Chapter 1

Introduction

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In the last few years, Mexico has launched the most ambitious reform package of its recent history, becoming the OECD leader in terms of the promotion and implementation of structural reforms. Some of these reforms have already started to bear fruit in key areas for Mexico's development, such as education, energy, telecommunications, tax revenue and informality. However, this effort must be continued with effective implementation, and there must be no going back. Other reforms, in particular relating to institutional change, must be introduced in order to enhance the quality of both public policies and institutions. In many aspects of well-being, including education, health and security, among others, Mexico still lags behind the OECD average and regional development remains very uneven. The role of the State and its efficiency should be reinforced to provide an appropriate framework where business and citizens can progress. Advancing in this direction is crucial for Mexico's development. The capacity of the public sector is weak, both in terms of human and financial resources, corruption remains widespread and the rule of law is weak, all hindering the effective implementation of policies. These factors, along with widespread poverty, vulnerability and inequality, hold back economic growth and prevent it from being translated into gains in well-being, as Mexico is not using all available talent. Mexico has taken measures to tackle these issues, but important implementation gaps remain. Moreover, reform efforts have not always gone far enough. It will be important for the next government to build on the current reform efforts, ensuring the full and effective implementation of already legislated changes, adjusting them as needed and improving them to take gains even further. Additional reforms should be launched in several priority areas, including the rule of law, institution building, education and social protection. A strategy focused on inclusive growth and productivity must be endorsed. Only then will Mexico be able to deliver a higher quality of life for all its people.

* The authors would like to thank Mario López Roldán for his contribution to the development and fine-tuning of this chapter's messages.

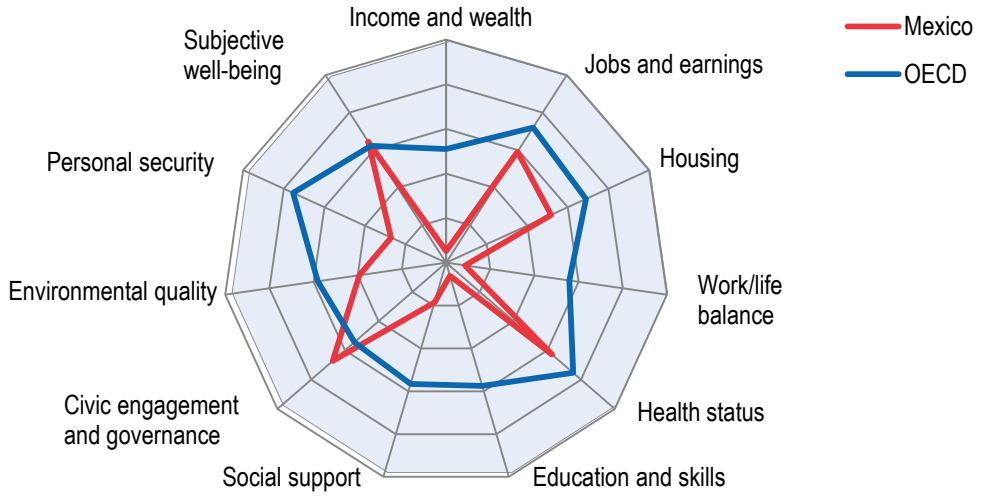
Mexico is now the world's 11th largest economy (in terms of gross domestic product [GDP] measured at purchasing power parity). Over the past three decades, the country has gone through tremendous structural changes that transformed a relatively protected, oil-dependent economy in the early 1990s into a booming manufacturing, international investment and export centre. Mexico has strategically promoted free trade and integration into global value chains (GVCs) and is increasingly becoming an international trade hub. Mexico is now a top global exporter of cars and flat screen TVs, among other products.

Despite this important progress, well-being still lags behind the OECD average in many areas (Figure 1.1). Notwithstanding the decrease in marginality, 53 million people still lived in poverty in 2016 (43% of the Mexican population) (Figure 1.2), according to a broader measure by CONEVAL (*Consejo Nacional de Evaluación de la Política de Desarrollo Social*), which accounts for different dimensions of well-being. Indeed, according to these estimates, most Mexicans live in either poverty or vulnerability (based on CONEVAL data, only 22.6% of the population is "not poor" and "not vulnerable"). At the same time, income and well-being inequalities are still among the highest in the OECD.

Employment and earnings in Mexico remain below the OECD average, and work/life balance is still unsatisfactory, as the country ranks second in terms of the number of employees working for 50 hours or more per week. Inter-regional disparities are still significant. Living in one of the worst-off states can mean being four times as likely to be at risk of poverty and seven times as likely to work longer hours for lower pay than people living in the better-off states.

FIGURE 1.1. **HOW'S LIFE IN MEXICO?**

Mexico's average level of well-being relative to other OECD countries, latest available year



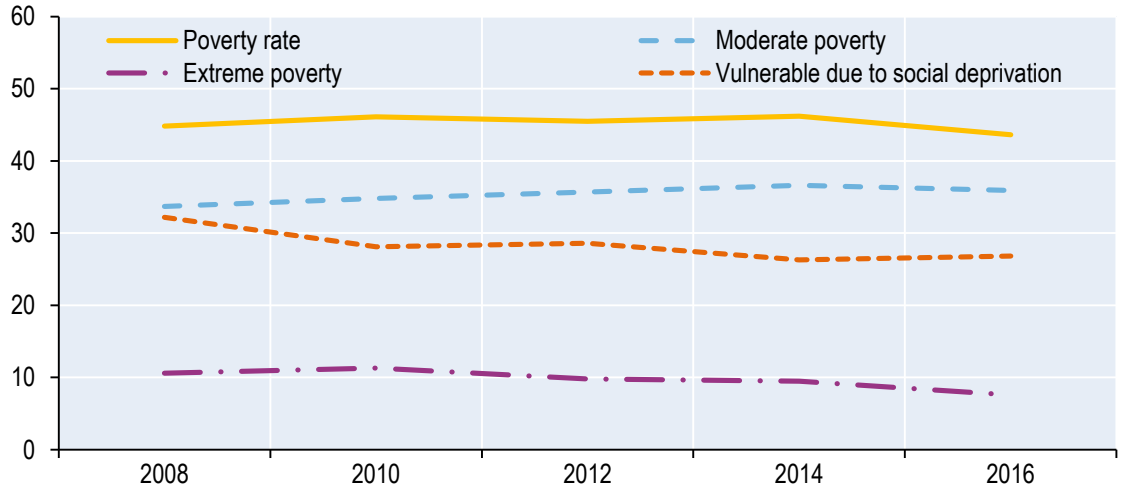
Note: Each well-being dimension is measured using one to four indicators from the OECD Better Life Initiative set. Normalised indicators are averaged with equal weights. Indicators are normalised by re-scaling (linearly) to be from 0 (worst) to 10 (best).
Source: OECD (2017), *Better Life Initiative 2017*, http://www.oecd.org/statistics/better-life-initiative.htm.

Personal security is a concern for many Mexicans: Mexico has the highest homicide rate in the OECD, with around 16 homicides per 100 000 people in 2015 according to the World Bank. In addition, only 46% of people report feeling safe walking alone at night in the area where they live, compared to an OECD average of 68%. Mexico also still performs below the OECD average in terms of its environmental performance. Only 67% of people say they are satisfied with the quality of their water, considerably lower than the OECD average of 81%, and one of the lowest rates in the OECD.

All these issues have a regional dimension. For instance, regional gaps in education outcomes are large, and differences in informality and poverty rates among Mexican states are staggering. Furthermore, anti-competitive practices vary widely, which hinders entrepreneurship. Although financial inclusion, a key enabler of economic growth, poverty reduction and women's empowerment, remains a nationwide concern, it has improved considerably in some municipalities.

