

End of outsourcing in Mexico: goal achieved by the current administration by 2024?

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Abstract

Transformations and eventualities have modified the different markets of an economy. In particular, labor reforms have impacted aspects such as work skills, unemployment and the questioned outsourcing. Thus, the problem addressed in this study is the implementation of subcontracting in certain sectors, and the working conditions faced by workers hired in this modality, because they can't afford to work this way. Since there is no clear stance whether outsourcing is beneficial or not and who it benefits; In this work we are inclined to accept the fact that this type of hiring is not supported by social security, salary compensation, vacation bonuses, bonuses, among other benefits that formal jobs have. In this sense, our objective is understanding the relationship between the reduction in subcontracting and the time elapsed since the implementation of the reform. Using information from INEGI, we determined a linear regression model to establish the relationship between the hiring period and the total number of subcontracted workers. Concluding, that labor subcontracting could finalize in a total of 3.5 years from when it became official.

Key Words

Subcontracting, employment, labor reform, job precariousness.

Classification JEL: E24, J01, J02, J41.

Introduction

Outsourcing, also known as subcontracting, is a labor phenomenon that has gained increasing relevance in the business world. It is a practice in which companies choose to hire the services of other companies for the execution of specific tasks and functions, rather than directly hiring employees on their payrolls to carry out these activities.

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This outsourcing strategy has proven to offer certain notable benefits for companies. Firstly, it involves a significant cost reduction, which is particularly attractive to organizations seeking to maximize their profit margins. Additionally, outsourcing allows for a deeper specialization in particular areas of operation, which can enhance efficiency and the quality of results obtained, according to Ruyter, Brown, and Burgess (2018).

However, outsourcing has also generated concerns and criticisms in various parts of the world, including Mexico. One of the main reasons for concern is the impact on the working conditions of employees involved in this model. Outsourcing can lead to situations where workers do not receive the same benefits and protections they would have if they were directly employed by the main company. This can manifest in forms such as lack of job security, absence of mandatory benefits, and uncertainty about the continuity of employment. Moreover, such outsourcing can alter labor reforms and, consequently, restructure international agreements that Mexico has, including the North American Free Trade Agreement (Bensusán et al., 2020).

In the context of current economic globalization, outsourcing has become a strategy frequently employed by large corporations to restructure their operations and segment them, allowing them to take advantage of economies of scale and ultimately maximize their profits. However, as pointed out by Rosas and Medrano (2002), this strategy, while profitable for companies, leaves workers in a vulnerable position.

In Mexico, outsourcing has been the subject of a growing public debate in recent years due to its implications for workers' well-being, compliance with labor laws, and income distribution. The increasing prevalence of outsourcing has raised additional concerns, such as labor exploitation, tax evasion, and inequality in access to benefits and labor rights.

As described by Díaz (1994), outsourcing involves a substantial reorganization in the allocation of resources and can have a significant impact on various sectors of the economy. Although it is a feasible strategy for large corporations, it does not necessarily translate into proportional benefits for workers. Temporality and lack of benefits are common concerns for subcontracted employees, who may find themselves at a disadvantage in terms of wages and job security. This precariousness in employment manifested during the COVID-19 crisis, disproportionately affecting women and resulting in a higher frequency of subcontracting accompanied by lack of protection and very low wages (Borderías and Martini, 2020).

This study conducted an analysis of the impact of the subcontracting reform on the Mexican labor market. Using information from the National Institute of Statistics and Geography (INEGI, 2023) and focusing on employment in Mexico (with the manufacturing sector as a reference), the analysis aimed to understand the relationship between the reduction in subcontracting and

the time elapsed since the implementation of the reform. The goal was to evaluate its effect on employment growth, particularly in the manufacturing sector due to the prevalence of this hiring modality in that sector.

The present article is structured as follows: in addition to the introduction, the first section provides the theoretical framework and background to subcontracting. The second section presents the methodology using linear regression; the third section presents the available information and results. The fourth section compares the literature with our findings, concluding with conclusions, limitations, and future work.

