

**The Temporary Staffing Industry and U.S. Labor Markets:
Implications for the Unemployment Insurance System**

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Shifting the burden for unemployment insurance: business cycles, business strategies, and the temporary staffing industry

The advent of labor flexibility—regarded as a hallmark of the New Economy—was widely heralded during the nearly decade-long economic expansion of the 1990s for helping U.S. firms achieve competitive advantages. In labor markets, flexibility has been achieved via the proliferation of contingent staffing arrangements such as independent contracting, on-call workers, and especially employment through temporary staffing agencies. The phenomenal growth of the temporary staffing industry (TSI) was one of the defining features of the 1990s economic expansion, coming as it did on the heels of the 1980s when the number of temporary staffing agencies operating in U.S. labor markets more than doubled. From 1982 to 1998, the number of jobs in the TSI rose a remarkable 577 percent, while the number of jobs in the overall economy increased by a robust, but in comparison still modest, 41 percent (GAO, 2000). By 2000, workers placed by temporary staffing agencies numbered more than 3.6 million, or approximately 3 percent of the U.S. workforce. Recent research, furthermore, suggests that such point-in-time estimates greatly underestimate the flows of workers through the sector. Houseman (1997), for example, estimates that the number of positions created for temporary-agency workers is seven to eight times the number of temporary-agency job assignments that exist at any one time (see also Osterman, 1998). In addition, it has been estimated that approximately 25 percent of the new jobs created between 1984 and 1996 were temporary positions (Cappelli, et al. 1997). These estimates cast the phenomenon of temporary staffing in a new light and suggest that temporary employment and other forms of contingent staffing are more pervasive than traditional measures indicate.

Temporary employment has assumed a unique position in the U.S. economy, operating as a buffer during cyclical swings in the wider economy and contributing to the dynamism of the economy through the enhancement of short-term labor market flexibility (see Katz and Krueger,

1999). Over the course the last 30 years, temporary employment has expanded rapidly prior to macroeconomic upturns, while sharp declines in temporary employment have led the economy into recessions, a pattern that was most pronounced during the mid-1980s recovery and early 1990s recession (Theodore and Peck, 2001; Segal and Sullivan, 1997; Segal, 1996). Perhaps not surprisingly, the counterpoint to the TSI's rapid growth during the 1990s expansion is evident during the economic slowdown that began in 4Q2000 and has continued through 2Q2001, when the TSI shed more than 387,000 workers between September 2000 and April 2001 (Staffing Industry Analysts, 2001a, 2001b). In April 2001 alone, job losses in the temporary employment sector accounted for nearly half of all job losses nationwide. Hence, this relatively small sector has borne the brunt of recent job losses as unemployment occurring in a wide array of manufacturing, construction, trade, and services industries is displaced onto the TSI and its workers.

The intensity with which the TSI has experienced job losses in what appears to be only a modest slowdown in the economy suggests that firms' use of temporary-agency workers has a pronounced cyclical sensitivity and that many firms use their temporary workforces as a rather blunt instrument for balancing labor supply and demand. Firms have turned to temporary staffing agencies to assist them in implementing strategies of labor flexibility, calling on agencies to remove constraints that otherwise limit the ability of employers to independently carry out flexible staffing strategies on a large scale. The first constraint is on the efficient recruitment and immediate deployment of workers on an as-needed basis. Whereas some firms maintain lists of on-call workers and direct-hire temporaries who can be recalled on short notice, in a tight labor market, costs associated with recruiting direct-hire temps increase dramatically, while additional costs may be incurred on the production side if job orders languish awaiting needed workers. Staffing agencies help remove this constraint by performing the recruitment function and providing a ready source of labor for their business clients.

Addressing a second constraint, temporary staffing agencies relieve their clients of significant legal responsibilities and costs associated with employing workers. In most cases, temporary staffing agencies are the legal employers of the workers they supply to business clients. Consequently, agencies assume responsibility for paying payroll taxes and ensuring compliance with many of the legal safeguards meant to protect employees from workplace abuses and to provide a safety net for unemployed workers. Of particular importance is the role the TSI plays in relieving its business clients of the responsibility for contributing unemployment insurance (UI) taxes for their temporary workforces. Temporary staffing agencies contribute UI taxes for workers supplied to business clients and, consequently, states hold agencies responsible when those workers claim UI benefits. Generally, states will penalize employers that layoff workers who go on to claim UI benefits by increasing employers' UI tax rates. The system of calibrating employers' tax rates to their layoff experience is commonly referred to as *experience-rating*. In principle, tax rates based on employers' layoff experience reflect the degree of risk of unemployment employers impose on their workforces. States' intent in experience-rating UI tax rates is, in part, to deter employers from temporarily laying-off their workforces thereby controlling the incidence of temporary unemployment.

The effectiveness of this deterrent, however, potentially is compromised when staffing agencies become the legal employer of their clients' temporary workforce. When a worksite employer cancels an order for temporary workers and these workers become unemployed and claim UI benefits, the costs associated with UI compensation are directly borne by the staffing agency, rather than by the worksite employer. Thus, the UI tax, in such cases, does not necessarily operate as a disincentive to worksite employers considering initiating layoffs of their temporary-agency workers. This is of particular importance from a public policy standpoint considering that temporary workers disproportionately experience unemployment arising from patterns of temp-worker use by worksite employers.

This paper explores the implications of worksite employers' increasing use of temporary-agency workers for the continued effectiveness of UI systems in deterring temporary layoffs. The next section reviews the efficacy of experience-rated UI tax systems for discouraging temporary layoffs. This is followed by an examination of the role of the TSI in employers' flexibility strategies and an analysis of the extent to which the TSI has relieved worksite employers of their responsibilities for compensating unemployed workers. The final section presents policy recommendations aimed at bolstering the effectiveness of UI in discouraging chronic, temporary layoffs.

Experience-rated UI tax systems: a deterrent to chronic, temporary layoffs

Unemployment insurance systems are designed to achieve multiple goals, including discouraging employers from chronically laying off workers by imposing costs on employers for worker termination. This section of the paper focuses on this aspect of UI systems and the principal mechanism through which states impose costs for unemployment on employers—experience-rating provisions that tie UI tax rates to employers' recent layoff experience.

The experience-rating component of UI systems acts to reduce the incidence of worker layoffs in two related ways. First, experience-rating formulas impose costs for layoffs on employers, thereby creating a financial incentive for firms to reduce the frequency of layoffs. Second, these mechanisms ensure that contributions made by low-turnover firms do not subsidize high-turnover firms by setting each employer's tax rate high enough so that their total contributions will cover the total claims charged to their account. It is through these experience-rating provisions of state UI systems that the social costs of involuntary unemployment are (to a certain extent) internalized by the firm.