FIGURE 1.2. **WHILE POVERTY HAS STARTED TO FALL ON SOME MEASURES, IT REMAINS VERY HIGH**

Poverty rates as a percentage, measured in terms of income and six social dimensions of well-being



Note: The multi-dimensional poverty measure considers income plus the following six social dimensions of well-being: access to social security; access to basic education; access to health services; access to food; housing quality and space; and access to basic services within the housing unit. The population in extreme poverty is the group whose income cannot ensure adequate nutrition (based on the minimum welfare line) and that is deprived in at least three of the six social indicators. The population in poverty includes those whose income cannot ensure adequate access to nutrition and basic services (the welfare line) and who are deprived in at least one of the social indicators. Moderate poverty represents the share of the population that is poor, but not extremely poor. The category of "vulnerable due to social deprivation" represents the share of the population who are deprived in at least one of the social indicators.

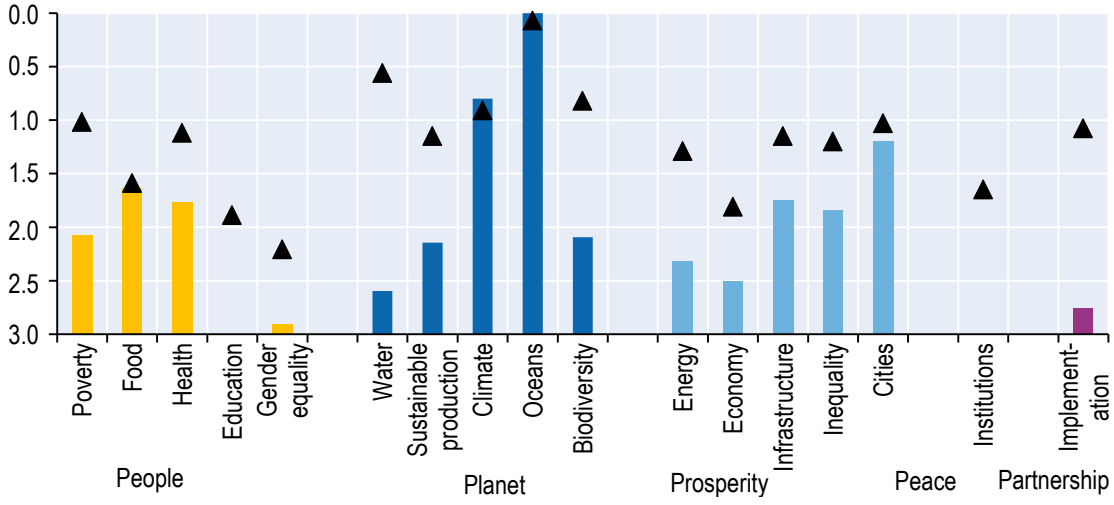
Source: Consejo Nacional de Evaluación de la Política de Desarrollo Social (CONEVAL).

Mexico's mixed performance in terms of well-being is also reflected in the country's position on the Sustainable Development Goals (SDGs). Mexico is on average closer to reaching the goals in the Planet category than the goals in the other categories (Figure 1.3). Gaps are particularly wide on education, institutions and gender equality (SDGs 4, 5 and 16). Mexico is either ahead of, or fairly close to, the OECD average distance on several goals, including food,

climate change, oceans and cities (SDGs 2, 11, 13 and 14). On other goals, Mexico is further from achieving the SDG targets than the OECD average, and considerably so on education, water, biodiversity, institutions and implementation (SDGs 4, 6, 15, 16 and 17). Mexico places a high importance on the SDGs, as signalled by the establishment of a National Council of the 2030 Agenda for Sustainable Development, which is headed by the President and includes representation from 32 state governments, 20 federal agencies, international agencies, the private sector and universities. The National Development Plan 2013-18 is considered the central instrument for aligning and ensuring coherence with the SDGs.

FIGURE 1.3. **MEXICO STILL HAS SOME WAY TO GO TO ACHIEVE THE SDGS**

Current distance from reaching the Goals and the 5Ps of the 2030 Agenda



Note: This figure shows Mexico's distance to travel towards each of the 17 Goals of the 2030 Agenda. The y-axis indicates the distance from reaching the target in standardised units. 0 indicates that the level for 2030 has already been attained, and the axis starts at 3 as most OECD countries have already attained this level. Distances to target are aggregated at the goal level (all targets weighted equally). To make the level of achievement within the country more distinct, in this figure, data on Official Development Assistance (ODA) are excluded in Goals 1 to 16. Nonetheless, total ODA, ODA focusing on capacity building and national planning, as well as ODA commitments to statistical capacity building, are included in Goal 17 "implementation" and under Partnership.

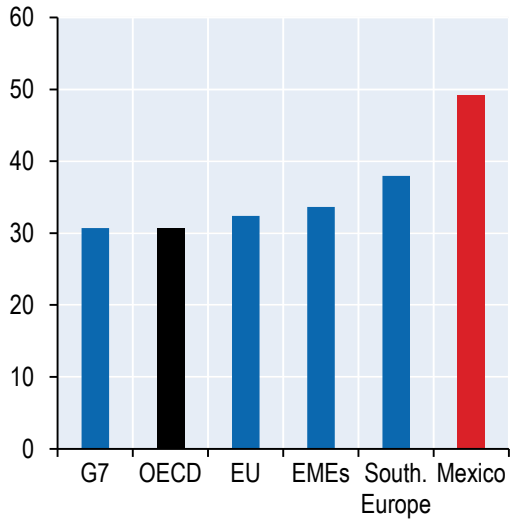
Source: OECD (2017), *Measuring Distance to the SDG Targets: An Assessment of where OECD Countries Stand*, www.oecd.org/std/OECD-Measuring-Distance-to-SDG-Targets.pdf.

Ambitious reforms have been launched to tackle Mexico's long-standing problems, but much more work lies ahead

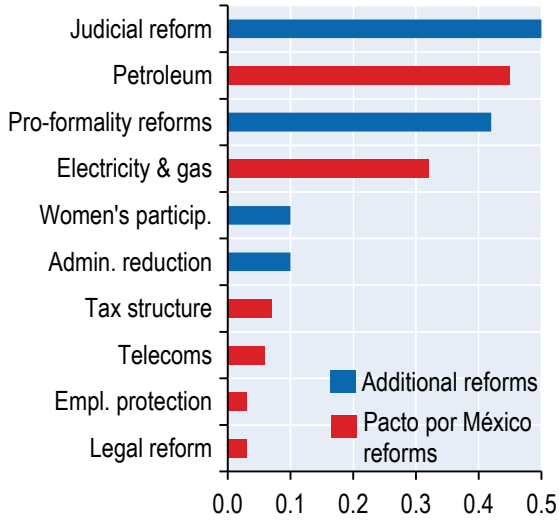
Since 2012, the government has enacted major structural reforms aimed at strengthening growth, improving well-being and fostering equality. The initial wave of reforms, kicked off by the multi-partisan political commitments in the *Pacto por México*, has led to notable progress across a range of areas and has put Mexico at the forefront of reformers among OECD countries (Figure 1.4). Key laws and constitutional amendments were approved, and secondary laws or regulations passed (Table 1.1).

FIGURE 1.4. **MEXICO'S HIGH REFORM ACTIVITY IS CONTRIBUTING TO BETTER ECONOMIC PERFORMANCE**

A. Share of OECD *Going for Growth* recommendations with significant action taken, 2013-16, in percentage



B. Expected boost to annual growth on average over the five years following reform, in percentage



Note: Panel A: EU includes OECD member countries that are also part of the EU. Emerging market economies (EMEs) include Brazil, Chile, Colombia, Hungary, India, Indonesia, Mexico, People's Republic of China (hereafter "China"), Poland, South Africa and Turkey. Southern Europe includes Greece, Italy, Portugal and Spain.

Sources: OECD (2017a), *Economic Policy Reforms 2017: Going for Growth*, http://dx.doi.org/10.1787/growth-2017-en; OECD (2015), *OECD Economic Surveys: Mexico 2015*, http://dx.doi.org/10.1787/eco_surveys-mex-2015-en.

A sound macroeconomic policy framework has allowed for growth to be resilient amid a challenging global environment. Although uncertainty regarding a potential globalisation backlash has recently curtailed investment, non-oil exports have remained robust, owing to Mexico's high level of integration into global value chains. Although the collapse in oil prices reduced government revenues and led to cutbacks in energy sector investments, the tax policy reform enacted in 2014 proved timely and allowed to offset this effect. Tax revenues have increased recently, helping the government to contain the fiscal deficit and attain its fiscal consolidation objectives.

