



## Limited duration employment

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### Abstract

This paper analyzes a matching model in which labor market participants use temporary employment as a waiting station between searches. Searchers entering the market see all available options. The best match, however, may not be particularly productive. Since all currently available traders are known, immediate search is not worthwhile. Over time, turnover replenishes the stock of potential traders and poor matches eventually find it profitable to search again. Searchers therefore take the best available match and simultaneously formulate if and when to look again. The best matches become indefinite; lower quality matches coexist as temporary employment. This duration increases with match quality and declines as matching improves.

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## 1. Introduction

Many employment arrangements are temporary.<sup>1</sup> Temporary employment spells can, of course, occur for a variety of reasons,<sup>2</sup> but recent evidence from the US and from the UK establishes that such arrangements play an important role in the job matching process.<sup>3</sup> Many workers as well as many firms use short-term employment as a stepping stone on the way to finding better, more stable arrangements, primarily with other partners. (Polivka, 1996; Houseman 1999, 2001; Booth et al., 2002; Addison and Surfield, 2006.)

Although temporary employment is closely linked with on-the-job search, conventional matching models are ill-equipped to account for such interim arrangements. It appears that employers and firms prefer to stay temporarily matched while waiting for conditions to improve. After some time has passed, they return to the market seeking a more suitable match. The standard random search set-up cannot capture this phenomenon since steady-state matching conditions do not meaningfully change over time. Moreover, as discussed below, the standard model is also unable to account for some empirical regularities associated with job search and temporary relationships.

To overcome these limitations, this paper adopts an alternative but plausible approach to matching frictions which leads to temporary arrangements. Suppose that when either a firm or a worker goes on the market in search of a partner, the searcher immediately becomes fully informed about the current stock of differentiated opportunities available. Employment agencies along with other networks provide details of all existing potential partners.<sup>4</sup> If a highly desirable match is found in the stock of potential partners, further search offers little prospect of improving matters and the relationship becomes indefinite. Searchers, however, may not especially like what they find among the available stock. If a poor pool of currently available candidates exists, searchers might reasonably expect to find preferred partners in the future as new, potentially better options flow into the market. Given that it takes time for turnover to replenish the market and given that visiting the market is a costly activity, searchers will not return to the market straight-away. Instead, traders can make the most of the situation by temporarily matching with the best candidate at hand. After some duration that depends on the quality of the current match, they return to the market to see if anything better has turned up. Firms as well as workers can use employment as a holding station between search activity.

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<sup>1</sup> Temporary employment occurs across a wide variety of occupations, sectors and skill levels. In the British Household Panel Survey, approximately three percent of all employees are non-seasonal fixed term workers in positions that correspond closely to the arrangements described in this paper (Booth et al., 2002). Similar magnitudes can be seen in US data. Expanding the definition of temporary work, these figures rise to above 10% of all existing employment at a point in time. Due to their transitory nature, these figures understate the role these positions play in total job flows.

<sup>2</sup> The wide diversity of observed durations in the US and UK rules out simple explanations such as seasonal and regulatory responses. This is unlikely to be the case in more regulated economies. For example, in Spain where approximately one third of all workers are temporary, high firing costs for established employees encourage these arrangements.

<sup>3</sup> The literature documents that temporary arrangements (widely defined) also play a prominent role in accommodating fluctuations in work loads over time or filling in for absentees, and is roughly as important as job search: see for example Houseman and Polivka (2000). On the other hand, evidence indicates that the jobs classified as temporary in the data play only a very limited role as a screening or probationary device (Polivka, 1996; Housman and Polivka, 2000; Houseman, 2001).

<sup>4</sup> The matching framework used here is most closely related to the stock-flow matching models of Taylor (1995), Coles (1999) and Lagos (2000). Search within a given market is “directed” as in Montgomery (1991), Moen (1997) and Acemoglu and Shimer (1999).

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