# Flexible Workforce

## *The role of temporary employment in recession and recovery*

BY BETTY JOYCE NASH AND JESSIE ROMERO

Sandra Youngblood's temporary staffing service took its first hit in 2008, when her clients started laying off temps. "So as not to affect their permanent staff," she says. She runs Youngblood Staffing with her husband; the home office is in Wilmington, N.C., with branches in Whiteville, Lumberton, and Fayetteville. The staffing company was lucky, she says, because they were able to cut expenses to the bone and save their own employees' jobs. "We did not have to close offices."

Things got better. By the middle of April 2010, "The skies opened and we tripled our business in a month and we have not slowed down."

This pattern of boom and bust has become typical of the temporary help services industry. Starting with the 1990-1991 recession, the drop-offs and subsequent spikes in temp employment have intensified with each downturn. Temp employment turns negative months before total nonfarm employment — 12 months before, in the case of the last recession — and then starts increasing before an employment uptick. As a result, economists see temp employment as a buffer during recessions and a harbinger of direct hiring during recoveries.

Temporary jobs accounted for 26 percent of the new private-sector jobs created in 2010, compared to 7.1 percent in the same period following the 2001 recession. The industry has added an average of 25,000 jobs each month for the last year, the most of any sector. With unemployment still around 9 percent more than 18 months after the recession officially ended, some observers are wondering if, not when, companies will start hiring new employees directly. But although temporary employment is increasing more rapidly than employment overall, it remains a small share of the total. Even at the industry's peak in 2000, it accounted for just 2 percent of total employment, and today it is 1.7 percent. But just how temporary is the current preference for temp workers — and does that preference have long-term implications?

### The Macro Level

The temp industry grew from 1 million to 2.7 million workers in the 1990s, and its growth is cited as a factor in the decade's historically low unemployment and inflation rates. At least in the short term, some economists view the relationship between unemployment and inflation as a trade-off: Low unemployment and strong economic growth may lead to upward pressure on wages and "overheating" in the economy generally, which lead in turn to higher prices. But the wide availability of temp workers may have reduced the wage pressures that typically accompany a tight labor market, as suggested by Lawrence Katz of Harvard University and Alan Krueger of Princeton University in a 1999 paper. Looking at state-level data, they found that wages rose more slowly in states with a higher share of temporary employment: An 0.25 percent increase in temporary employment was associated with 0.2 percent slower wage growth.

At any given time, there is a certain rate of "natural" or "frictional" unemployment caused by the fact that it takes time to match workers with open jobs. Katz and Krueger note that temporary employment may smooth this friction by making matching more efficient. A worker can sign on with a temp agency instead of spending time searching for an open position, and a company can contract with a temp agency instead of spending time recruiting workers. And although a worker may be in a temp job involuntarily, preferring to find a permanent job, at least that worker is no longer unemployed. For these reasons, the rise in temporary employment between 1979 and 1993 may have lowered the natural unemployment rate by as much as 0.25 percent, according to a 1999 paper by Maria Ward Otoo of the Federal Reserve Board of Governors.

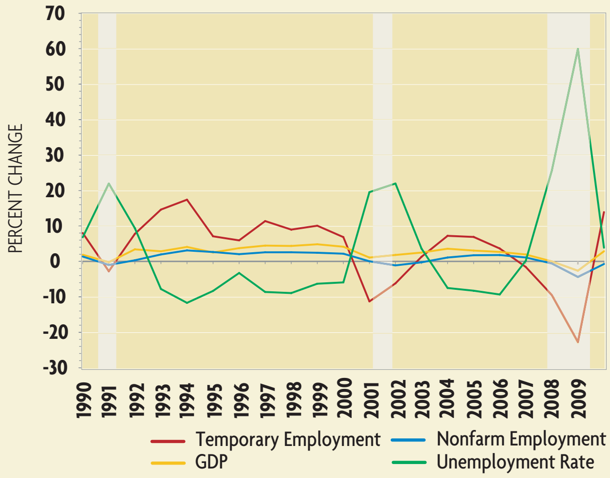
During a downturn, temps lose their jobs first. During the 2001 recession, temporary workers accounted for 26 percent of net job losses, although they made up only 2 percent of the workforce prior to the recession. Between December 2007 and December 2008, temp employment dropped by more than 484,000 jobs, about 19 percent, while total employment fell by 2.3 percent, according to the Bureau of Labor Statistics (BLS). The trough was in June 2009, when temp employment fell to its lowest rate since 1995, but since then it has increased every month, except for a regular seasonal downturn in January.

### Temping's Appeal

Such flexibility is what the temp industry was designed for: Companies use temps to respond to changes in demand without incurring the costs of hiring and firing. It is expensive to recruit, train, and provide benefits for new employees. If demand falls, the "adjustment costs" of laying off workers, such as mandatory advance notice of layoffs or severance packages, can equal as much as a full year of payroll. Firms may also use temporary workers to screen potential new employees or to fill in for sick employees.