Strong efforts have been made to open sectors such as energy and telecoms to more competition. Institutional settings have improved with the establishment of a new National Productivity Commission, independent competition authorities and an expanded number of sector regulators, while their independence has also been strengthened. OECD estimates suggest that a subset of Mexico's reforms could add two percentage points to GDP growth after five years (Figure 1.4, panel B). Some impact is already showing up in the data, especially on productivity growth, which is picking up (Figure 1.5). Moreover, in the telecom sector, the number of mobile broadband subscriptions rose from 24 million in 2012 to over 74 million in 2016, while prices for mobile telecommunication services declined by 61% for the OECD medium-usage basket and by 75% for the OECD high-usage basket. These achievements are helping advance Mexico's transition to a digital economy.

TABLE 1.1. **MEXICO HAS LAUNCHED AN AMBITIOUS SET OF REFORMS**

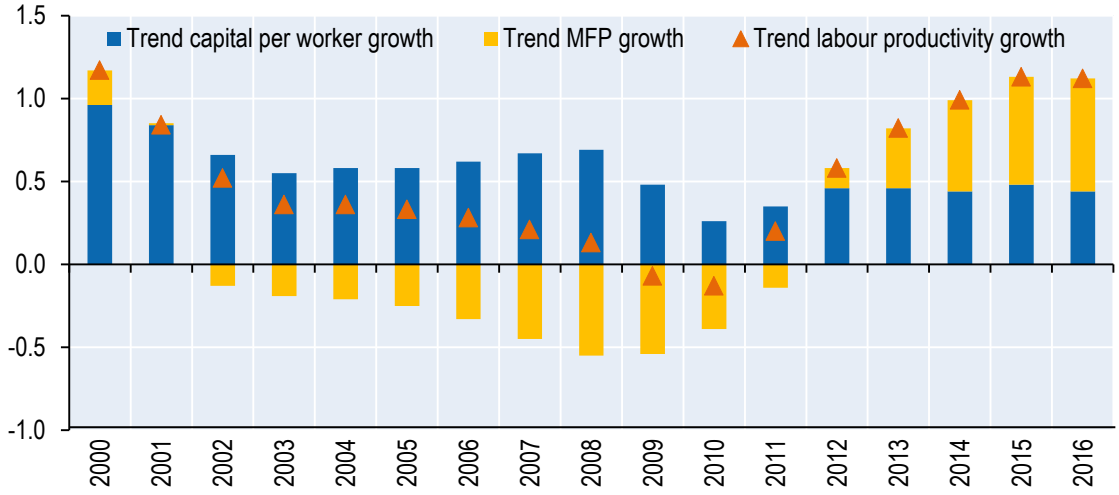
Key reforms launched since 2012 and their goals

Structural reforms	Purpose of the reform
Reforms with implementation well advanced	
Tax policy reform	Raise more revenue, reduce dependency on oil revenues, plug tax loopholes, enlarge the tax base, increase progressivity and simplify the tax system. Strengthen enforcement.
Financial sector liberalisation	Provide more access to credit at a lower cost and improve competition in the banking sector.
Telecommunications and broadcasting reform	Protect consumer interests, by promoting competition to reduce the cost of telecom services and increase access.
Election system reform	Increase women's participation in political life; allow re-election of mayors and parliamentarians by 2018.
Competition policy and regulatory reform	Strengthen competition policy and improve the regulatory environment.
Energy market openness	Open the oil and gas sector to private operators; liberalise the electricity sector.
Reforms with gaps in implementation	
Labour market reform and tackling informality	Improve incentives to join the formal sector and update and upgrade Mexico's labour laws.
Education reform	Substantially revamp the education system and introduce a "new education model", which seeks to promote equality of opportunities by harmonising access to good quality education, reducing inequities across schools, institutionalising teacher and general education system evaluation and strengthening school autonomy.
Anti-corruption and transparency reform	Strengthen the National Anti-corruption System and step up sanctions to those convicted of corruption, and improve public sector transparency and public governance.
Judicial reform	Improve the efficiency of the justice system.
Innovation system reform	Boost research and development, and infrastructure; develop more clusters and special economic zones. Promote digitalisation.
Fiscal federalism	Strengthen fiscal responsibility at the subnational level.
Reforms that have not advanced enough	
Modernisation of agriculture	Promote farm consolidation and private sector investment in agriculture by relaxing rigidities in land tenure system and removing disincentives on land privatisation.
Unemployment insurance, pensions and social benefits	Reduce income risks related to unemployment and boost the incomes of the elderly poor.
Health system reform	Further integrate, expand and improve the health system.

Source: OECD Secretariat.

FIGURE 1.5. **THANKS TO THE AMBITIOUS REFORMS PRODUCTIVITY GROWTH IS STRENGTHENING**

Trend in labour productivity growth, as a percentage



Note: MFP = multi-factor productivity.

Source: OECD (2018), *The Global Forum on Productivity – Compare Your Country Tool*, http://www.oecd.org/global-forum-productivity/data/.

To tackle high levels of poverty and inequality, Mexico has implemented significant social programmes, which have increased coverage and benefits. For instance, PROSPERA, the cash transfer programme, has proven successful in increasing school attendance, fighting malnutrition and providing extended health care to poor families. Helped by these investments and Mexico's National Inclusion Strategy, the share of people living on less than 50% of the median income fell by two percentage points during 2012-14.

With the aim of fighting informality, the government stepped up supervision for firms with 50 or fewer employees. It introduced labour, tax and social security reforms, simplifying tax compliance and substantially reducing personal, social security, value added and excise tax obligations for the first decade of firms' operation. These reforms, which include incentives to help new firms expand (including access to government-backed financing and training and a series of electronic tools to simplify tax compliance), have induced 1.5 million informal firms to join the tax system since 2014. A dynamic service sector is also supporting formal employment growth, taking the unemployment rate to a ten-year low.

To improve learning outcomes, Mexico launched important education reforms that work towards putting students and schools at the centre of the system. Mexico's new education model was introduced in 2017 with the aim of ensuring that children receive a quality education that prepares them for 21st-century challenges. Mexico has also made efforts to improve school environments, invest in more and better infrastructure, refine evaluation and assessment practices, foster equity and inclusion, and raise the quality of the teaching profession. The 2013 Professional Teaching Service (*Servicio Profesional Docente*) established a teacher evaluation system that appraised almost 87% of teachers on a voluntary basis in 2016. After making some adjustments to the process, the National Institute for Educational Assessment and Evaluation (*Instituto Nacional para la Evaluación de la Educación*, INEE) reintroduced the mandatory nature of teacher appraisal in 2017. These evaluations are a major step towards improving Mexico's education system and by all means need to be continued. As a consequence of the reform, the education system now focuses on learning outcomes, with the students at the centre of this effort.

To close gender gaps in labour market outcomes, gender equality budgets have been increased, with major resources dedicated to advancing women's economic autonomy. Public scholarships are keeping more girls in upper secondary school. An increase in the quantity and quality of childcare centres is giving mothers more childcare options – a key tool for improving women's labour force participation. Women's access to financial services was improved by strengthening the programmes of the National Development Bank. In 2017, financial sector regulation was changed to enhance women's participation in boards and decision-making positions in companies listed on the Mexican Stock Exchange. To advance gender equality in public institutions, Mexico incorporated a gender perspective in its National Development Plan 2013-18, among others, and introduced gender parity with the 2014 electoral reform. As a result, Mexico now has the highest female representation in Congress in the OECD. Mexico has also adopted laws against harassment and discrimination in the workplace, and a general law against violence against women.

Mexico has also launched important reforms to better protect the environment. The government ratified the Paris Agreement and is unconditionally committed to reducing greenhouse gas (GHG) emissions and short-lived climate pollutants, implying a 22% reduction of GHG emissions and a 51% reduction of black carbon, relative to current levels, by 2030. Changes to the climate change law now mandate the creation of a cap-and-trade system. Progress in improving access to drinking water and sanitation has also been considerable and the government has taken steps to raise the efficiency of water use. Water use tariffs have been significantly increased since 2014, and incentives to better use and treat water have been introduced. To better protect its precious biodiversity, the government established 11 new protected areas between 2009 and 2015, increasing coverage to 91 million hectares. Mexico also uses a range of other policy tools to conserve and sustainably use biodiversity, including subsidies and payment for ecosystem services (PES). In fact, Mexico's PES programme is one of the world's largest.

