



The pay gap of temporary agency workers – Does the temp sector experience pay off? [☆]



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HIGHLIGHTS

- We estimate the effects of the intensity of agency employment on the temp wage gap in Germany.
- The paper uses a two-stage selection-corrected method within a panel data framework.
- Temps accept high wage penalties compared to permanent workers.
- The wage gap for temps decreases with time employed in the sector.
- Agency employment stigmatize workers who move frequently between temp jobs.

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ABSTRACT

It is a well-known fact that temporary agency workers accept high wage penalties compared to permanent workers. However, remarkably little is known about the wages of workers who regularly take jobs in the temp sector or who do temp work for a substantial period of time. Based on a rich administrative data set, the effect of the intensity of agency employment on the temp wage gap in Germany is estimated. Using a two-stage selection-corrected method within a panel data framework, the paper shows that the wage gap for temps with low treatment intensity is high but decreases with time spent in the sector, presumably reflecting that temporary agency workers are able to accumulate human capital while employed in the temp sector. However, agency employment seems to stigmatize those workers who move frequently from one temp job to the next.

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1. Introduction

The working conditions and wages of temporary agency workers have become a major research concern in recent decades as the temporary employment sector in most OECD countries continues to grow.² As temporary agency jobs are often regarded as bad jobs, the expansion of this sector raises concerns that labor market segmentation may trap some low-skilled workers in jobs with few career prospects and poor

² To ease readability, the terms “temp job” and “agency employment” are used as synonyms for “temporary agency employment,” and “temps” or “agency workers” are often used instead of “temporary agency workers.”

pay. The empirical evidence indeed indicates that the average wage of agency workers lags behind that of permanent workers (see [Section 2](#)).

All studies on the relative earnings of agency workers to date have assumed that the agency market is homogenous, and have therefore focused on binary definitions of treatment. However, if one looks at the duration of agency jobs and the number of agency jobs workers hold over their employment career, it becomes apparent that agency employment is in fact a rather heterogeneous form of employment: While some workers do temp work on a regular basis or work in the temp sector for considerable lengths of time, others hold a temp job only once in their entire employment career. The heterogeneity of agency work compared to other flexible employment forms (such as fixed-term contracts) probably results from the wide variety of reasons why workers take temp jobs or why firms fall back on temp agencies to provide part of their workforce (e.g. [Bryson, 2013](#)).

The paper argues that the variety in the duration and number of jobs held by workers in the temp sector manifest themselves in the temp wage gap. If agencies provide workers with free training or if agency workers are able to increase their human capital while working for different user firms, one might suspect that the wage gap for workers who remain in the temp sector might decline or even disappear altogether. In this case, longer temp agency experience might be of equivalent value to a career outside the temp sector, and concerns about the quality of agency jobs might be unfounded for at least one part of the flexible workforce.

On the other hand, if agency workers are employed below their skill level, they will be unable to improve their human capital. It may even depreciate, and agency work may stigmatize workers. In this case, more exposure to the temp sector may reduce workers' current wages earned in the sector, and agency employment may even foster the development of dual labor markets in which low-wage workers move from one bad job to the next.

This study contributes to the literature on the wage gap of temporary agency workers in several respects: First, the article gathers new evidence on the relative wages of agency workers not only by estimating the wage differentials between temp and non-temp workers as in the previous literature, but also by taking into account the heterogeneity of this employment form. The heterogeneity expressed in the temp sector experience as well as in the individual observed and unobserved heterogeneity both in characteristics and returns has been largely overlooked in the literature to date. Analyzing temp employment in a multi-valued treatment setting allows testing directly for whether higher exposure to temporary agency employment results in increased or decreased wages in the temp sector. Second, the paper provides evidence on the causal impact of agency employment intensity on wages. One of the most difficult issues in the literature on the wage gap of agency workers is the question of how to control for self-selection of workers by unobserved individual traits such as ability or motivation that affect earnings ([Autor, 2009](#)). If one does not take into account the individual's endogenous contract decision, observed market wages for different doses may still be the result of selection, even after controlling for observable individual worker and job characteristics. In this case, parameter estimates might be inconsistent and biased either upwards or downwards. To address the issue of selection into different treatment levels, this paper combines a dose–response function approach with a control function approach within a panel data setting, using a rich administrative data set for Germany covering the period 2000–2008. Focusing on Germany may be of particular interest as Germany is one of the biggest markets for temporary agency employment along with Japan, the UK, and the US in the world ([CIETT, 2013](#)).

