Acute Morbidity and Labor Outcomes in Mexico: Testing the Role of Labor Contracts as an Income Smoothing Mechanism

Federico H. Gutierrez

PII:	S0304-3878(14)00074-1
DOI:	doi: 10.1016/j.jdeveco.2014.05.009
Reference:	DEVEC 1915

To appear in: *Journal of Development Economics*

Received date:	25 July 2012
Revised date:	18 May 2014
Accepted date:	29 May 2014

Please cite this article as: Gutierrez, Federico H., Acute Morbidity and Labor Outcomes in Mexico: Testing the Role of Labor Contracts as an Income Smoothing Mechanism, *Journal of Development Economics* (2014), doi: 10.1016/j.jdeveco.2014.05.009

Acute Morbidity and Labor Outcomes in Mexico: Testing the Role of Labor Contracts as an Income Smoothing Mechanism

Federico H. Gutierrez[a,1]

[a]*Department of Economics, Vanderbilt University, VU Station B # 351819, 2301 Vanderbilt Place, Nashville, TN 37235-1819*

Abstract

Economic development is associated with an increase in the share of workers in salaried jobs. This process may be accompanied by a reduction in wage fluctuations if labor contracts are used as income smoothing mechanisms. This paper tests to what extent salaried jobs help reduce the volatility of wages by insuring workers against productivity shocks. Analysis of MxFLS data indicates that the average contractual arrangement in Mexico insure the worker against idiosyncratic productivity fluctuations associated with episodes of illness. The evidence is stronger for workers in formal jobs. To validate the methodology, the test is also implemented on a sample of self-employed workers. In this case, it correctly rejects the presence of insurance against productivity shocks.

JEL: O120, O170, J410, J240

Keywords: Implicit contracts, acute morbidity, illness, health shocks, Mexico, occupational choice

1. Introduction

It is widely accepted that economic development is associated with a structural transformation of the economy, consisting of workers migrating from the agricultural-rural sector to the manufacturing and the service sectors located in urban areas. Traditional theories such as the Harris and Todaro (1970) model of internal migration, the Lewis (1954) hypothesis on labor surplus and the Kuznets (1955) curve contain this idea. Less studied is the fact that economic development is also associated with a change in the type of employment. Figure 1 panel A shows the cross-country association between GDP per capita and the share of workers in salaried jobs. The evident correlation is not only a mere consequence that salaried jobs are more prevalent in urban areas while self-employment dominates in rural areas. Figure 1 panel

Email address: `federico.h.gutierrez@Vanderbilt.Edu` (Federico H. Gutierrez)

[1] Tel.: +1-615-322-3339; fax: +1-615-343-8495.