy options include:

- Promote labor market productivity and job creation by reducing labor market rigidity and increasing the relative benefits of formalization.
- Create a more productive labor force by raising the level and labor market relevance of skills through a national skills strategy that recognizes labor-market skills acquisition throughout the life-cycle, continued reorientation of upper-secondary school toward the labor market, and portability of skills across the education, training, and labor market systems.
- Improving allocative efficiency, and thus productivity, of the labor force by facilitating job search and matching through integrated employment services, including unemployment insurance, and strengthening competency-based certification.

OBJECTIVE

This policy note outlines short- and medium-term policy options for addressing critical challenges affecting labor markets in Mexico, and in particular labor productivity. As labor is the main source of income for most of the population, poverty is closely linked to underemployment and low wages. Yet labor markets have played a limited role in poverty reduction in Mexico. Labor income accounted for just 22 percent of the decline in poverty in Mexico over the last decade compared with 38 percent in the rest of the region.¹ Between the third quarter of 2008 and the third quarter of 2011, the labor income poverty index² continued to decline in Brazil, Ecuador, and Peru but increased in Mexico (figure 1).³ The equivalent measure produced by CONEVAL (*Consejo Nacional de Evaluación*), shows the labor poverty trend to be increasing through the first quarter of 2012. Finding the right bundle of policies to improve labor productivity and the functioning of the labor markets can serve to improve economic growth and welfare outcomes.



KEY CHALLENGES

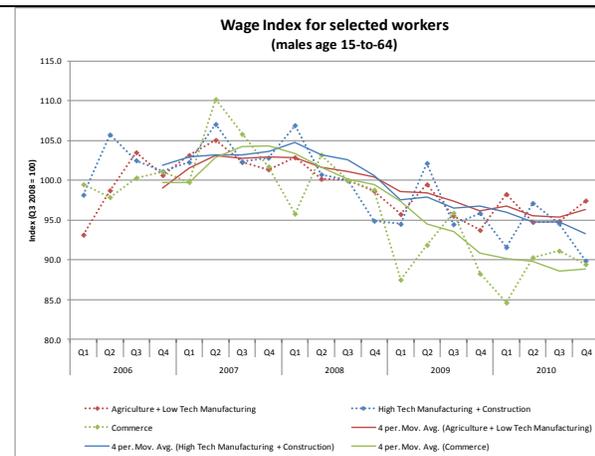
Labor productivity is low in Mexico and economic crises have played a key role in the lack of growth in productivity. Over the past 20 years, labor productivity grew 2.1 percent, as compared to a 64 percent increase in Ireland or an 82 percent increase in South Korea over the same period.⁴ This is partly due to economic crises that reversed gains. The 1995 crisis caused labor force productivity to fall drastically and the crisis in 2008 derailed the slow recovery that was occurring. In real terms, labor productivity in 2011 is below its 1995 level. So increases in productivity have been insufficient to offset the various crises suffered by the country. Capital accumulation has accounted for a greater share of growth than labor.

Despite economic growth in the past decade, real wages have been falling since 2007, driven by low labor productivity, and are low by regional standards. By 2010 real wages had fallen to about 90 percent of their 2008 level (figure 2). GDP per capita is 65 percent lower than in the richest third of OECD countries, more due to low labor productivity than low labor resource utilization.⁵ The crisis aggravated this trend. The number of jobs paying below two times the minimum wage rose during the crisis and these jobs now make up the largest share of jobs. Before the crisis, jobs paying between two and three times the minimum wage were the most common (figure 3). The increase in the size of the labor force in recent years has also created a downward pressure on wages.

The sectoral composition of jobs has changed over the past decade, with a decline in the share of employment in the tradable sectors (figure 4) and a rise in the services sector. To some extent this can be seen as the effects of the crisis of 2008. Demand for exports fell and labor moved into the non-tradable sectors. However, this shift in employment began prior to the crisis so while the crisis may have exacerbated the shift it is not the sole cause.

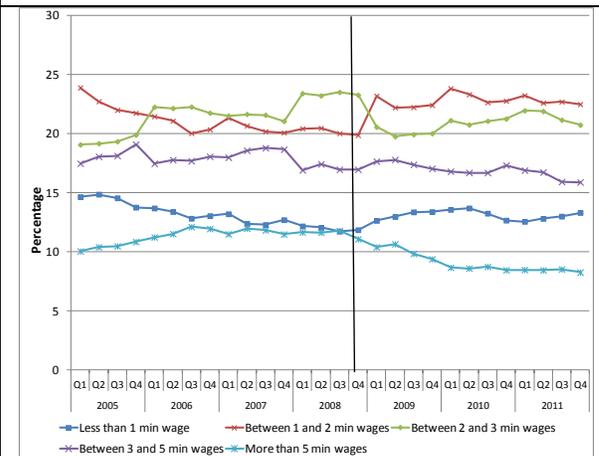
Low productivity persists despite large gains in school enrollment. Mexico has nearly achieved universal coverage in primary and lower secondary school enrolment rates.⁶ Over the past five decades, completion rates for upper secondary education doubled (from 21 percent among people ages 55–64 to 42 percent among those ages 25–34).⁷ Net enrolment in upper secondary was 53 percent in 2010.⁸ Today, 16 percent of the economically active population in Mexico has an upper secondary education or higher.⁹ However, school enrollment takes time to translate into increased worker productivity: despite impressive gains in enrollment and completion rates, the average education level of the labor force only increased by 2.1 years between 1995 and 2010, more than the regional average of 1.4 years but still with substantial room for improvement.¹⁰

Figure 2. Decline in real wages, 2006–10



Source: Labor Database for Latin America and the Caribbean (LABLAC); World Bank and CEDLAS 2012