Theoretical Framework and Background

One of the concerns regarding outsourcing is that subcontracted workers often face lower wages, less job stability, and limited access to essential benefits such as social security and pensions. Additionally, it has been argued that outsourcing can be used by companies to circumvent labor and union laws, undermining workers' ability to organize and defend their rights, creating a significant gap in labor treatment between direct and subcontracted employees. It is becoming more prevalent, and the formal sector is consistently weakening as a consequence (Pérez and Cordero, 1994). It is also important to note that some authors, such as Hafiz (2020), emphasize the relevance of governmental intervention to eliminate illegal monopsonies and provide legal resources for worker-formed organizations.

In response to these concerns, the Mexican government implemented a subcontracting reform in 2021, aiming to protect workers' rights and ensure fair treatment in the workplace. Acknowledging the urgency of fair treatment for workers, at least in terms of wages, is justified by Carrera, Lara, and Policardo (2022), who, through econometric analysis for the Mexican labor market, argue that a salary increase, besides not causing inflation, can stimulate the economy through increased labor productivity and contribute to economic growth.

The reform, according to the Government of Mexico (2021), focuses on eight main points:

- 1. Prohibits the use of this modality in essential activities of the company and its predominant economic activity.
- 2. Allows the use of this modality only in specialized services and works.
- 3. Companies receiving specialized services must be responsible for workers in case of non-compliance.
- 4. Mandatory registration of specialized subcontracting companies with the Ministry of Labor and Social Welfare (STPS), subject to accreditation of fiscal and social security obligations.
- 5. To prevent simulation and tax fraud, criteria from the Fiscal Code, the Income Tax Law,

- and the VAT Law are aligned with the Federal Labor Law.
- 6. Thousands of workers will transition to a formal employment scheme and gain the right to profit-sharing.
- 7. Regarding the reform's timelines, the STPS will issue guidelines for the registration of specialized subcontracting companies. Once the guidelines are issued, companies have 3 months to regularize and transfer their workers, recognizing them as their own, and every 3 years, companies must update their registration with the STPS.
- 8. The Federal Law of State Workers is reformed to eliminate personnel subcontracting in the Federal Government. A diagnostic process will begin in government agencies to regularize subcontracted personnel.

Furthermore, by acknowledging their employees, companies grant them the right to profit-sharing, and with the reform, it is expected to increase by approximately 100 billion pesos, the amount received by workers through profit-sharing (Government of Mexico, 2021).

While the fourth industrial revolution in labor, which includes outsourcing, changes in skill sets, and home-office, is not only necessary but inevitable, companies, workers, and governments must adapt to these needs (de Ruyter, Brown, and Burgess, 2018). However, the outsourcing reform in Mexico, although initiated with the best intentions, has also raised a series of concerns and debates about potential consequences and effects on the country's labor and economic landscape.

In this way, there are diverse opinions on this issue, making it somewhat more complex to understand due to the many perspectives it can have. One of the main points of discussion is that the prohibition of outsourcing may have negative effects on employment and, ultimately, on the economy as a whole. This perspective, as noted by Malacara (2021), argues that by eliminating the possibility of subcontracting, many people currently working under this modality could become unemployed. In other words, the reform, instead of being a positive solution, could bring about worse consequences than the current situation. Additionally, there is fear that companies may stand firm in not hiring new employees due to the costs and additional requirements associated with direct hiring, potentially leading to a slowdown in job creation and economic recovery.

Another significant concern raised is that the prohibition of outsourcing could affect the competitiveness of Mexican companies in international markets. Outsourcing has been a strategy that has allowed companies to expand and compete effectively in the global arena, leveraging advantages such as flexibility and cost efficiency. The elimination of this option could hinder the ability of companies to compete in an increasingly globalized and competitive world. Furthermore, issues of needs and identity have not been considered; for example, in the rural

sector, people become accustomed to precarious working conditions (Dorado and Urbano, 2020).

However, there is also concern about whether the reform will be effective in addressing concerns related to outsourcing. Companies may find ways to bypass the new regulations and continue to benefit from labor exploitation and tax evasion, potentially counteracting the reform's objectives. Effective implementation and enforcement of the reform pose a considerable challenge due to the scope and complexity of the outsourcing phenomenon in Mexico. This implies the need to establish strict monitoring and compliance mechanisms to ensure that companies adhere to the new regulations.

