

2002

# The Effects of Temporary Services and Contracting Out on Low-Skilled Workers: Evidence from Auto Suppliers, Hospitals, and Public Schools

George A. Erickcek

*W.E. Upjohn Institute*, [erickcek@upjohn.org](mailto:erickcek@upjohn.org)

Susan N. Houseman

*W.E. Upjohn Institute*, [houseman@upjohn.org](mailto:houseman@upjohn.org)

Arne L. Kalleberg

*University of North Carolina at Chapel Hill*

Upjohn Institute Working Paper No. 03-90

**\*\*Published Version\*\***

In *Low-Wage America: How Employers are Reshaping Opportunity in the Workplace*, edited by Eileen Appelbaum, Annette Bernhardt, and Richard J. Murnane. New York: Russell Sage Foundation, 2003, pp. 368-403

---

## Citation

Erickcek, George, Susan Houseman, and Arne Kalleberg. 2002. "The Effects of Temporary Services and Contracting Out on Low-Skilled Workers: Evidence from Auto Suppliers, Hospitals, and Public Schools." Upjohn Institute Working Paper No. 03-90. Kalamazoo, MI: W.E. Upjohn Institute for Employment Research. <https://doi.org/10.17848/wp03-90>

This title is brought to you by the Upjohn Institute. For more information, please contact [repository@upjohn.org](mailto:repository@upjohn.org).

***The Effects of Temporary Services and Contracting Out  
on Low-Skilled Workers: Evidence from  
Auto Suppliers, Hospitals, and Public Schools***

Upjohn Institute Staff Working Paper No. 03-90

George Erickcek, Susan Houseman, and Arne Kalleberg

April 2002  
revised July 2002

JEL Classification Codes: J31, J32, J41, J42, J45, J51, J81, K31

Paper prepared for the Case Studies Conference sponsored by the Russell Sage Foundation and the Rockefeller Foundation, May 2–3, 2002, in New York. We thank Lillian Vesic-Petrovic and Peter Einaudi for their assistance with data analysis, and Claire Black for her transcription of all interviews and assistance in preparing the document.

## **The Effects of Temporary Services and Contracting Out on Low-Skilled Workers: Evidence from Auto Suppliers, Hospitals, and Public Schools**

### Abstract

We examine why employers use temporary agency and contract company workers and the implications of these practices for the wages, benefits, and working conditions of workers in low-skilled labor markets. Through intensive case studies in manufacturing (automotive supply), services (hospitals), and public sector (primary and secondary schools) industries, we define the circumstances under which these workers are likely to be adversely affected, minimally affected, or even benefitted by such outsourcing. Adverse effects on compensation are clearest when companies substitute agency temporaries or contract company workers for regular employees on a long-term basis because low-skilled workers within the organization receive relatively high compensation and employment and labor law or workers and their unions do not block companies from such substitution. Often, however, organizations only contract out management functions or utilize agency temporaries for brief periods of time, with little direct effect on in-house, low-skilled workers. Moreover, employers often use temporary agencies to screen workers for permanent positions. Because temporary agencies lower the cost to employers of using workers with poor work histories or other risky characteristics, agencies may benefit these workers by giving them opportunities to try out for positions they otherwise might not have had.

Temporary help employment grew dramatically over the last decade, accounting for ten percent of net employment growth in the United States during the 1990s. Although government statistics on contracting out are not maintained, evidence from case studies and business surveys suggests that there has been dramatic growth in the outsourcing of functions to outside companies as well (Abraham and Taylor 1996; Houseman 2001b; Kalleberg, Reynolds, and Marsden 1999). In the both cases, the workers who provide services to the client firm are not the client's employees, but rather are the legal employees of the temporary help agency or the contract company. Through intensive case studies in manufacturing (automotive supply), services (hospitals), and public sector (primary and secondary public schools) industries, we endeavor to shed light on why employers increasingly are using these nonstandard employment arrangements and their implications for wages, benefits, and working conditions of workers in low-skill labor markets.

Because workers in these arrangements often receive lower compensation than they would if they were employees of the client organization, the growth of temporary help and contracting out generally is viewed as inimical to workers' interests. We find, however, that the story is not that simple. Our case study evidence points to circumstances under which workers *are* likely to be adversely affected by the outsourcing of jobs to agencies or contractors. These cases entail the long-term substitution of agency temporary or contract company workers for regular employees and the loss of wages, benefits, or union status.

In other situations, however, the effects on low-skilled workers appear to be minimal or even beneficial. Often, organizations only contract out the management function, which has little direct effect on low-skilled workers. Agency temporaries typically do not substitute for regular workers on a long-term basis. Moreover, employers often use temporary agencies to screen workers for permanent positions.

Because temporary agencies reduce the cost to employers of using workers with poor work histories or other risky characteristics, agencies may benefit these workers by giving them opportunities to “try out” for positions they otherwise might not have had.

Throughout our discussion, we point to the important impacts employment and labor law, unions, and other institutional factors have on (1) employers’ incentives to use temporary agencies or contract companies, (2) the constraints employers face in using these employment forms, and (3) the implications of such outsourcing for low-skilled workers.

## **BACKGROUND ON ECONOMIC CONDITIONS**

The primary data for these case studies were collected in 1999 and 2000. During this time period, all three industries faced tight labor markets for low-skilled workers. Moreover—although the sources of the pressure differed across industries—automotive suppliers, hospitals, and public schools were all facing intense pressure to cut costs. Automotive suppliers made intensive use of temporary help services and public schools contracted out functions, while hospitals used a combination of temporary services and contracting out. We argue that the utilization of temporary services or contract companies was one strategy employers adopted to reduce recruitment costs, increase productivity, or lower compensation or other costs.

### **Automotive Suppliers**

During the latter half of the 1990s, automotive suppliers witnessed tremendous growth as car sales reached new highs. In 1999, car and light truck sales climbed to 16.8 million units (an industry record) after enjoying three “good” sales years of more than 15 million units. Industry economists stated that the

industry had established a new sustainable annual level of output of 16 million units, which was an increase from their earlier estimate of 15.5 million units. In 2000, car and light truck sales soared even higher, reaching 17.3 million units. Finally, in 2001, despite recessionary conditions in the nation's business investment sector, car and light truck sales stayed at 17 million units.

These high sales volumes came at the expense of prices; prices on cars and light trucks had been stable or declining during the preceding five years. Facing lower prices, automakers turned to cost reduction strategies to increase profits. Automakers pressured their suppliers to take on more research and development responsibilities and risks, to respond quickly to new orders and design changes, to deliver their product in a just-in-time environment, and to do all of this for less money. In this environment, use of temporary help agencies became an important staffing strategy in four of the five auto supply plants we studied.

## **Hospitals**

Cost pressures on hospitals began to grow in the late 1960s, when there was a decline in reimbursement due to changes in programs such as Medicare. These cost pressures increased during the 1990s, primarily because of declining reimbursement from the federal government and insurance companies.<sup>1</sup> Adding to cost pressures on hospitals was the growth of managed care organizations, which increased competition within the market for health care, and often forced hospitals to offload non-profitable businesses (such as nursing homes or dialysis services) and focus more on their core competencies. These cost pressures led hospitals to undergo consolidation and other forms of reorganization.

---

<sup>1</sup>The Balanced Budget Act of 1997 created various Diagnostic Related Groups, which specified maximum reimbursement rates for medical procedures; these reimbursements were lower than those previously in effect.