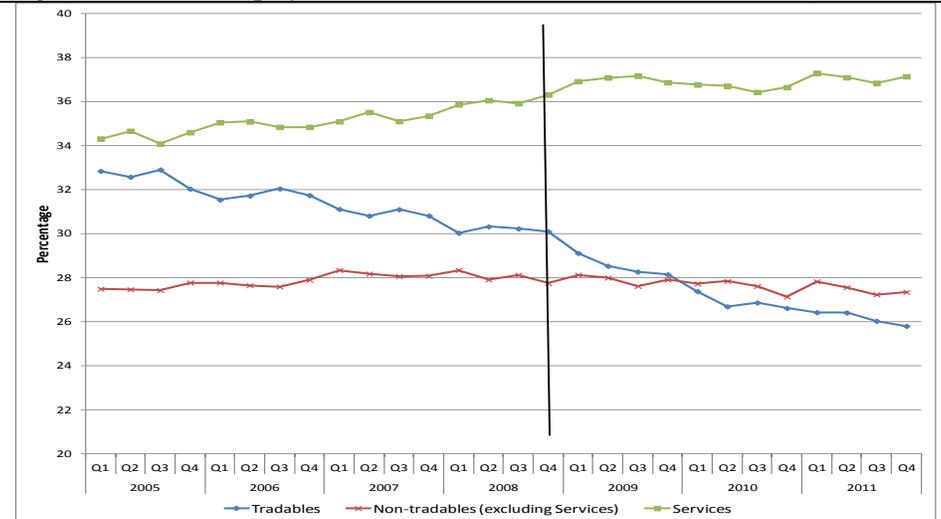
Figure 3. Employment by earnings relative to the minimum wage, 2006–11



Note: The categories “not specified” and “no income” were excluded

Source: Banco de Informacion Economica, INEGI, 2012.

Figure 4. Share of employment in the tradable and nontradable sectors, 2006–11

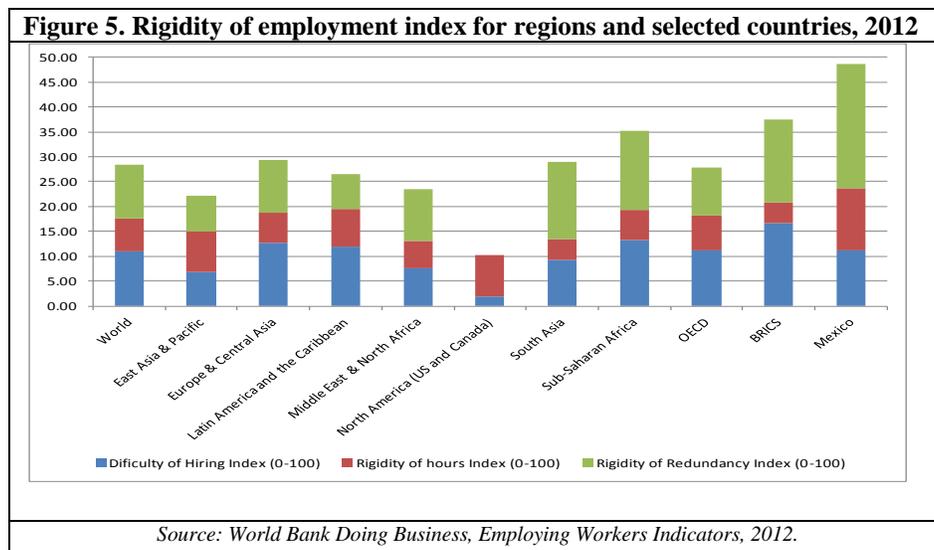


Note: Tradables are agriculture, manufacturing; nontradables (excluding services) are construction and commerce. It excludes the public sector.

Source: Banco de Informacion Economica, INEGI, 2012.

Factors behind the limited job creation and low productivity

Labor market rigidities increase labor costs in Mexico and may partly explain why recovery from the crisis has been accompanied by only limited job creation. Mexico ranks 23 of 183 countries on a composite index of rigidity of employment that includes difficulty of hiring, constraints on hours, and difficulty in firing (figure 5). Its score was above the world average and above the averages for the OECD and for the newly emerging economies of Brazil, China, India, Russian Federation, and South Africa. Extremely high severance pay requirements, particularly for short-term workers, play a large role, creating strong disincentives to hiring. New labor market entrants are likely disproportionately affected. Together with inadequate skills, this helps explain why youth unemployment rates are double the average rate. Rigid labor regulations may prevent labor markets from operating efficiently: when GDP rises, unemployment falls less in countries with more rigid labor markets.¹¹ The high costs of hiring and firing reduce the total number of jobs in the formal sector,¹² affect the composition of the labor force (youth and female unemployment is higher¹³), and constrain productivity (firms adopt less technology or adopt it more slowly, cannot adapt to new environments, and invest less in training, especially small firms¹⁴).



Labor market rigidities that increase informality also impede economic growth. Informal firms have little access to formal credit and formal contracts, which constrains productivity improvement and job generation. The “missing middle” in Mexico, where firms are concentrated at the small and large ends of the distribution, is one outcome of the high rate of informality.¹⁵ Reducing the cost of becoming formal (lower social security contributions and taxes and simplification of registration requirements) can make it easier for firms to start up and grow.¹⁶