The outsourcing reform in Mexico is a controversial topic that has generated a wide range of opinions and concerns. Despite the good intentions behind the reform, its impact on employment, the economy, and its effectiveness in addressing underlying issues related to outsourcing are matters that require continuous analysis and a careful approach to achieve a balance between protecting workers' rights and fostering a competitive business environment, as both are important for the country's economic development. Based on this, Didry (2019) comments that the adoption of labor laws can modify the progress made in labor law for workers, and situations resulting from these reforms, such as recruitment and opportunities for new professionals, will be significant tests for companies and the government.

To begin, detailed data on the evolution of outsourcing in Mexico before and after the reform will be collected, along with information on employment in the manufacturing sector. This data will undergo a linear regression analysis that will assess whether there is a significant correlation between the decrease in outsourcing and the increase or decrease in job creation. Additionally, extra variables, such as the size of the companies, the specific industry being analyzed, and the region, will be considered to obtain a more complete and accurate picture of the situation.

The analysis may also include a comparison with other countries that have not implemented similar regulations on outsourcing. This will help evaluate whether the decrease in outsourcing in Mexico has unique effects or is part of a global trend. According to Guerrero (2021), outsourcing is increasing worldwide, with 30% of leading companies opting for this modality. Comparing with other countries will help contextualize the results and provide valuable data.

It is important to note that this analysis falls within the United Nations Sustainable Development Goal 8, "Decent Work and Economic Growth." Evaluating the impact of labor reforms on employment growth and work quality is essential for progress toward sustainable development, promoting equity and economic prosperity.

Statistical analysis using linear regression will accurately address the impact of the outsourcing reform on the Mexican labor market, understanding how this measure affects employment and whether it can serve as a reference for other countries facing similar challenges in the context

of increasing global outsourcing. This approach will contribute to achieving sustainable development goals and designing effective labor policies.

The choice of linear regression as a method to explain the outsourcing phenomenon and its impact in Mexico after the 2021 reform is justified by its ability to model relationships between variables clearly and understandably. This statistical approach allows evaluating the relationship between the reform and specific changes in the labor market, such as employment and working conditions. Linear regression is suitable in this context due to its simplicity and effectiveness in handling direct relationships between variables, such as the effect of outsourcing on wages and job stability.

Furthermore, linear regression facilitates the inclusion of multiple independent variables, such as the size of the companies, the industry, and the region, allowing for a more holistic and detailed analysis. This method is effective in identifying and quantifying trends, patterns, and correlations, offering a solid foundation for drawing informed conclusions about the impact of the reform. In such a multifaceted topic as outsourcing and its effects on the economy, linear regression provides a robust and accessible analytical framework to explore these complex interactions.

Methodology:

To demonstrate the correlation between variables, two conditions must be met: i) the intuitive part that reflects the expected theoretical analysis (direction of that relationship represented in the slope of the resulting equation), and ii) statistical significance, which indicates the minimum explanation error committed by the independent variable on the dependent variable.

To capture conditions (i) and (ii), we rely on the following linear expression,

$$Y_i = a_0 + a_1 X_{1i} + a_2 X_{2i} + \dots + a_k X_{ki} + U_i$$
(1)

Where, Y_i represents the dependent or explained variable, and $X_1, X_2, ..., X_k$ are the k possible independent variables. The coefficients a_j represent the effects of changes in the independent variables on the dependent variable, expressed as

$$\frac{\partial Y_i}{\partial X_{ji}} = a_j$$
, for $j = 1, 2, ..., k$.

On the other hand, U_i represents uncontrolled and random variables, called disturbances; classic examples of these disturbances include a crisis, a war, an illness, among others. Equation (1), which considers the effects of independent variables on the dependent variable, combined with the disturbance factor, represents an econometric model.