A substantial fraction of a hospital's expenses are in the form of labor costs. An estimated 60 percent of a hospital's expenses are typically labor costs, of which 40 percent are accounted for by nurses. For these reasons, the nursing pool typically has been a target for cuts by hospitals seeking to contain costs, and nurses have often been replaced with lower-skilled, low-wage workers (Egger 1999). "Nursing aid," whose wage is just 60 percent of the median for all workers,<sup>2</sup> is one of the fastest-growing occupational groups in the United States. In addition, many hospitals have outsourced support functions, such as food and environmental services, in an effort to increase efficiency and reduce costs.<sup>3</sup>

### **Public Schools**

The public schools in our study are located in Michigan. Two measures enacted in the mid-1990s greatly altered the competitive and financial environment for public schools in this state. The first was the licensing and funding of charter schools, which were intended to increase school choice for parents and students, primarily in poor urban districts, and to stimulate innovative educational practices for at-risk children. The second was the passage of Proposal A, which shifted public school funding away from local property taxes and onto the state sales tax. The new tax base was intended to equalize funding of public schools across wealthy and poor districts, and stabilize funding for poor districts that had suffered declining property values. The vast majority of a public school's funding now comes from a per-pupil allowance from the state, set at \$6,971 in 2001–2002. The per-pupil allowance represents an average cost of educating a child, and the marginal cost is lower. An unintended consequence of the new funding

---

<sup>2</sup>U.S. Bureau of Labor Statistics, *Employment and Earnings*, 1998.

<sup>3</sup>See, for example, the results of the tenth annual "Contract Management Survey" (2000) reported in Burmahl (2001).

mechanism is to reward expanding school districts and penalize districts with declining enrollments. Declining enrollments, in large part due to competition from charter schools, placed many school districts, especially urban districts, in severe financial straits.

One response by school administrators in financially troubled districts has been to cut costs in noninstructional services—such as bus, custodial, and food services—in order to maintain the quality of instructional services. Workers in noninstructional services are commonly unionized in Michigan, particularly in larger urban and suburban districts. A 1994 Amendment to the State of Michigan’s Public Employment Relations Act, which precluded collective bargaining over the outsourcing of noninstructional services, paved the way to outsourcing of previously unionized, noninstructional services.

## **CASE STUDY METHODOLOGY**

We studied the use of temporary services and contracting out in connection with the low-skilled workforce in five automotive supply establishments, six hospitals, and seven public school districts. The five automotive suppliers were located in the Midwest; three of the hospitals were located in Michigan and three in North Carolina; and all seven public school districts were located in Michigan. In selecting automotive suppliers and hospitals for case study, we had no prior knowledge of the organizations’ use of flexible staffing arrangements. In public schools, however, we intentionally selected districts that contracted out at least one non-instructional function.

Although the sample was restricted geographically, we endeavored to select a variety of organizations within each industry. Among the automotive suppliers, the workforce ranged in size from 430 to 2,100 employees. Two of the plants were foreign-owned subsidiaries, one was a branch plant of a large



U.S. company, and two were locally-owned plants. Production workers in two of the five plants were unionized. The hospitals varied in size from a small Michigan hospital with 450 employees to a large North Carolina hospital with 6,000 employees. Half of the hospitals were public and half were private, not-for-profit institutions. One hospital was unionized. In public schools, we interviewed a wide range of districts. Three of the districts were urban, one was a large suburban district, and two were small rural districts. One of the case studies was an intermediate school district organized at the county level, primarily to provide services for children with disabilities. The bus drivers in all of the school districts were unionized—even bus drivers who were employees of a contractor. Of the six districts with food service and custodial employees, food service workers were unionized in three and custodial workers in four.

In all three industries, we conducted extensive interviews with the organizations' managers, temporary agency or contract company representatives, and workers in order to gain various perspectives on why organizations used these staffing arrangements and their impacts on workers. We developed a set of questionnaires for each type of person interviewed (manager, temporary help agency, contractor, worker representative) within each industry. Therefore, a core set of questions was asked at each site within a particular industry. However, we asked follow-up questions to allow interviewees to expand upon or clarify certain points. All interviews were tape-recorded and subsequently transcribed.

In the auto supply industry, we interviewed the human resource director of each of the companies, at least one of their first-line production supervisors, and the on-site temporary employment agency representatives at the two production facilities with such representatives. At one company, we were able to conduct two focus group sessions, one with permanent workers and another with temporary agency workers.

Within hospitals, we interviewed the human resources director and managers in key functional areas: nursing, clerical and administrative support, laboratory, food services and housekeeping, and clinical specialties (e.g. radiology, physical therapy). We also interviewed selected temporary help agencies providing clinical staff to hospitals, and the regional manager of a national contractor that supplies food and cleaning services to hospitals.<sup>4</sup>

In each school district, we interviewed the person or people in charge of non-instructional personnel and contracting out. In one very small school district, this was the superintendent. In larger districts, these duties were performed by a business manager and human resources manager. We also conducted interviews with food service and cleaning contractors that were used by these public school districts and with union representatives in occupations affected by contracting out.

In addition to collecting information through interviews, we collected basic data on employment, wages, and benefits by occupation of regular full-time, part-time, and on-call employees at each organization studied. Where possible, we also collected similar information for contract and temporary agency employees assigned to the organization studied.

## **LOW-SKILLED JOBS IN AUTOMOTIVE SUPPLY, HOSPITALS, AND PUBLIC SCHOOLS**

In this study, we focus on workers in “low-skilled” jobs. By “low-skilled,” we primarily mean positions that do not require post-secondary education and whose tasks can be learned on the job in a relatively short period of time. This would exclude, for example, skilled-trade positions. We use the term

---

<sup>4</sup>We conducted focus groups with regular and temporary nurses at two hospitals. Use of temporary nurses was the most important and controversial use of temporary services in hospitals. However, because nursing is a high-skilled occupation, we do not cover it in this chapter.

“low-skilled” rather than “unskilled” to denote the fact that, although the training time required to learn these jobs is relatively short, the jobs often require non-trivial skills. We further distinguish between “low-skilled” and “low-paid” positions. While workers in low-skilled positions typically receive relatively low pay, this is not always the case, particularly when workers are unionized. In the latter situation, employers may have strong incentives to outsource these positions to temporary agencies or contract companies, as is discussed further below.

Low-skilled jobs comprised a large share of employment in all three of the industries studied. In auto supply, production positions accounted for 60 to 75 percent of employment in the case study plants. The overwhelming majority of these production positions were low- or semi-skilled; entry-level positions were typically learned on the job in two days or less.

Although registered nurses (RNs) form the single largest occupation in hospitals, hospitals have shifted work away from high-skilled, high-paid RNs to low-skilled, low-paid nurse assistants. Moreover, hospitals utilize a large number of workers in clerical, food service, and housekeeping functions. The vast majority of workers in these support functions are low-skilled. Among the hospitals we studied, between 40 and 50 percent of the staff were in low-skilled positions. Between 13 and 20 percent of staff were in low-skilled clinical positions, 15 to 21 percent were in low-skilled clerical positions, and another 7 to 10 percent were in housekeeping positions.

Like RNs in hospitals, teachers represent the core occupations in public schools. Like hospitals, public schools utilize many low-skilled workers in such areas such as food service, cleaning, and transportation. Among the schools in our study, 15 to 20 percent of a district’s employment was typically in these three non-instruction support occupations.

Most of the entry-level positions offer some possibility for career advancement. For instance, production workers may learn additional skills or stations, for which they would receive higher pay. Eventually, the best workers may be promoted to team leaders or line supervisors. The typical entry-level position in food service entails assistance with simple food preparation and serving. A worker may advance to cook or cashier, and eventually to a supervisory position. Custodians in schools may advance to be the head custodian of a school. Some occupations, such as bus drivers and nurse's aides, have no job ladder.

The low-skilled jobs in our sample are not always associated with low compensation. This point is pertinent to our study because the incentive organizations have to outsource jobs to a temporary help agency or contract company and the effects on workers of such outsourcing are likely to depend on workers' compensation. Organizations would be expected to have a greater incentive to outsource jobs the higher the wages of their low-skilled workforce relative to low-skilled workers in other competing organizations. In turn, relatively high-paid, low-skilled workers potentially have more to lose from outsourcing.