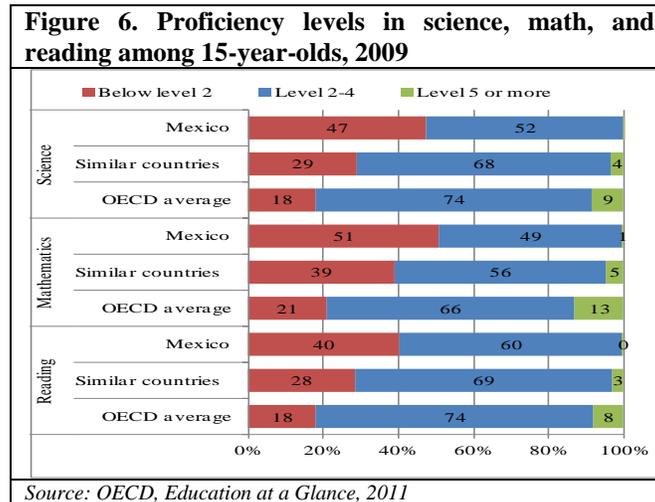
Inadequate levels of skills and the limited labor market relevance of skills constrain productivity and economic growth. As defined by Article 45 of the *Ley General de Educacion*, skills are the set of knowledge, abilities, and attitudes that an individual requires to perform effectively at the workplace. A low-skilled workforce may inhibit economic growth because

firms will be less willing to invest in more productive, high-skill technologies. Furthermore, it causes society to forgo the benefits of additional productive workers, their relatively greater earnings and tax revenues. Productivity is affected by both the quantity and quality of skills. The importance of knowledge in math, language, and sciences – often referred to as “cognitive skills” – is the main focus of Mexican schools. The role of technical skills, as defined by abilities that are specific to a narrowly defined occupation, is most commonly understood as job-relevant and is the realm of technical training schools. New research, primarily from the US and Europe, finds, however, that socio-emotional skills – defined as team work, communications skills, customer relations, punctuality, honesty, etc. – are much more responsible for higher wages than are cognitive skills and they are negatively associated with unemployment.¹⁷ However, socio-emotional skill development is still not seen in Mexico as important for job preparation and there is not a systematic way to teach these skills.

Employers report that the level and type of cognitive, technical, and socio-emotional skills in the labor market do not match their demands. In the Mexico Enterprise Survey, three firms in ten cited inadequate skills as an obstacle to productivity growth.¹⁸ And 43 percent of Mexican employers surveyed by Manpower cited difficulties filling vacancies, as compared to a global average of 31 percent. Difficulties are not limited to highly specialized jobs; the top-10 jobs that firms in Mexico have the greatest difficulty filling include sales representatives, secretaries, assistants, administrative personnel, laborers, and receptionists.¹⁹ Employers place a premium on cognitive and technical skills, but 40 percent of firms in the Mexico World Enterprise Survey identified socio-emotional skills as the most difficult skill set to find.²⁰ Socio-emotional skills are increasingly critical in economies where jobs are more interactive, as in the service sector, which is the largest sector in Mexico.²¹

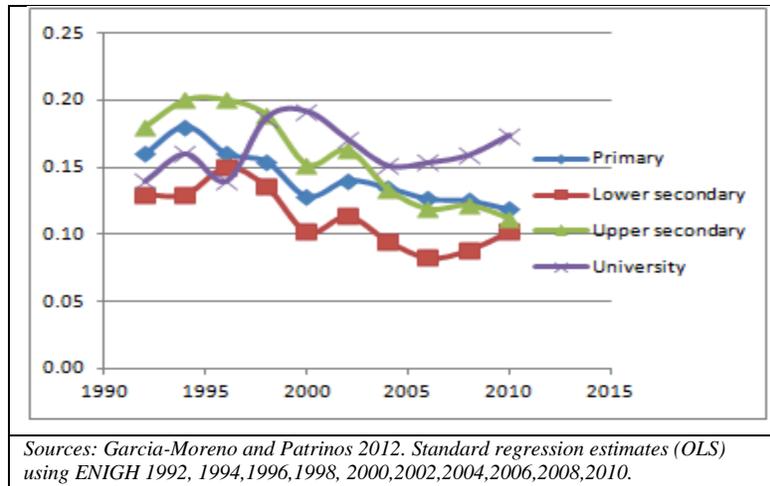
While school enrolment rates have increased significantly over the past few decades, insufficient labor market-related skills are still partly a result of low education levels. Levels of upper secondary education among the working age population in Mexico are on par with Brazil at 35 percent and 41 percent respectively, half the share found in Chile and the OECD.²² Enrollment rates among youth ages 15–19 and 20–29 remain well below those in Brazil, Chile, and the OECD. Only 45 percent of Mexican youth are expected to complete an upper secondary education, compared with the OECD average of 82 percent. Tertiary enrolments of 30 percent lag behind the LAC average of 37 percent.²³

Similarly, while Mexican students have improved their performance on tests of cognitive skills acquisition, as reflected on international tests in science, math and reading, they still lag behind countries of a similar level of development suggesting that education quality is an issue. Results from the 2009 PISA test show that Mexican students score above the LAC average. However, among the 14 benchmarking countries worldwide with a similar GDP per capita, Mexico ranks 10th in reading and 11th on the PISA math and science tests (figure 6), that measure knowledge, the ability to apply it in different contexts, and attitudes toward learning.²⁴



The institutions responsible for skills development in Mexico—schools as well as training institutions—do not fully prepare the labor force with the skills required by the productive sector. Rates of return to education in Mexico have been healthy and stable for several decades, with an extra year of schooling raising earnings by an average of 12 percent in 2010. Nonetheless, there have been fluctuations around this trend, especially by level of education.²⁵ As depicted in figure 7, rates of return for tertiary have increased by approximately 24 percent for males since 1992 while other levels have experienced significant declines in returns at times since the 1990s. Notably, the largest decline in rates of return has been in upper secondary education. These rates of return are likely overestimated since dropout rates are still quite high among (disadvantaged) Mexican youth. In themselves, these high dropout rates highlight shortcomings in education quality. On average, 14.5 percent of the country’s upper secondary students failed to complete upper secondary in the 2010-2011 school year, with dropout rates varying between 13.8 percent among general track students and 20.9 percent among students of technical programs.²⁶ Together, the relatively low returns to upper secondary education, as compared to tertiary education, and high dropout rates underscore the need to encourage skills development at this level.

