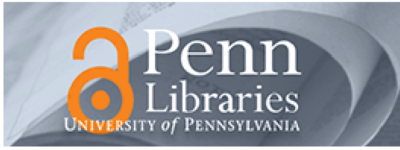

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Chapter 4
The Benefits Implications of Recent Trends in Flexible Staffing Arrangements

Susan N. Houseman

The U.S. labor market has seen important growth in temporary and contract employment of late. Best-documented is rise in temporary agency employment, which grew 265 percent between 1990 and 2000, and accounted for about 10 percent of net employment growth over the decade. Although time series data on other types of temporary and contract employment arrangements do not exist, employer surveys suggest that employment in other flexible staffing arrangements has grown as well (Houseman and Polivka 2000).

This chapter considers the benefits implications of the growth in flexible staffing arrangements. Traditionally, benefits offered at the employers' discretion have primarily targeted regular, full-time workers. Similarly, laws mandating benefits, like workers' compensation or family and medical leave, and laws regulating benefits, like pensions and health insurance, are designed with the full-time, regular employee in mind. The growth in various flexible staffing arrangements raises concerns about whether workers in temporary and contract arrangements are adequately covered by key benefits and regulations governing them. It also raises concerns that employers' desire to control benefits costs has stimulated some of the growth in these arrangements.

I begin by providing some background on flexible staffing arrangements: the definition of various types of temporary and contract positions in government statistics, available evidence on trends in these arrangements, and the characteristics of workers in these arrangements. Next, I examine several key questions related to benefits: How does the incidence of benefits vary between those in flexible staffing and regular arrangements? How do regulations governing benefits cover workers in various flexible staffing arrangements? And, is savings on benefits costs an important motivation for

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employers to use certain flexible staffing arrangements? A brief discussion of policy issues concludes.

Understanding Terminology

Our focus is on workers in a variety of so-called flexible staffing arrangements: agency temporaries, leased employees, contract company workers, independent contractors, direct-hire temporaries, and on-call workers. In the first four categories of employment, workers usually are not regarded as legal employees of the establishment for whom they are performing work.[1] "Agency temporaries" work for a staffing agency that places them with a client company. The agency temporary generally works at the client's worksite, and typically, though not always, the assignment is for a short period of time (less than a year). The work the agency temporary performs usually is directed by the client, though temporary help agencies increasingly are sending a supervisor to monitor their workers at the clients' site (Peck and Theodore 1998). In the case of "employee leasing," a company leases all or a portion of its workforce on a fairly permanent basis from a leasing company or professional employment organization (PEO). The workers are on the payroll of a PEO, but their work is typically directed by the client company. Often temporary help agencies also lease workers. "Contract company workers" work for a company that contracts out their services to a client company. In the definition used by the Bureau of Labor Statistics (BLS) and in the data reported below, contract company workers also perform their work at the client's worksite and usually work for just one client at a time. Typically, their work is supervised by the contract company, not by the client.

The distinction between agency temporary, leased employee, and contract company worker is often blurred. For instance, widely cited statistics on employment in the temporary help industry from the Bureau of Labor Statistics establishment survey, the Current Employment Statistics (CES), actually cover help supply services, which incorporates many leased employees. Many other government statistics on workers in flexible staffing arrangements come from supplements to the February Current Population Survey (CPS) on Contingent and Alternative Work Arrangements, which have been conducted biannually since 1995. In these supplements, workers were simply asked to identify themselves as employed or paid by a "temporary help agency," by a "leasing company," or by a "company that contracts out your services," and the meaning of these terms was left to the interpretation of the respondent.[2] The lack of a single definition of leasing companies and leased workers was cited in a recent Department of Labor report (KRA Corporation 1996).

Legally, "independent contractors" are self-employed. The only statistics on the number of independent contractors come from the CPS Supplements

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on Contingent and Alternative Work Arrangements. In that survey, workers who stated that they worked as independent contractors, independent consultants, or freelance workers were classified as independent contractors.[3] In the BLS data, independent contractors may or may not perform their services at the client's worksite.

In contrast to the other flexible staffing arrangements, "direct-hire temporaries" and "on-call workers" are employees of the company where they work. Direct-hire temporaries are hired for a limited period of time, for instance for seasonal work or for a special project. On-call workers may be hired for an indefinite duration, but they do not have regularly scheduled hours. Instead they are called in to work on an as-needed basis, often to fill in for an absent employee or to help with an increased workload. Substitute teachers and many hospital employees are on-call workers.