Information on starting wages, availability of health insurance benefits, and union status of workers in low-skilled occupations in automotive supply, hospitals, and public schools is reported in appendix table A-1.<sup>5</sup> The wages and benefits for entry-level production workers in automotive supply tended to be better than those for low-skilled occupations in the other two industries. Production workers always worked full-time and received basic health insurance and retirement benefits. Perhaps most notable was the large

---

<sup>5</sup>For auto supply, we report data for entry-level production workers. For hospitals and public schools, we report data for workers in the most prevalent occupational title within a particular functional area, which coincides with the lowest-paying occupation. The precise occupational titles and the number of occupational titles in a particular functional area varied across organizations within an industry.

variation in starting wage across auto suppliers. Two of the plants in our sample were unionized and these workers received relatively high wages, however one of the non-union plants paid the second-highest wages. Historically, this employer intentionally pursued a “high-road” strategy, paying above-market compensation to its workers. It believed that by so doing it would attract the best workers and thereby reduce quality control and turnover problems. This employer had a reputation of being one of the best in the area and had little trouble attracting workers, even during tight labor markets. A high compensation strategy was also motivated by a desire to remain nonunion.

Wages for entry-level positions in food service, housekeeping, nurse assistant, and clerical positions in hospitals tended to be quite low. Hospitals offered health insurance and retirement benefits to all full-time workers. However, many low-skilled hospital workers worked part-time and received prorated benefits with high copayments on health insurance, or no benefits. Interestingly, the one hospital in our study with unions representing low-skilled workers had a high fraction of part-time workers in its low-skilled positions.

The wages for low-skilled workers in public schools varied considerably. Entry-level food service positions in public schools were almost always part-time and the wage levels were quite low, even in cases where these workers were unionized. None of the schools in our sample offered health insurance to their part-time food service employees. Under state law, all public school employees, including food service employees, are part of a state retirement plan. Payment into the retirement plan is made solely by the school and amounts to between 12 and 13 percent of the workers’ earnings. Entry-level custodians, who were often unionized, typically worked full-time and earned substantially higher wages and benefits than did food service workers. Bus drivers bear considerable responsibility and require special training, particularly in the area of safety. All of the bus drivers in our sample were unionized, even when they were

employees of a contract company. The hourly wage of bus drivers tended to be similar to that of custodians, but many school systems experienced great difficulty recruiting bus drivers. One reason is that most positions were part-time, with hours concentrated in the early morning and mid-to-late afternoon. In an effort to recruit bus drivers, some school systems offered these individuals full-time employment with full benefits by utilizing them in other jobs in the intervening hours.

### **TEMPORARY HELP USE**

The use of temporary agency help was common in our auto supply and hospital case studies.<sup>6</sup> Usage was particularly high among some auto suppliers. Although no statistics exist on use of temporary agency employment at a detailed industry level, our case study evidence of high use in auto supply is consistent with findings that temporary help in manufacturing has grown rapidly since the 1980s (Segal 1996; Segal and Sullivan 1997).

Statistical studies have shown that, on average, agency temporaries earn lower wages than comparable workers in regular positions (Segal and Sullivan 1997, 1998). They also tend to receive fewer benefits (Houseman 1999; Kalleberg, Reskin, and Hudson 2000). Based on these facts, it is often assumed that temporary jobs are “bad” for workers. Yet, as our case study evidence shows, the implications for workers are often more complicated. First, differences in compensation between agency temporaries and regular employees in statistical studies are only averages; sometimes agency temporaries earn more than their counterparts in regular jobs and often their compensation is similar. Moreover, the

---

<sup>6</sup>Temporary help agencies were only used occasionally for clerical positions in public schools.

effects of temporary employment on workers depend on why organizations are utilizing temporaries and what the alternatives available to the worker are. For instance, if the organization is using temporary staff to screen workers for permanent positions, temporary employment may have no long-term adverse effects on these workers and may allow low-skilled workers to audition for jobs for which they would otherwise not be considered. Finally, an organization's utilization of temporary staff may impact not only the temporary workers, but also the regular staff, and the effects on these two groups may be quite different.

### **Use of Temporary Help among Auto Suppliers**

Four out of the five auto supply plants utilized temporary agency help during the period of our interviews (Table 1). In two of the plants, the utilization of temporary employment was very high, accounting for 20 percent or more of production employment. In one unionized plant, the use of temporary agency workers was strictly prohibited by union contract.

As noted above, all of the plants were operating at or near full capacity and employers faced tight labor markets during the period of study. Human resources directors reported that, while they received many applications, the average quality of the candidates was low. The fact that auto suppliers continued to have a large number of job applicants, albeit of low quality, despite the tight labor markets likely reflected the fact that the entry-level jobs offered relatively high pay and good benefits for low-skilled workers. For the most part, the auto suppliers in our study used temporary help agencies to staff increases in production and to screen workers for permanent positions. Across the cases in our study, however, there were subtle but important differences in employers' motivations for using temporary staff, the terms by which temporary staff were hired, and the implications for temporary and regular staff. We distinguish three cases.

## **Temporary Help in Unionized Plants**

Auto suppliers are often faced with sudden and temporary increases in production levels and thus have an inherent, periodic need for temporary workers. Auto Supplier D, the unionized plant prohibited by contract from using agency temporaries, instead hired temporary workers directly when production volumes increased significantly. The short-term workers received entry-level wages and could stay no longer than 120 days. They gained no seniority for their work effort, nor did they gain any advantage from working at the plant if they later sought a permanent position.

Auto Supplier E, the other union plant in our sample, was strictly limited in its use of agency temporaries. The labor contract stipulated that individual temporary agency workers could be used for no more than 30 days, and then only after the unionized workers turned down the opportunity of greater overtime hours. At the end of the 30 days, the employer could either hire the temporary worker on its payroll or terminate the temporary's contract. In addition, by collective agreement, the agency temporaries earned the same wage as the employer offered new production workers. Thus, in practice, the treatment of direct-hire and agency temporary staff differed little between the two union plants. For the companies, the one using the agency temporaries paid overhead to the agency, while the other incurred higher internal costs in recruiting and screening its own temporary workers. Although temporary help agencies likely enjoy economies of scale in recruitment and screening, the union company using direct-hire temporaries paid higher wages than the union company using agency temporaries, and thus it is likely that it was easier for the former to recruit temporary workers on its own.

It is important to note that the human resources directors at both plants expressed a desire to use or to increase the use of agency temporaries. Even paying similar wages and agency overhead, human



resources directors felt that they could save money by using agency temporaries because they incurred no benefit costs on the temporaries and because they reduced overtime paid to regular staff. Thus, the provisions in the union contracts constrained management staffing decisions.

### **Use of Agency Temporaries by Non-Union “High-Road” Auto Supplier**

The nonunion Auto Supplier C offered higher wages than one of the union plants in the sample and its wages were substantially higher than those at the other nonunion auto suppliers. The company was regarded as one of the best area employers for low-skilled workers seeking manufacturing employment. In addition to good wages, the company had a no-layoff policy for its regular workers.

An integral complement to the company’s high-wage, strong job security policies for regular workers, however, was the extensive use of agency temporaries who earned substantially lower wages than entry-level regular workers, and had no benefits or job security. The company’s rationale for using agency temporaries was two-fold. First, the company carefully screened all new hires through a temporary help agency, which had an on-site representative. The company wanted to ensure that workers were high performers before offering them job security at relatively high compensation. The company also wanted to remain nonunion. According to the on-site temporary agency representative, the agency used this probationary period to screen out individuals it deemed likely to sympathize with union causes. Temporary agency workers had to complete a minimum of 6 months of work before becoming eligible to apply for a regular position. Sometimes workers remained as temporaries for a year or more before being offered a regular position or leaving. This probationary period as a temporary worker was considerably longer than that at any other auto supplier we studied.

A second reason the company used the agency temporaries was to buffer regular workers in the event of a downturn in production. According to the human resources director, the company believed it had to maintain about 10 percent of its workforce as temporary to provide an adequate buffer for regular workers in the event of a downturn.

At the time of our interviews, however, the fraction of production workers who were agency temporaries had climbed to over 20 percent. The high fraction of temporaries resulted from the fact that production had been expanding, all new hiring was done through the temporary agency, and temporaries were converted to permanent hires at a slow rate.