Unemployment insurance taxes are another major expense. Companies are "experience rated" according to the number of workers they lay off who then claim benefits; more layoffs bring higher taxes. But temp workers are employed by the staffing agency, which means the agency,

**Temporary Employment, GDP, Nonfarm Employment, and Unemployment**




NOTES: Data are seasonally adjusted. GDP in real 2005 dollars. Shaded areas represent recessions.
SOURCES: Bureau of Economic Analysis, Bureau of Labor Statistics, Haver Analytics

not the company where the work was performed, gets the rating.

There are some disadvantages to using temporary workers. They can be less productive, perhaps because they are not motivated by the prospect of future raises or promotions, according to Chicago Fed economist Yukako Ono. Companies also pay a fee to the staffing firm, which varies depending on the number of workers, skill level, and contract length, among other factors. The total "bill rate" covers the worker's wage plus a markup for expenses such as workers' compensation and payroll taxes, operating expenses, and a profit margin.

That markup may not translate into higher wages for the employee. Temp workers in high-skill, high-demand fields, such as nursing, may earn more per hour than a similar permanent employee. But the majority of temporary positions are in low-skill fields such as clerical or light industrial work, where average hourly pay ranges from 75 percent to 85 percent of the national average wage for the same position, according to the BLS. Benefits also tend to be worse for temps than for regular employees, except in high-end fields. Although many temp firms offer health insurance, the policies are often bare bones and the worker is responsible for most of the cost, so the share of workers opting for coverage is low, according to Bryan Pena of Staffing Industry Analysts, an industry consulting group.

The uncertainty of temp work may make workers more likely to be depressed or anxious, according to researchers at McGill University. Anecdotally, temp workers report feeling like "second-class citizens" in the workplace, and miss feeling connected to an employer and their coworkers. Others prefer the flexibility, however, and view temp work as an opportunity to quickly learn new skills. But the majority of temp workers accept temporary jobs for economic reasons, either because it was the only job they could find or because they hope the placement will translate into a permanent position. In the last few years, the industry also has emphasized its role as a bridge to traditional employment. Surveys conducted by the American Staffing Association (ASA) report that about half of temporary workers are eventually hired directly by the company where they were placed as a temp or with another firm.

Results are mixed for the less-skilled and low-wage workers who make up the bulk of the industry. Temporary work employs a significant portion of participants in government employment and training programs; after the 1996 welfare reform in the United States, 15 percent to 40 percent of former welfare recipients found work in temporary jobs. A 2009 study followed welfare-to-work clients who were randomly placed in either temporary or direct-hire jobs. The workers placed in direct-hire jobs were more likely to be employed and had substantially higher earnings over a two-year period, but placement in a temporary job had no long-term positive effects on the probability of remaining employed or on earnings. "Placing them in a temporary job was about equivalent to no placement at all," says David Autor of MIT, who conducted the study with Susan Houseman of the Upjohn Institute for Employment Research. Still, when unemployment is high, a temporary job is better than no job. "You make more as a temp worker than you do when you're unemployed," Autor says. "Being employed is a positive thing."

The number of people looking for jobs right now means that competition is stiff even for temp jobs. Just ask Zachary Basham, 23, of Nellysford, Va. As a recent college graduate, he secured a temp job at a law firm reviewing claims. "It was my first job out of college and I was simply looking for a place to start." But he was let go after a week, along with several others, with no explanation or warning. He returned to doing maintenance on a golf course, but is currently unemployed except for his volunteer work in an alumni office at a private school. He's registered with several temp agencies but has had no calls.

## Harbinger of Hiring?

Temporary employment is broadly viewed by economists and policymakers as a leading indicator of permanent job creation — a sign that companies are trying out new workers and positions in anticipation of increased demand. But persistently high unemployment combined with the rapid growth of temp jobs has some observers worried that this recession is different.

Data proving the relationship between temporary and permanent employment are hard to come by. An analysis of BLS data by the American Staffing Association shows that, in the past, temp employment has led overall employment by about six months during normal economic times, and by three months when the economy is coming out of a recession. The ASA study doesn't include data from the current recession, which was both deeper and longer than the ones before it.

Economists and other researchers don't think that a "perma-temp" workforce is likely. "I don't see what would make us think this is some kind of brand-new paradigm. It seems a perfectly plausible response to a period of sustained uncertainty," Autor says. A large and permanent increase in temporary employment would mean that something dramatic had changed in the economy to change the costs of direct versus temporary hiring, he explains. "In general that would be an indicator of some type of deeper ailment. I don't think that's going to happen." Instead, the magnitude of the initial downturn may mean that there is a longer lag between temporary and permanent hiring on the upturn. "It's been a long deep recession and faltering recovery. It's natural that employers would not be hiring like gangbusters," says Autor.

The "absorptive capacity" of the temp industry has increased with each of the last three recessions, which could be a factor in the jobless recoveries that have followed. Erica Groshen, an economist at the New York Fed, suggests that perhaps one-third of the current job loss is due to cyclical change, resulting from decreased demand, and two-thirds to structural change, meaning that the jobs that have been lost aren't coming back in the same industries or locations. Temp work may facilitate structural change by enabling companies to use a downturn as an opportunity to reorganize production processes and trim payrolls. It may also make companies more likely to shed jobs via permanent layoffs, rather than laying off workers temporarily and then recalling them if things pick up, as Groshen explains in a 2003 article with fellow New York Fed economist Simon Potter.