Figure 7. Rates of Returns to Schooling by Level, males



There is both underinvestment in training and concentration of training among higher-skilled workers. Especially where education quality is low or mismatched to labor markets, such training can be critical for developing technical and socio-emotional skills. Enrolments rates in vocational training programs in Mexico are half of those in Brazil and Colombia and only one-fifth of those in Turkey and Poland, for example.²⁷ In Mexico, 35 percent of industrial workers and 44 percent of services workers report having received training.²⁸ Overall, however, workers in other OECD countries report receiving more training than their peers in Mexico: six times more in Denmark, Switzerland, and the United Kingdom and three times more in Canada and the United States. Training tends to be concentrated among workers who already have higher education, among white-collar workers and managers, and among people who are already employed, partly because succeeding in technical training requires a strong cognitive and socio-emotional skills base. Most job training (outside of formal education) is, appropriately provided by (and funded by) firms,. However, much of this is less than 20 hours, is classroom-based, and does not provide competency certification.²⁹

Mexico’s skills development institutions – schools and training centers – have recognized these challenges and have begun to reform their policies and teaching methods to this end. Efforts have been made across all levels of education to increase the professionalization of teachers by improving teacher training, competitively selecting new teachers, and certifying teacher competencies. After poor results in the 2000 PISA assessment, Mexico has been evaluating student performance through ENLACE in primary, lower secondary and, more recently, in upper secondary school. Furthermore, a competency-based curriculum – which included development of socio-emotional, cognitive, and technical skills – was introduced at the upper secondary level (through the *Reforma Integral de la Educación Media Superior* – RIEMS) and at the lower secondary level. The RIEMS also introduced a single national certificate for all secondary school graduates and remedial support to vulnerable upper secondary students to reduce dropout rates. In 2010-2011, almost 1.3 million scholarships were provided to upper secondary students.³⁰ With the additional 600,000 scholarships planned under the Program for the Expansion of Upper Secondary Education (*Síguele*) starting in 2012, overall approximately 6 in 10 young people will receive scholarships for upper secondary education.³¹ At the tertiary level, financial resources provided to economically disadvantaged students increased their attendance from 5 percent in 2003 to 20 percent by 2011.³² And, in 2012, Mexico introduced a

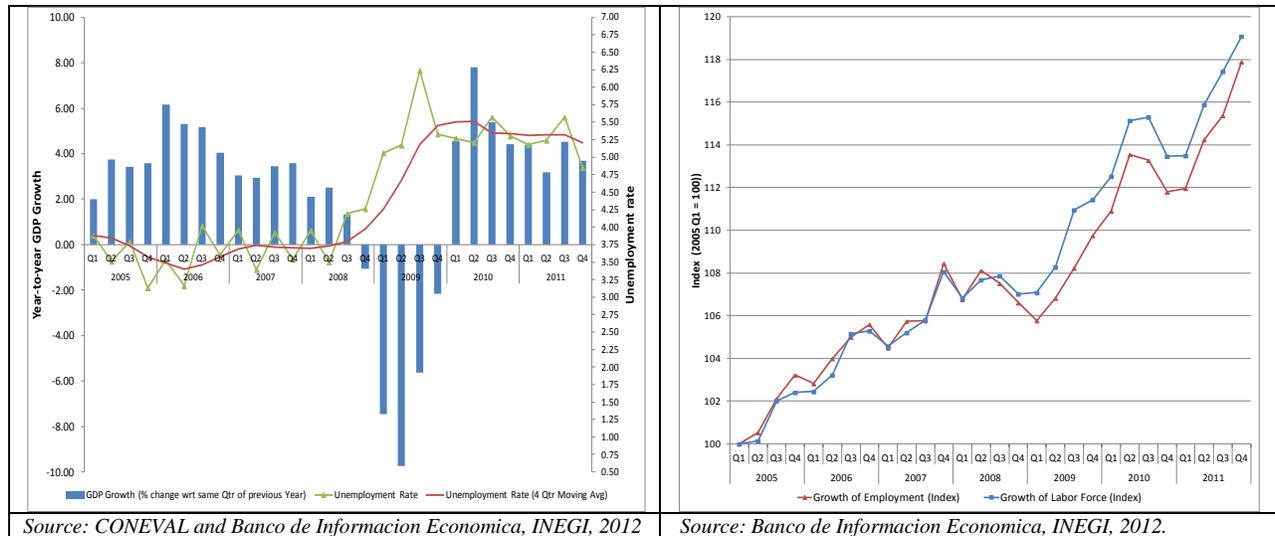
Constitutional Reform that makes upper secondary education universal. But the gains have not yet been institutionalized and there is more to do.

While skills-development institutions and organizations are individually contributing to improving labor productivity, they are not sufficiently coordinated to create a cohesive, efficient skills system. A review of the legal documents that articulate Mexico’s education system, labor relations, and the organizations involved in skills development shows that all define “skills” and “training” differently.³³ Several institutions regulate and approve the training sector, but there is no clear division of labor between institutions. The legal framework for skills development does not foresee ministerial or sectoral collaboration, even if some institutions have in practice initiated bi-lateral dialogues. As a result, while each organization is developing strong strategies, they tend to work separately, making it difficult for individuals to navigate the system and access what they need most.

To maximize the effectiveness of training and schooling changes, employment services that connect individuals with appropriate employment are key. However, existing employment services to better match skills and employment opportunities have inadequate scope and coverage. More than half of Mexican workers at all education levels reported finding their jobs through relatives, friends, or acquaintances.³⁴ This informal matching mechanism, while common across the world, likely results in misallocation of skills and lower productivity as one’s circle of relatives and friends is unlikely to have a broad knowledge of job opportunities. Mexico’s *Servicio Nacional de Empleo* serves a very small segment of the workforce and is not commonly used by employers.³⁵ As in other countries in the region, spending on intermediation services is lower than in other OECD countries, and there is a greater focus on programs that support startup firms or self-employment, especially in rural areas, whereas most unemployment is in urban areas among those seeking wage-employment. Furthermore, in spite of significant advances by CONOCER, the system of competency-based skills certification, which can signal skills and improve matching, is incomplete.