The Extent of Flexible Staffing Arrangements

Table 1 presents the distribution of the workforce by staffing arrangement, according to data from the February 1999 CPS. To avoid double counting, the employment categories are mutually exclusive. One possibility for overlap across categories occurs with direct-hire temporaries, since some on-call workers, wage and salary independent contractor workers, and contract company workers are hired on a short-term basis. The percentage of workers in these categories who are also direct-hire temporaries is indicated in Table 1. The category "other direct-hire temporaries" refers to those short-term hires not classified in another flexible staffing arrangement. Including the on-call, independent contract, and contract company workers who are also direct-hire temporaries, direct-hire temporaries account for over 3 percent of the workforce.[4] In addition, a small number work on an on-call basis for a contract company and in the table, are classified as on-call workers.[5]

TABLE 1. Distribution of Employment by Work Arrangement

Employment arrangement	*Percent of workforce*	*Percent direct-hire temporaries*	*Percent working part-time*
Agency temporaries	1	na	23
On-call or day laborers	2	33	53
Independent contractors	6	1	27
Contract company workers	0.5	17	11
Other direct-hire temporaries	3	100	52
Other self-employed	5	na	22
Regular employees	83	na	17

Source: Author's tabulations from the February 1999 CPS Supplement on Contingent and Alternative Work Arrangements.
na = not applicable.

Independent contractors comprise the largest category of flexible staffing arrangements. In fact, over half of all the self-employed call themselves independent contractors, independent consultants, or freelancers. Collectively, agency temporaries, on-call workers, independent contractors, contract company workers, and direct-hire temporaries comprise about 12 percent of the workforce.

It is noteworthy that agency temporaries account for only 1 percent of total employment in the CPS Supplement, whereas they account for about 2 percent of employment in the CES. Data from the National Association of Temporary Staffing Services suggests employment in temporary services is slightly less than that reported in the CES, but is much higher than that reported in the CPS. It is generally presumed that the CPS understates employment in temporary help agencies.[6]

Those in flexible staffing arrangements are more likely to work part time than workers in regular wage and salary positions. This is particularly true for on-call workers, day laborers and other direct-hire temporaries. Somewhat surprisingly, agency temporaries are only somewhat more likely to be employed part time than are regular employees.

Data on the number of workers hired by employee leasing companies are not currently available. In the February 1995 CPS Supplement, respondents were asked if they were paid by an employee leasing agency. A very small percentage (0.3 percent) responded in the affirmative. Subsequent field tests by the BLS showed considerable confusion among respondents over that question, so it was omitted from subsequent surveys.

Trends in Flexible Staffing

Very little is known about trends in most flexible staffing arrangements in the United States; agency temporary employment is the only flexible staffing category for which a relatively long time series exists. As noted above, the CES provides information on employment in the help supply services industry, which is comprised primarily of temporary help agencies. According to this source, employment in the temporary help industry grew dramatically in the last two decades. From 1982 (the first year for which data on this industry are available) to 2000, the share of nonfarm payroll employment in help supply services grew from 0.5 percent to 2.6 percent. Statistics for on-call, independent contractor, contract company, and direct-hire temporary workers were first collected in the February 1995 Supplement to the CPS. Between 1995 and 1999, the percentage of employment in these categories was stable, but this four-year time period is too short to determine any trend, particularly because the economy was in rapid expansion.[7]

In the absence of employment data on specific flexible staffing arrangements, some researchers have looked at the growth in business services employment (e.g., Abraham 1990). In addition to including agency temporaries

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within help supply services, the business services sector is thought to include many employed as contract company workers. Figure 1 depicts indexes of employment in help supply services, business services, and the aggregate non-farm payroll sector over the 1982–2000 period. Help supply services grew more rapidly than aggregate business services, which grew more rapidly than aggregate employment over the period. Within the business services sector, help supply services was the fastest growing component. However, each component of the business services sector also increased faster than aggregate employment over the period.

Evidence from employer surveys also points to growth in various flexible staffing arrangements. For instance, in a Conference Board (1995) survey of members, 34 percent of companies reported sizable growth in their use of direct-hire temporaries in the preceding five years and 24 percent expected sizable growth in the coming five years. Thirty-one percent reported sizable growth in their use of independent contractors and 28 percent expected sizable growth in their use of independent contractors in the next five years. Data from BLS Industry Wage Surveys in 1986 and 1987 show growth in contracting out of services in manufacturing industries between 1979 and 1986–87 (Abraham and Taylor 1996). In a survey of members of the Bureau of National Affairs, a larger percentage of employers reported an increase than a decrease in their use of direct-hire temporaries, on-call workers, administrative or business support contracts, and production subcontracting relative to regular workers between 1980 and 1985 (Abraham 1990). In a nationally representative survey of employers conducted in 1996, a much

