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## Comment Daniel G. Sullivan

Dey, Houseman, and Polivka have brought together in one place virtually all that is known about the overall extent of and trend in contracting out work in the United States. They did this in admirable fashion by carefully combining and comparing numerous data sources. However, despite their careful and creative work, we are left with rather incomplete knowledge of this important phenomenon. Currently available data collection programs simply are not well designed for studying the general phenomenon of contracting out. Moreover, even when significant data collection efforts have been devoted to studying portions of the contracting out phenomenon, as with employment by temporary help agencies, alternative data sources yield very different results. Clearly, the statistical agencies have a great deal more work to do if we are to adequately understand the collection of employment practices known as contracting out.

There are two categories of reasons to be interested in the work presented by the authors. The first category relates to its implications for the function-

ing of labor markets and public policy. When a firm decides to contract out tasks it might have done in-house, the relationship between worker and firm often changes in ways that are worth understanding. In some cases, such as with the use of temporary help services employment, greater reliance on contracting out likely increases labor market flexibility, as these intermediary firms appear able to efficiently match unemployed or underemployed workers to firms that have at least a short-term need for additional help. Such increased flexibility might even allow lower equilibrium levels of unemployment, though perhaps at the cost of a general reduction in the level of job security. The increased prevalence of contracting out in general and temporary work specifically may also have public policy implications in the area of unemployment insurance, health insurance, and pensions, where institutions have evolved in ways that often assume a standard, long-term employment relationship. Finally, it is of interest to know whether contracting out is driven primarily by firms' desire to minimize inherent transaction costs, as might be expected on the basis of the work of Coase, Williamson, and others on vertical integration, or is instead a strategy to avoid taxes or regulation. As an example of the latter motivation, note that in order to obtain the tax benefits of paying workers in the form of benefits rather than cash wages, firms need to make benefit plans available to all their workers. If the optimal mix of wages and benefits differs across categories of workers, firms have incentives to create artificial divisions between those workers, perhaps by using contract help to fill roles for which the firm would not want to pay generous benefits. In order to evaluate such policy questions, we need good data on the extent and variation in contracting out.

The second class of reasons to be interested in the authors' work relates to its implications for the study of the industrial breakdown of employment and productivity. If, for example, we want to know how productivity levels and trends differ between manufacturing and other sectors, we need to match the output of each industry to the hours of work that were used to produce it. Firms' contracting out can make this more difficult. In particular, if contracting out reduces the recorded number of hours worked in an industry, but not the level of measured output, a false increase in productivity will be recorded for that industry. To properly adjust the labor input in the calculation of productivity, one needs good data on the extent of contracting out. Alternatively, one could rely on value-added measures of output, but this requires an accurate input-output table to convert nominal value added into real quantities. Either way, good information on the extent of contracting out is needed to properly measure sector-level productivity.

The authors contribute to our understanding of contracting out in several ways. They start by constructing data series on occupation by industry employment over the period from 1989 to 2004. The primary source for these new data series is the underutilized data from the Occupational Employment Statistics (OES) program, which the authors use to estimate

the share of workers in eighteen broad occupations for each of sixteen industry groups. The occupational employment counts are controlled to industry employment totals derived from the Current Employment Statistics (CES) program, which are in turn benchmarked to population estimates from the Quarterly Census of Employment and Wages (QCEW). As the authors are careful to note, annual estimates of the occupational shares are based on data pooled across multiple years, so fine, year-to-year changes need to be treated with some caution. However, this new data source should be quite useful for assessing broad changes over longer periods.