Experience-rated UI tax systems are designed to discourage layoffs by calibrating an employer's UI tax contributions to the rise and fall in UI benefit claims made by its laid-off employees relative to the size of the employer's remaining payroll. Generally, as the number of UI benefit claims increases, all else being equal, so too do the UI tax contributions paid by the former employer(s) of UI claimants. From a public policy standpoint, rising UI claims signal an increase in the risk of unemployment generated by employers and borne by their workforces. States, therefore, require these employers to incur larger UI tax rates.

All states experience-rate employers' UI tax rates in some manner. While the mechanisms for experience-rating UI tax rates differ, all states use variations on one of two methods. Seventeen states use the benefit-ratio method that indexes UI tax rates to the ratio of the value of UI benefits charged to an employer relative to the size of the employer's payroll over a specified period of time (U.S. DOL ETA, 2000). The remaining 33 states use the reserve-ratio method that indexes UI tax rates to the ratio of an employer's UI account balances (UI tax contributions minus UI benefits charged commonly referred to as their "reserves") to the size of the employer's payroll. Some states also weight an employer's UI tax rates to account for the overall layoff experience in the industry in which the employer operates or for the unemployment rate in the local labor market.¹

States determine an employer's actual UI tax contributions by applying their UI tax rate to a portion of their current payroll—the taxable wage base. Typically, employers pay UI taxes on the first \$12,000 (the average taxable wage base for all states) of each of their employee's earnings (U.S. DOL ETA, 2000). In addition, the taxable wage base is capped. Thus, adding additional earnings by existing employees in excess of the limit on taxable wages will not impact the employer's UI tax contributions. Adding additional employees to the payroll, on the other hand, will almost always

¹ Studies comparing the efficacy of reserve-ratio versus benefit-ratio taxation find that neither system produces significantly superior results in terms of reducing temporary layoffs under all circumstances (Cook, 1997).

add to an employer's total UI contributions. Consider, then, an employer's advantage to outsourcing its temporary workforce. Adding temp-agency workers to the workforce will never increase an employer's UI contributions and shedding temporary workers will never affect its UI tax rate because these workers are the legal responsibility of the temporary staffing agency. On the other hand, if these temporary workers were employed directly by the worksite employer, any temporary layoff could have direct consequences for the UI tax rates levied on that employer.

To experience-rate UI taxes, states must determine which of a claimant's previous employers is responsible for causing the claimant's unemployment. When a worker claims UI benefits, some states will charge the total cost of those benefits only to the claimant's most recent employer. However, if a claimant worked for multiple employers during the base period (typically defined as the most recent four of the last five completed quarters), most states will divide the total charge between all of the worker's employers, assuming all are responsible for the worker's unemployment. The amount of benefits charged to each employer is proportional to the share of total earnings the claimant received from each employer during the base period.

Most states calculate UI tax rates annually based on an employer's layoff experience from the previous year(s). Therefore, an employer generating layoffs resulting in UI claims in the current year will not face higher UI tax rates until the following year (over the long run, claims made by laid-off employees should be roughly equivalent to an employer's total UI contributions). The average UI tax rate fluctuates around a standard rate of 5.4 percent, depending on the layoff experience of the particular employer. Tax rates for new employers with no layoff experience is less than this standard (U.S. DOL ETA, 2000). Each state has its own pre-defined minimum and maximum rates, ranging from zero to 10 percent. Experience-rated UI tax systems can impose significant additional costs on an employer that has frequent layoffs. It has been determined that a layoff of 50 workers at one time can raise UI tax rates for an employer by 2 to 3 percent every year (Lambert and Legan, 1999).

For even a mid-sized employer, this can mean sizable tax contributions. In 1998, firms paid, on average, \$208 per worker for unemployment insurance.²

Research on the efficacy of UI tax systems demonstrates that experience-rating reduces the incidence of temporary layoffs. In their analysis of UI taxes and seasonal unemployment, Card and Levine (1994) found a strong negative relationship between experience-rating in UI systems and the rate of temporary layoffs generated by employers. Their analysis indicated that this negative relationship is strongest in high-layoff industries such as manufacturing and construction and during recessionary periods. Likewise, Albrecht and Vroman's (1999) analysis of UI tax systems found a negative correlation between experience-rated UI taxes and temporary layoffs. The authors explain that experience-rating acts as a penalty to firms that generate unemployment, inducing employers to adopt higher-wage, lower-turnover strategies. Presumably, employers take into account the increased costs associated with layoffs. Employers would rather achieve efficiencies by paying workers higher wages to increase productivity than by laying-off workers and absorbing the higher UI-related costs.

Other studies have also indicated that greater reliance on experience-rating mechanisms in UI systems minimizes the incidence of temporary layoffs. More heavily experience-rated systems include UI systems that apply a wider range of tax rates allowing greater distinctions to be made between high- and low-turnover employers. Similarly, systems that apply tax rates to a greater share of an employer's payroll (the taxable wage base) are also considered to be more extensively experience-rated because the financial consequences of higher UI taxes for employers is more severe. Using an econometric model to test the impacts of various experience-rated UI systems, Ronald Moomaw (1998) found that states with the highest taxable wage base encountered 40 percent lower unemployment rates when other leading variables were held equal. Card and Levine

² UI costs per worker vary widely across states from \$729 per employee in Rhode Island and \$84 per worker in Nebraska

(1994) found that as the extent to which taxes are experience-rated increases, seasonal fluctuations in layoffs common to manufacturing and construction are also moderated. Finally, studies by Feldstein (1978) and Topel (1983) suggest that a fully experience-rated UI system would eliminate 50 percent of all temporary layoffs, again suggesting that experience-rated UI tax systems discourage employers from cycling its workforce through temporary layoffs.

