



“Summary of article by Katherine G. Abraham: Restructuring the Employment Relationship: The Growth of Market-Mediated Work Arrangements” in Frontier Issues in Economic Thought, Volume 4: The Changing Nature of Work. Island Press: Washington DC, 1998. pp.185-188

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## **“Summary of article by Katherine G. Abraham: Restructuring the Employment Relationship: The Growth of Market-Mediated Work Arrangements”**

This paper compares two approaches to the employment relation. In market-mediated relationships, firms look outside to find the labor and skills they need. Here the paper focuses on three specific types of such relationships: the use of *temporary workers*, *production subcontracting*, and *contracting out* for business support services. An important finding is the differences among these in the reasons that they are attractive to firms -- especially their roles in buffering change.

Internal labor markets are administrative mechanisms for finding, training, retaining, and promoting workers from within the firm's own employee base, rather than allowing these decisions to be determined in direct response to market forces. The coverage and administrative development of internal labor markets seemed to increase over much of the twentieth century, but during the 1980s there were signs of a reversal in this trend.

The paper considers the factors that could confer advantages on firms who turn to market-mediated employment relationships, and seeks evidence that these factors are increasing in importance.

### **TRENDS IN MARKET-MEDIATED WORK ARRANGEMENTS**

Internal labor markets use administrative rules to allocate and compensate labor. This can reduce the costs of recruiting and screening employees, and allows firms to incorporate training and rewards for good performance into long-term employment relationships. If skills are specific to the firm or industry, long-term employees will become more productive and more valuable. If employees value stability, they may work for a lower wage in return for stable employment.

During the period examined in this study (1972-1986), the trend toward strong employer-employee attachments slowed while the use of market-mediated work arrangements increased. Direct evidence for market-mediated employment is limited, but the patterns of growth, fluctuation, compensation, and benefits for certain industries and occupations allow some inferences to be drawn. Although their methodologies are not directly comparable, both the U.S. Bureau of Labor Statistics (BLS) monthly payroll survey and the Bureau of the Census (BOC) five-yearly Census of Service Industries show that employment in the business services industry grew much faster than the overall rate of employment growth. This category contains a number

of specialized services, ranging from computer programming and data processing to janitorial and mail room services, which are good candidates for market-mediated work arrangements. The business services industry also includes personnel supply services, of which temporary help is a large component.

From 1972 to 1986 personnel supply services employment expanded at an annual rate of 11.5% (as compared to total non-agricultural employment, which grew at an annual rate of 2.2%). From 1982 to 1986 the temporary help industry grew at almost 20 percent a year, bringing employment in this sector to around 800,000 people -- nearly up to the level of the automobile industry, and significantly above employment in the manufacture of computers and semiconductors. Beyond the agencies specializing in supplying temporary help, a reasonable guess is that "the aggregate employment of all types of temporary workers averaged something over 1.5 million people" during 1986. [91]

A survey of businesses conducted on behalf of the Bureau of National Affairs (BNA) was designed to fill in some of the gaps in other data sources. About 90 percent of responding firms used some form of short-term employment, either through direct short-term hiring, agency temporaries, or on-call workers. These forms of work increased the total hours worked in these companies by about 1.4 percent. The survey was useful in investigating whether the growth in employment through temporary help agencies offset declines in other functionally equivalent work arrangements; the answer appears to be that "there has been across-the-board growth in the use of market-mediated work arrangements." [92]

## **REASONS FOR THE USE OF MARKET-MEDIATED WORK ARRANGEMENTS**

There are three possible reasons why employers may prefer market-mediated work arrangements. The first involves *staffing flexibility*. Firms that use market-mediated work arrangements may be enabled to adjust the quantity and skill mix of labor to changing conditions while protecting regular employees. Since internal labor markets generally involve some investment in selecting and training long-term employees, these employees are likely to be kept on the payroll even during slack periods in order to ensure that they are available when needed. If fluctuations in demand are expected, there is an incentive to keep the core of regular employees small and use supplemental staff on an as-needed basis. This can save on labor costs even if short-term workers earn higher hourly wages or are less productive than regular employees.