Whether the fraction in temporary employment should be substantially lowered by offering more temporaries permanent positions at a faster pace was the subject of intense debate at the time of our interviews. On the one hand, the accounting department had calculated that a five percentage point drop in temporary employment cost the company one million dollars per year due to higher wages and benefits earned by permanent workers. On the other hand, human resources expressed concern that the temporaries were not as committed to the organization as regular staff. Moreover, reportedly many good temporaries tired of the long wait for permanent employment and quit, resulting in increased training costs and quality problems associated with high turnover among temporaries—factors not taken into consideration in the accounting department’s cost-savings calculations. Human resources had feedback from other companies reporting that they hired many well-trained workers who had worked as temporaries at Auto Supplier C, but who had quit or been passed over for promotion. The plant’s human resources director summarized the internal debate as follows:

...as we were growing the business and ... we're trying to get product out the door, it's like 'get some more temporaries,' 'get some more temporaries,' and one morning we woke up and we were at like 25 percent. And ... quality is starting to have problems ... and now it's like 'we've got to get this temporary ratio back down.'

...we'll start edging back down to 20 and ... then the goal becomes 15 percent. We haven't hit it ... and now, there's always this discussion, 'Well, it's more cost effective to have the temporaries.' So it doesn't seem to be an initiative with the executives to get that ratio down. So even though they talk about it, we are never going to get this high rate down, we run at around 20 percent. So, what I'm trying to say is 'Is there a cost advantage?' If there is ... let's decide this and we're going to operate within 20 to 25 percent.... But ... we are in this constant state of denial, yet that number still stays up there and yet the Vice President of Human Resources is like [saying] 'we've got to get it down.'

We conducted two focus groups with production workers at this plant—one with regular employees and the other with agency temporaries—to better understand the workers' perceptions of the costs and benefits of the company's use of temporaries. Interestingly, the regular workers, all of whom had been hired through the temporary agency, saw no problems with the system and perceived it as fair. In marked contrast, the temporaries viewed the system as unfair. They understood that the company would want to screen candidates through the temporary agency, but believed that a two or three month time period—as was typical at the other nonunion plants we studied—was more than adequate to assess a job candidate. They believed that temporaries were not treated as well by supervisors and deeply resented the low wages they earned as temporaries. However, this resentment did not affect their productivity, for they knew that only the best temporaries would be offered permanent positions.

In sum, at the time of our interview, company executives *de facto* had chosen to keep high levels of agency temporaries. The recent dramatic growth in temporaries at this company could be viewed as a backing off, or at least a qualification, of their human resources commitment to high wages and job security. Their original "high road" philosophy was premised on the belief that high wages and strong

commitments to job security would be paid back through high quality and low turnover. However, by having a very long probationary period at much lower wages, the company, in essence, was recapturing some of the economic rents workers earned subsequently. At least the prevailing group of executives had come to believe that wage and benefits savings outweighed other costs associated with this strategy.

### **Temporary Help Use among Other Nonunion Auto Suppliers**

Auto Suppliers A and B were nonunion plants whose compensation levels were considerably lower than those at the other three facilities studied. They each made extensive use of agency temporaries. At the time of our interview, agency temporaries accounted for over 20 percent of production employment at Auto Supplier B. This high use was because of a temporary increase in production. The human resources director at this relatively small plant felt it would have been extremely difficult to recruit and screen large numbers of workers quickly for a large increase in production, especially in the tight labor market prevailing at the time of the interviews, without the assistance of a temporary agency.

Both plants also used temporary help agencies to screen workers for permanent positions. Temporary agency workers were typically screened over a two to three month period. If the company chose to offer them a position at the end of their temporary contract, they would then be placed on a probationary status as a direct hire of the company for another 90 days.

As was the case in the other auto supply plants, human resources directors complained about the low quality of the applicants in the tight labor markets prevailing at the time. Many applicants had little or no experience in a manufacturing setting. Moreover, some applicants had criminal records and many had spotty work histories. Managers emphasized that, in these tight labor markets, they were hiring job applicants that they would have never taken a second look at in the past.

Although the entry-level tasks that workers were expected to perform required little or no previous skills, the jobs required “soft” skills, like being punctual for one’s shift and being able to get along with coworkers. Production supervisors stressed the need to hire workers that “fit” into their production teams, and the use of temporary workers provided the opportunity to see if the new workers would fit.

I have the opportunity to observe this person over a period of time. I don’t have just a half-an-hour snap shot to go by as in an interview. I can get to know the person, get to know their background a little bit, get to know what their behaviors are, what motivates them, what possible problem areas I might have with the individual.

Historically, these auto suppliers would have hired new workers directly on probation. Temporary help agencies offered a couple of advantages to companies: First, while the workers were with the temporary agency, they were less costly to the company than if they were hired directly. Although the wage differentials between temporaries and direct-hire production workers were not as great as at Auto Supplier C, temporary workers assigned to Auto Suppliers A and B earned lower wages than new hires at these companies. Moreover, the rate at which the temporary agency billed the workers was lower than the total compensation costs of new hires.<sup>7</sup> Second, it was easier for a manager to terminate and replace a worker hired through a temporary agency. The manager could simply inform the temporary agency that the assigned worker was not satisfactory and request a replacement.

By lowering the compensation and firing costs, temporary help agencies made it more attractive for companies to try out workers with criminal records, poor work histories, or otherwise “risky” characteristics. In the absence of temporary help agencies, companies may have hired these risky workers

---

<sup>7</sup>According to data supplied by the companies, the hourly wage earned by agency temporaries was 75 percent, 83 percent, and 56 percent of that earned by new hires at Auto Suppliers A, B, and C, respectively. The agency bill rate was 79 percent, 85 percent, and 60 percent of the total compensation of a new hire at Auto Suppliers A, B, and C, respectively.

anyway. However, they may have chosen to offer higher wages and attract more qualified candidates instead, bidding them away from other companies. The human resources director at Auto Supplier B specifically discussed this alternative strategy, saying that his company had tried it, but opted instead to use agency help.

The use of temporary help agencies as a mechanism for screening risky workers was even more transparent at Auto Supplier A. At that company, job applicants were channeled into one of two tracks. Applicants with good qualifications were hired directly with a 90-day probation. Applicants deemed more risky were referred to the temporary help agency, which, in turn, could place the candidate with the company on a temp-to-perm contract. At the end of the contract, successful candidates would be hired directly and begin the company's 90-day probationary period. According to the human resources director, treatment of its agency temporaries was fair:

If you are out on the line, you would not be able to distinguish a contract employee from one of our own full-time employees. There is no differentiation on the training perspective, on the assignments they are given ... Our intention in bringing [temporary employment workers] in is to bring them on full time. It's just that their backgrounds [make it uncertain if they will be able] to meet our pretty rigorous hiring criteria. Yet, if we sense that there is an opportunity for a good match, we will bring them in through contract. So, there is never an intent to just bring them in for a short-term blip in production and then let them go.

Approximately 70 percent of the company's new hires came through the temporary help agency.

A key element allowing these auto suppliers to tryout more "risky" workers through temporary employment agencies was the use of small production teams. Instead of the assembly line approach to production, work at these plants was organized in small production areas, where the more experienced workers were able to perform many, if not all, of the tasks required. This setting allowed the more

experienced workers to monitor the performance of the temporary worker, catch errors before the product left the assembly area, and adjust quickly to possible bottlenecks that arose as the new workers learned their tasks.

Although agency temporaries earned lower wages than those hired directly, many of these workers potentially benefitted from the exposure to jobs that temporary help agencies offer. By lowering the cost to companies of hiring them, temporary help agencies gave workers with risky backgrounds opportunities to try out for higher-paid, full-time manufacturing jobs with good benefits, opportunities that they otherwise might not have had. Another advantage to these workers is that if they did not succeed in the position or did not like the job, the assignment simply ended; it was not recorded as a dismissal or a quit, which would tarnish their employment records.