Temping and the externalization of UI costs by worksite employers

The discussion above highlighted the multiple labor market benefits of experience-rated UI systems. As was discussed, under traditional employment arrangements, the experience-rating mechanisms of state UI systems operate to discourage chronic, temporary layoffs and to encourage “high road” business practices. In cases where layoffs do occur, employers bear some of the associated costs and workers receive a reduced share of their previous earnings while searching for work. However, the introduction of temporary staffing agencies into the traditional employment arrangement, functioning as they do as the *de jure* employers of temp workers, “de-couples” the cause-and-effect relationship between the generation of unemployment and the costs of unemployment compensation incurred by worksite employers. The use of temporary staffing agencies allows worksite employers to externalize some of the costs of unemployment, particularly in cyclically volatile, high-turnover industries and in those occupations where high turnover is the norm. The outsourcing of high-turnover occupations within the firm to temporary staffing agencies weakens the influence of experience-rating policy mechanisms which have been shown to have positive effects on local labor markets through their influence on employers’ staffing strategies. Worksite employers (the *de facto* employers that control production timetables and workflows as well

(“Employers are paying less unemployment tax,” 1999).

as worker deployment) may terminate job assignments filled by temporary-agency workers—in essence laying them off—without any repercussions on their UI tax rates. Instead, the benefits claimed by laid-off temporary-agency workers would be charged to their staffing agencies.

The growing use of temporary-agency workers has consequently shifted a greater share of the costs for compensating unemployed workers “downstream” in the employment relationship—away from worksite employers and towards the TSI. The magnitude of this shift in responsibility during the last decade has been striking. Table 1 presents data on the percentage change in the number of UI weeks claimed from workers’ “primary” and “last” employers, aggregated from eight states—Arizona, California, Florida, Illinois, Massachusetts, New York, Texas, and Washington. These states were selected because they have a large TSI, collectively comprising 50 percent of temporary-agency employment nationwide, thereby permitting an analysis of the changing impact of UI on the temporary staffing industry and on the industries of some of their business clients. The data analyzed in this section are based on statistics derived from the Benefit Accuracy Measurement (BAM) series collected by the U.S. Department of Labor Employment and Training Administration (U.S. DOL ETA). U.S. DOL ETA randomly samples records of UI claims from each state. The sample includes payments from the State UI, UCFE (Federal civilian), and UCX (military) unemployment compensation programs. For the states examined here, the average annual sample size (unweighted) ranged from 581 for Arizona to 1,787 for California. Our calculations are based on weighted population estimates of the distribution of UI claims across four-digit SIC categories as calculated by U.S. DOL ETA.

Table 1: Percent change in UI weeks claimed by industry group, selected states, 1993-2000

| Industry | % Change in weeks claimed: primary employer | % Change in weeks claimed: last employer |
|--|--|---|
| Employment Services [TSI] | +60% | +29% |
| Construction | -35% | -36% |
| Manufacturing | -42% | -42% |
| Wholesale trade | -29% | -30% |
| Retail trade | -47% | -47% |
| Transportation and warehousing | -16% | -19% |
| Professional, scientific, and technical services | -32% | -32% |
| Health care and social assistance | -12% | -17% |
| Accommodation and food services | -44% | -42% |
| Other services (except public administration) | -19% | -28% |
| Administrative support (not including employment services) | -25% | -23% |

Note: Estimates are based on Benefit Accuracy Measurement (BAM) sample collected by the U.S. Department of Labor from state UI agencies. The states are: Arizona, California, Florida, Illinois, Massachusetts, New York, Texas, and Washington.

Source: U.S. DOL ETA, 2001.

The data presented in Table 1 show that the TSI (employment services)³ became the primary and last employer of a growing proportion of UI claimants during the last decade.⁴ According to these estimates, UI weeks claimed by workers employed primarily by employment service agencies *increased* by nearly 60 percent while in every other major industry group, UI weeks claimed *declined* by anywhere from 16 percent to 47 percent.⁵ The change in weeks claimed in

³ Employment services as defined by the North American Industry Classification System includes employment placement agencies, temporary help services, and employee leasing services. Nationwide in 1999, the TSI accounted for approximately 70 percent of all employment in the employment services industry.

⁴ UI compensation is distributed to eligible unemployed workers on a weekly basis. At the time of an initial claim, a determination is made as to which of the worker's previous employers is responsible for the unemployment. Estimates are a measure of total weeks claimed by all unemployed workers, not a measure of the number of persons claiming benefits. The estimates also do not indicate to which employer (e.g., the last or primary employer) the claim was charged.

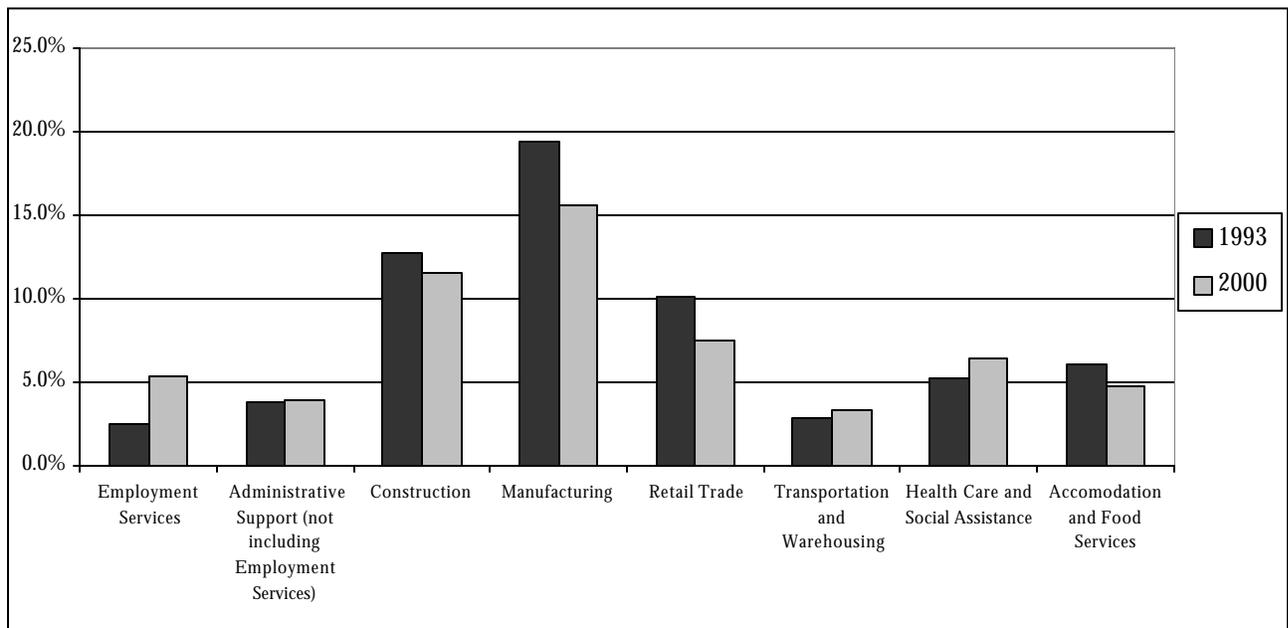
⁵ The average annual percentage change in weeks claimed was negative for all major industry groups. Employment services posted an average annual increase in weeks claimed of 4 percent.

industries representing the last employer of UI claimants followed a similar pattern. Considering that, in most states, primary employers often bear the greatest responsibility for UI benefit claims, it is important to note that by 2000, employment services agencies were the primary employers of UI claimants nearly as often as they were the last employers, a shift that reflects the growing role that staffing agencies play in the employment opportunities of the workforce. In 1993, employment agencies were identified as the last employers in 1.87 million weeks claimed and the primary employers in 1.38 million weeks claimed.⁶ By 2000, the gap shrank to 0.2 million weeks claimed.