However, while this set of reforms has laid the foundation for higher prosperity and well-being, it is just a first step. Fully implementing the legislative and institutional changes is now crucial to ensure continuity and allow the reforms to show the desired effects. Moreover, reform implementation has been slow in areas that are essential to guarantee the effectiveness of the overall reform process, notably in fighting corruption, enhancing transparency and improving the rule of law and the functioning of the judicial system (Table 1.1). For example, while reforms such as the establishment of the National Anti-corruption System created a good foundation to fight corruption, implementation is still a work in progress. Mexico is in the midst of appointing several key positions, including the Anti-corruption Attorney, and states are still developing the necessary legal reforms to implement local anti-corruption systems. Moreover, reforms have not always gone far enough. This is in particular the case for public governance reform, but also in the areas of pensions and health care.

Public sector weaknesses are the main impediment to progress as they hamper the effective implementation of policies

Strengthening Mexico's public sector is a prerequisite if the country wants to achieve stronger, greener and more inclusive growth. As with economic performance, there are wide disparities in the capacities of the public sector between the national and the regional level and across different regions. The federal government, along with some state governments, has been able to build a more capable workforce and an institutional setting that provides more certainty and effective services. However, institutional capacity is weak on average and progress made in the economic and social institutional infrastructure (in terms of

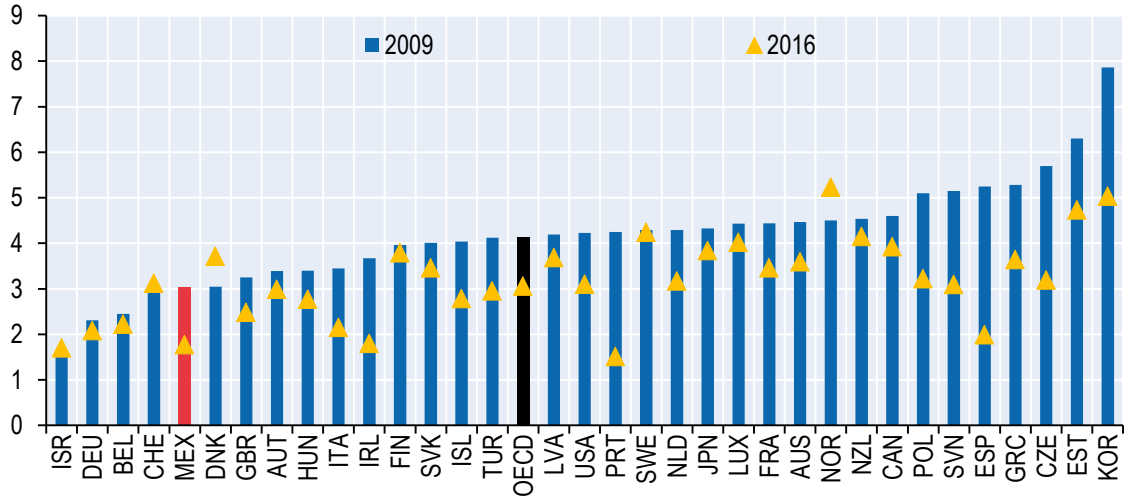
effectiveness and access) has not been followed by improvements in the judicial system and the rule of law, both of which are still weak in international comparison. In addition, insufficient public revenues hamper the government's ability to fulfil its obligations in terms of infrastructure investment and social spending.

While tax revenues have increased thanks to the 2014 tax reform, they remain very low in international comparison. Revenues are too low to foster sustainable development and support the necessary spending on infrastructure, education, health care, poverty reduction, family support and social protection. Government investment is low by international comparison and, in fact, has declined in recent years (Figure 1.6). While there is room to improve the efficiency of spending, there is also potential to raise additional tax revenues, including by broadening the tax bases and adjusting the tax mix by stepping up taxes on immovable property and environmentally related taxes. A more decisive fight against informality and corruption would improve tax collection and enhance the redistributive role of its tax system. A co-operative effort is needed to provide the State with the necessary capacities to boost development, human and financial resources, competencies and skills, and tools to fight corruption. Strengthening governance is particularly important at the regional level, where there is still high institutional disparity and, in many cases, widespread corruption.

Even though successive governments have worked towards improving the functioning of Mexico's public sector (e.g. the possibility to re-elect municipal leaders for more than one term has recently been made possible), institutional capacity remains low and uneven, especially at the state and local levels. A majority of municipalities, for example, lack a professional workforce. Policy delivery is further hampered by unclear and overlapping responsibilities across levels of government along with inadequate resources. While the share of states and municipalities of total public expenditure is in line with the OECD average of federal countries, the difference between taxing power and spending responsibilities is larger in Mexico. In fact, Mexico's subnational governments have one of the lowest shares of resources from tax revenue among OECD countries.

FIGURE 1.6. **GOVERNMENT INVESTMENT IS FALLING**

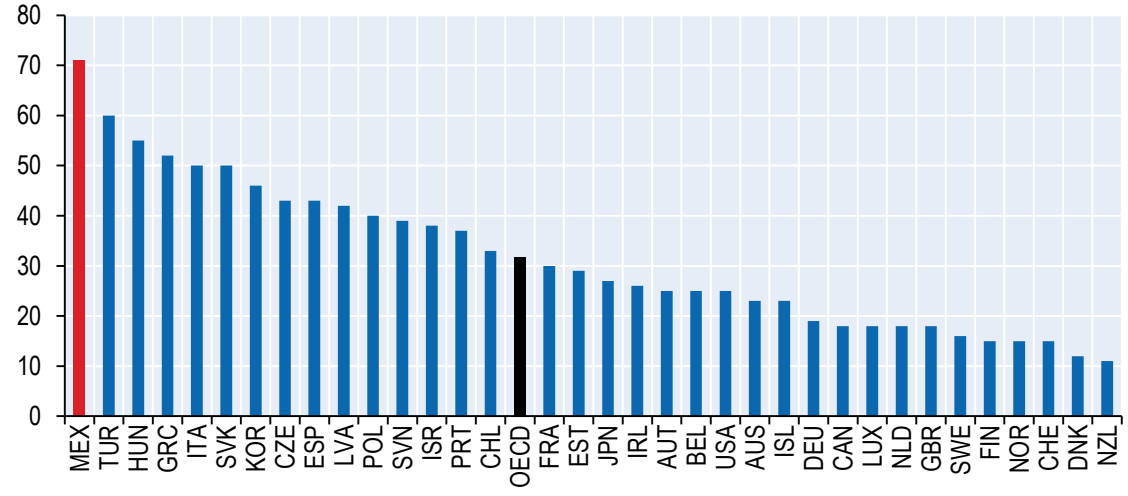
Government investment as percentage of GDP



Source: OECD National Accounts Statistics (database).

FIGURE 1.7. **MEXICO IS THE POOREST PERFORMER FOR CORRUPTION ACROSS THE OECD**

Perceived level of public sector corruption,
index from 100 (most corrupt) to 0 (least corrupt), 2017



Source: Transparency International (2017), *Corruption Perceptions Index.*

Corruption and the perception of corruption also remain major issues, both at the national level, but even more so at the local level. More than 60% of people believe that government corruption is widespread (Figure 1.7). Advancing reforms in this area is therefore absolutely critical. Corruption hinders the effective implementation of policies not only because it skews the system to benefit those who are in a position to pay bribes, but also because it erodes people's and firms' trust in government. Moreover, it means that significant amounts of money are not spent in a way that would advance the Mexican economy (e.g. on productive investments by firms).