After controlling for time-variant and time-invariant unobserved heterogeneity and self-selection into different doses of agency employment, the estimations show that the wage gap decreases with the amount of time a worker spends in the temp sector. This may indicate that workers are able to accumulate human capital in the temp sector and that this pays off in terms of remuneration. The paper also

finds that temp sector experience is valued differently by gender: While the pay gap declines only moderately for men with longer temp sector experience, it declines considerably for women. This difference can be traced back to the different types of occupations in which women tend to be concentrated. Finally, the paper provides evidence that agency work likely stigmatizes workers who move frequently from one temp job to the next.

The remainder of this paper is set out as follows. [Section 2](#) provides some background information on temporary agency employment and presents the main hypotheses. [Section 3](#) describes key aspects of the temp sector in Germany. [Section 4](#) introduces the data set and the main descriptive statistics. [Section 5](#) outlines the empirical strategy. [Sections 6 and 7](#) describe and discuss the results of the empirical analysis, and [Section 8](#) concludes.

2. The debate on temporary agency employment

Poor working conditions and the disproportionate concentration of disadvantaged workers in the temporary employment sector have brought agency employment to the fore in the policy debate on labor market flexibility. Studies on the stepping-stone effect of agency employment stress the acquisition of human capital as the main channel through which agency employment offers a path into regular jobs (e.g., [Abraham, 1990](#)). The argument is that temporary agency work may not only improve workers' human capital through their on the job training in the sector and variety of assignments, but that agency workers may even be able to acquire more human capital than workers employed in other sectors for a given period of time ([Autor, 2001](#)). Critics of this argument, however, claim that these human capital effects cannot be strong given the short job duration, low-skilled content, and low match quality ([Segal and Sullivan, 1997](#)).

So far, the question of whether temporary agency employment facilitates the transition to regular employment has been an open one. While some studies find that agency employment improves subsequent employment outcomes ([Ichino et al., 2008](#); [Lane et al., 2003](#); [Jahn and Rosholm, 2010, 2013](#)), others find no evidence of a stepping-stone function of agency work ([Amuedo-Dorantes et al., 2008](#); [Autor and Houseman, 2010](#); [Autor et al., 2012](#); [De Graaf-Zijl et al., 2011](#); [García-Pérez and Muñoz-Bullón, 2005](#); [Kvasnicka, 2009](#); [Malo and Muñoz-Bullón, 2008](#)). The latter findings suggest that agency jobs might in fact be the only way for some people to participate in the labor market. This raises the question of whether working in this sector for an extended period may increase earnings, or whether this results in a two-tier labor market in which part of the labor force remains trapped in poorly paid jobs.

Theoretically, the size of the temp wage gap is not clear-cut: The theory of compensating wage differentials claims that a competitive labor market rewards poor working conditions ([Smith, 1776](#)) such as a higher risk of unemployment. However, there are also arguments for why temps should have to accept wage penalties. First, temporary agency employment has features of an investment: If agency workers can improve their skills, then human capital theory would suggest that workers should also have to bear the costs by accepting lower wages while employed in this sector (e.g., [Becker, 1964](#)). Second, temps may also gain from the placement activity of the labor market intermediary, which decreases their search costs and improves match quality. The wage penalty can then be seen as a compensation for this service ([Jahn, 2010](#); [Neugart and Storrie, 2006](#)). Third, compared to workers in other sectors, temps may be less productive due to lower motivation, lower investments in firm-specific human capital, and more frequent employment below their qualifications ([Houseman et al., 2003](#)). Finally, there is ample evidence that most agency workers accept temp jobs to avoid or escape unemployment and that they do not have any other alternative means of participating in the labor market (e.g., [CIETT, 2000](#); [Eurofound, 2006](#)). This might provide the basis for labor market segmentation, as agencies are able to exercise

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