As Table 1 reveals, the distribution of the costs of compensating the unemployed is shifting across industries, primarily in the direction of the TSI. Chart 1 illustrates the change in the distribution of total UI weeks claimed from 1993 to 2000 aggregated for the targeted eight states. The TSI (employment services) increased its share of total UI weeks claimed relative to the industries that are among the major users of temporary-agency workers. Chart 2 shows that since 1993 the TSI has steadily increased its share of total UI weeks claimed, peaking in 2000.

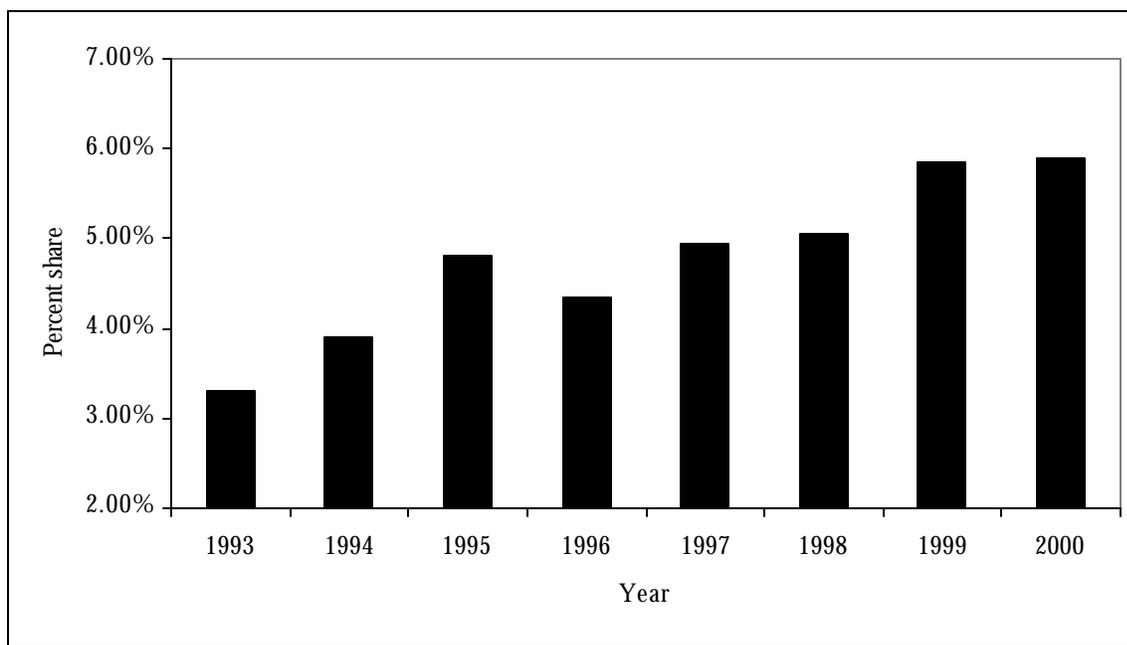
⁶ Because the BAM sample estimates obtained aggregates the frequency of NAICS codes identified as last and primary employers, the authors cannot estimate what percentage of claimants identifying employment services agencies as their last employer also identified them as their primary employer.

Chart 1: Share of total annual weekly claims by industry of primary employers, 1993 and 2000, selected states



Note: the states are Arizona, California, Florida, Illinois, Massachusetts, New York, Texas, and Washington.

Chart 2: Annual change in employment services' share of total UI weeks claimed, 1993-2000, selected states



Note: the states are Arizona, California, Florida, Illinois, Massachusetts, New York, Texas, and Washington.

By 2000, the employment services industry's share of total UI weeks claimed exceeded the share of weeks claimed charged to employers in the administrative support, transportation and warehousing, and accommodation and food service industries. Employment services also posted the highest increase—3.0 percent from 1993 to 2000—in its share of total UI weeks claimed.⁷ The only other industries that increased their share of total UI weeks claimed were administrative support establishments (excluding employment services), health care and social assistance, and transportation and warehousing. The remaining industry groups reduced their share of total UI weeks claimed. The manufacturing sector posted the largest absolute decline (-3.8 percent) in its share of total UI weeks claimed, while retail trade posted the largest percentage reduction (-26 percent) in its share.

Subsequently, UI tax rates for the TSI appear to have remained significantly higher than those for the industries that it supplies. Unfortunately, several of the target states in this study could not provide average UI tax-contribution rates by detailed industry categories, preventing meaningful industry-level comparison of tax rates. However, UI tax rate data provided by Illinois, Massachusetts, Ohio, and Washington suggest that the TSI is responsible for a growing share of UI claims. Tables 2 through 5 present the average UI tax rates charged to firms in the personnel supply services industry (the TSI) and the major industry groups that are traditional users of temporary-agency workers.⁸ Consistently within each state, UI tax rates for the personnel supply services industry met or exceeded the rates for industries that are major users of temporary agency workers.⁹

⁷ The 1993-2000 change in UI weeks claimed (where the TSI is the primary employer) across the target states ranged from -5 percent in Arizona to +115 percent in Washington. The change in the share of UI weeks claimed ranged from 1.2 percent in Massachusetts to 3.8 percent in California. The 1993-2000 change in UI weeks claimed (where the TSI is the last employer) across the target states ranged from zero percent in Massachusetts to +86 percent in Washington. The change in the share of UI weeks claimed ranged from 1 percent in Arizona to 3.7 percent in Florida.

⁸ States reported tax rates by industry group using the SIC coding system. Personnel supply services, SIC 736, includes help supply services and employment agencies. According to County Business Pattern data collected by the U.S. Census Bureau, nationwide in 1997, help supply services, which includes temporary help service and employee leasing,

Table 2: Illinois Average UI Tax Rates

| Industry | 1998 Average Tax Rate | 2000 Average Tax Rate |
|----------------------------------|--------------------------------------|--------------------------------------|
| Personnel Supply Services | 3.25% | 1.93% |
| Manufacturing | 1.81% | 1.61% |
| Wholesale and Retail Trade | 1.11% | 1.04% |
| Services | 1.01% | 0.95% |

Source: Illinois Department of Employment Security, 2001.