To find the values of the coefficients a_j (j=1,2,...,k) ordinary least squares (OLS) are used, which estimate the average behavior of Y_i given the observation $X_1, X_2, ..., X_k$, this is, $\widehat{Y}_i = E(Y_i|X_1, X_2, ..., X_k,) = \widehat{\alpha_0} + \widehat{\alpha_1}X_{1i} + \widehat{\alpha_2}X_{2i} + \cdots + \widehat{\alpha_k}X_{ki}$

To check if the variables $X_1, X_2, ..., X_k$, are individually significant on Y_i , the following hypothesis test is proposed:

$$H_0: a_i = 0$$
 vs $H_a: a_i \neq 0$, para $j = 1, 2, ..., k$ (2)

To test it, p-values (probability of error) are used. A p_{value} < 0.05 indicates that the variable X is statistically significant in explaining the behavior of Y_i , at least with 95% confidence.

Analysis and Results

Using statistical information from the National Institute of Statistics and Geography regarding employment in Mexico (with the manufacturing sector as a reference), we define the change in the proportion of outsourcing in Mexico:

This is from 2021, the year in which the reform against outsourcing is promoted and comes into effect, until February 2023, decreasing from 19.02% to 1.70%. OUTSOURCING PROPORTION IN MEXICO 19.07% 19.02% 19.18% 19.08% 19.01% 18.05% 9.73% 5.70% 4.10% 3.27% 2.83% 2.74% 2.53% 2.40% 2.26% 2.04% 2.00% 1.94%	This is form 2021 the man in which it f				
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1.94%	2.00%				
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1.89%	1.89%				
1.87%	1.87%				

"End of outsourcing in Mexico: Has the current administration's goal for 2024 been achieved?"

1.82%	
1.79%	
1.78%	
1.76%	
1.69%	
1.70%	

Table 1. Percentage Change in the Proportion of Outsourcing. Source: INEGI. Statistics from the Program for the Manufacturing, Maquiladora, and Export Services Industry.

We subtract the total employment in February 2023 from the total employment in January 2021 to verify if there was an increase or decrease in employment after the reform, and we do the same with directly hired employment, as shown in Table 2.

DECREASE IN OUTSOURCING PROPORTION	-19.02%
CHANGE IN TOTAL EMPLOYMENT	227536.00
CHANGE IN DIRECTLY HIRED EMPLOYMENT	693,245
CHANGE IN SUBCONTRACTED EMPLOYMENT	-465,709
TOTAL EMPLOYMENT:	2,929,652
TOTAL SUBCONTRACTED	49,684
TOTAL NOT SUBCONTRACTED:	2,879,968

Table 2. Change in Employment after the Reform.

Source: INEGI. Statistics from the Program for the Manufacturing, Maquiladora, and Export Services Industry.

For the second part of the analysis, we define an equation that describes the change in subcontracted personnel over time elapsed since the reform.

$$Ls = a - b(Tr) + U_t$$

When:

Ls = Subcontracted workers.

Tr =Time elapsed since the reform.

 U_t = Is the disturbance in each period.

A partir de la información disponible, tenemos la siguiente estimación,

$$Ls = 113822.65 - 2825.79(Tr)$$

$$p_{value}$$
 (0.000)

In addition to being significant ($P_{value} = 0.000$), expression (4) shows that with each increasing period, there are 2826 fewer workers who will stop offering their services under the subcontracting scheme every monthly period.

Based on the estimation (4), we can make predictions, such as the period in which the reform will achieve its main objective: completely eliminating subcontracting. For this purpose, we set expression (4) equal to zero.

$$0 = 113822.65 - 2825.79(Tr)$$

Resolving for the elapsed time (Tr) by adding 2825.79 (Tr) to both sides.

$$2825.79(Tr) = 113822.65$$

Subsequently, both sides are divided by 2825.79.

$$Tr = \frac{113822.65}{2825.79} \approx 41 \text{ (month)}$$

This is practically equivalent to 3.5 years, showing that if the reform started two years into the current administration, it will achieve its "success" when the administration concludes its term in 2024.

Results and Impacts Achieved

In this study, an analysis focused on evaluating the impact of the subcontracting reform in Mexico and its direct effect on worker hiring has been conducted. To carry out this assessment, a linear regression model has been employed. The results obtained through this statistical analysis are revealing and suggest a moderate correlation between the time elapsed since the implementation of the reform and the decrease in subcontracting. The expression is significant and indicates that the total number of subcontracted workers can be explained by the period elapsed since the reform.