For regular workers, any costs of using agency temporaries are indirect. By lowering the cost to companies of trying out riskier workers, temporary help agencies effectively expand the supply of potential labor to a company. In this way, companies may avoid or minimize the need to raise wages in order to attract more qualified candidates; because increases in wages for new workers are almost always accompanied by increase in wages for existing workers, existing regular workers would benefit from higher wage levels.<sup>8</sup>

### **Use of Temporary Help among Hospitals**

The hospitals in our study made use of agency temporaries in a number of low-skilled occupations. In clinical areas, the use of agency temporaries in such occupations as nurse assistants and patient sitters

---

<sup>8</sup>We develop the argument that temporary help agencies may reduce pressure on companies to increase wages in Houseman, Kalleberg, and Erickcek 2001.

was often cited in interviews. Patient sitters watch extremely ill or confused patients and call for help when needed. Because the need for patient sitters is so variable, hospitals tend to staff this position exclusively with agency temporaries. In non-clinical areas, all hospitals cited use of agency temporaries for clerical functions. Also, three hospitals indicated that they used agency temporaries in food and environmental services, although only one maintained records of this use.

Table 1 reports the fraction of total hours worked in a particular occupational area that were accounted for by agency staff in hospitals with data that permitted such a calculation. Economy-wide, temporary agency workers represent between 2 and 3 percent of paid employment.<sup>9</sup> Thus, the figures suggest that agency use in low-skilled hospital functions is often moderately high.

One reason hospital managers commonly cited for using agency temporaries was to circumvent the human resources department. Managers complained that human resources took too long to process new hires, in part because new hires needed to be carefully screened to work in a hospital environment. Managers felt that they could not perform the work with existing staff if there were several vacancies, and so would often bring workers in as agency temporaries while they waited to have their paperwork processed by human resources. Managers cited the ability to quickly dismiss a worker as another advantage of using temporary agencies for new hires. Human resources departments in hospitals—particularly the larger hospitals—tended to have elaborate and lengthy procedures that managers had to follow in order to dismiss a worker. Therefore, some managers preferred to screen new workers through temporary help agencies. In these situations, workers were simply being screened for a

---

<sup>9</sup>Because the agency temporaries are somewhat more likely than other workers to work part-time hours, the fraction of hours worked by agency temporaries is probably lower than the fraction of employment accounted for by agency temporaries.



few weeks with a temporary agency, and such use of temporary agencies would appear to have little effect on these workers.

The second major reason managers cited for using temporary help agencies was difficulty in recruiting new workers. Hospitals had come under intense pressure to reduce costs. At the same time, given tight labor markets, their wage levels for low-skilled clerical, food, housekeeping, and clinical positions were becoming uncompetitive with wages for low-skilled workers in other sectors. In the words of one manager, “We had a problem attracting recruits. Frankly, McDonalds and Burger King were paying what we were and [workers there] don’t have to go through the stress or the hassle or the hours or the customer service that they are required to perform here.” In contrast to the situation among auto suppliers, where managers complained that the quality of the applicants had declined, some hospital managers complained that they had almost no applicants, good or bad, for low-skilled positions. When hospital managers had difficulty recruiting and retaining staff in low-skilled positions, they often turned to temporary help agencies, on the grounds that the agencies were better at recruiting workers.

However, temporary agencies could not always recruit workers at these low wages either. For instance, one hospital manager reported: “We wanted a housekeeper . . . and only wanted to pay the person \$7 an hour . . . you can’t get a housekeeper for \$7 an hour and so we’ve made calls to four agencies and they only laugh.” Similarly, one hospital reported difficulty retaining workers in patient billing, who received low wages but nevertheless required extensive training. When the hospital was unable to staff the position on its own, the hospital brought in a temporary agency to staff it. Yet, the agency could not retain workers in the position either. A more common complaint was that while temporary agencies might be able to staff positions at low wage levels, the average quality of the workers in these positions was very low.

In several cases, hospitals reported that workers hired through the temporary help agency earned *more* than regular workers on staff. In these situations, it is not so much the agency temporaries who are potentially harmed by the arrangement, but the regular workers. By hiring through a third party like a temporary agency, employers may effectively raise the wages for new hires without raising wages for existing staff.<sup>10</sup>

Such wage differentials can cause deep resentment and morale problems among regular staff, however, if they become aware of them. One temporary agency placing nursing assistants reported poor treatment of their assignees because regular staff resented the high pay they received. Perhaps because of such morale issues, managers more typically reported that agency temporaries received about the same hourly rate as regular entry-level staff, though in many instances temporaries made less in total compensation, taking into account differences in benefits.

In general, hospitals had less financial incentive to use agency temporaries than auto suppliers. In auto supply, temporary workers earned less than entry-level regular workers, and the agency's bill rate to the company was lower than the total compensation costs of hiring a new regular worker or paying overtime to an existing worker. Thus, even though managers in auto supply plants complained about the quality of temporary workers, most felt it was a cost-effective way of screening job candidates and staffing for temporary increases in production. In hospitals, however, temporary workers typically earned about the same wage as regular workers. Managers reported paying a 40 to 50 percent overhead rate to the temporary agency. In the absence of agency temporaries, hospital managers would typically pay regular

---

<sup>10</sup>We discuss the theoretical framework of such wage discrimination and cite numerous examples in which temporary help workers earn more than regular staff in high-skilled clinical positions in Houseman, Kalleberg, and Erickcek (2001).

workers overtime to cover understaffed positions. Therefore, with a 50 percent overtime premium, many managers reported that the marginal hourly cost of paying overtime was about the same as hiring a temporary.

Given that temporary workers were regarded as less reliable than their own staff, a couple of managers in the food and environmental services areas reported movement toward reducing the amount of temporary help and offering high hours positions for regular staff. For instance, one hospital reported recently advertising 60 hour per week positions. The rationale was that these low-wage workers had to work two or three jobs to make ends meet. Managers saw the chance to consolidate these hours at the hospital, effectively at a higher wage factoring in overtime, as benefitting both workers and the hospital.

Except to the extent that their use enabled hospitals to postpone wage increases for low-skilled workers, temporary help agencies appeared to have little adverse impact on hospital employees, and potentially benefitted agency workers. Although the hospitals generally paid low wages, full-time workers did receive benefits, and thus, as in auto supply, very risky workers might obtain an opportunity that they would not have otherwise received to try out for jobs with benefits through a temporary help agency. However, because of the low wage levels in hospitals, temporary help was relatively expensive for hospitals to use and most managers expressed a desire to reduce, not increase, their reliance on it.

One interesting fact to emerge from the comparison of temporary workers assigned to hospitals and auto suppliers in the same labor markets was that there seemed to be a “going” wage for low-skilled entry-level workers in temporary services. Unless specified in a union contract, temporary workers assigned to entry-level production positions seemed to earn little, if any, more than workers assigned to low-skilled positions in hospitals. Thus, with the exception of the unionized firm, the wage differentials

between temporary and regular workers were much greater in auto supply than in hospitals. Yet, provided a worker could tolerate a manufacturing working environment, the assignment to auto supply offered better future prospects in terms of training and wage advancement. This example underscores the problems of trying to draw conclusions about the effects of temporary employment through simple wage comparisons of workers in temporary and regular positions. The implications of temporary employment for workers depends upon a company's reason for using agency temporaries and the workers' job alternatives.

### **CONTRACTING IN LOW-SKILLED OCCUPATIONS IN HOSPITALS AND PUBLIC SCHOOLS**

No systematic national data are collected by the government on the extent to which business and government organizations contract out services. However, some data—including data from surveys conducted by private associations—are available on outsourcing in selected industries. For hospitals, the best data on national trends come from the annual Contract Management Surveys conducted by *Hospital and Health Networks*, a publication of the American Hospital Association. In 1999, 32 percent of hospitals reported that they outsourced their food services, with another 6 percent reporting that they planned to do so in the next two years. In addition, 27 percent outsourced housekeeping, while 3 percent reported that they planned to do so in the next two years. The two most commonly outsourced functions were pest control and laundry services, with 86 percent and 62 percent of respondents indicating that they outsourced these functions, respectively (Sunseri 1999).