Table 3: Massachusetts Average UI Tax Rates¹⁰

| Industry | 1994 Average Tax Rate | 1999 Average Tax Rate |
|----------------------------------|--------------------------------------|--------------------------------------|
| Apparel | 5.90% | 4.23% |
| Textile Mill Products | 4.90% | 3.83% |
| Personnel Supply Services | 5.38% | 3.51% |
| Private Households | 4.30% | 3.23% |
| Industrial Machinery | 5.70% | 3.03% |
| Electronic Equipment | 4.90% | 2.93% |
| Business Services | 4.90% | 2.93% |
| Fabricated Metal Products | 5.10% | 2.83% |
| Misc. Manufacturing | 5.10% | 2.83% |
| Real Estate | 4.90% | 2.83% |

Source: Massachusetts Division of Employment and Training, 2001.

accounted for 93% of total employment in personnel supply services. Massachusetts and Ohio compute UI tax rates using the reserve-ratio method while Illinois and Washington use the benefit-ratio method (U.S. DOL ETA, 2000).

⁹ Average tax rates on construction firms are an exception. The seasonal nature of the industry and its relatively higher degree of unionization generally translate into more UI weeks claimed charged to construction firms and subsequently, higher UI tax rates for the industry.

¹⁰ Massachusetts' Department of Labor could only provide data on a limited number of two-digit SIC groups that precluded aggregation of average tax rates at the one-digit level. Table 2 lists the industries with the highest average UI tax rates. Massachusetts and Ohio compute UI tax rates using the reserve-ratio method while Illinois and Washington use the benefit-ratio method.

Table 4: Ohio Average UI Tax Rates

| Industry | 1995 Average Tax Rate | 1999 Average Tax Rate |
|----------------------------------|--|--------------------------------------|
| Personnel Supply Services | 2.92% | 1.88% |
| Manufacturing | 2.96% | 1.69% |
| Services | 2.40% | 1.55% |
| Wholesale Trade | 2.38% | 1.43% |
| Retail Trade | 1.98% | 1.16% |

Source: Ohio Bureau of Labor Market Information, 2001.

Table 5: Washington Average UI Tax Rates

| Year | Personnel Supply Services | Services | Wholesale and Retail Trade | Manufacturing |
|-------------|--|-----------------|---|----------------------|
| 1993 | 2.4% | 1.8% | 2.0% | 2.4% |
| 1994 | 2.1% | 1.6% | 1.6% | 2.2% |
| 1995 | 2.2% | 1.5% | 1.6% | 2.2% |
| 1996 | 2.2% | 1.5% | 1.5% | 2.1% |
| 1997 | 2.3% | 1.6% | 1.7% | 2.2% |
| 1998 | 2.2% | 1.7% | 1.8% | 2.3% |
| 1999 | 2.3% | 1.8% | 1.9% | 2.4% |
| 2000 | 2.3% | 1.6% | 1.8% | 2.4% |

Source: Washington Employment Security Department, UI Research and Analysis Division, 2001.

Using temp agency workers generates significant UI cost savings for worksite employers

The total UI tax contributions made by the TSI represents, to a large degree, the UI-related cost savings to employers using temporary-agency workers rather than employing their temporary workforces directly. Of our target states, only Washington was able to provide data detailing

employers' UI tax contributions aggregated by four-digit SIC. Table 6 presents data for each component of the total UI tax contribution from 1993 to 2000: the taxable wage base, tax rate, and total taxes paid by the TSI (personnel supply services). UI tax rates remained stable over time, so the rapidly increasing number of new temporary workers added to the TSI's payroll accounts for most of the growth of the industry's UI contributions.

Table 6: Total Personnel Supply Services (TSI) UI Tax Contributions, Washington State

| Year | Taxable Wage Base | UI Tax Rate | UI Tax Contribution |
|-------------|--------------------------|--------------------|----------------------------|
| 1993 | \$247,460,890 | 2.4% | \$ 7,425,048 |
| 1994 | \$301,314,332 | 2.1% | \$ 8,298,588 |
| 1995 | \$320,159,918 | 2.2% | \$ 8,965,324 |
| 1996 | \$334,157,516 | 2.2% | \$ 8,607,742 |
| 1997 | \$452,563,031 | 2.3% | \$ 11,745,627 |
| 1998 | \$597,541,728 | 2.2% | \$ 15,554,523 |
| 1999 | \$705,354,229 | 2.3% | \$ 18,817,885 |
| 2000 | \$812,526,744 | 2.3% | \$ 23,136,884 |

Source: UI Research and Analysis Division, Washington Employment Security Department, 2001.

If worksite employers in Washington contributed UI taxes on the taxable wage base of workers they procured through staffing agencies, they would have incurred approximately an additional \$23 million in UI taxes in 2000—the amount contributed by the personnel supply services industry to insure its temporary workforce. Aside from having saved this direct cost of insuring temporary workers, worksite employers gained additional cost savings by shedding the segments of their workforces most likely to endure layoffs, claim UI benefits, and drive up UI tax rates on the remainder of employers' taxable wage bases. In this way, temporary staffing agencies help worksite employers shield the taxable wage base of their core workforces from higher UI tax rates.

Low UI reciprocity among temp workers understates externalization of UI cost burden

The TSI may have faced higher UI tax rates than it already had if temporary-agency workers received UI at rates closer to the average for all workers.¹¹ In a study of UI reciprocity among contingent workers, Vroman (1998) demonstrates that temporary-agency workers experience the lowest UI reciprocity rates relative to other contingent workers (independent contractors, part-time workers, and on-call workers) and all adult workers regardless of type of employment contract. In 1994, the average UI reciprocity rate (defined as the number of workers receiving unemployment compensation relative to the total number of unemployed workers) for all workers 25 years and older was 39 percent. For temporary-agency workers, this figure was only 28 percent. In addition, temporary-agency workers receive UI compensation at lower rates relative to rates for workers in industries that represent the largest users of temporary agency services. According to Vroman, UI reciprocity was 46 percent for all industrial workers (16 years and older) and 34 percent for all clerical and sales workers, both far greater than the 28 percent reciprocity rate for temp workers.