Also, Mexico's justice system faces immense challenges, notably in terms of credibility, effectiveness, timeliness and integrity. For instance, in 2016, 83% of Mexicans perceived the judiciary as corrupt, well above the OECD average of 65%. In addition, unequal access to justice remains a major issue. To better meet justice needs, Mexico has amended its Constitution and other laws to facilitate the enforcement of constitutional rights. It has also profoundly changed its criminal justice system, which is key to improving personal safety and the rule of law. The challenge is now to ensure coherent public policy on justice and security both across states and the federal level and across all justice stakeholders at each level of government. Moreover, addressing the lack of training of criminal justice stakeholders, from police to lawyers and judges, is crucial.

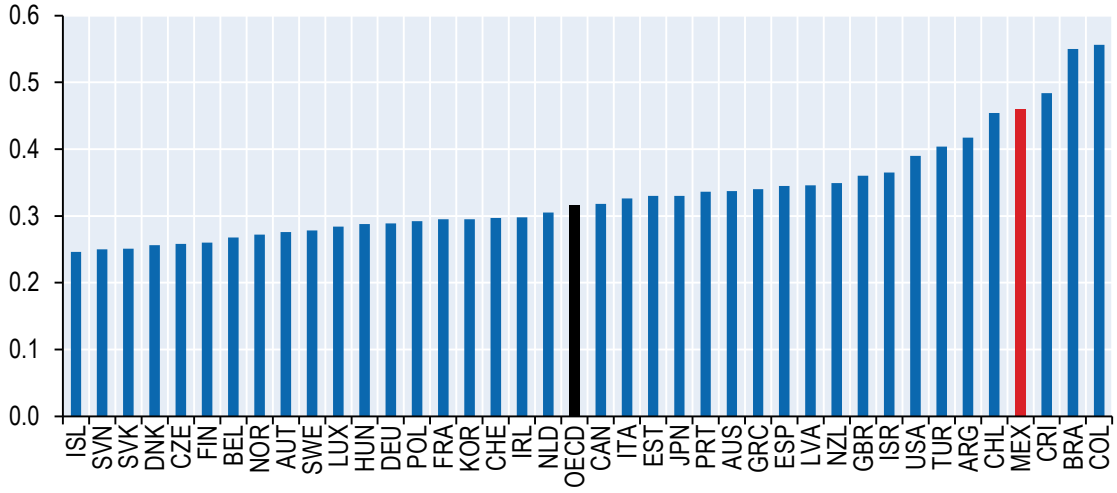
Advancing inclusion is not only important from a social perspective, it is also a prerequisite for Mexico to realise its economic potential

In 2014, inequality of disposable income as measured by the Gini coefficient was 0.46 (Figure 1.8). This measure is down from about 0.50 in the mid-1990s, but still about 50% higher than the OECD average of 0.315. The decline in relative income poverty since the late 1990s has slowed and it is still high in comparison to other OECD countries and some Latin American countries at similar levels of per capita GDP. In 2014, almost 17% of Mexicans had an income after taxes and transfers of less than the median, almost twice the OECD average. Mexico's tax and transfer system, in fact, does little to improve equality. The difference between inequality (as measured by the Gini coefficient) before and after taxes and transfers is the lowest in the OECD. Moreover, despite improvements, Mexico's social safety net remains weak.

These high levels of income inequality hamper both economic and social progress in Mexico as people from lower-income families are not able to live up to their potential. While Mexico has still a relatively young population, the demographic bonus is declining rapidly, raising the importance of fully using all available talent. As in other OECD countries, family background still has a strong impact on an individual's life chances. The education outcomes of children are strongly related to the socio-economic status and education of their parents. For instance, youth from high-income families are three times as likely to enrol in tertiary education as those from low-income families (Figure 1.9). A person's education level not only influences her means to improve her socio-economic conditions, but also her health outcomes. For example, in Mexico a 30-year-old man with tertiary education degree can expect to live 5.3 years longer than a 30-year-old man with education below upper secondary (Figure 1.9).

FIGURE 1.8. **INCOME INEQUALITY REMAINS VERY HIGH IN MEXICO**

Gini coefficient from 0 (perfect equality) to 1 (perfect inequality), 2015 or nearest available year

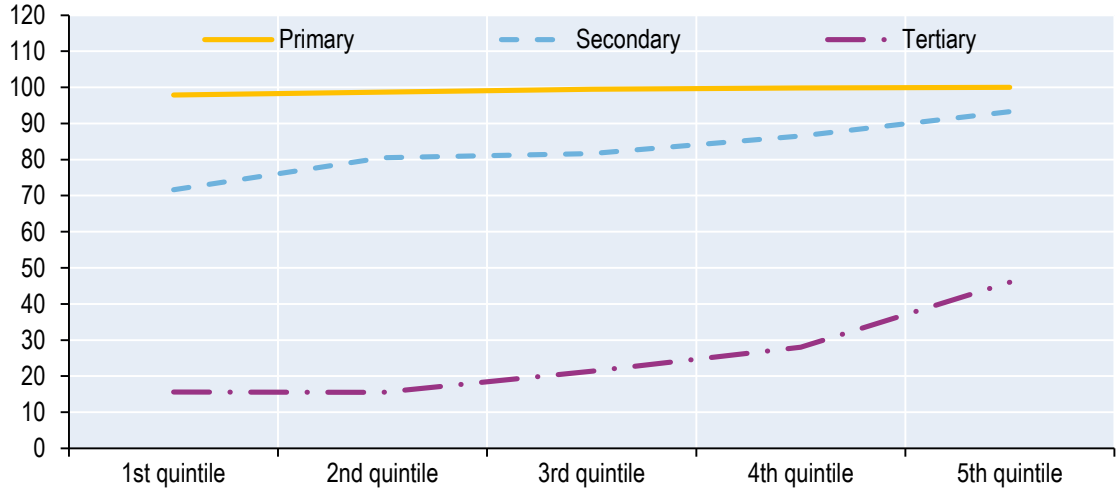


Note: Income defined as equivalised disposable household income.

Source: OECD Income Distribution Database, http://oe.cd/idd.

FIGURE 1.9. **YOUTH FROM HIGH-INCOME FAMILIES HAVE A HIGHER PROBABILITY OF ENROLLING IN TERTIARY EDUCATION THAN THOSE FROM LOW-INCOME FAMILIES**

Net enrolment rates by income decile, percentage, 2014



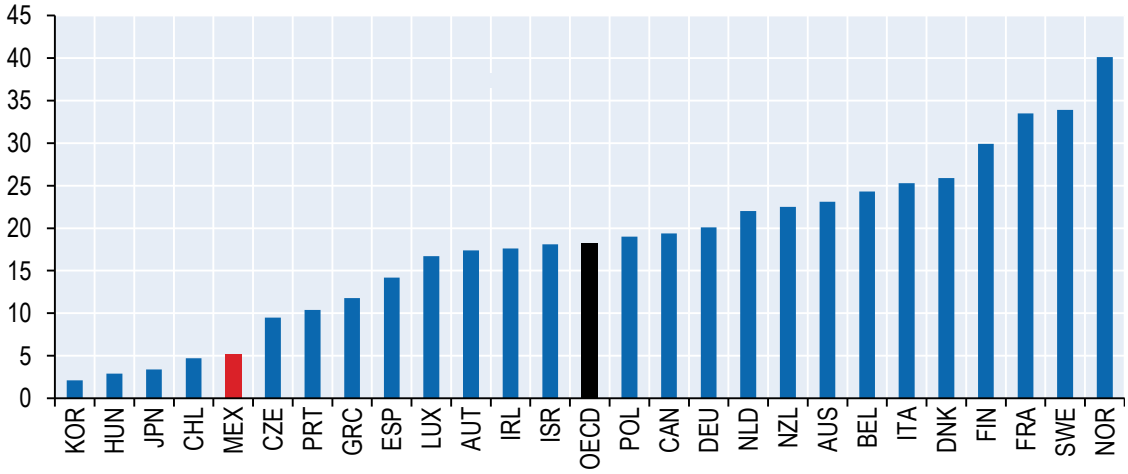
Source: SEDLAC and World Bank (2018), *Base de datos socioeconómica para América Latina y el Caribe.*