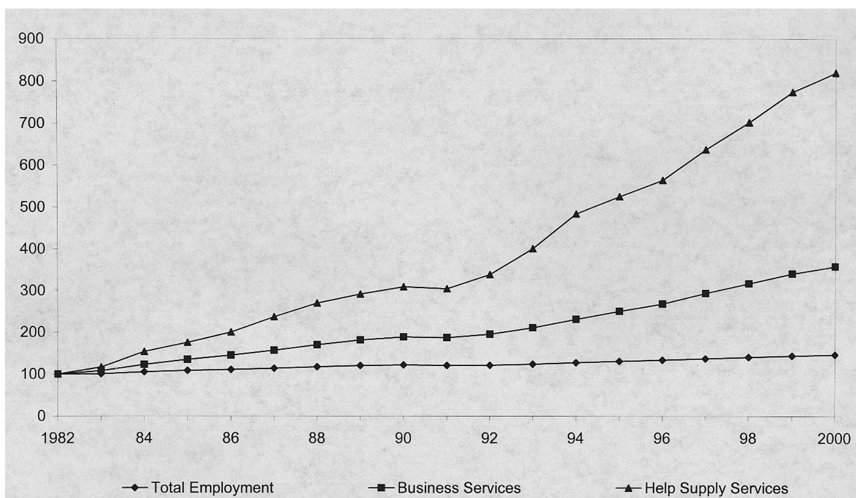

Figure 1. Employment index (1982 = 100). Source: U.S. Department of Labor, Bureau of Labor Statistics.

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larger percentage of employers had contracted out work previously done in-house than had brought work back in-house since 1990. Moreover, two-thirds of respondents to this survey predicted that organizations in their industry would increase their use of flexible staffing arrangements in the coming five years (Houseman 1997, 2001). Thus, it is reasonable to assume that there has been recent growth in other types of flexible staffing arrangements besides temporary help, though the extent of the growth is not well known.

Characteristics of Workers in Flexible Staffing Arrangements

The distribution of worker characteristics varies considerably across staffing arrangements (see Table 2). Agency temporaries, on-call workers, and direct-hire temporaries are disproportionately female and young. A disproportionate number of agency temporaries are black or Hispanic, while a large percentage of on-call workers are high-school dropouts. In contrast, independent contractors and contract company workers are disproportionately male, older, more educated, and in the case of independent contractors, white.

The occupational and industrial distribution of employment by work arrangement is shown in Table 3. It is not surprising that many agency temporaries work in administrative support occupations, but many others work as operators and in the manufacturing sector. On-call workers, independent contractors, and direct-hire temporaries are heavily represented in the construction and services industries. A large share of contract company workers is found in services and precision production occupations. Over one quarter of direct-hire temporaries are in professional occupations and over half are in services industries.

The government is a major employer of workers in several flexible staffing arrangements. Over 20 percent of on-call, day, and contract company workers and over 30 percent of direct-hire temporaries work for federal, state, or local government (see Table 4).[8]

Benefits Among Workers in Flexible Staffing Arrangements

Because of the diversity in average worker, industry, and occupational characteristics across staffing arrangements, one cannot generalize about the quality of jobs in flexible staffing arrangements. For instance, compared to regular employees, agency temporaries, on-call and day laborers, and other direct-hire temporaries tend to earn lower wages, whereas contract company and independent contractors earn similar or higher wages.[9] The same patterns are evident with respect to job stability: the jobs of agency temporaries, on-call and day laborers, and other direct-hire temporaries are less stable

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TABLE 2. Characteristics of Workers by Working Arrangement (percent distribution)

	Agency temporaries	*On-call or day laborers*	*Independent contractors*	*Contract company workers*	*Other direct-hire temporaries*	*Other self-employed*	*Regular employees*
Gender							
Male	42	50	66	71	48	63	52
Female	58	50	34	29	52	37	48
Age							
16–19	6	10	1	5	16	0	5
20–24	21	11	3	10	23	3	10
25–34	29	23	18	32	23	14	24
34–44	19	24	30	28	17	28	28
45–54	15	15	26	17	11	26	21
55–64	7	10	15	7	6	20	9
65+	3	8	7	2	4	9	2
Race/ethnicity							
White	61	72	85	75	69	84	74
Black	21	12	6	11	10	4	12
Hispanic	14	13	6	6	13	6	11
Other	5	3	4	8	9	6	4
Education							
< High school	16	20	8	7	16	8	12
High school	32	30	30	23	19	31	32
Some college	36	28	28	33	33	26	29
College +	17	22	34	37	32	35	27

Source: Author's tabulations from February 1999 CPS Supplement on Contingent and Alternative Work Arrangements.