Several reasons explain why temporary-agency workers experience lower UI reciprocity rates relative to workers in standard employment relationships. First, most temporary-agency workers work full-time but for only part of the year, making it difficult for them to meet earning thresholds that in part determine benefit eligibility. An examination of population estimates from the March supplement to the Current Population Survey (CPS) from 1993 to 2000 indicates that 48 percent of unemployed temporary- agency workers worked full-time but for only part of the year.¹² Of these

¹¹ All states establish maximum UI tax rates at which employers may be charged. Therefore, there is an upper limit at which the industry may be taxed. At this point, an additional increase in UI claims will not result in a proportional increase in UI tax rates. Only Washington and Massachusetts provided data that would allow analysis of actual tax rates by four-digit SIC. In both states the majority of TSI firms had not reached the maximum UI tax rate.

¹² Data were collected from the March supplement to the Current Population Survey. The dataset includes workers in Illinois, Michigan, Arizona, California, Florida, Massachusetts, New York, Texas and Washington indicating they were employed by an employment agency and involuntarily unemployed but remained in the labor force. CPS surveys

workers, only 15 percent were receiving UI benefits during their current spell of unemployment. Temporary-agency workers also tend to be low-wage workers, compounding the difficulties they face in meeting earnings thresholds. According to a recent study by the General Accounting Office of the role UI plays as a safety net for low-wage workers, between 1992 to 1995, low-wage workers were twice as likely to be out of work as higher-wage workers, but only half as likely to receive UI benefits (GAO, 2000).

Temp agency worker utilization strategies explain externalization of UI costs

The magnitude of the shift in responsibility for compensating unemployed workers from worksite employers to the TSI is predictable considering that most worksite employers: (1) have increasingly adopted flexible staffing strategies; (2) have outsourced their temporary workforces to the TSI; and (3) “churn” temp workers through job slots characterized by a high degree of turnover and involuntary layoffs. According to an Upjohn Institute employer survey regarding flexible staffing arrangements, employers most commonly reported that they used temporary-agency workers to provide needed assistance at times of unexpected increases in business; to fill in temporarily for absent employees; and to fill vacancies until regular employees are hired (Houseman, 1997). Only 5 percent of employers reported that they filled positions with temporary-agency workers for more than one year. These findings are supported by an American Management Association (AMA) survey that found that 91 percent of employers cited flexibility in staffing as a “very important” or “somewhat important” reason for their use of contingent workers (quoted in Staffing Industry Analysts, 2000a). Another survey of managers at 500 companies found that

indicate that the majority of temporary agency workers prefer full-time, standard employment. The 1995 contingent worker supplement survey indicates that nearly two-thirds of all temporary workers would rather have a traditional

staffing for the completion of special projects and staffing for peak periods accounted for more than half of all temporary-agency worker usage (Gillian, 1995).

Statistics on job tenure of temporary-agency workers support employers' claims that most use temporary workers only on an intermittent basis. Approximately 45 percent of temporary workers spend, on average, less than six months on any single job assignment, while 72 percent worked for less than one year on a single assignment (Cohany, 1996). In the light industrial segment of the staffing industry, temporary workers—often referred to as day laborers—have been found to typically spend less than five days on a given assignment (Theodore, 2000). In comparison, almost half of all workers hired permanently and directly by employers spend four years or more on the job (Cohany, 1996). Workers in flexible arrangements (including temporary-agency workers) comprise approximately one-quarter of all workers, yet account for approximately 40 percent of workers with job tenures of less than one year (Cohany, 1996).

Detailed occupational characteristics of temporary-agency workers compiled by the Bureau of Labor Statistics through the Occupational Employment Survey confirm that the top occupations held by temporary-agency workers tend to be low-skilled jobs that are peripheral to the core function of firms. Table 7 identifies the top 10 occupations held by temporary-agency workers in 1999 (comprising 42 percent of all temporary agency jobs). With the exception of technical occupations and healthcare practitioners, temporary-agency workers are predominantly found in low-wage occupations in manufacturing, retail trade, and sales and other service industries.

employment arrangement and of those working part-time for a temporary agency, one-half cited economic reasons for their part-time status.

Table 7: Occupational Distribution in Personnel Supply Services, 1999

| Occupation | Total Staffing Industry Employment | Share of Total Staffing Industry Employment | Median Wage |
|--|---|--|--------------------|
| Laborers and freight, stock, and material movers | 292,100 | 7.70% | \$7.32 |
| Office clerks, General | 271,730 | 7.17% | \$8.99 |
| Packers and packagers, hand | 182,070 | 4.80% | \$6.87 |
| Helpers—production workers | 170,380 | 4.49% | \$7.19 |
| Data entry keyers | 140,740 | 3.71% | \$9.09 |
| Healthcare practitioners and technical occupations | 129,010 | 3.40% | \$20.15 |
| Secretaries, except legal, medical, and executive | 120,790 | 3.19% | \$10.69 |
| Sales and related occupations | 118,780 | 3.13% | \$10.86 |
| Customer service representatives | 109,660 | 2.89% | \$9.82 |
| Receptionists and information clerks | 91,990 | 2.43% | \$9.00 |
| Total | 1,627,250 | 42.91% | |

Source: Bureau of Labor Statistics, Occupational Employment Survey, 2000.

The intermittent nature of most temporary job assignments means that temporary-agency workers spend a significant amount of time involuntarily unemployed and potentially eligible to collect UI benefits. Vroman's (1998) study of UI reciprocity rates for workers in nonstandard employment arrangements found that temporary-agency workers were unemployed at a rate of 40 percent compared to 10 percent for all adult workers, while a study by Houseman and Polivka, (1999) on job stability among workers in flexible staffing arrangements found that the probability of being unemployed was anywhere from 1 to 4.5 percent higher for temporary-agency workers compared to workers in standard employment relationships. This greater probability of becoming unemployed is reflected in the 12 percent unemployment rate for temp workers, compared to 2.4 percent for full-time workers in standard employment relationships (Houseman and Polivka, 1999).

Costs do not move “upstream”—temp agencies absorb increased UI expenses

If temporary staffing agencies were to pass increasing UI costs onto high-turnover business clients by raising billing rates for temp workers, a larger share of the TSI’s UI cost could be re-internalized into the cost structures of worksite employers. Yet, in most markets, severe price competition between temporary staffing agencies for business clients prevents the TSI from passing increasing UI costs back onto their high-turnover clients—thereby further insulating worksite employers from UI-related costs resulting from their flexible staffing arrangements. In some specialized niches of temporary labor markets, such as markets for executives, scientists, and accountants where demand for these workers outstrips the supply of labor, temporary staffing agencies may be successful in charging higher billing rates that reflect increasing UI costs. But for the majority of temporary staffing agencies that primarily supply low-wage workers, relentless competition has provoked a price-competitive environment in local labor markets that forces agencies to absorb additional UI costs (see Froud, Johal and Williams, 2001; Peck and Theodore, 1998).