Similarly, persistent gender inequalities do not only reduce the well-being of women, but also limit the country's growth potential. While Mexico has made progress in increasing prime-age (25-54 years-old) women's participation in the labour force since the early 1990s, it remains lower than the OECD average and significantly lower than men's participation rate. OECD estimates suggest that halving the gender gap in labour force participation between Mexican men and women by 2040 could increase per capita GDP by nearly 0.2 percentage points, per year, over baseline projections. Mexican women earn on average 17% less than men, which is partly a result of women's career breaks, occupational and sector segregation in low-paid and

informal jobs, differences for paid and unpaid work hours, and discrimination in hiring and promotions (OECD, 2016a). The participation of mothers is particularly low, in part owing to the lack of good quality and affordable early childcare for children aged two and younger (for children aged three to five, the situation has improved over the last years). The gender gap in terms of family responsibilities is the highest among OECD countries, with Mexican women spending about four hours more than men on unpaid work per day. Also, less than 10% of seats on boards are held by women, a low level compared to other OECD countries (Figure 1.10). Moreover, while Mexican women are well represented in the Mexican Federal Public Administration (accounting for 51% of public employees in 2016), they fill only one-third of managerial positions. Despite progress, reducing violence and aggression against women and making inroads on access to justice continue to be pending items on the national agenda, as well as at the regional level, where performance is highly unequal. Focusing efforts on particularly vulnerable groups, such as single mothers, will be key to achieving real progress on this agenda.

FIGURE 1.10. **WOMEN TAKE UP FEWER LEADERSHIP POSITIONS THAN MEN**

Proportion of women on boards, 2015

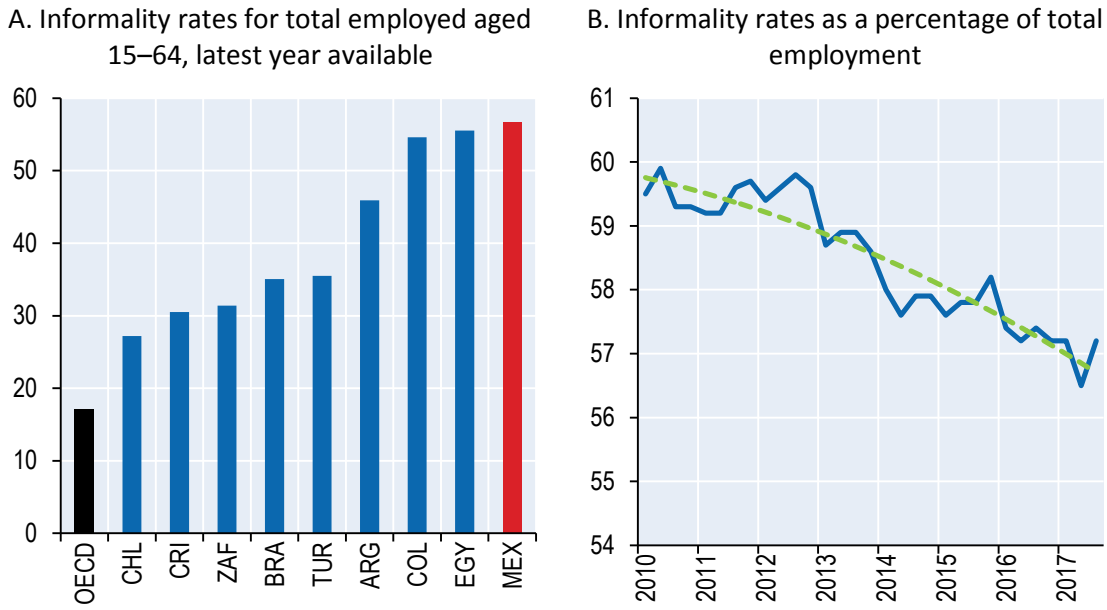


Source: OECD Labour Force Statistics Database and *MSCI ESG Research Survey of Women on Boards.*

Unequal access to opportunities by Mexico's indigenous people is another important obstacle to stronger and more inclusive growth. Indigenous people face persistent disadvantage and discrimination, and have lower rates of educational attainment, literacy and school attendance than non-indigenous Mexicans. Of indigenous Mexicans over age 15, 19% are illiterate compared to just 6% of non-indigenous Mexicans. Indigenous people also tend to be concentrated in lower-paying jobs. Designing effective policies that provide equal educational opportunities regardless of the socio-economic background, giving every student the same chance to succeed, is therefore crucial. Mexico also faces significant challenges in ensuring a good quality of life for those in old age. Old age poverty is much higher in Mexico, touching 25.6% of those over 65 in 2014, twice the OECD average. Pensions have a propensity to transmit a significant part of working life inequality to old age. On average, about two-thirds of the increase in wage inequality is transmitted to pension inequality in OECD countries, with Mexico close to the OECD average. The defined contribution system of individual accounts, introduced in 1997 for private-sector workers and in 2007 for public-sector workers, has been relatively successful in increasing the capacity of the Mexican economy to finance pensions.

However, contributions to the system are too low to guarantee pension benefits of more than 50% of final salary. Moreover, as the contributory pension system only covers formal sector workers who are in dependent employment and registered, a large part of the working-age population is not reached. Like all pension systems in OECD countries, the Mexican system has a non-contributory old-age social protection component for those individuals who have been unable to accumulate enough rights or assets, but the levels of this safety net are very low (6.2% of average earnings, OECD, 2017d).

FIGURE 1.11. **DESPITE SOME PROGRESS, INFORMALITY REMAINS HIGH**



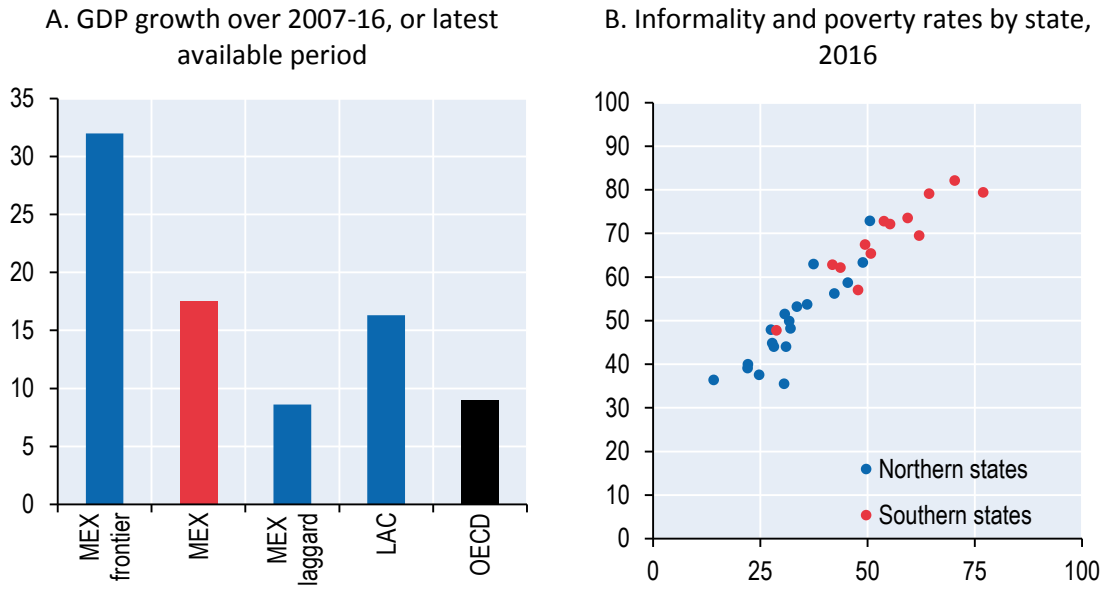
Note: In panel A, informality is defined to include: (i) employees who do not pay Social Security contributions, and (ii) self-employed who do not pay Social Security contributions (Chile, Costa Rica and Turkey), or whose business is not registered (Argentina, Brazil, Colombia, Egypt, Mexico, Peru and South Africa).