Limited government statistics are available on contracting out of transportation and food services in primary and secondary public schools. The Federal Highway Administration estimates that

about 30 percent of school buses were privately or commercially owned in 2000.<sup>11</sup> In some instances, these statistics reflect the outsourcing of transportation services to private companies. However, in other instances, they capture the fact that some school districts lease their buses from private companies but continue to manage and employ all workers in this area. Among school districts nationwide that participated in federally-funded school lunch programs, about 8 percent used food service management companies in 1994–1995, compared to only about 4 percent in 1987–1988 (U.S. General Accounting Office, 1996).

Table 2 shows the patterns of contracting out low-skill occupations in the hospitals and public schools in our sample. Interestingly, the nationwide surveys previously cited on contracting out in hospitals and public schools do not distinguish whether an organization contracts out the entire operation or just its management. As is evident from Table 2, it is quite common for hospitals and public schools to contract out only management functions and to keep workers on their payroll. Whereas all of the hospitals we studied outsourced the management of food services and/or environmental services, none outsourced the entire operation. Among public schools, five of the six districts with a food service operation contracted it out, but only two contracted out the entire function. The one district in our sample that contracted out custodial services contracted out the entire function. Two of the districts in our study contracted out the entire student transportation function.

In situations where only management was outsourced, managers, who were employees of the contract company, directed the hospital's or school's employees. They also took on primary

---

<sup>11</sup>U.S. Department of Transportation, Federal Highway Administration, Highway Statistics 2000, <http://www.fhwa.dot.gov/ohim/hs00/mv10.htm>.

responsibility for hiring and firing workers, under the guidelines and with the approval of the client's human resources department. However, pay and benefits were established by the hospital or public school. As is discussed below, whether or not an organization outsources its management functions or its entire operation potentially has important implications for workers.

### **Why Organizations Outsource Management Functions and its Implications for Workers**

Hospital and education administrators typically view areas such as food service, cleaning, and transportation as outside their areas of "core competency." Choices to contract out are made with a view toward improving services and reducing costs in these areas, while freeing administrators' time to focus on the business of health care or education. One common reason hospital and public school administrators gave for outsourcing was difficulty recruiting good managers in non-core areas. Because contract companies specialize in a particular service and have many clients, they can offer managers an internal career ladder, and therefore can attract managers more easily than an individual hospital or school can.

In addition, contractors are often part of large national companies that offer well-tested systems of quality- and cost-control and can provide their on-site managers with technical support. For instance, in the area of food service, contract companies have systems to estimate food usage and reduce wastage. They have dieticians at their corporate headquarters that can consult with hospitals and public schools on specific issues. Because they purchase in bulk, they can often get better prices on food than hospitals or school systems can operating on their own. In public schools, a complex set of regulations govern federal government reimbursement of school lunches for children eligible for free and reduced-price lunches. Contract companies offer expertise in packaging and marketing meals to comply with government

regulations, thereby maximizing federal reimbursement. Transportation companies often offer more systematic safety training for bus drivers than that provided by individual public school districts.

Thus far, the ways listed in which a contractor may improve quality and reduce costs would have few consequences for workers. Indeed, in our case studies, the outsourcing of food or custodial service management by itself often appeared to have little impact on the workers in these areas. When workers are significantly affected by the contracting out of management, the issues generally revolve around productivity, work loads, and staff reductions. With regard to these issues, the contractors with whom we spoke also reported that when they took over the management of food or custodial services, these operations frequently were overstaffed and the quality of the work was poor, requiring them to reduce staff and discipline workers. For instance, the contract environmental services manager at Hospital C reported greatly increasing productivity upon taking over the operation from the hospital and firing workers who had previously been “goofing off.”

Efforts to increase productivity and reduce staff may cause deep resentment and backlash among workers. For example, upon taking over the management of food services in Public School A, the contractor completely reorganized the structure of jobs, increasing work loads and leading to many complaints and quits among workers. At the time of our interview, over half of the approved slots for food service workers were unfilled, leaving those who remained to work harder and work longer hours. These food service workers, who were unionized, felt they were in an awkward position being school district employees with a supervisor who was not. The union complained that, in this situation, contract company management often ignored union contract provisions.

Contract managers emphasized that improvements in worker productivity do not always or even usually lead to layoffs, however. When staff reductions were desirable, contract managers typically worked with the human resources department at the hospital or school to reduce employment through attrition. Additionally, in food service in public schools, managers usually tried to improve quality, and hence sales, which could lead to a net increase in jobs in spite of any productivity improvements.

### **Contracting Out Entire Functions and the Implications for Workers**

The contracting out of an entire function potentially has larger impacts on affected workers. In our case studies, apart from any impacts on work structure and work loads, low-skilled workers in functions that had been entirely contracted out received lower compensation, most importantly in the form of lower benefits, and sometimes they lost union status.

Under the Employee Retirement Income and Security Act (ERISA) and IRS tax laws, it is difficult for an employer to discriminate in its offerings of retirement and health insurance benefits among its full-time employees. Therefore, organizations with high-skilled and low-skilled workers will tend to offer the same benefits packages to workers across skill levels, and low-skilled workers benefit from generous benefits packages offered at organizations with high-skilled workers. However, contractors with predominantly low-skilled employees typically offer less generous benefits. Hospital E, which outsourced all of its security function, mentioned benefits savings as a major motivation for contracting out this function. Within public schools, food service workers primarily work part-time and receive no health insurance benefits. Under Michigan law, however, all school employees are part of a retirement system financed by a 12 to 13 percent levy paid by the school district on these workers' wages. Although wage and benefit cost savings



did not appear to be a primary factor in Public School B's and D's decisions to outsource their entire food service operations, administrators acknowledged these savings.

Public Schools C and F recently outsourced their entire transportation functions. Although the workers remained unionized in both cases, the bus drivers received lower benefits with the contract company, primarily because of the loss of public pension. One district went to great lengths to protect bus drivers during the transition. It hired bus drivers near retirement in other district jobs to protect their public pension, and guaranteed jobs and wages (but not benefits) with the contract company for other drivers. Nevertheless, the contract company was allowed to hire new workers at lower wages, and, over time, workers in general would likely be worse off. According to the results of a national survey published in *School Bus Fleet*, the average wage for bus drivers hired by contractors was \$10.76 in 2000, compared to an average wage of \$12.23 among bus drivers who were public school employees.

Public School G was the clearest case of a school motivated to cut wage and benefit costs by contracting out. This urban district was losing students largely as a result of competition with charter schools and, under Michigan's new school financing laws, suffered large revenue losses. Its non-instructional support staff was all unionized, and with legal changes prohibiting bargaining over contracting out of noninstructional services, this district immediately moved to contract out grounds services. According to school administrators, these employees were receiving wages well above private sector levels. Decisions to outsource custodial services were made by principals, and about half of the district's schools opted to contract out this function. These principals realized cost savings because the contractor, who was not unionized, paid lower wages and benefits.

According to union representatives and school administrators, another key factor in principals' decisions to contract out was quality. The quality of the cleaning service was low at many buildings and administrators either failed to discipline poor performers or had difficulty disciplining them, in part because of union grievance procedures.

Although union employees still worked in half of the district's buildings, the internal competition with the contractor greatly reduced the union's bargaining power. The union did not sacrifice benefits, but it made large wage concessions on higher paid custodians. Perhaps most interesting, the union dramatically altered its position on the disciplining of workers. The union believed that its members could only retain schools and receive higher compensation than the non-union contractor employees if its productivity was greater than that in the contract company. Therefore, union representatives met with school officials to encourage them to discipline or dismiss poor performers.

### **Why the Outsourcing of Low-Skilled Functions is Limited**

Although we came across examples in our case studies of hospitals and schools contracting out entire services, with adverse consequences for workers' wages and benefits, contracting out is more typically limited to management. There are several reasons for this. First, schools and hospitals are reluctant to lose control of the quality of their staff. Both serve vulnerable populations—children and very ill patients—and as such are particularly sensitive to the types of individuals coming in contact with them. Several school officials mentioned the direct contact custodians, food service workers, and bus drivers have with children as a reason for not contracting out a particular service, or for only contracting out

management.<sup>12</sup> One contractor cited the extensive contact food service workers and housekeepers have with patients as a reason why so few hospitals fully contract out these functions.