Price competition in the light industrial and clerical segments of the staffing industry—which accounts for roughly 75 percent of the TSI’s total annual employment—have driven billing rates, and subsequently gross margins, to surprisingly low levels (Staffing Industry Analysts, 2000b). Table 8 presents estimates of billing rates and average gross margins (bill rate per hour for temporary workers less total labor costs) for four different categories of temporary workers: data entry clerks, shipping and receiving clerks, helper/production workers, and secretaries. Gross margins do not account for other operating expenses outside of the direct costs of compensating temporary labor, so agency profit margins will, in actuality, be even thinner than the 10 to 22 percent gross margins detailed in Table 8.

Table 8: Estimated Gross Margins on Temporary Workers

| <i>Data Entry Clerk</i> | | |
|---|---------|-------------------------|
| Bill Rate (\$ per hour) | | \$13.21 |
| Median Wage (\$ per hour) | \$9.09 | |
| Legally Required Benefits | \$1.32 | |
| Total Labor Costs | | (\$10.41) |
| Gross Margin (Bill Rate - Total Labor Costs) | | \$2.80 |
| | | 21% of Bill Rate |
| <i>Shipping and Receiving Clerk</i> | | |
| Bill Rate | | \$12.20 |
| Median Wage | \$8.99 | |
| Legally Required Benefits | \$1.30 | |
| Total Labor Costs | | (\$10.29) |
| Gross Margin (Bill Rate - Total Labor Costs) | | \$1.91 |
| | | 16% of Bill Rate |
| <i>Helper - Production Worker</i> | | |
| Bill Rate | | \$9.35 |
| Median Wage | \$7.19 | |
| Legally Required Benefits | \$1.04 | |
| Total Labor Costs | | (\$8.23) |
| Gross Margin (Bill Rate - Total Labor Costs) | | \$1.12 |
| | | 12% of Bill Rate |
| <i>Secretary</i> | | |
| Bill Rate | | \$15.63 |
| Median Wage | \$10.69 | |
| Legally Required Benefits | \$1.55 | |
| Total Labor Costs | | (\$12.24) |
| Gross Margin (Bill Rate - Total Labor Costs) | | \$3.39 |
| | | 22% of Bill Rate |

Sources: Wages obtained from the Bureau of Labor Statistics Occupational Employment Survey, 2000; Billing Rates obtained from Institute of Management and Administration, Inc., 1999; and Legally Required Benefits based on Wiatrowski, 1999.

This degree of price competition and downward pressure on margins is not likely to change soon. As John Bowmer, CEO of Adecco, the largest staffing company in the world explains, “Certainly, one of the global trends that is out there and not likely to disappear soon is the trend to

lower margins. In some part, this is the inevitable price to be paid for having higher visibility and bigger volumes with clients” (quoted in Staffing Industry Analysts, 1999a). On the other hand, according to some industry analysts, larger staffing agencies are culpable for imposing high degrees of price competition on the rest of the industry, a strategy, analysts say, that is intended to drive out of the market smaller competitors less able to absorb these rising costs. Adecco is only one of several large, publicly held staffing agencies that have been accused by its competitors of creating downward pressures on billing rates. Manpower is another. In 1998, Manpower was widely criticized by its competitors for cutting billing rates to “[go] for share over profit” in order to seize control of the French temporary labor market (Staffing Industry Analysts, 1999b). Gross margins for some of the largest staffing agencies like Adecco, Kelly Services, and Manpower reflect this purported strategy. In 2000, Adecco reported gross margins of 18.7 percent, Kelly Services reported 17.6 percent, and Manpower reported 18 percent (Staffing Industry Analysts, 2001c). Since 1992, gross margins for Kelly Services and Manpower have declined from 21.7 percent and 21.8 percent respectively, to their current levels.¹³

Given the high degree of price competition in the TSI, staffing agencies’ have few avenues through which to recover increased UI expenses from their clients. Agencies’ cost recovery strategies must therefore rely on reducing the costs of doing business by containing administrative costs, holding down wages paid to temporary workers, and limiting future UI claims in order to maintain control over their UI tax rates. This partly explains efforts on the part of the TSI to advocate for rule changes and regulations at the state level to make it more difficult for temporary-agency workers to collect UI benefits. The American Staffing Association (ASA), the primary representative of the TSI, has promoted its state model unemployment insurance policy for several years with considerable success (NATSS, 1999). This model legislation would require temporary

¹³ Historical gross margin data was not available for Adecco.

workers to return to their agency upon completion of a job assignment and require workers to accept “suitable” employment or else be ineligible for UI. Of the eight target states examined here, Florida, Illinois, and Texas have adopted ASA’s model unemployment insurance policy either through regulation, administrative order, or by statute as have at least 23 other states (NELP, 2001; Lenz, 1997). ASA’s proposed policy would counter eligibility rules in some states that, under some circumstances, allow temporary-agency workers to quit an assignment or allow them to refuse further temporary assignments in order to seek permanent work without the risk of disqualification from UI eligibility. No state definitively allows workers with a history of temporary work to refuse an assignment in order to seek permanent work. However, of our target states, Massachusetts and New York do not necessarily *disqualify* workers for refusing new assignments upon completion of their temporary assignments in order to seek permanent work (Chasanov, 1995).

Policy recommendations

As U.S. firms continue to pursue labor-flexibility strategies through the outsourcing of high-turnover positions to the TSI, the resultant externalization of the costs of worker unemployment poses significant challenges to UI policy. By using temp agencies to supply their worker needs, worksite employers are able to shield themselves from greater UI claims made by temporary workers when they become unemployed. In the process, the effectiveness of experience-rated UI systems to discourage chronic, temporary layoffs is greatly diminished. Evidence presented in this paper suggests that a major shift is underway as worksite employers in a wide variety of industries push UI costs onto the TSI.

As discussed in section 2, experience-rated UI tax systems discourage employers from generating temporary layoffs because they act as a progressive tax that increases with the number of laid-off workers claiming UI benefits. Experience-rating works when employers that layoff workers

bear the resultant increases in UI costs. However, this is not the case when temporary staffing agencies are the employers of laid-off workers. In such cases, layoffs pose financial consequences for the agencies, not the business clients who terminated job assignments and actually created the unemployment. As the TSI increases its penetration into labor markets, UI systems may be rendered less effective when firms that generate unemployment do not directly bear its costs.