The form of contracting out best tracked in official data is that which takes place through the intermediary firms of the Employment Services industry. Indeed, the number of workers employed through such arrangements can be tracked in four different ways—through the CES, the Current Population Survey (CPS), and for some years, the Contingent Worker Survey (CWS) and the Economic Census (EC). Unfortunately, as the authors show, the estimates derived from these sources differ very significantly. The biggest discrepancies appear to relate to whether the ultimate data source is workers or firms. For instance, in 2001, slightly less than 1.0 percent of the workers in the CPS reported being employed in Employment Services, while the CES figure based on firm reports was over 2.5 percent.<sup>1</sup> It seems likely that many workers in the CPS answer the question about industry referring to the client firm where they do their work, as opposed to the firm that pays them. The CWS was specifically designed to address that problem by asking, for example, whether workers were employed by a temporary help firm. The more specific question does appear to raise the count of workers responding that they work for a temp firm. The CWS estimate of the share of employment in the temporary help supply component of Employment Services is about 1.0 percent, but that is still much less than the CES estimate, which is about 1.8 percent. Moreover, over the 1995 to 2005 period, the worker-based CWS estimates fell slightly, while those from the firm-based CES rose by 0.4 percentage points. To add yet more uncertainty, the firm-based estimates from the Economic Census turn out to be even higher than those from the CES. For instance, in 2002 EC estimates for temporary help supply were 12 percent higher than CES estimates. Given the difficulty workers are likely to have answering the industry question, it seems very likely that the firm-based estimates are closer to the truth than the worker-based estimates, but it is hard to know how to judge the relative accuracy of the CES and EC data.

The authors also provide a good deal of new information on the Professional Employer Organization (PEO) industry. One might argue that this industry is of less inherent interest than the temporary help industry because in many cases PEO firms play little role in the recruitment of workers. Instead, they often simply take over an existing payroll and act essentially like a pay-

1. Such a discrepancy was noted in Segal and Sullivan (1995).

roll processing firm. However, the existence of PEO firms can still have a nontrivial effect on measured industry employment distributions, an effect that needs to be understood in order for one to properly evaluate trends in sectoral employment. As the authors show, this is currently not possible. First, as the authors clarify, practice varies across states as to whether PEO employees are counted in the totals of Employment Services or the client firm's industry. Moreover, comparing state-level CES and EC data, even states that claim to reassign workers to client-firm industries appear to do so incompletely. Second, we have only sketchy information about the actual industrial work setting of workers whose employer of record is a PEO.

Another significant contribution of the chapter is simply explaining how the Bureau of Economic Analysis (BEA) estimates the portion of its input-output tables covering the purchase of temporary help services, information that is not easy to find in the BEA's standard documentation. As the authors note, input-output information is potentially valuable in gauging the growth of contracting out. However, as they also explain, given the BEA's actual estimation methods, such data should be treated with extreme caution. The relevant portions of the input-output tables are estimated from only a subset of purchasing industries, several dissimilar categories of contract work are pooled together, and the published estimates rely on strong assumptions about the constancy of certain ratios.

In the final portion of their chapter, the authors use their newly constructed occupation by industry time series to study contracting out for six select occupations identified in the CWS as frequently contracted out. Their method relies on being able to identify an industry for which almost all of the employment in the occupation being studied is likely to have been contracted out from another industry. For example, employment of school bus drivers in the trade and transportation sector almost certainly reflects contracting out by school districts. This is essentially an occupation-specific version of examining trends in temporary help, for which almost all workers of all occupations are actually doing their work for client firms in other industries. As the authors note, it is possible that this methodology could conflate changes in industrial mix with actual changes in the prevalence of contracting out. However, it seems quite likely that their findings of trends toward increased employment shares of bus drivers, truck drivers, computer occupations, and janitors in the relevant industries reflect actual increases in contracting out. This is significant because these trends are not reflected in standard tabulations of the CWS.

Given the obvious shortcomings of current data collection on contracting out, it is not hard for the authors to identify possible improvements. In some cases, simply documenting current methodologies would be a significant step forward. In addition, reassigning all PEO workers to their client-firm industries in the CES and QCEW would significantly clarify the industrial distribution of employment. Improving the data underlying the relevant

portions of the input-output data by surveying all using industries and examining a finer breakdown of supplying industries would also be a big improvement that would make the data of much greater use to the study of contracting out. However, I think the authors are correct in arguing that to make really substantial progress in understanding contracting out, the statistical agencies would need to field some special surveys of firms' practices. It would be highly valuable to survey firms on their practices in contracting out specific kinds of work and, in addition, to survey firms in industries such as Employment Services on the nature of their client firms. Combining the data from such surveys would allow us to develop a more complete understanding of the contracting out phenomenon.

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