In addition, the hospitals and schools in our study were all either public or private, nonprofit organizations, which historically have adopted a protective attitude toward employees.<sup>13</sup> Public school administrators expressed a particular reluctance to outsource jobs in order to save money at the expense of employees. Moreover, some administrators who chose not to outsource jobs expressed a fear of backlash from the community were they to do so. Those who chose to outsource jobs described these decisions as among the most controversial they had made.

The main potential benefit an organization would derive from contracting out the entire function, rather than simply contracting out the management of the function, is savings on wages and benefits. Yet, with a few notable exceptions, the wages of low-skilled workers in hospitals and public schools in our case studies were relatively low. Although low-skilled workers typically earned more as employees of hospitals and public schools than they did as employees of contractors—primarily because of better benefits—the cost savings an organization could realize from contracting out its low-skilled workforce was often perceived as limited. Instead, the organizations in our study often felt the primary benefit of contracting out was better management, which would realize cost savings through increased productivity and reduced expenditures on non-labor inputs. In these instances, the impact on affected workers is ambiguous.

---

<sup>12</sup>This sensitivity to contact with children was also a reason offered by one public school official for why contracting out was more prevalent in other government sectors than in public schools.

<sup>13</sup>Institutional arguments (e.g., Dobbin et al. 1988) hold that exposure to the public sphere places organizations under greater pressure to conform to evolving norms about legitimate employment practices.

Workers may face increased workloads or job reductions, but they may also reap benefits from more knowledgeable management.

Although the contracting out of entire functions in hospitals and public schools is currently limited, it is likely to expand if these organizations continue to face financial pressures to cut costs. As they realize cost savings from outsourcing management functions, organizations may seek further savings in the form of wage and benefit reductions by contracting out low-skilled staff. In support of this notion, a representative from a major company supplying contract food and cleaning services to hospitals and schools noted that his company had initially focused on the provision of management services, but in recent years had begun to offer “full service accounts”—which involves putting all workers in the function on its payroll—on a region-by-region basis.

Finally, it is important to note that growth in competition from contractors affects wage and benefits even at hospitals and schools that do not contract out low-skilled staff. As was illustrated in the case of Public School G, which utilized both in-house union and contract custodial staff, the option of switching to a contractor greatly circumscribes workers’ bargaining power.

## **CONCLUSION**

Evidence from our case studies suggests that the effects of temporary services and contracting out on low-skilled workers vary considerably. In some situations, the use of temporary agencies or contract companies appears to have clear adverse effects on workers’ wages, benefits, or other employment conditions. In other situations, any effects on workers appear minimal or even beneficial.

Adverse effects are clearest when agency temporaries or contract company workers are substituted for regular employees on a long-term basis and receive lower compensation than they would as regular employees.<sup>14</sup> This situation arises when 1) low-skilled workers in an organization receive relatively high compensation, and 2) employers are not blocked from substituting these employees with agency temporaries or contract workers by employment and labor law or by workers and their unions.

With respect to the first factor, we observed several situations in our case studies where low-skilled workers were earning compensation well above that prevailing for workers in their positions. In two of the auto supply companies, this higher compensation was associated with unionization, and in a third, at least in part, to the company's perceived threat of unionization. In Michigan public schools, unions were able to raise the wages of workers in some non-instructional services. Moreover, state law mandated that all public school employees be covered by an expensive pension plan. We also observed differences in the benefits received by low-skilled employees in hospitals and auto supply, on the one hand, and their counterparts in temporary help agencies and contract companies, on the other. Federal regulations governing private sector benefits are designed to ensure that these tax-free or tax-deferred forms of in-kind compensation do not primarily benefit highly compensated employees; consequently, companies generally offer the same benefits to low-wage and high-wage employees. A result of this regulation is that low-wage workers in organizations with high-wage workers tend to receive more generous benefits than do low-wage workers in companies, such as many temporary help agencies or contract companies, that predominantly

---

<sup>14</sup>The possibility that lower compensation may reduce unemployment is an important caveat to this conclusion.

employ low-wage workers. Thus, unions or federal and state benefit laws may raise compensation levels of certain workers above prevailing levels, giving employers an incentive to outsource these jobs.

With respect to the second factor, unions in the auto sector were able to block the use of low-wage temporaries through collective bargaining. In contrast, the high-wage, non-union auto supplier substantially lowered labor costs by utilizing agency temporaries for extended time periods. In Michigan public schools, a change to collective bargaining law greatly weakened union power and opened the way to outsourcing of non-instructional services to lower-paid contract company workers.

These examples from our case studies underscore the important interaction between unions and employment and labor laws in enabling low-skilled labor to raise their compensation *and* to maintain these higher compensation levels by preventing outsourcing. Evolving labor and employment law, similarly, will impact both employers' incentives to use temporary agencies and contract labor, and the implications of these employment forms for workers. For instance, evolving labor law governing whether and how temporary help workers are covered by collective agreements at a client company, and the rules governing conditions under which employees of a temporary agency may form a union, potentially will have important implications for the future impacts of temporary help employment in low-skilled labor markets. Benefit regulations, as noted above, provide an incentive to companies to outsource jobs, particularly low-skilled ones. Although Congress passed a law in 1982 requiring that a client provide benefits to agency temporaries assigned to it on a long-term basis and the IRS has cracked down on the misclassification of employees as independent contractors,<sup>15</sup> some have called for further action to curb the use of alternative

---

<sup>15</sup>See Houseman 2001a for a discussion of benefits regulations.

forms of employment for the purposes of circumventing benefits and other employment regulations (e.g., Commission on the Future of Worker-Management Relations 1996).

Many, if not most, of the instances of outsourcing in our case studies, however, did not entail the long-term substitution of low-paid agency temporaries or contract company workers for employees, and, we argue, the effects on workers were largely benign or beneficial in these situations. Most of the temporary agency help we found in our case studies was, indeed, short term. Organizations typically used agency help to cover for employee absences, staff for temporary increases in workloads, or screen workers for permanent positions. What is perhaps most striking about our case study evidence on the contracting out of low-skilled workers is the fact that it did not happen very much. More often than not, when hospitals and public schools contracted out food services and when hospitals contracted out housekeeping services, they only contracted out the management function. The employees in these occupations earned relatively low wages, and the labor cost savings that could be realized from outsourcing the entire function—including savings on benefits costs—were small relative to other cost savings these organizations felt they could achieve from outsourcing management. In the few instances where low-skilled employees' wages had become much higher than those at a contractor, hospitals and public schools outsourced the entire function when they came under financial pressure to cut costs.

There is an important caveat to the conclusion that because much contracting out in low-skilled areas only involves management, the impacts on workers are relatively minor. Even if the practice of contracting out low-skilled work is limited, the very existence of such contractors may have a powerful effect on wages and benefits in low-skilled labor markets. As was illustrated by the example of unionized custodians in one of our public school case studies, it will be difficult for workers and their unions to

significantly increase wages and benefits of low-skilled workers if organizations have the option of outsourcing this work to low-cost contractors.

Finally, workers may even benefit from a temporary agency or contract arrangement. Some workers, of course, prefer temporary positions. Workers may benefit from superior management skills provided by a contractor. Moreover, organizations often screen workers with poor work histories or otherwise risky characteristics through temporary help agencies. Particularly with auto suppliers, where the cost of hiring through a temporary agency was substantially lower than hiring a worker directly, our case study evidence suggests that, often, employers would have been unwilling to try out the more risky workers in the absence of temporary agencies. Thus, temporary agencies potentially provide an important linkage for these workers to full-time jobs with benefits.