The importance of this matching system is particularly critical in the wake of the financial crisis. The crisis’ impact on growth was deep and brief, however it served to delink labor force growth and employment growth, increasing unemployment and underemployment (figure 8). Before the crisis, the economy was able to absorb all the growth in the labor force, keeping unemployment low. In the second half of 2008 and in 2009, however, a gap developed between labor force growth and employment growth (figure 9). By the second quarter of 2010, employment growth again matched labor force growth, but the economy has not been able to generate enough jobs to employ all the potential new workers who joined the labor force during the crisis, so unemployment has risen.

Figure 8. GDP growth and unemployment rate, 2005–11	Figure 9. Decoupling of labor force growth and employment growth, 2005–11
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Mexico’s labor force has grown substantially over the last decade, rising 18 percent since 2006, due to a convergence of several factors. The population has continued to grow faster than expected (fertility did not fall as much as projected), and labor force participation rates have risen 5 percent since 2005. Net migration to the United States, which formerly absorbed some excess labor, dropped to zero between 2005 and 2010, a result of the impact of the crisis on the U.S. economy.³⁶ The flattening of the upward trend in enrollment among children under age 17 in urban areas and the effect of the crisis on female labor force participation also affected the labor supply.

POLICY OPTIONS

The following short- and medium-term policy actions address the challenges facing the Mexican labor market—recovery with limited job creation, low productivity, high informality, and weak links to poverty reduction—and focus on both supply and demand.

Reducing labor market rigidities and simultaneously improving social protection for the unemployed, such as unemployment insurance and job-matching services, to increase the demand for labor and reduce informality

If Mexico increased the flexibility of its labor markets to levels found in the United States, its unemployment rate would be 2.4 percentage points lower and less persistent.³⁷

Making hiring more flexible could boost job creation and productivity. Mexican labor laws consider employee-employer relationships as permanent, with little room for any but open-ended contracts. The legislation further constrains contracts by restricting hours of work and nonstandard work schedules.³⁸ Contracting modalities that can lower the costs of hiring workers and provide more opportunities for formal employment would allow for probationary periods, training/skill development using self-selection contract provisions (specific age group, lower wages), fixed-term appointments, and seasonal variations in employment that protect worker rights while allowing industries with cyclical demand to function efficiently. Legislation to allow for more contract modalities would need to strike a balance between protection and flexibility, to avoid abuse.³⁹

Reducing mandatory severance payments could also encourage job creation. Mandatory severance payments, unlike unemployment insurance, place the burden on individual firms and discourage formal employment. Reducing severance pay can have a positive impact on labor markets. When Spain lowered severance pay requirements and social security taxes in 1997 and 2001, the probability of permanent employment increased among young workers.⁴⁰ Total employment also rose when Chile capped severance payments.⁴¹

There is a need to balance this reduction in severance costs with a comprehensive system of protection for the unemployed that should include income protection as part of a broader set of employment services. The system would need to promote risk pooling and redistribution while limiting moral hazard, perhaps through a combination of individual accounts and a solidarity component. The system would need to avoid dampening the incentives of the unemployed for job search by the unemployed, for instance by keeping benefits fairly low, by limiting the amount that can be accumulated in the individual account, or by decreasing benefits over time. Benefits are most effective when combined with or conditioned on other services (search requirements in particular). Part of the funding for the broad set of employment services could come from eliminating some of the services that are now bundled within the payroll tax (such as housing and child care), as well as some of the least effective active labor market programs.

Reducing the uncertainty of how the labor courts (JCA) will resolve dismissal cases. The current incentive structure does not favor the swift resolution of labor disputes. Furthermore, the composition of tribunals—composed of employers, employees, and government—often results in the government casting the deciding vote, usually a compromise between employer and employee interests. The high level of discretion undermines transparency and creates incentives for both sides to bring cases to the court. Improving the efficiency, transparency, and timeliness of judicial proceedings would lower an important cost associated with termination of employment and could boost formal employment. Incentives could be introduced to encourage mutual agreement (deadlines, maximum salary caps, and guidelines for reaching decisions), the grounds for bringing a case before the JCA could be narrowed, and the JCA's independence could be strengthened. Collecting timely data for monitoring and evaluation will be vital for identifying other bottlenecks.

Replacing severance payments with unemployment insurance could lower employer costs and encourage firms to create higher productivity jobs. The labor code's reliance on high severance payments to provide income support during unemployment is ineffective. More than half the cases before the JCA end in private settlements below legal mandates, legal fees absorb 30–40 percent of severance payments,⁴² and many workers do not even bring suit for these reasons.⁴³ Formal workers can draw on their pension savings during periods of unemployment, but this option is primarily for those in the formal sector and has the negative consequence of lowering retirement savings. Replacing mandatory severance payments with a well designed unemployment insurance scheme could lower the costs of employment, encourage firms to create higher productivity jobs,⁴⁴ better protect workers against risk, and allow for more effective job search.⁴⁵

Adjusting social security contributions could lower the costs of formality. One option would be to remove some benefits bundled together with old-age pension and health insurance under social security contributions and payroll taxes, such as housing and child care. How large an

effect this has on employment will depend on the extent to which workers undervalue the benefits provided through social security contributions and payroll taxes. Research shows this undervaluation is particularly high for low income workers who are not willing to surrender wages in exchange for the current benefits.⁴⁶ Another option is to create a universal system of health insurance and old-age pensions that is delinked from labor status. Again, understanding the implications for labor market incentives is critical.