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TABLE 3. Occupational and Industry Distribution of Employment by Work Arrangement (%)

	Agency temporaries	*On-call or day laborers*	*Independent contractors*	*Contract company workers*	*Other direct-hire temporaries*	*Other self-employed*	*Regular employees*
Occupation							
Executive, administrative	4	5	21	11	7	25	14
Professional	7	22	19	30	31	12	15
Technical	4	4	1	7	3	1	4
Sales	2	5	17	2	7	21	12
Administrative support	36	9	3	4	20	5	15
Services	8	24	9	18	14	11	14
Precision production	9	11	19	15	6	7	11
Operators	19	2	2	1	3	1	6
Transportation occupations	2	8	4	3	2	2	4
Laborers	8	7	1	6	4	1	4
Farming and forestry	1	3	4	3	4	14	1
Industry							
Agriculture	0	3	5	0	4	15	1
Mining and construction	3	12	20	7	6	7	5
Manufacturing	34	5	5	21	6	6	18
Transportation, communication, utilities	10	9	6	16	3	4	8
Trade	12	16	14	5	14	26	22
Finance, insurance, and real estate	10	3	9	10	3	6	7
Services	32	50	42	27	60	36	34
Public administration	1	3	0	14	5	0	5

Source: Author's tabulations from February 1999 CPS Supplement on Contingent and Alternative Work Arrangements.

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TABLE 4. Distribution of Employment Between the Private and Government Sectors, by Work Arrangement (%)

	Private			*Government*			
	Total	*Profit*	*Non-profit*	*Total*	*Federal*	*State*	*Local*
Agency temporaries	98	97	1	2	0.5	0.5	1
On-call or day laborers	77	71	6	23	2	5	16
Contract company workers	96	93	3	4	2	1	2
Other direct-hire temporaries	69	58	11	31	4	14	13
Regular employees	84	78	6	16	3	4	9

Source: Author's tabulations from February 1999 CPS on Contingent and Alternative Work Arrangements.
Figures may not sum to totals because of rounding.

than those of regular workers in the sense that they are more likely to lead to a job switch or unemployment, whereas the jobs of contract company workers and independent contractors have similar or even more stability compared to those of regular workers (Houseman and Polivka 2000).

The one issue that cuts across workers in all flexible staffing arrangements is benefits: Workers in flexible staffing arrangements are far less likely to have benefits such as health insurance or a retirement plan than are regular workers. Table 5 shows the incidence of health insurance and retirement benefits by work arrangement. Because many employees who are eligible to participate in an employer-provided health insurance or retirement plan decline to do so, it is interesting to look not only at the percentage of workers who receive these benefits from their employer, but also at the percentage that are eligible to receive them. Among wage and salary employees (a category that includes agency temporaries, on-call workers, contract-company workers, direct-hire temporaries, and regular workers) those in flexible staffing arrangements are much less likely than regular workers to participate in and be eligible to participate in a health insurance and retirement benefit plan.

The incidence of these benefits is particularly low among agency temporaries. Whereas 64 percent of regular workers receive health insurance through their employer and 76 percent are eligible to participate in an employer health insurance plan, just 9 percent of agency temporaries receive health insurance through their employers and only 28 percent are eligible to participate in an employer health insurance plan. Only 7 percent of agency temporaries participate in an employer retirement plan and only 12 percent are eligible to do so, compared to 58 percent and 63 percent of regular employees who participate or are eligible to participate, respectively, in an employer retirement plan.

TABLE 5. Incidence of Health Insurance and Retirement Plan, by Work Arrangement (percent)

	Health Insurance			*Retirement Plan*		
	Health insurance	*Health insurance through employer*	*Eligible for health insurance from employer*	*Covered by employer pension plan or has tax deferred retirement account*	*Participates in employer pension plan*	*Eligible to participate in employer pension plan*
Agency temporaries	43	9	28	20	7	12
On-call or day laborers	69	21	30	38	25	29
Independent contractors	76	na	na	43	na	na
Contract company workers	84	60	76	55	42	46
Other direct-hire temporaries	75	26	35	27	18	22
Other self-employed	83	na	na	47	na	na
Regular employees	86	64	76	65	58	63
Part-time	88	17	32	33	21	26
Full-time	76	73	84	70	64	69

Source: Author's tabulations from February 1999 Supplement on Contingent and Alternative Work Arrangements.

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One might be less concerned about the absence of benefits if workers in flexible staffing arrangements had health insurance available from other sources or saved for retirement through a tax-deferred retirement account. However, agency temporaries, on-call workers, independent contractors, and direct-hire temporaries are much less likely to have health insurance coverage from any source as compared to regular employees. Over half of agency temporaries have no health insurance from any source. Similarly, workers in all types of flexible staffing arrangements are much less likely than regular employees to have some type of retirement plan. Statistical analysis shows that workers in all flexible staffing arrangements are significantly less likely to be eligible to participate in an employer-sponsored health insurance or pension plan or to have health insurance from any source, even after controlling for worker and job characteristics (Houseman 1997). These findings are consistent with evidence from an employer survey showing that while employers typically offer benefits like paid vacations and holidays, paid sick leave, health insurance and a retirement plan to their full-time regular employees, they rarely offer these benefits to employees who are on-call workers or temporaries (Houseman 2001).