To remedy this failure of UI policy to adequately respond to rising unemployment rates of workers on assignment by the TSI, states should revise UI policy instruments to internalize into the operating budgets of worksite employers the UI-related costs of laying off temporary-agency workers. For instance, states could require worksite employers to contribute UI taxes for all procured temporary agency workers. Under such a policy, states would charge UI claims made by temporary workers to the accounts of worksite employers where they held their last or primary job assignment. Temporary staffing agencies could continue to perform all payroll functions for their clients and shoulder the legal and financial responsibility for other areas of employment and labor law. However, worksite employers would carry the responsibility for insuring procured temporary-agency workers against involuntary unemployment.

Some states regulate employee-leasing arrangements in this manner. Kentucky, for example, defines the business client as the employer of leased employees for the purpose of determining liability for UI contributions (Lenz, 1997). Similarly, although less explicit in their intent, several other states hold the entity that supervises, controls the work of, and has the authority to terminate leased employees—most often the worksite employer—responsible for UI tax contributions. In these cases, states experience-rate worksite employers' UI tax rates for the benefit claims of its leased employees.

An alternative to requiring worksite employers to make UI contributions for procured temporary-agency workers, states could instead weight UI tax rates of worksite employers that use

temporary staffing agencies to account for the UI claims experience of the TSI. States may prefer the weighting option rather than holding worksite employers directly accountable for UI tax contributions because it requires fewer new administrative procedures. Some states weight employers' UI tax rates to account for the UI claims experience of the industry in which they operate, the reason being that the risk of unemployment within an entire industry is reflected to some degree upon all the firms that comprise that industry. Comparably, worksite employers are responsible for a significant share of the risk of unemployment within the TSI. Therefore, states should weight worksite employers' UI tax rates to reflect the layoff experience in the TSI.

Minimally, states should address the low UI reciprocity rates faced by temporary-agency workers by altering eligibility requirements. Low UI reciprocity among temporary-agency workers indicates that the cost of unemployment has been not only externalized by the worksite employer but, indeed, by the TSI as well. Any policy changes that increase UI reciprocity for unemployed temp workers would at least achieve the goal internalizing these costs somewhere within the temporary staffing agency-business client relationship. To this end, states should target inherent biases against unemployed temporary agency workers in UI rules that relate to earnings thresholds, benefit levels, and the definition of a voluntary quit (see NELP, 1997 and NELP, 2001 for a thorough discussion of policy alternatives for restoring the UI safety net for contingent workers).

1. Reduce earnings thresholds to expand eligibility

Reducing both the aggregate base-period earnings and high-quarter earnings thresholds would expand UI eligibility of temporary-agency workers. Studies indicate that the level at which earnings thresholds are set significantly impacts the rate of UI reciprocity among low-wage workers.

For example, a GAO (2000) study found that a \$1,000 increase in minimum earnings requirements, holding other policy factors constant, decreases UI reciprocity rates by nearly 5 percentage points.

Temporary workers face disadvantages related to base-period earnings under most state UI systems largely because they tend to earn less than their counterparts in standard employment arrangements. Analysis of the 1999 contingent worker supplement to the CPS found that part-time and full-time contingent workers consistently earned less per week than their counterparts in standard employment relationships (Hipple, 2001). Furthermore, our examination of earnings characteristics of unemployed temporary-agency workers from the March supplement to the CPS from 1993-2000 indicates that median hourly wages are significantly and positively correlated to the incidence of receipt of unemployment compensation benefits (the correlation coefficient of -.129 was significant at the .01 level).

A second disadvantage low-wage temporary agency workers face in qualifying for UI is the difficulty in obtaining consistent work assignments. According to the GAO, average base-period earnings thresholds are attainable for minimum-wage workers in all states if they work 20 hours per week for 40 weeks during the base period (GAO, 2000). However, the study found that eligibility of minimum-wage workers becomes less attainable if they work fewer than 40 weeks over the course of one year.

Lowering earnings requirements may also increase the share of unemployed temporary-agency workers applying for UI benefits. According to results from a 1993 supplement to the CPS designed to examine the characteristics of UI recipients, 15 percent of job losers (involuntarily unemployed persons) did not even file for benefits because they believed they had not worked or earned enough to be eligible—the most common reason for non-filing among job losers (Wandner and Stettner, 2000).

2. Increase benefit levels

Increasing benefit levels may also increase the rate of UI application among low-wage temporary-agency workers. On average, state UI programs replace 33 percent of claimants' average weekly earnings (Wenger, 2001). Based on this estimate, a typical full-time temporary-agency worker earning \$470 per week (the national average weekly earnings for temporary agency workers) could only expect to receive \$155 per week in unemployment compensation (authors' calculations based on Hipple, 2001).¹⁴

Existing research on reciprocity rates suggests that increasing benefit levels would positively impact the number of unemployed persons claiming UI benefits. Anderson and Meyer's (1997) model of UI take-up rates found that increasing benefit levels by 10 percent would increase the UI reciprocity rate for all workers by 2 to 2.5 percent. The GAO (2000) estimates a 4 percent decline in UI reciprocity for every 10 percent drop in replacement of earnings.

3. Change voluntary quit rules to allow search for full-time work rather than returning to staffing agency for assignment.

States should allow temporary agency workers the opportunity to seek permanent work and still claim UI even if temporary assignments are available. In most states, however, a voluntary quit or refusal of new assignments would disqualify temps from eligibility. According to a survey conducted by the U.S. Department of Labor in 1994, of our target states, only Massachusetts and New York allow workers leeway to voluntarily quit temporary work assignments in order to search for permanent work and still qualify for UI (Chasanov, 1995). California, Illinois, Texas, and

Washington impose greater restrictions on UI eligibility for workers with a history of temporary work who refuse new temporary-work assignments in order to search for permanent work. Texas and Florida disqualify temporary workers from UI eligibility if they do not return to their staffing agency upon completion of job assignments.

Appropriately, states should not charge temporary staffing agency accounts for claims by temporary-agency workers refusing suitable temporary assignments if the agency was able to offer the worker another suitable job assignment. States allow some UI benefits to go uncharged because of the reason for job separation. For example, a person who involuntarily leaves their job because their spouse was forced to move out of town for work may still remain eligible for UI compensation. In such cases, states will not charge the claimant's benefits to their previous employer(s). Similarly, states could encourage temporary workers to seek permanent work without punishing temporary staffing agencies by providing uncharged UI benefits to temporary workers for the length of their job search.

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¹⁴ Also at issue is the negative impact on UI application rates of the average four-week time lag between application for benefits and payment of benefits.

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