Sources: OECD (2016b), "Closing gender gaps in the labour markets of emerging economies: The unfinished job", in *OECD Employment Outlook 2016*, http://dx.doi.org/10.1787/empl_outlook-2016-8-en; OECD (2017c), *OECD Reviews of Labour Market and Social Policies: Costa Rica*, http://dx.doi.org/10.1787/9789264282773-en; INEGI, *Encuesta Nacional de Ocupación y Empleo.*

Informality remains widespread, amounting to close to 57% by the end of 2017 (Figure 1.11). Informality is concentrated in very small informal firms (which employ more than half of Mexico's informal workers) and in the South. Informality harms vulnerable workers by offering lower wages and fewer career progression opportunities, as well as excluding them from labour market and social protection regulations. Informality also represents a significant hurdle for the up-skilling of the Mexican workforce. First, firms in the informal sector do not provide learning and training opportunities and invest little (or not at all) in their workers. Second, the informal sector represents a viable alternative for students who drop out from education, halting the development of their skills in formal education or training. As a consequence, and also due to the resulting misallocation of resources, informality is a major drag on productivity.

The inequalities at the individual level are reproduced at the spatial level (Figure 1.12). Disparities between a highly productive modern economy in the North and in the Centre and a low-productivity, traditional economy in the South, have increased. Inter-regional differences in per capita GDP among small regions, as measured by the Gini index, were the second highest in the OECD in 2013, albeit the gap has decreased since 2008. The richest region was six times richer than the national average. Productivity in the region with the highest level, Campeche, was 12 times higher than in the least productive region, Chiapas.

FIGURE 1.12. **REGIONAL DISPARITIES REMAIN LARGE**



Note: Panel A: The fastest-growing states are: Mexico City, Querétaro, Nuevo León, Tabasco and Aguascalientes. The slowest-growing states are: Baja California, Baja California Sur, Chiapas, Nayarit and Tlaxcala. States most dependent on the oil sector (Campeche and Tamaulipas) are excluded since they suffered from both a deep recession since the collapse of oil prices and from the trend of declining oil production.

Source: INEGI and CONEVAL.

These spatial differences in economic performance are mirrored in differences in broader measures of well-being. Regional disparities are due to unequal resource endowments and investments, distance from markets, long-standing power imbalances, ethnic and racial disadvantage and institutional weaknesses (see below). Providing regions with the means to tap their full potential is crucial for stronger and more inclusive growth in Mexico. This implies investing in the capacity of regional and local governments to successfully design and deliver policies, but also in dearly needed transport and digital infrastructure to better connect laggard regions with the rest of Mexico and with other countries.

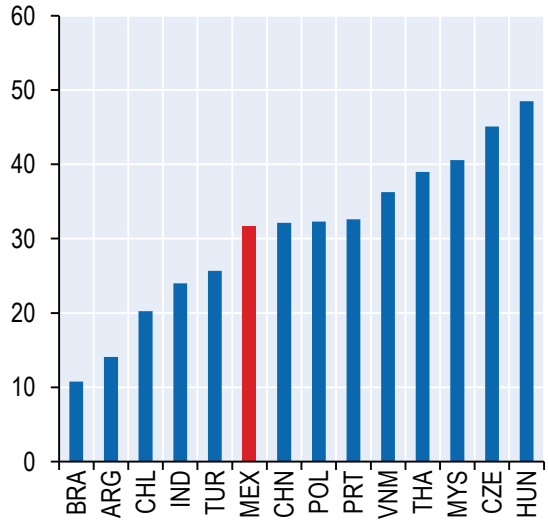
Building on recent competition-enhancing reforms is key to fully reap the benefits of globalisation and digitalisation

While Mexico's integration into global value chains (GVCs) is successful, it remains incomplete. Following the North American Free Trade Agreement, Mexico became the prime

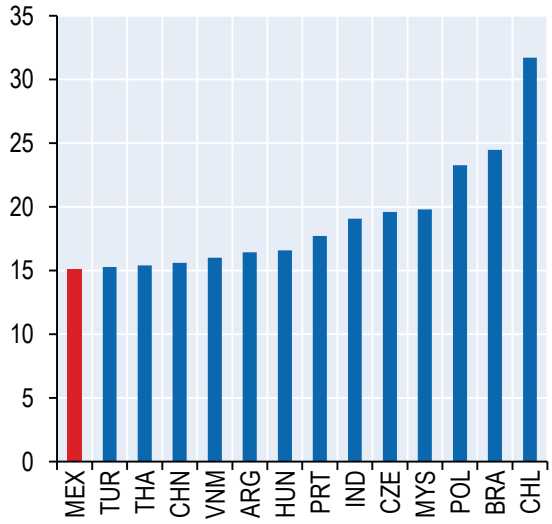
supplier of intermediate goods and assembler for the US manufacturing sector. Its integration into GVCs has therefore been mostly through its integration into the US business cycle, making the country very exposed to economic developments in the United States. In recent years, domestic content has increased and imported content declined, meaning that more domestic value added is present in Mexico's exports. Still, Mexico has room to do even better (Figure 1.13, panel A). Moreover, the share of Mexican value added embodied in foreign countries' exports is low by international comparison (Figure 1.13, panel B).

FIGURE 1.13. **MEXICO HAS ROOM TO FURTHER INTEGRATE INTO GLOBAL VALUE CHAINS**

A. Backward participation (share of foreign value added in Mexico's gross exports), 2011



B. Forward participation (share of domestic value added embodied in foreign countries' exports), 2011



Source: OECD (2017b), *OECD Economic Surveys: Mexico 2017*, http://dx.doi.org/10.1787/eco_surveys-mex-2017-en.

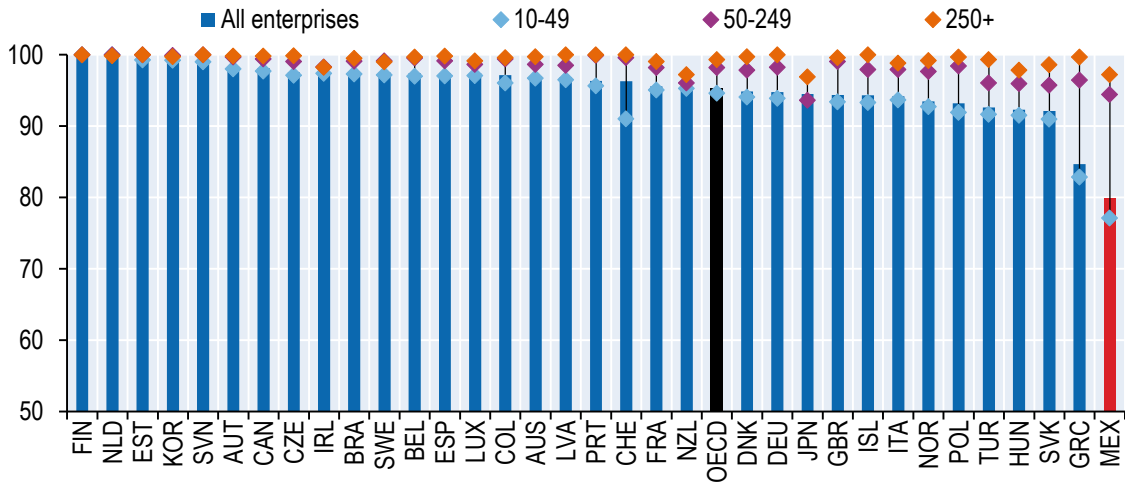
To draw more value-added from its global engagement, Mexico needs to further improve its capabilities in knowledge- and skill-intensive activities within GVCs. The highest level of value creation in a GVC is often found in certain upstream activities, such as new concept development, design, research and development (R&D), or the manufacturing of key parts and components, as well as in certain downstream activities, such as marketing, branding or customer service. Boosting innovation is vital for Mexico to move up value chains. Private sector R&D expenditure in Mexico is well below that of nearly all OECD and BRICS countries (Brazil, Russia, India, China and South Africa). Obstacles to raising the country's innovative potential include a weak domestic research and skills base, an underdeveloped knowledge-based start-up environment and institutional challenges. Co-operation between public and private research centres is weak and the early stage financing framework insufficient.