Flexible Staffing Arrangements by Benefits Regulations

Various federal and state laws mandate that employers provide specified employees with certain benefits, including workers' compensation, unemployment insurance, and family and medical leave. If the employer chooses to offer employees benefits like a retirement or health insurance plan, federal laws also regulate the provision of these benefits. For instance, if an employer chooses to offer a retirement plan to employees, the benefit plan must meet certain conditions specified in the Employee Retirement Income and Security Act (ERISA) and the IRS tax code in order to receive favorable tax treatment. One purpose of these requirements is to ensure that the beneficiaries of such in-kind, tax-deferred income are not primarily highly compensated employees. Specifically, under ERISA a tax-qualified pension plan must cover at least 70 percent of all non–highly compensated employees who worked one thousand hours or more over the last twelve months. Provisions in the IRS tax code stipulate that self-insured health insurance plans not discriminate in favor of highly compensated individuals as well (Collins 1999; Miller 2000).

These laws mandating or regulating benefits were written with the traditional employee — a full-time, permanent worker — in mind. The large and growing number in flexible staffing arrangements, however, has sparked concern that existing law is inadequate to protect these workers. A related concern is that, although businesses have many legitimate reasons for using alternative arrangements, legal loopholes provide an added incentive to use these arrangements in order to avoid or reduce benefits costs.

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Several factors affect whether and how workers in flexible arrangements are covered by benefits regulations. The first is whether the worker is an employee or an independent contractor. Laws governing benefits pertain only to employees, and independent contractors, who are self-employed, are not covered. If the worker is an employee, another issue is who is the statutory employer for the purposes of the benefits regulation. This issues arises in the context of temporary agency workers, contract company workers, and leased employees, who are paid by one employer but perform work for another. Finally, benefit laws typically include hours or earnings thresholds and thus exclude many temporary and part-time workers from coverage.

Who Is an Employee? Determining Independent Contractor Status

Independent contractors, by definition, are self-employed and because they are not employees, independent contractors are not covered by employment, labor, and related tax laws. Employers may be tempted to reclassify employees as independent contractors in order to avoid taxes, benefits, and other liability. Whether or not a worker is covered by a particular employment, labor, or tax law hinges on the definition of an employee. Yet, statutes usually fail to clearly define the term "employee," and no single standard to distinguish between employee and independent contractor has emerged.

For example, the IRS uses the so-called "20-factor test," in which it assesses the degree of control the company exercises over the way the work is performed by an independent contractor. If the company exercises too much control, the worker is deemed to be an employee. The IRS "20-factor, right-to-control" test is used to assess an employers' tax liability. A similar test is used in most states to determine status under workers' compensation laws.

The so-called "economic realities test" or a hybrid of the right-to-control and economic realities test often is used by courts to determine independent contractor status in other circumstances. In essence, the economic realities test makes it harder to classify a worker as an independent contractor, because, in addition to considering the degree of control the employer exercises, it takes into account the degree to which a worker is economically dependent on the business. The economic realities test is used to determine employee status under the Family and Medical Leave Act (entitling workers to unpaid leave under certain circumstances), the Fair Labor Standards Act (establishing a minimum wage), and the Worker Adjustment and Retraining Act (providing for advance notice in event of plant closings and mass layoffs). Additionally, it is often applied by courts in determining independent contractor status in civil rights cases under Title VII of the Civil Rights Act, the Age Discrimination in Employment Act, and the Americans with Disabilities Act. States use a variety of other tests to determine independent contractor status for unemployment insurance

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purposes.[10] This plethora of tests defining independent contractor status applied across federal and state laws makes it possible for a worker to be classified as an independent contractor under one law, but as an employee under another.

Who Is the Employer? Determining Joint-Employer Status

Besides failing to define who are "employees," most statutes also fail to spell out who the employer is. There is potential ambiguity on this issue when businesses use temporary agency, leased, or contract workers. Although the primary employer is generally the temporary help, leasing, or contract company, the client may be regarded as a "joint employer" under some laws.

Perhaps by virtue of the fact that it is a recent statute, the Family and Medical Leave Act is one of the few laws to explicitly address possible joint-employer relationships. When a leasing or temporary help agency is the primary employer, a client company may be required to place the individual in the same or comparable position upon his or her return from FMLA leave. Additionally, leased and temporary workers will count as employees of the client company for the purposes of determining employment levels for FMLA. Thus, although the FMLA only covers employers with fifty or more employees, a small employer may have to provide FMLA benefits to all workers if the number of regular plus temporary and leased employees is fifty or more (Pivec and Massen 1996).