Aligning the skills development system with the needs of the labor market by improving institutions and programs to deliver labor market-relevant skills

A national strategy for building labor market-relevant skills at appropriate periods of the life cycle would mobilize all actors around a common goal. Defining the broad range of skills valued by the labor market, articulating a strategy for people to acquire those skills, and setting up institutional and coordination mechanisms can help Mexico make the leap to higher skills and earnings, as was recently done in South Korea and Ireland.⁴⁷ This strategy would identify the cognitive, technical, and socio-emotional skills that the market values. Developing the mechanisms for a meaningful, continuous, and actionable dialogue between public actors (ministries of education, labor, the economy, and social development; state governments) and private actors (trade associations, unions, training and education institutions, firms,⁴⁸ and others) will help ensure that the productive sector's needs inform the design of education and training programs. Such a strategy would also need to identify, and include in the dialogue, the appropriate service providers at each stage of the life-cycle.⁴⁹ A full matching of skills training needs with appropriate providers will allow for the definition of organizational roles. Finally, the legal and institutional framework would need to be updated to reflect the focus on skills, establish roles for core actors, and setup mechanisms for coordination.⁵⁰

National or regional development strategies would complement the more general skills development strategy. These sub-strategies would identify the sectors and regions that are likely to generate jobs in the future, so that clear investments plans for specific technical skills development can be decided. This could reduce the over- and under-supply of workers for some types of skills⁵¹ and thus boost productivity.

Interventions that help vulnerable groups to acquire labor market-oriented skills will increase social inclusion. Having the skills the labor market needs is the best way to increase income-generating capacity and escape poverty. On the basis of a deeper understanding of the main causes of dropout, especially at the upper secondary level, efforts should be made to identify appropriate policies to overcome these constraints.⁵² For those who have already dropped out of formal education, training services should be tailored to take into account the lower cognitive, technical, and socio-emotional skills of this group, as well as providing other services that address the broader set of employment barriers they face. And for those who have completed secondary school, the PRONABES student scholarship program should be continued and expanded into a hybrid loan-scholarship program for less disadvantaged youth who are financially restricted from entering quality tertiary education programs.

Continue implementing the RIEMs, with a particular emphasis on integrating the priority skills identified by employers into the curriculum and teaching methods in education and training institutions. The recent reforms to improve the quality and labor market orientation of education at all levels, by raising the quality of basic education and of competency-based

curricula at the upper secondary level, are still fragile.⁵³ To institutionalize these reforms, it is important to continue to bolster teacher development and certification; expand the new training to support even more teachers in modern, interactive pedagogical methods; monitor classroom success through the EXCALE and ENLACE to improve the targeting of training; and continue to implement regular assessments and enhanced quality assurance and accountability systems to boost teacher quality. Efforts to improve labor market–relevant skills need to start early, and an early child development system that focuses on developing socio-emotional skills will reduce school dropout, improve school performance, and boost labor market access and productivity.

Support lifelong learning through greater integration of different education streams and of education and training systems. The integration of the upper secondary education system, that the RIEMS has started, should expand to the larger skills-development system. The next step is to ensure compatibility and integration between institutions that transfer skills, such as between community colleges and universities in the United States. It will also be important to ensure portability of skills between the skills-development system and the labor market so that individuals can move easily between skills development in formal education and on-the-job training. A system of competency-based certification (discussed below) is required to signal the acquisition of skills recognized by all the major players.

Multiple sectors, including the private sector, have a role in preparing people for the labor market. The government's chief contributions are convening stakeholders, generating and disseminating labor statistics and information about training offers, and creating a regulatory framework to ensure quality and provide incentives. Strengthening the accreditation system for education and training institutions is also important for ensuring that training programs align with the skills demanded by the productive sector. Linking public funding for training programs to job placement or retention can encourage a focus on results.

Facilitating job search and matching through comprehensive employment services

Linking employment services with other interventions and with the private sector can support transitions to the labor market. Employment services include job intermediation services as well as more intensive interventions such as guidance, counseling, remedial education, and training or re-training for those with the greatest difficulties. Investing in employment services has demonstrated impacts—greater success finding a job, less informal sector employment, and higher wages—and intermediation and job counseling are among the most cost-effective services.

Combining a comprehensive set of job-oriented services could help systematically tackle the most binding constraints to employability, especially for the poor. Evidence shows that a combination of training programs (that teach cognitive, technical and social-emotional skills), job search assistance, temporary financial support (for transport and basic maintenance), and referrals to other social services is often a key to success—even if they might best be provided by different institutions. Orientation and counseling can also direct people to the right training, reducing discrepancies between labor demand and supply.⁵⁴ Finally, experience shows that it is critical that employment services refer individuals to a broader set of services when needed (education, training, scholarships, social workers, transport subsidies, and so on).

Tools and a methodology are needed to manage integral employment services that are closely linked to the productive sector. Building on the experience of the national employment service and numerous private providers, such a model would need to ensure greater participation by the private sector. It should also have a specific component for the poor that links employment services to social assistance programs. Developing clear objectives and a strong information system would help manage services on the basis of results (services will typically be provided by a range of public and private providers). Because employment services have to be decentralized, the quality of local services will influence success.

The national system of competency needs to be strengthened. A competency system can promote efficient matching in labor markets by signaling skills across professions, regions, and jobs. A competency system can also ease transitions between the education and training systems and guide the development of curricula that are directly related to skills in demand in the labor market. Such a system would also recognize skills acquired outside of formal training programs. Currently, many employers prefer to rely on experience or references rather than on diplomas or certificates as indicators of skills, because these do not indicate that skills have actually been acquired but are mainly evidence of attendance or completion of training.⁵⁵ The government can also promote the use of competency certification by providing and funding only competency-based courses (in sectors where these are sufficiently developed).

The political and legal foundations of the competency system also need to be stronger to promote collaboration. Mexico should strengthen CONOCER, providing it with the autonomy it requires and ensuring that its mechanisms involve all actors at the national and local levels (including employers, education and training providers, and students). The system needs to serve all workers by certifying on demand those who have acquired skills in formal education, training, or on the job. Ultimately, the success of a competency system depends on its use by all actors, particularly the private sector, which needs to lead the effort.