This finding has important implications as it suggests that the reform has had a significant impact on reducing subcontracting in Mexico. While the entirety of this decrease cannot be solely attributed to the reform, as there are other factors that can influence subcontracting, such as workers themselves no longer allowing to be hired in this manner, the analysis conclusively points out that the reform has greatly contributed to the observed decrease in subcontracting practices.

Such statistical assessments are crucial for understanding the impact of labor policies and reforms on the dynamics of the labor market. In this case, the results support the effectiveness of the reform in reducing subcontracting and, consequently, in protecting labor rights and promoting more stable and secure work in Mexico. Additionally, these findings can serve as a reference and guidance for other countries considering similar measures in the context of the growing global trend towards subcontracting.

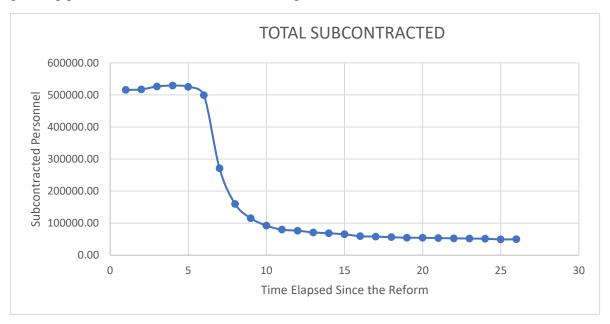


Figure 1. Decrease in subcontracting in Mexico after the reform.

Source: INEGI. Statistics from the Program for the Manufacturing, Maquiladora, and Export Services Industry.

An important aspect is that total employment in Mexico has not decreased; rather, it continues to grow. This was a concern before the implementation of the reform, as some argued that the decrease in subcontracting could negatively impact employment. However, the results suggest that the reform has not had a negative impact on total employment, which could be considered a positive outcome.

Date	PERIOD	ACTUAL	ESTIMATION
sep-21	<u>9</u>	<u>115,374</u>	88390.51462
<u>oct-21</u>	<u>10</u>	<u>92,193</u>	85564.72205
<u>nov-21</u>	<u>11</u>	79,592	82738.92948
<u>dic-21</u>	<u>12</u>	76,402	79913.13691
<u>ene-22</u>	<u>13</u>	<u>71,064</u>	77087.34434
<u>feb-22</u>	<u>14</u>	<u>68,382</u>	<u>74261.55177</u>
<u>mar-22</u>	<u>15</u>	<u>65,219</u>	71435.7592
<u>abr-22</u>	<u>16</u>	<u>59,151</u>	<u>68609.96663</u>
<u>may-22</u>	<u>17</u>	<u>57,960</u>	<u>65784.17406</u>

<u>jun-22</u>	<u>18</u>	56,208	<u>62958.38149</u>
<u>jul-22</u>	<u>19</u>	54,548	<u>60132.58892</u>
ago-22	20	54,391	<u>57306.79635</u>
<u>sep-22</u>	<u>21</u>	<u>53,454</u>	<u>54481.00378</u>
<u>oct-22</u>	<u>22</u>	<u>52,474</u>	<u>51655.21121</u>
<u>nov-22</u>	<u>23</u>	<u>52,077</u>	<u>48829.41864</u>
<u>dic-22</u>	<u>24</u>	<u>51,220</u>	<u>46003.62607</u>
<u>ene-23</u>	<u>25</u>	<u>49,290</u>	<u>43177.83351</u>
<u>feb-23</u>	<u>26</u>	<u>49,684</u>	<u>40352.04094</u>
<u>mar-23</u>	<u>27</u>		<u>37526.24837</u>
<u>abr-23</u>	28		<u>34700.4558</u>
<u>may-23</u>	<u>29</u>		<u>31874.66323</u>
<u>jun-23</u>	<u>30</u>		<u>29048.87066</u>
<u>jul-23</u>	<u>31</u>		<u>26223.07809</u>
<u>ago-23</u>	<u>32</u>		<u>23397.28552</u>
<u>sep-23</u>	<u>33</u>		<u>20571.49295</u>
<u>oct-23</u>	<u>34</u>		<u>17745.70038</u>
<u>nov-23</u>	<u>35</u>		<u>14919.90781</u>
<u>dic-23</u>	<u>36</u>		12094.11524
<u>ene-24</u>	<u>37</u>		9268.322669
<u>feb-24</u>	<u>38</u>		<u>6442.5301</u>
<u>mar-24</u>	<u>39</u>		<u>3616.73753</u>
<u>abr-24</u>	<u>40</u>		790.9449604
<u>may-24</u>	<u>41</u>		<u>-2034.847609</u>