Congress tried to clear up the ambiguity — and stem abuses — regarding benefits provision to leased employees in 1982. Businesses allegedly were "firing" their non–highly compensated staff and leasing them back through leasing agencies to avoid providing benefits to these employees. Under section 414(n) in the Tax Equity and Fiscal Responsibility Act of 1982, leased and temporary help workers must be counted by the client firm as employees for the purposes of qualifying retirement plans and certain other fringe benefits (such as life insurance and cafeteria plans) if the workers have provided these services "on a substantially full-time basis for at least a year" and the client primarily controls or directs the work of the leased or temporary employees. The rule does not apply to health insurance plans (Klein 1996).

Several states have passed legislation clarifying joint-employer liability in workers' compensation cases. New York State has actually ruled that the client is the common law employer of leased employees and is primarily responsible for providing workers' compensation benefits. However, most states have not clarified joint-employer status in workers' compensation cases, leaving the courts to resolve these issues where there is some dispute. Court rulings on the issue, in turn, have been inconsistent (Bowker 1997). Similarly, no guidelines have been drawn up clarifying joint employer status under OSHA or other health and safety regulations.

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Exclusions from Benefits Regulations

Even if a worker is clearly classified as an employee of a particular organization, that worker still may be exempted from coverage by various benefits laws with which its employer must otherwise comply. For instance, under ERISA, a tax-qualified pension plan is required to only cover 70 percent of all non–highly compensated employees who worked 1000 hours or more in the preceding 12 months. Thus, many on-call, temporary, and part-time workers may be excluded from employer-provided pension plans. Similarly, although regulations governing self-insured health insurance plans generally require that organizations offering such insurance offer it to all non–highly compensated employees, temporary and part-time workers are exempted (Collins 1999; Miller 2000). The Family and Medical Leave Act of 1993 — which requires employers to provide employees with up to 12 weeks of job-protected, unpaid leave during any 12-month period to care for a new born or adopted child, recuperate from a serious health condition, or care for an immediate family member who has a serious health condition — covers only employees who have worked for that employer at least 1200 hours during the 12 months immediately preceding the date the leave commences (Klein 1996).

Unemployment insurance programs vary from state to state, but all specify that an employee work a minimum number of weeks and/or earn a certain minimum amount within a base period to qualify for unemployment insurance. The purpose of these requirements is to prevent those with insufficient attachment to the workforce from receiving benefits. As with ERISA and FMLA, however, these requirements effectively preclude many in temporary and part-time positions from being covered.

Even when temporary workers fulfill the minimum earnings and work time requirements to qualify for unemployment compensation, they may be disqualified on other grounds. For instance, if workers separate from a temporary job with a predetermined expiration date, they might be disqualified from receiving unemployment insurance on the grounds that they voluntarily accepted a job with an ending date, and so the unemployment might be deemed voluntary. Several states have passed laws precluding disqualification for this reason. Workers employed through a temporary help agency also can be disqualified from receiving unemployment benefits if they fail to report to the temporary help agency for a new assignment after their last assignment ends. From the employers' perspective, temporary agencies do not want to raise their unemployment insurance tax rates, which are experience-rated, by covering workers whom they could place in other assignments. From the workers' perspective, agency temporaries may need time off with unemployment insurance coverage to look for permanent employment and not covering these workers may relegate them to a cycle of short-term, dead-end jobs. Ambiguity also exists as to whether an agency temporary who quits in

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the middle of an assignment for "good cause," such as hazardous working conditions, must accept another offer of employment through the same temporary help agency (National Employment Law Project 1997).

A related issue is whether temporary agency workers can refuse an assignment without jeopardizing their unemployment benefits. This issue is particularly pertinent when state employment agencies refer unemployment insurance recipients to temporary services. In the absence of state requirements, federal law stipulates that if an assignment offers "wages or other conditions of employment [that] are substantially less favorable than those prevailing for similar work in the locality, or are such as tend to depress wages or working conditions," the assignment is unsuitable. However, specific factors vary from state to state and may be decided on a case-by-case basis (National Employment Law Project 1997).

Employers' Use of Flexible Staffing Arrangements to Reduce Benefits Costs

From the above discussion, workers in all flexible staffing arrangements are much less likely than regular full-time workers to receive health and pension benefits from their employers, even after controlling for worker and job characteristics. In addition, benefits regulations often do not apply to those in flexible staffing arrangements. This raises the question of whether and to what extent employers use various flexible staffing arrangements in order to circumvent regulations and reduce benefits costs.