Matrix of short and medium-term policy options*

Policy area	Short-term policy options	Medium-term policy options
Reducing labor market rigidities to increase the demand for labor and reduce informality		
Making hiring modalities more flexible	<ul style="list-style-type: none"> • Build consensus on the best options for expanding hiring modalities. 	<ul style="list-style-type: none"> • Implement legal changes required to expand contracting modalities (LR) • Monitor and evaluate effectiveness.(AR)
Reducing the cost of terminating employment	<ul style="list-style-type: none"> • Review previous proposals to increase the efficiency and predictability of labor courts. • Review international experience on labor tribunals and labor court reforms. • Propose ways to reduce the costs of employment termination. 	<ul style="list-style-type: none"> • Reform labor courts.(AR, LR) • Implement alternative severance pay (with introduction of unemployment insurance mechanism; see below).(LR)
Reducing the cost of formality	<ul style="list-style-type: none"> • Identify mechanisms to provide social security with fewer distortions (unbundling benefits, for 	<ul style="list-style-type: none"> • Remove some (noninsurance) services from social security bundles. (LR)

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	<p>example).</p> <ul style="list-style-type: none"> • Explore options to de-link old- age income support and health insurance from labor status (including fiscal implications). 	<ul style="list-style-type: none"> • Implement feasible option for delinking old-age income support and health insurance from labor status.(LR)
Improving institutions and programs to deliver labor market–relevant skills		
Developing a national skills strategy	<ul style="list-style-type: none"> • Build consensus on skills and develop skills strategy, including as part of broader national or regional development strategy. • Identify specific needs of the vulnerable and program design adjustments to meet these needs 	<ul style="list-style-type: none"> • Identify necessary legal adjustments • Propose institutional mechanisms for implementation (LR).
Improving the quality, labor market orientation, and accessibility of skills development through the education and training sectors	<ul style="list-style-type: none"> • Review the private sector orientation of curricula. • Review the design of core training programs and identify reform agenda. • Explore options to link funding for training to results in labor markets. • Strengthen the design of accreditation system for education and training programs 	<ul style="list-style-type: none"> • Modernize teacher training and strengthen monitoring to improve teacher performance (LR). • Implement changes for training programs (including incentive mechanisms for a focus on results) (LR) • Implement the accreditation system (LR) • Strengthen the early childhood development system.
Strengthening and expanding mechanisms to integrate skills institutions and programs	<ul style="list-style-type: none"> • Identify areas where bridges need to be established or strengthened between systems or institutions. • Review options for mechanisms to establish bridges and switch between systems. 	<ul style="list-style-type: none"> • Set up mechanisms to allow individuals to switch between systems (LR).
Facilitating job search and matching through comprehensive employment services		
Developing an integral model of employment services	<ul style="list-style-type: none"> • Identify services needed by different population groups to enter the labor market. • Identify existing services and possibilities for linking them. 	<ul style="list-style-type: none"> • Develop an integral model, including for the vulnerable (AR).
Developing a mechanism to provide income-protection during unemployment	<ul style="list-style-type: none"> • Design models, explore institutional arrangements, estimate costs, and explore mechanism to switch from severance to unemployment insurance. 	<ul style="list-style-type: none"> • Establish the system (LR).
Strengthening the national system of competency-based certification	<ul style="list-style-type: none"> • Explore options to provide more autonomy to CONOCER and to increase the demand for certification from workers and the 	<ul style="list-style-type: none"> • Expand certification system to cover all skills sets, ensuring its compatibility with external labor markets (particularly the United

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	private sector	States) (AR)
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* LR= Legal Reforms; AR=Administrative Reforms, Preliminary Classification

¹ Azevedo, Inchauste and Sanfelice 2012.

² The index measures the ability to purchase the basic food basket with labor income.

³ World Bank 2011.

⁴ Centro de Investigación para el Desarrollo A.C. 2011.

⁵ OECD 2011d.

⁶ Puryear, Santibañez, and Solano 2012.

⁷ OECD 2011c.

⁸ SEP 2012

⁹ Based on author's calculations using INEGI, Encuesta Nacional de Ocupación y Empleo, first trimester of 2010.

¹⁰ Author's calculations using Barro-Lee data on population aged 25 years and more. The LAC Average is derived from average education rates of 25 Latin American countries.

¹¹ Bertola 1990; Di Tella and MacCulloch 2005; Blanchard and Summers 1986; and Lindbeck and Snower 1989.

¹² Kaplan, Sadaka, and Silva-Mendez 2008.

¹³ Feldmann 2009; Djankov and Ramalho 2009; and Samaniego 2010.

¹⁴ Acemoglu and Shimer 2000; Lopez-Acevedo 2002; and World Bank 2006.

¹⁵ OECD 2011b.

¹⁶ Koettl and Weber 2011.

¹⁷ Gintis 1971, Edwards 1976, Bowles and Gintis 1976 and 2002, and Bowles et al. 2001 find that the returns to schooling attributable to cognitive skills are rather small when compared to the effects to non-cognitive skills, with about 80 percent of the return to schooling formally assigned to non-cognitive skills. More recently, Carneiro et al. 2007 and Heckman and Rubinstein 2001 have found similar results. Non-cognitive skills also affect unemployment, as demonstrated by Anger and Heineck 2006 and Lindqvist and Vestman 2011.

¹⁸ Data from the 2010 World Bank Enterprise Survey for Mexico.

¹⁹ The share of firms reporting difficulties is also high in many other Latin American countries, including Argentina, Brazil, Colombia, Costa Rica, Guatemala, Panama, and Peru. Manpower 2010.

²⁰ Authors calculations from 2010 World Bank Enterprise Survey for Mexico.