Table 3. Predictions based on regression. Source: Own elaboration from INEGI. Statistics from the Program for the Manufacturing, Maquiladora, and Export Services Industry.

The use of the linear regression model has not only allowed us to assess the impact of the subcontracting reform in Mexico but has also helped predict when subcontracting will be completely eliminated in the country. According to the results of the analysis, it is estimated to occur in period 41, and considering that these are monthly periods, it would correspond approximately to May 2024.

It is important to note that this prediction, although made as accurately as possible and with the help of linear regression, should be considered an estimate and not absolute certainty. This estimate is subject to possible changes in economic and political conditions that could influence subcontracting in Mexico. Due to these external factors and unpredictable variables that may affect labor dynamics, the date that was obtained for the elimination of subcontracting is susceptible to changes.

Additionally, it is important to mention that the prediction is based on known data about subcontracting, meaning that unregistered or non-publicly known data is not taken into account.

This adds an additional source of uncertainty to the prediction since unregistered information may influence the future path of subcontracting.

In summary, the linear regression model has provided an estimate of when subcontracting could be completely eliminated in Mexico, pointing to May 2024 as a possible timeframe. However, it should be noted that this estimate is a projected expectation and is subject to possible changes, as well as the influence of unregistered factors. Nevertheless, we note that this type of analysis is valuable for planning labor policies, understanding trends in the labor market, and considering changes that may arise unexpectedly.

Discussions

Our work aims to present alternative mechanisms for protecting workers, different from the classics involving transfers and salary increases. Some others, as suggested by Hafiz (2020), highlight government intervention to eradicate illegal monopsonies and legal resources for the support of worker-formed entities.

Additionally, issues of needs and identity have not been considered, meaning that in many places, especially in rural sectors, people become accustomed to living with low wages and precarious working conditions (Dorado and Urbano, 2020). It is genuinely concerning that, as mentioned by Pérez and Cordero (1994), the importance of the formal sector is diminishing, and it is becoming easier to access the informal sector, which continues to grow and be encouraged. Currently, the labor market is undergoing significant changes, but these changes must be for further improvement, ensuring that both the company and the worker collaborate and have the best conditions and results or benefits, without one being harmed while the other gains. Therefore, it is of utmost importance that subcontracting is regulated and modified in such a way that both parties benefit.

Conclusions

The results obtained in this study provide an extremely positive overall picture, suggesting that the subcontracting reform in Mexico has had a significant impact on its reduction, while also achieving growth in total employment. This was one of the main concerns about the implementation of this reform. The findings from this study have relevance beyond national borders, as they could offer valuable insights to other countries considering the implementation of similar reforms in their labor markets.

One of the standout aspects of these results is that they demonstrate that it is possible to reduce subcontracting without necessarily harming overall employment. This translates into an approach that seeks to balance the protection of labor rights and the improvement of working conditions for workers, and this balance is essential to promote more stable and secure work.

However, it is crucial to note that, while the reduction in subcontracting is a significant step, there are still pending considerations that need attention in future research. One of these considerations includes evaluating the impact on the salary offered to workers affected by subcontracting, as this variable can influence the quality of employment. Additionally, it would be appropriate to perform a regression on the change in long-term unemployment to more solidly demonstrate that the reform will not cause harm to the labor market in the future. All these considerations will be left for future work.

The results of this study support the effectiveness of the subcontracting reform in Mexico in terms of reducing this practice and maintaining employment growth. These findings provide valuable insights for other countries and highlight the importance of considering the complexities of the labor market equitably. However, it is acknowledged that there are still variables and considerations to explore in future research, enriching the understanding of this issue and supporting the design and implementation of more effective labor policies.

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