Further reducing barriers to foreign investment and services trade in productive sectors not yet well integrated into GVCs but with high comparative advantages is also important. While barriers to foreign investment and services trade have been reduced in key sectors – notably media and telecoms – a substantial gap remains to OECD best practice in nearly all sectors. In particular, sectors that are key determinants of GVC integration (e.g. logistics) have stringent

regulation. Despite important efforts to reduce administrative burdens, they remain substantial. More progress is particularly needed at the local and state levels, where entry barriers often remain substantial and high sectoral concentration persists. Greater harmonisation of rules with trading partners could yield a further boost to trade flows.

FIGURE 1.14. **MEXICO LAGS BEHIND OTHER OECD COUNTRIES IN TERMS OF ENTERPRISES' BROADBAND CONNECTIVITY**

Share of enterprises with a broadband connection, 2016



Notes: Except where otherwise stated, the sector coverage consists of all activities in manufacturing and non-financial market services. Only enterprises with ten or more employees are considered. Size classes are defined as: small (10–49 employees), medium (50–249 employees) and large (250 employees or more). For country exceptions, see note 2 at the end of the chapter.

Source: OECD, *ICT Access and Usage by Businesses* (database), http://oe.cd/bus.

Mexico is not yet fully reaping the benefits of the digital revolution. Employment in the information and communication technologies (ICT) sector is just above 1% of total employment and, in contrast to other OECD countries, has declined in recent years. The sector's contribution to private sector research is also low. In 2015, it accounted for only 0.17% of total business expenditure on R&D, well below the OECD average of 0.40%. Internet usage is low in Mexico, largely due to low skills. Only 85% of all 16-24 year-olds are using the Internet, compared to figures close to 100% in most other OECD countries. Similarly, the share of enterprises with a broadband connection in Mexico is well below that in other OECD countries (Figure 1.14).

Economic growth is coming at a cost to the environment, an important component of people's well-being

Mexico's per capita emissions of greenhouse gases – excluding most of those due to forest clearance – are well below the OECD average, but have been rising. Emissions per unit of GDP have declined very little over the past 25 years and are now not much below the OECD average. GDP growth since 1990 has been accompanied by a decline in energy intensity (total primary energy supply per unit of GDP), but in recent years the decline has faltered. The legal and institutional framework that Mexico has put in place provides a good basis to tackle these

issues. The problem going forward will be to deliver on the promises, which will require overcoming institutional weaknesses.

Avoiding water stress is another important issue for Mexico. The country still has the lowest rate of connection to public wastewater treatment plants in the OECD and water-use efficiency remains low by OECD standards. Due to population growth, Mexico will have to provide an additional 36 million people with drinking water and 40 million people with sanitation services over the next two decades, a significant challenge. Multi-level and river basin governance issues are an important obstacle to progress as are overlaps and gaps in regulatory functions and inconsistencies across water, agriculture and energy policies.

Mexico is one of the most biodiverse countries in the world, being home to more than 10% of the world's biodiversity. But Mexico's biodiversity and ecosystem services are under threat, with many species either "critically endangered", "endangered" or "vulnerable". Terrestrial biodiversity loss is caused by a multitude of factors, including the conversion of natural ecosystems for crop and livestock production; urban expansion; poor agriculture, livestock and forestry management practices; and infrastructure construction. Marine biodiversity loss is mostly due to overexploitation by fisheries, pollution from agricultural run-off and sewage, and habitat modification. Weaknesses in the institutional framework for biodiversity management are a key hindrance to tackling these problems effectively.

Fostering stronger, greener and more inclusive growth requires a set of bold reforms in several complementary policy areas

To tackle these challenges, Mexico needs to continue past reform efforts, ensuring the effective and full implementation of already legislated reforms and complementing them with additional reforms. In doing so, it is crucial for Mexico to realise complementarities between reforms in three different areas, namely reforms to continue building a highly competitive economy, reforms to foster inclusion and reforms to strengthen institutions. Making growth more inclusive will not only ensure that higher growth translates into widespread gains in well-being, but it will also help the pro-competitiveness reforms to reach their desired growth-effects by allowing firms to use all available talent. Improving the functioning of public institutions, including equipping them with the required financial and human resources, in turn, will help ensure an effective implementation of policies in the other two areas. For instance, they will allow a proper enforcement of the new competition law and the enhanced regulatory management framework, they will allow social policies to be well-targeted and provide sufficient support, and they will assure that public services are not skewed and mainly benefit the better off or well-connected.

This report has been prepared to help the next government of Mexico identify the necessary policy actions and prioritise them. It proposes an integrated package of policy recommendations destined to bolster growth and well-being and improve the lives of the Mexican people, based on experiences from OECD countries.

Chapters 2 to 4 investigate how Mexico can further strengthen its public sector to ensure the efficient and effective delivery of policies. Chapter 2 first looks into Mexico's tax and transfer

system, proposing ways to raise additional tax revenues, while at the same time identifying potential to improve the efficiency of spending. It also makes suggestions for how to raise the redistributive effect of Mexico's tax and transfer system. Chapter 3 focuses on Mexico's institutional framework, discussing measures to better fight corruption, make the judicial system more effective and strengthen the rule of law. Chapter 4 examines how Mexico can reduce the wide regional disparities in well-being by fostering greater fiscal, technical and human resource capacity, as well as transparency at state and local government levels. It also looks at how cities can better reap the productivity benefits associated with scale and how the tourism sector can be better used for regional development objectives.

Chapters 5 to 8 focus on making growth more inclusive to ensure that all Mexicans can contribute to and benefit from it. Chapter 5 discusses how Mexico can enhance the quality and equity of its education and skills system. Concentrating efforts on those at the bottom will be crucial; ensuring that the education system provides them with the tools they need is crucial. In particular, early childhood care and education is important in this regard since its impact on people's skills and dispositions lasts a lifetime. Chapter 6 then takes a look at Mexico's labour market and social policies, proposing ways to reduce informality, create more good-quality jobs and strengthen social protection. Chapter 7 investigates how Mexico can make further inroads on gender equality by removing barriers to paid work, fighting violence against women, changing social norms and expectations and mainstreaming gender in all policy areas. Chapter 8 takes a closer look at Mexico's health care system. While significant progress has been achieved in recent years on expanding health care coverage, low health care spending and high out-of-pocket costs lead to inequalities in access to quality services. Moreover, the fragmentation of the system remains a major issue as it leads to performance differences across sub-systems and states, gives rise to duplication and coverage gaps, and lowers the overall quality of care.

Chapter 9 discusses how Mexico can fully reap the benefits of globalisation and digitalisation by building on past competition-enhancing reforms and ensuring that they are more widely spread across firms, regions and people. Continuing the liberalisation in the energy and telecommunication sectors is crucial in this regard, but Mexico also needs to remove remaining barriers in services trade to further facilitate the country's integration into global value chains. Despite important progress, there is room to strengthen competition law even more, particularly as regards public procurement and combating bid rigging. Strengthening innovation policies is also crucial, not least to allow the country to fully reap the benefits of the digital transformation.

Chapter 10 looks into how Mexico can tackle its multiple environmental challenges as a clean and diverse environment is a key element of people's well-being. Delivering on the country's climate change commitments will require progressively increasing carbon taxes and ensuring that rates more uniformly reflect the carbon content of fuels. Strengthening the institutional framework for biodiversity management and reforming environmentally-harmful government support in sectors such as agriculture and fisheries are also important. Promoting water-use efficiency across sectors, allocating water where it creates most value and encouraging investment in water infrastructure will help Mexico address its water management challenges.

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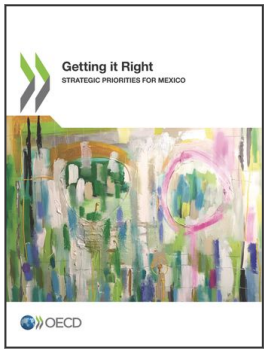

From:

Getting it Right

Strategic Priorities for Mexico

Access the complete publication at:

https://doi.org/10.1787/9789264292062-en

Please cite this chapter as:

Ramos, Gabriela and Isabell Koske (2018), "Introduction", in OECD, *Getting it Right: Strategic Priorities for Mexico*, OECD Publishing, Paris.

DOI: https://doi.org/10.1787/9789264292062-2-en

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