



Labor market flexibility and poverty dynamics

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ABSTRACT

The past two decades have witnessed a rapid growth in flexible work arrangements that, in some instances, could expose workers to a higher poverty risk via limited job stability, few advancement opportunities, and low wages. Nowhere in the world has this increase in flexible work arrangements being more evident than in Spain, where about a third of the wage and salary workforce holds fixed-term contracts. Using Spanish panel data and maximum-likelihood binary models that account for state dependence and unobserved heterogeneity, we examine the poverty implications of past and present temporary employment. Our findings suggest that fixed-term contracts are linked to a greater poverty exposure among women and older men relative to open-ended contracts. Furthermore, this greater poverty exposure can last several years due to feedback effects operating via job instability or via the transition to work statuses characterized by higher poverty hazards. Finally, the adverse impact of temporary employment is linked to the short duration of some contracts, thus signaling the importance of work attachment.

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1. Introduction

One of the major labor market developments of the past decades has been the rapid growth of jobs lacking an explicit or implicit contract for long-term employment. The increased prevalence of these fixed-term jobs has delivered some benefits, such as maintaining a low unemployment rate,² providing a second household income, or serving as a stepping-stone to better paid jobs for many individuals.

However, these benefits have not come without costs. First, workers in temporary work arrangements often endure limited job stability, experience fewer opportunities for advancement, and earn lower wages than employees with open-ended contracts in so-called permanent jobs. Second, temporary employees suffer frequent unemployment spells due to the short-term nature of their work arrangements, which result in sharp income shortfalls endangering their economic self-sufficiency. These factors enhance the poverty risk

of temporary workers contemporaneously and in the near future. While the increasing availability of longitudinal surveys has fostered a series of poverty studies that examine poverty dynamics among workers,³ very few studies have directly assessed the link between temporary employment and poverty due to: (a) the econometric challenges involving such an exercise, and (b) the weak link in family-oriented southern European countries between individual and household income. This is surprising considering the prevalence of temporary employment in some economies and the poor working conditions often associated to these jobs.⁴

In this paper, we examine the link between temporary work and poverty using Spanish data from the European Community Household Panel (ECHP). The Spanish labor market constitutes a remarkable case with approximately one third of its workforce employed in temporary jobs. Additionally, Spain is one of the European countries with higher

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² For instance, in the U.S., (Katz and Krueger, 1999) have estimated that the unemployment rate would be 14% higher if not for the expansion of temp agencies, which is estimated to account for approximately 10% of the job growth in the 1990s (Wessel, 2001).

³ For instance, in the U.S. (Hill, 1981; Plotnick, 1983; Duncan, 1984; Bane and Ellwood, 1986; Sawhill, 1988; Gottschalk and Moffitt, 1994; Hoynes and MaCurdy, 1994; Huff Stevens, 1994), and Duncan et al. (1996), among other ones, use the Panel Study of Income Dynamics (PSID). Other authors, such as (Blank and Ruggles, 1994) and Klawitter et al. (2000), use the Survey of Income and Program Participation (SIPP) and the 1979 National Longitudinal Survey of Youth, respectively. For Spain, see (Cantó, 1996; Cantó, 2002).

⁴ As we shall discuss in what follows, the exceptions are studies focusing on the U.S. and, often, on specific types of fixed-term contracts. In particular, Heinrich et al. (2005) examine the link between temporary help agency employment and welfare dependency, and (Bansak and Amuedo-Dorantes, 2003) analyze the relationship between various forms of contingent employment and poverty.

levels of low-wage employment⁵ and structural unemployment rates. Via frequent unemployment spells owing to the limited duration of their contracts, temporary workers are likely to endure a higher poverty risk. Using maximum-likelihood limited dependent variable models that account for state dependence, individual heterogeneity correlated with the regressors and feedback effects, we examine the link between past and present temporary work of varying duration and the likelihood of being poor. The distinction between contemporaneous and future links of temporary employment to poverty is important since policy implications may differ depending on whether the welfare effects associated to fixed-term contracts are long lasting.

We also distinguish between the direct link between poverty and past temporary employment (i.e. controlling for *present* work status) and the indirect link between poverty and past temporary employment via feedback effects. In particular, we relax the unrealistic assumption of temporary employment being exogenous and, instead, allow for any indirect or feedback effects from past temporary employment on poverty operating via job instability or via the transition to work statuses characterized by higher poverty hazards.