Currently, consumers are spending more freely, business investment is picking up, and GDP is generally projected to grow 4 percent in 2011. And employers are adding to payrolls, albeit slowly. Hiring is likely to come around once employers trust the recovery, says Michael Doyle, vice president and general manager of the Southeast division of Manpower, one of the nation's largest temporary staffing firms. He is also seeing an increase in the number of people moving from temporary to direct-hire jobs. "I think [firms] cut beyond, maybe 2 percent to 3 percent more than they should have, and they're now hiring temps back rather than full-time employees." That said, for some companies, a leaner staff that uses the flexibility of temps may become their

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## How Temping Grew

In 1956, about 20,000 employees worked in temporary help services, mostly in factories and offices. Though temp use has spread across job sectors in the last 20 years, about 80 percent of temp labor is still low-skill, low-paying light industrial and clerical work. The remaining 20 percent includes professional jobs such as engineering, information technology, and health care specialties.

Many factors played a role in the rapid growth of the temporary sector, which expanded by 11 percent annually between 1979 and 1995. About 20 percent of the increase can be explained by the decline of employment at will, according to MIT economist David Autor.

Employment at will traditionally assumed that employers and employees can unilaterally end a relationship when and why they choose, unless otherwise stated by contract. The doctrine was recognized throughout the United States in the middle of the 20th century. Between 1973 and 1995, however, the courts of 46 states found exceptions that limited employers' discretion to let workers go. The direct and indirect costs to employers of legal action in the wake of those decisions are hard to quantify. But Autor's results found rapid growth of temp employment after a state's courts adopted an exception to employment at will, about 10 percent in the year of the ruling. The paper notes that temporary help continued to expand after 1992, several years after adoption of the most recent exception, suggesting other factors are involved as well.

As advances such as just-in-time delivery caught on, firms incorporated the idea of just-in-time labor into employment practices. Temp agencies also got good at matching people to jobs, using technology and expanded footprint to reach across geographical areas. The agencies added client services such as training and consulting, which has contributed to growth in the sector. As the concept of the variable workforce has taken hold, Michael Doyle of Manpower observes that this has become an integral part of company strategy, especially for large corporations

Today, the $70 billion temp employment industry consists of about 23,000 agencies. Almost half are small, with fewer than 100 full-time employees. At the other end of the spectrum are companies like Manpower, which operates in 82 countries and has 4 percent market share in the United States. During and after the recession, buyers have been negotiating lower fees, and the industry has consolidated. Weaker firms have been acquired by larger firms that, in some cases, cut rates to knock out the competition, according to Brian Pena of Staffing Industry Analysts.

Temp agencies face many of the same pressures as their client firms — particularly unemployment insurance taxes. Sandra Youngblood, of Youngblood Staffing, headquartered in Wilmington, N.C., says she's careful to serve only workers she can place elsewhere, in the event of layoffs. She recently turned down a chance to place 60 seasonal employees. "Back in the day, we would have jumped all over that," she says. "But knowing that in July those people are going to be gone, I don't see where I could place them." She, too, worries about the rising rates. The jobs recovery may have started first in the temp agencies, but even they still face tough decisions when it comes to hiring.

— Betty Joyce Nash

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don't know, we're dealing with unfamiliar territory here.'"

Unfortunately, he says, it would take a discipline-wide commitment to turn that around. The AEA recently considered adopting a code of ethics to induce economists to disclose any paid consultancies that could potentially sway their research conclusions. A better move, Colander says, would be for economists to have a culture that discourages people from purporting undue certainty in their predictions and explanations.

If there's a bottom line to recent criticisms of what economists study, Whaples says, it is that the fundamental dispute dates back at least a century. The consensus vacillates between those who say markets don't work well and that we need to put regulations on them, and those who point out the unintended side effects of government intervention and the fact that smart people will exploit regulations. "That basic argument goes back and forth, around in a circle, forever," Whaples says. "When we haven't had any crises for a while, the 'markets work' group will get stronger. And when we have a crisis the 'markets don't work so well' group will get stronger."

Nobody can say which is right, he says; there are valid points to be made on both sides. "But there's always going to be that middle ground. The problem is, it's kind of wide." The crisis may have helped narrow the question some: In what situations do markets work, and how does policy affect how markets function?

Economics is about the journey, not the destination; economists will never be "done" understanding the economy and human behavior. But the constant drive toward better understanding can only be a good thing for future economic thought. **RF**

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new normal. "I don't know — I'm waiting to see," he says.

Temp work is an important part of the flexibility that is one of the U.S. economy's great strengths. "In the long run, this flexibility helps make our country more competitive, it increases living standards, it lowers prices for goods," Groshen says. "But in the short run, there can be high costs to the workers involved — the costs are very concentrated, while the benefits are diffuse." **RF**

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