Here it is important to distinguish between two situations. One is that employers may make illegal use of flexible staffing arrangements, in part, to avoid benefits regulations. The other is that because flexible staffing arrangements are associated with fewer regulations and hence lower benefits costs, employers make more legal use of these arrangements than they would in the absence of the regulations.

With respect to the former, recent high-profile cases such as those involving Microsoft and Time Warner have highlighted the problem in which companies misclassify employees as independent contractors or temporary workers and thereby save on pension, health insurance, and other benefits costs. It is widely believed that the fraudulent use of contract and temporary workers is largely motivated by workers' compensation costs. Each state requires that employers purchase workers' compensation insurance, which provides benefits to employees in the event of an occupational injury, but independent contractors, being self-employed, are not covered by these laws. One problem, particularly prevalent in the construction industry, is that companies reportedly will require workers to be "independent contractors" to avoid workers' compensation costs. When these workers become injured, they are reclassified as employees and file for workers compensation (Montana Legislative Council 1994).

Another issue in workers' compensation is that workers sometimes are misclassified, particularly by temporary help and leasing agencies, which usually are responsible for purchasing workers' compensation insurance for temporary or leased employees. The insurance rate depends partly on the occupation in which the worker is classified, and some agencies allegedly misclassify workers in order to obtain lower rates. Although several states have taken steps to crack down on misclassification by leasing companies, little has been done to eliminate such practices by temporary help agencies (Klein 1996).

A related problem is that typically workers' compensation rates are based on experience rating of the leasing or temporary help agency. Allegedly, some leasing or temporary help agencies hire a minimal number of people for some period of time to establish a low rate and then move large numbers of leased or temporary employees into this operation. When the rate increases, they close this "company" and move the employees into another such operation. Some have recommended that the workers' compensation rate be tied to the client company in response to this practice.[11]

As with workers' compensation, it is believed that some businesses avoid paying unemployment insurance (UI) or pay rates that are too low by misclassifying workers as independent contractors or by establishing low experience rates in shell companies before transferring leased or temporary agency employees to their payrolls (De Silva et al. 2000). One study found substantial evidence of UI rate manipulation among leasing companies (KRA Corporation 1996).

In most cases, employers' use of flexible staffing arrangements is perfectly legal, and evidence from employer surveys shows that savings on benefits costs is one of several reasons employers use these arrangements.[12] For instance, in a survey of 21 large companies, 38 percent using direct-hire temporaries, 19 percent using agency temporaries, and 29 percent using independent contractors did so, in part, to reduce health care costs (Christensen 1995). In a large nationally representative employer survey, 16 percent of businesses cited avoiding fringe benefits costs as a very important reason they used agency temporaries or contract company workers and another 22 percent said this factor was moderately important (Kalleberg, Reynolds, and Marsden 1999). Although less than 12 percent of employers in another nationally representative survey of employers stated they used various flexible staffing arrangements to save on wage and benefits costs, surveyed employers indicated that they often saved on labor costs, especially benefits costs, by using these arrangements. Moreover, survey evidence suggests that employers who offer more generous benefits to their regular, full-time employees are more likely to use workers in various flexible staffing arrangements (Houseman 2001; Mangum, Mayall, and Nelson 1985).

Of course, firms do not necessarily save on labor costs by using flexible staffing arrangements, even if the wages and benefits of these workers are

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less than those of regular employees. Detailed cost-benefit analyses on the use of "contingent" workers in several firms showed in some cases the higher costs associated with turnover, training, and lower productivity of contingent workers outweighed the savings from lower wage and benefit costs (Nollen and Axel 1996). Thus, although firms may be motivated to use flexible staffing arrangements in order to save on wage and benefit costs, firms sometimes incur higher overall labor costs by using these arrangements.

Conclusions

Three key points emerge from the above discussion. First, workers in flexible staffing arrangements are less likely than regular employees to be covered by laws mandating or regulating workplace benefits. Second, workers in such arrangements are less likely than regular employees to receive benefits such as health insurance and a retirement plan, through their employer or from any source. Finally, although reducing benefits costs is not the only reason employers use independent contractors, agency temporaries, on-call workers, and others in flexible arrangements, it is an important factor motivating many employers to use them, and the level of and growth in these arrangements would almost certainly be lower in the absence of this incentive.

This situation has provoked a number of policy responses and proposals for change. Most significant has been stepped-up enforcement of existing laws by the IRS and states to crack down on misclassification of workers as independent contractors and to stem the loss of tax revenues and workers' compensation and unemployment insurance fraud. States have also sought to cut down on fraud particularly in the area of workers' compensation associated with some temporary agency operations.