Finally, we investigate possible differences in the association between poverty and temporary employment by gender, age, and the duration of the fixed-term contract held by the employee. This analysis is of special interest given the diverse implications of short-term versus longer term temporary work depending on the employee's gender and age.⁶

In sum, this project provides insight into whether temporary employment strengthens or, rather, dampens temporary workers' economic opportunities contemporaneously and in the near future relative to permanent employment. When doing so, we account for the endogeneity of the current work status emerging: (a) via unobserved individual level heterogeneity contemporaneously, and (b) via feedback effects referred to past temporary work. Despite these controls, we cautiously interpret our results as evidence of a strong correlation or link between temporary work and poverty rather than as unequivocal evidence of a causal relationship between the two given that there may be additional sources of endogeneity.⁷ We find that temporary employment is linked to a higher contemporaneous poverty risk among women and older men relative to permanent employment. This link seems to be driven by the harmful impact of short lived fixed-term contracts, thus signaling the importance of work attachment. Additionally, past temporary employment adds to men's and women's poverty risk via significant feedback effects. As such, while lower salaries and worse working conditions endured by temporary workers may contribute to their contemporaneous poverty risk, it is the inherent lack of job stability endured by past temporary employees that seems to reinforce their future poverty risk. These findings underscore the value of longer lived work contracts and policies aimed at facilitating the transition from fixed-term to open-ended contracts in fighting poverty.

⁵ See the report "Working Poor in the European Union" from the European Foundation for the Improvement of Living and Working Conditions, Luxembourg: Office for Official Publications of the European Communities, ([European Foundation for the Improvement of Living and Working Conditions, 2004](#)).

⁶ For instance, short-lived contracts are more likely to be representative of precarious work arrangements with a lower level of employee and employer commitment. Yet, the poverty implications of holding short-lived contracts may differ with the worker's age. For example, short-term contracts may not be linked to poverty when held by younger workers as a stepping-stone to better employment. Likewise, as we discuss later on, men and women may use fixed-term contracts with different purposes.

⁷ The fact that up to 85% of temporary employment is considered involuntary reinforces our concern regarding the potential endogeneity of the type of work contract held (see the report: "Employment in Europe 2008" from the European Commission, Directorate General for Employment, Social Affairs, and Equal Opportunities, Brussels, ([Directorate General for Employment, Social Affairs, and Equal Opportunities, 2008](#))).

2. Temporary employment in Spain

2.1. The Spanish labor market

Following Franco's regime, the Spanish economic infrastructure was obsolete and its system of industrial relations was characterized by strong government intervention and centralized bargaining that protected lifetime jobs ([Jimeno and Toharia, 1993](#)). The need for flexibility and modernization of labor market institutions and employment contracts became evident. The Workers' Statute (1980) and its 1984 reform accommodated the needs of a changing labor market and an economy in recession by deregulating the use of temporary work contracts by firms. In particular, the new employment regulation introduced an array of work relationships that implied a complete breakthrough from the highly paternalistic employment regulation contained in the 1976 Law of Labor Relations, the Spanish Jurisprudence, and various labor ordinances protecting lifetime jobs. Fixed-term contracts offered firms the possibility to hire and dismiss workers at a much lower cost compared to open-ended contracts. In addition to the new types of work contracts, the Workers' Statute regulated working conditions for temporary and permanent workers requiring equal wages for the same type of job.⁸ Nonetheless, despite the legislation's mandate to pay equal wages, temporary workers have been found to earn lower wages than their counterparts in more stable jobs ([Jimeno and Toharia, 1993](#); [Bentolila and Dolado, 1994](#)).

As pointed out by [Dolado et al. \(2002\)](#), temporary employment quickly grew from less than 10% in the early 1980s to approximately 30% of the workforce by the second half of the decade. In response to its rapid growth, several reforms were implemented during the 1990s and in 2001 aimed at reducing firms' extensive use of fixed-term contracts. However, temporary employment has shown considerable resilience, only declining from 35% in the mid 1990s to approximately one third of the Spanish workforce as of today.

2.2. Temporary employment and poverty

According to human capital theory, limited on-the-job training and frequent unemployment spells characteristic of fixed-term contracts impede the continuous accumulation of work skills and, instead, favor the depreciation of acquired human capital.⁹ Coupled with commonly lower wages and frequent ineligibility for unemployment benefits, these factors may contribute to temporary workers' contemporaneous and future poverty risk. Moreover, the differential treatment that the early regulation of temporary and permanent employment granted to workers in each of these work arrangements, together with unions' clout and traditionally high unemployment rates, favored the emergence of a segment of rationed well-paid permanent jobs and another segment of contingent jobs with worse working conditions ([Bentolila and Dolado, 1994](#)). According to the theory on dual labor markets, the limited mobility between these two labor market segments may further favor the involuntary confinement of temporary workers into jobs with lower wages and poorer working conditions; hence, enhancing their future poverty risk. Finally, in the case of women, interrupted work patterns may also foster statistical discrimination by employers, impairing

⁸ The unconstitutionality of paying different wages to workers carrying out the same type of job has been repeated in various occasions by the Supreme Courts, see: TS 13-5-91, RJ 3909, RJ 5483, and RJ 118. Additionally, the Constitutional Courts in TCo 177/1993 have stated that the shorter contract duration is not sufficient to justify a lower rate of pay.

⁹ [Bartik \(1997\)](#) finds evidence that welfare recipients in the U.S. who stay longer in the job benefit from more work experience and opportunities for general and firm-specific skills training compared to those who take short-duration temporary jobs.

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