²¹ The demand for, and shortage of, socio-emotional skills are observed by employers across the world, in countries as diverse as India, North Africa (8 countries surveyed), Vietnam, Botswana, the Caribbean, and Tonga (Bassi, Busso, Urzua, and Vargas 2012, Blom and Hobbs 2008, Blom and Saeki 2011, Castro, Yamada, and Arias 2011, Di Gropello 2010, and IFC 2010). See also OECD and Statistics Canada 2011; Brunello and Schlotter 2011; Carneiro and Heckman 2003; World Bank 2009 and 2011; OECD 2007 and 2011c.

²² OECD 2011e, table A1.2a. The share of 25 -64 year olds with at least upper secondary education is 69 percent for Chile, and 73 percent for OECD countries on average.

²³ An estimated 2.1 million 15-18 years-old are not studying nor working (about 22 percent of that age group), many of which have not completed primary schools. Cardenas, de Hoyos and Szekely 2011.

²⁴ The 14 benchmarking countries include Argentina, Brazil, Chile, Croatia, Estonia, Hungary, Latvia, Lithuania, Mexico, Poland, Romania, Russian Federation, Trinidad and Tobago, and Turkey.

²⁵ Garcia-Moreno and Patrinos 2012.

²⁶ SEP 2011

²⁷ Puryear, Santibañez, and Solano 2012

²⁸ Author's calculations from the 2009 ENOE.

²⁹ Villaseñor 2012.

³⁰ These were provided predominantly under *Oportunidades* and the *Programa de Becas de Educación Media Superior*, and represent an increase of 77 and 40 percent for these programs, respectively, since 2006-2007.

³¹ Presidencia de la República Mexicana 2012.

³² *Programa Nacional de Becas para la Educación Superior—PRONABES*.

³³ For example, the General Law of Education uses interchangeably the concepts of knowledge, abilities, capacities and/or skills, when dealing with training and education contents (Articles 45 and 47). In the Federal Labor Law, training refers to acquiring knowledge and abilities, without a competence-based approach (Article 153). Only the regulatory framework of CONOCER uses the concept of labor competences, which includes knowledge, abilities, skills and attitudes (Article 1). Both laws regulate the registry, approval and/or delivery of training services in Mexico, and the creation of different types of training commissions, which purpose is not clear.

³⁴ ENOE 2011.

³⁵ Villaseñor 2012.

³⁶ Cohn, D., A. Gonzalez-Barrera and J. Passel, 2012.2012.

³⁷ Based on the methodology of Di Tella and MacCulloch 2005 using data from the World Bank (various years) and Fraser Institute 2012. These scenarios compare Mexico with OECD countries over 2000–10. Over this period, the mean labor market flexibility index (as defined by the Fraser Institute 2012 using data from the World Bank, the World Economic Forum, and the Institute for Strategic Studies) for Mexico was 53.2 on 0–100 scale, where 0 is very rigid and 100 is very flexible. The mean labor market index was 88.1 for the United States, 37.1 for Germany, and 55.7 for Chile.

³⁸ Articles 5 and 123 of the 1917 Constitution provide for a maximum of 8 hours of daytime work, 7 hours of night shift work, and overtime premiums of 100 percent.

³⁹ Spain's 1984 reform, which expanded the use of temporary contracts, resulted in a segmented labor market that reduced efficiency and equity (Dolado, García-Serrano, and Jimeno 2002; Feldmann 2009; Bank of Spain 2009).

⁴⁰ Kugler, Jimeno-Serrano, and Hernanz 2003.

⁴¹ Pages and Montenegro 1999.

⁴² Kaplan, Sadaka, and Silva-Mendez 2008.

⁴³ Dávila Capalleja 1997 and Kaplan and Sadka 2004.

⁴⁴ Acemoglu and Shimer 2000.

⁴⁵ Hopenhayn and Nicoloni 1997.

⁴⁶ There is evidence in Mexico that some segment of the workforce undervalues benefits (Levy 2008; Cunningham and Maloney 2001). Reviewing the social security system is beyond the scope of this note, but see Mexico Policy Note 5 on social protection for recommendations.

⁴⁷ Villaseñor 2012.

⁴⁸ Many enterprises organize or contract training programs, especially among larger firms (84 percent of firms with more than 100 employees, 71 percent of firms with 31–100 employees, 53 percent of firms with 11–30 employees, and 39 percent of firms with 6–10 employees, according to World Bank Enterprise Surveys). According to the 2009 ENOE, half of the training in the industrial and services sectors is provided by the firm, a colleague or supervisor.

⁴⁹ For example, the most fundamental socio-emotional skills for the labor market – impulse control, working with others, for example – are best taught in pre-school and in the home, reading and numeracy are best taught in primary education, and firm-specific skills are best learned on the job.

⁵⁰ These include the Federal Labor Law, the General Education Law, and the Organic Law of the Federal Public Administration, as well as other legal documents such as the Partnership for Education Quality and the Comprehensive Reform of Upper-Middle School.

⁵¹ Many graduates do not hold jobs that match their skills, as is the case for about 40 percent of those with industrial, electrical, electromechanical, and computer science training are in jobs that do not match their skills. This is also the case for 45–50 percent of those who studied management, marketing, or economics (ENOE 2009).

⁵² The 2010 survey of dropouts at the upper secondary level undertaken by the *Secretaría de Educación Pública* is an important source for this. According to Bravo 2009, 34 percent of dropouts cited economic conditions, 29 percent cited family reasons such as childbirth, and 11 percent cited a perception that studies are too difficult.

⁵³ Defined in the Integral Upper Secondary Education Reform of 2007.

⁵⁴ In most countries, student preference remains the main driver of educational choices, and better career guidance in support of individual choices could play an important role in reducing discrepancies in supply and demand of workers by field of study (about two in five overqualified OECD workers are employed in a job that is unrelated to their field of study; OECD 2011a).

⁵⁵ Less than a third of workers were certified or received a record of their skills after their last training in the industry and service sectors. ENOE 2009.

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