Others have proposed making a uniform set of rules to determine who is an employee and who is the employer, thereby greatly simplifying the system and reducing unintentional misclassification of workers as independent contractors and confusion over employer responsibilities to workers. The Commission on the Future of Worker-Management Relations (1996) specifically recommended that a standardized test to determine independent contractor status be based on the more restrictive concept of economic realities. Besides simplifying the law, this would make it more difficult for employers to legally classify workers as independent contractors than tests currently used for many purposes. Similarly, with temporary help agencies, contract companies, and other joint-employer situations, the commission recommended that the employer legally responsible for the worker be determined based on the economic realities of the relationship, and not simply on notions of control. Doing so, it asserted, "would remove the incentives that now exist for firms to use variations in corporate form to avoid responsibility for the people who do their work" (36).

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Others have proposed more sweeping changes to the laws that would force employers to provide equal or prorated benefits to many more workers in flexible staffing arrangements (Callaghan and Hartmann 1991; duRivage 1992; National Employment Law Project 1997, 1999). Although this approach has gained little backing in the United States, laws regulating the use of flexible staffing arrangements and requiring employers to provide equal social protections to workers in these arrangements are common in Europe (Schoemann and Schoemann 2000).

In closing, it should be pointed out that better enforcement of existing laws and the enactment of laws to require equal treatment of workers in the provision of benefits would not necessarily increase benefits receipt and improve welfare among workers. Increases in benefits costs associated with these actions, if unmatched by reductions in wages, could lead to lower employment levels. In addition, faced with the prospect of having to extend health insurance, pension, and other voluntary benefits to more workers, employers instead could cut back on the benefits they choose to offer.

Notes

1. A discussion of legal issues related to who is the employer and who is the employee under various employment and labor laws is provided below.
2. In fact, due to confusion over terminology, the question on employee leasing was dropped from the 1997 and 1999 CPS Supplements. Contrast the way information is collected on these flexible staffing arrangements with the way information is collected on part-time workers. Instead of being asked if they work part-time, workers are asked if they usually work fewer than thirty-five hours per week. Based on this response, they are classified as part time or full time.
3. In these surveys about 12 percent of those who call themselves independent contractors also say they are employees, not self-employed. Legally, however, independent contractors must be self-employed.
4. Although the CPS does not include a specific question classifying individuals as direct-hire temporaries, I constructed this category from questions in the 1999 February Supplement. Specifically, individuals were classified as direct-hire temporaries if they indicated that their job was temporary or they could not stay in their job as long as they wished for any of the following reasons: they were working only until a specific project was completed, they were temporarily replacing another worker, they were hired for a fixed period of time, their job was seasonal, or they expected to work for less than a year because their job was temporary.
5. The classification scheme used in this table follows that used in Houseman and Polivka (2000).
6. Some of the difference in the CPS and CES figures on temporary agency employment stems from differences in the type of data collected in the two surveys. Specifically, the CES counts jobs in the temporary help services industry, while the CPS counts workers whose main jobs are in this industry. Consequently, individuals registered with more than one temporary agency would show up once in the CPS, but would show up more than once in the CES, if they worked two or more jobs for two or more temporary help agencies during the survey week. Also, multiple job holders with secondary jobs in the temporary help industry would not be counted

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in the CPS as agency temporaries, whereas those workers' secondary jobs would be counted in the CES. Another possible explanation for the differences is that, in spite of questions in the CPS designed to avoid this problem, some respondents may still view the client to whom they are assigned as their employer and thus fail to report that they are paid by a temporary help service. The widespread confusion over who is their employer is evidenced by the fact that among those identified as agency temporaries in the CPS, over half at first incorrectly named their client, rather than the temporary help agency, as their employer. Finally, many establishments classified as temporary help agencies in the CES may also provide contract company workers or leased employees (Polivka 1996).

7. Future CPS Supplements on Contingent and Alternative Work Arrangements will provide valuable evidence on trends in these work arrangements.

8. In Table 3, the industry public administration captures some, but not all of public sector employees. Many public sector employees work in the services sector, for example, for public hospitals and public schools.

9. See Houseman (1999) for a summary of evidence on wages of workers in various flexible staffing arrangements compared to wages of workers in regular jobs.

10. Joerg (1996, chapters 3 and 7) contains a detailed discussion of the IRS 20-factor test, the economic realities test, and various other tests.

11. See KRA Corporation (1996), Clark (1997), and Montana Legislative Council (1994) for a discussion of these issues.

12. Other particularly important reasons include accommodating fluctuations in staffing needs, screening workers for regular positions, and accessing special skills. I provide a more complete discussion of evidence pertaining to why employers use various flexible staffing arrangements in Houseman (1999, 2001).

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