If seasonal or cyclical fluctuations are being absorbed by the business services industry, relieving other firms of the strains of demand fluctuations, this should be reflected in the relative variation in employment levels in personnel supply services, which is dominated by temporary help agencies. "[P]ersonnel supply services employment... is so strongly seasonal and so strongly cyclical as to lend support to the conclusion that agency temporaries are filling a buffer role for user firms." [99-100] By contrast, neither the seasonality nor the cyclicity of demand appears to affect the use of subcontractors.

The second employer motivation involves *wage flexibility*. Firms may look to the outside labor market to circumvent some wage constraints imposed by internal labor markets. The relevant

wage constraints may include union contracts or efficiency wages -- higher wages paid to induce greater effort or lower turnover. While a firm may pay efficiency wages for essential or highly skilled jobs, it could reduce labor costs by contracting out peripheral activities like cleaning. However, workers' ideas about equity may also generate morale problems if there are large wage differences within the firm. "Moving work outside the internal labor market permits the firm to take advantage of low market wage rates for certain types of work without violating internal equity constraints." [96]

In order to fully understand the role of wage flexibility it is not only necessary to compare wages and benefits, but also the productivity levels of long-term and short-term employees. Where there are intermediaries such as subcontractors or agencies, fees and markups need to be compared to a firm's own overhead expenses when doing the work in-house. Though data for such a complete analysis is not available, data that has been obtained from employer survey responses indicate that lower wages and benefits are important motivations for contracting out low-skilled work. In contrast, these are generally not the main reasons for the use of temporary workers.

The third possible employer motivation reflects a need for *specialized services* that cannot be economically provided in-house. This figures prominently in employers' reports of why they use outside contractors, particularly among those who contract for administrative support services.

### **WHY HAVE MARKET-MEDIATED WORK ARRANGEMENTS INCREASED?**

While this paper cannot examine all possible explanations for the recent increase in market-mediated work, evidence may be adduced for several possible causes. One is increased variability in product demand. Since the early 1970s there has been an increase in macro-economic volatility. Exchange rates have fluctuated, producing uncertainty in export markets. Product life cycles have become shorter, requiring more frequent adjustments of equipment and labor.

Another motivation may be greater costs of hiring and firing employees. There is some indication that it is more expensive for U.S. firms today to adjust the size of their workforce. Anti-discrimination legislation restricts the ability of employers to use race, sex, or age as factors in dismissing or laying off employees. A few court cases have further restricted the ability of firms to dismiss employees at will, holding that in some cases there are implicit contracts which obligate the employer to fulfill assurances made to their employees. Explicitly short-term arrangements would circumvent these constraints.

Finally, there is evidence that during the 1970s and 1980s there was a significant widening of wage differences between high wage and low wage firms, creating an incentive for high wage firms to contract work out to firms with lower wages.

### **CONCLUSIONS**

The BLS and Census statistics, together with survey data, add up to a picture in which employers have quite different motivations for the different sorts of market-mediated work arrangements in which they engage.

Temporary employment -- including both agency temporary employment and hiring of temporaries onto organizations' own payrolls -- is the only category of market-mediated work for which buffering regular employees from fluctuations in demand appears to be a primary employer motivation. For business services requiring relatively low skills, wages and benefits in the business service sector appear to be substantially less generous than elsewhere in the economy and employers appear quite likely to view savings on labor costs as important in their contracting-out decisions. Labor-cost savings are also cited as important by a substantial fraction of organizations that subcontract production work. The ability of contractors to provide specialized services that cannot be economically provided in-house has been conspicuously absent from popular discussions of market-mediated work arrangements. It is therefore all the more striking that so many organizations cite contractors' special expertise as a reason for their contracting-out activity. [110]

It is a mistake to lump together all of the market-mediated arrangements discussed here under the single heading, "contingent work." Only temporary workers, who absorb the pains of demand fluctuations, should be so labeled.