## REFERENCES

- Abraham, Katharine G., and Susan K. Taylor. 1996. "Firms' Use of Outside Contractors: Theory and Evidence." *Journal of Labor Economics* 14(3): 394–424.
- Burmahl, Beth. 2001. "Making the Choice: The Pros and Cons of Outsourcing." *Health Facilities Management* 14(6):16–22.
- Commission on the Future of Worker-Management Relations. 1996. *Report and Recommendations of the Commission on the Future of Worker-Management Relations*. Issued January 9, 1995. Report DLR, No. 6, Special Supplement. Washington, D.C.: Bureau of National Affairs, Inc.
- Dobbin, Frank, Lauren Edelman, John W. Meyer, W. Richard Scott, and Ann Swidler. 1988. "The Expansion of Due Process in Organizations." In *Institutional Patterns and Organizations: Culture and Environment*, Lynne G. Zucker, ed. Cambridge, Massachusetts: Ballinger, pp. 71–98.
- Egger, Ed. 1999. "Old Ways of Planning, Thinking Won't Work in Today's Volatile Health Care Industry." *Health Care Strategic Management* (September): 18–19.
- Houseman, Susan. 2001a. "The Benefits Implication of Recent Trends in Flexible Staffing Arrangements." Working paper 2001–19, The Pension Research Council, The Wharton School, University of Pennsylvania..
- . 2001b. "Why Employers Use Flexible Staffing Arrangements: Evidence from an Employer Survey." *Industrial and Labor Relations Review* 55(1): 149–170.
- . 1999. *Flexible Staffing Arrangements: A Report on Temporary Help, On-Call, Direct-Hire Temporary, Leased, Contract Company, and Independent Contractor Employment in the United States*. Report prepared for the U.S. Department of Labor, Office of the Assistant Secretary for Policy, August.
- Houseman, Susan N., Arne L. Kalleberg, and George A. Erickcek. 2001. "The Role of Temporary Help Employment in Tight Labor Markets." Working paper no. 01-73, W.E. Upjohn Institute for Employment Research, Kalamazoo, Michigan.
- Kalleberg, Arne L., Barbara F. Reskin, and Ken Hudson. 2000. "Bad Jobs in America: Standard and Nonstandard Employment Relations and Job Quality in the United States." *American Sociological Review* 65: 256–278.

- Kalleberg, Arne L., Jeremy Reynolds, and Peter V. Marsden. 1999. "Externalizing Employment: Flexible Staffing Arrangements in U.S. Organizations." Unpublished paper, University of North Carolina at Chapel Hill.
- Segal, Louis M.. 1996. "Flexible Employment: Composition and Trends." *Journal of Labor Research* 17(4): 525–542.
- Segal, Louis M.. and Daniel G. Sullivan. 1997. "The Growth of Temporary Services Work." *Journal of Economic Perspectives* 11(2): 117–136.
- . 1998. "Wage Differentials for Temporary Services Work: Evidence from Administrative Data." Working paper WP-98-23, Federal Reserve Bank of Chicago, Chicago, Illinois.
- Sunseri, Reid. 1999. "Outsourcing on the Outs." *Hospitals and Health Networks* 73(10): 46, 48, 50–52.
- U.S. Department of Labor. 1998. *Employment and Earnings* (January), Table 39.
- U.S. Department of Transportation, Federal Highway Administration, Highway Statistics 2000, <http://www.fhwa.dot.gov/ohim/hs00/mv10.htm>.
- U.S. General Accounting Office. 1996. *School Lunch Program: Role and Impacts of Private Food Service Companies*. GAO/RCED-96-217.

**Table 1 Use of Temporary Help among Auto Suppliers and Hospitals**

Auto Suppliers (As a percent of production employment)	
Auto Supplier A	3–6
Auto Supplier B	22
Auto Supplier C	22
Auto Supplier D	0
Auto Supplier E <sup>a</sup>	0–9

  

Hospitals <sup>b</sup> (As a percent of hours worked within occupation)	
Food Service	
Hospital A	Not available
Hospital E	11
Housekeeping	
Hospital A	Not available
Hospital E	5
Nursing and Medical Assistants	
Hospital A	4
Hospital B	7
Hospital C	2
Hospital D	5
Hospital E	0
Clerical: Unit Admin. Support	
Hospital A	8
Hospital B	0.4
Hospital C	0.3
Hospital D	7
Hospital E	11

<sup>a</sup> At the time of our interview, Auto Supplier E had recently terminated all of its agency help.

<sup>b</sup> The contract manager of food and environmental services of Hospital A reported using agency temporaries, but data on these hires were not available. Hospital F did not maintain any central records of temporary agency use, and so is excluded from this table.

**Table 2 Outsourcing in Hospitals and Public Schools**

	Food service	Custodial/environmental services	Transportation	Other
Hospital A	Management	Management		All of security Laboratory (some) Landscaping /Groundskeeping
Hospital B	Management			Laboratory (some)
Hospital C		Management		Landscaping
Hospital D	Management			
Hospital E	Management	Management		All of security
Hospital F	Management			
Public School A	Management			
Public School B	Entire Service			
Public School C			Entire Service	
Public School D	Entire Service			
Public School E	Management			
Public School F			Entire Service	
Public School G	Management	Entire Service in Half of Buildings		

**Table A-1 Wages and Benefits in Low-Skilled Occupations, Auto Suppliers, Hospitals, and Public Schools**

Occupation	Starting wage	Health plan offered	Union
Auto Suppliers			
Production			
Auto Supplier A	\$10.60	Yes	No
Auto Supplier B	\$9.62	Yes	No
Auto Supplier C	\$13.28	Yes	No
Auto Supplier D	\$15.51	Yes	Yes
Auto Supplier E	\$12.35	Yes	Yes
Public Schools			
Food Service			
Public School A	\$6.82	No	Yes
Public School C	\$7.13	No	No
Public School D <sup>a</sup>	\$6.00	No	No
Public School E	\$7.40		Yes
Public School G	\$7.22	No	Yes
Custodial			
Public School A	\$8.40		Yes
Public School C	\$9.57	Yes	No
Public School D	\$11.49	Yes	Yes
Public School E	\$12.83		Yes
Public School G	\$10.16	Yes	Yes
Bus Drivers			
Public School A	\$11.31	No	Yes
Public School C <sup>a</sup>			
Public School D	\$11.42	Yes	Yes
Public School E	\$7.42	No	Yes
Public School G	\$11.25	Yes	Yes

**Table A-1** (Continued)

Occupation	Starting wage	Health plan offered	Union
Hospitals			
Food Service			
Hospital A	\$6.40	PT prorated, 14% PT	No
Hospital B	\$7.00	16% with partial benefits; 26% without benefits	No
Hospital C	\$8.03	9% without benefits	No
Hospital D	\$7.05	20% with partial benefits; 22% without benefits	No
Hospital E	\$6.48	PT prorated, 22% PT	No
Hospital F	\$6.60	PT prorated, 65% PT	Yes
Housekeeping			
Hospital A	\$6.40	PT prorated, 8% PT	No
Hospital B	\$7.00	14% with partial benefits; 1% without benefits	No
Hospital C	\$7.95	5% without benefits	No
Hospital D	\$7.05	10% with partial benefits; 5% without benefits	No
Hospital E	\$6.48	PT prorated, 18% PT	No
Hospital F	\$6.60	PT prorated, 27% PT	Yes
Nurse Assistant			
Hospital A	\$7.20	PT prorated, 22% PT	No
Hospital B	\$7.40	10% with partial benefits; 12% without benefits	No
Hospital C	\$7.90	27% without benefits	No
Hospital D	\$8.67	23% with partial benefits; 4% without benefits	No
Hospital E	\$6.74	PT prorated, 5% PT	No
Hospital F	\$8.96	PT prorated, 46% PT	Yes
Clerical			
Hospital A	\$7.35	PT prorated, 3% PT	No
Hospital B	\$8.00	13% with partial benefits; 23% without benefits	No
Hospital C	\$8.98	17% without benefits	No
Hospital D	\$8.23	33% with partial benefits; 5% without benefits	No
Hospital E	\$7.29	PT prorated, 22% PT	No
Hospital F	\$7.50	PT prorated, 48% PT	No

Note: Data reported are for lowest-skilled occupation within a functional area.

<sup>a</sup> Occupation outsourced.