

## REGULATING THE USE OF TEMPORARY CONTRACTS BY ENTERPRISES

The use of temporary employment allows enterprises to adjust their workforces to changing circumstances. However, an over-reliance on the use of temporary workers can lead to productivity challenges, both for individual firms and for the overall economy. Legislation governing the use of temporary contracts plays an important role in influencing firms' decisions on how intensively to rely on temporary labour.<sup>1</sup>

### Key findings

- On average 7 per cent of enterprises in 118 developing and transition countries use temporary labour intensively, with more than half of their workforces employed on temporary contracts. Such enterprises differ from firms that make moderate use of temporary labour with respect to attributes, motivation and performance.
- Using temporary employment solely to reduce costs may ultimately have negative consequences for the productivity of the firm, the sector or the economy. It can lead to complacency among businesses in terms of their competitiveness, or to them undercutting the responsible employment practices of other enterprises.
- Legislation governing the use of temporary contracts may have different effects depending on the type of enterprise. Intensive users of temporary employment are unlikely to be influenced by changes to employment protection for workers with open-ended contracts. Such firms are more influenced by laws governing the use of temporary contracts, especially those authorizing their unlimited use.

### Research question

Temporary employment gives enterprises the flexibility they need to respond to changes in aggregate demand and allows them to replace temporarily absent workers or evaluate new employees before offering them an open-ended contract. Temporary employment is of particular importance to economic sectors that are subject to seasonal fluctuations, such as agriculture, construction and transport, as well as for enterprises facing adverse macroeconomic conditions and financing constraints. Some firms employ temporary workers specifically to shield their core workers from any potential downsizing that may result from demand fluctuations or adverse shocks. Small enterprises are more likely to use temporary

labour as they often do not have enough employees to meet temporary adjustment needs.

Over the past several decades, throughout many countries of the world, the use of temporary employment by firms has increased. It has spread to industries that did not previously rely on these arrangements, such as airlines and telecommunications, reflecting a shift in the organizational strategies of firms. This has implications for workers, enterprises, the economy and society. The increased

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<sup>1</sup> This research brief is based on Aleksynska and Berg (2016). For more details on the findings, please consult the working paper.

reliance on temporary workers follows the general pattern seen in the world's labour markets, whereby many firms have made non-standard employment arrangements the mainstay of their operations. Some firms depend extensively on non-standard forms of employment, including part-time, temporary agency or "leased" workers or the dependent self-employed. The shift away from the "traditional reasons" for using temporary labour has in part been due to changes in labour legislation to accommodate alternative employment arrangements, or the realization that there are gaps in the law that have permitted its use, or instances in which the law will not be applied (ILO, 2016).

Rather than being a natural phenomenon, temporary employment is the outcome of explicit decisions. While its use is influenced by considerations of cost saving, flexibility and technology issues, most critically it reflects a specific organizational choice made by enterprises. But what are the implications for enterprises of relying heavily on temporary labour, and what roles do labour market legislation and policy play in influencing firms' choices?

## What works

To answer these questions, the ILO took a closer look at firms' use of temporary labour.<sup>2</sup> It found that, in the vast majority of developing and transition economies, temporary employment tends to be concentrated among a relatively small proportion of enterprises.<sup>3</sup> In fact, the majority of firms – 60 per cent – do not use temporary labour at all. Within the 40 per cent of firms that do use it, temporary labour accounts for 28 per cent of the labour force, on average. Furthermore, the using firms can be split into two types: those that use temporary labour in moderate amounts (up to 50 per cent of their workforce is temporary) and those that use it intensively (over 50 per cent of their workforce is temporary). In "moderately using firms", which represent 82 per cent of all using firms, the average proportion of temporary labour is about 19 per cent. In "intensive users", which comprise the other 18 per cent of using firms, and account for 7.2 per cent of all firms, the average proportion of temporary workers is 63 per cent. In fact, among all the firms analysed, just 5 per cent of firms account for 57 per cent of all the temporary labour used, which highlights the concentration of this organizational practice among a select group of enterprises.

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2 Aleksynska and Berg, 2016. The analysis is based on data from the World Bank Enterprise Survey, an establishment survey of formally registered private manufacturing and service companies with five or more employees in 132 developing and transition countries. The survey includes a question on the number of "temporary or seasonal employees, defined as all paid, short-term (less than one year) employees with no guarantee of renewal of employment contract".

3 Similar findings for developed European economies are reported in ILO, 2016.

While the proportion of intensive users of temporary labour is generally small, it tends to be high in those countries where the overall incidence of temporary employment is also high, such as India, Peru or the Philippines (figure 1). Moreover, the share of intensive user firms is relatively evenly distributed across economic sectors. This implies that these firms are organizing their production processes around the use of temporary labour and are making such employment arrangements central to their human resource strategies, regardless of sector specificities. It also suggests that labour demand from sector-specific production processes is not always the dominant factor in decisions on whether to use temporary employment arrangements.

The observation that there are two types of using firms leads to the hypothesis that the different types may have different characteristics, organizational strategies and performance outcomes, and that they may respond differently to policies regulating the use of temporary contracts. Indeed, the research found that intensive users tend to be the older, larger, more labour-intensive and less productive<sup>4</sup> enterprises, and that they invest less in the training of workers or in technology acquisition. Moderate users, on the other hand, tend to employ temporary labour for probationary purposes, provide such workers with training, and are most likely to convert their temporary contracts into permanent ones. Intensive users rely on temporary labour mainly to save on labour costs and to increase their flexibility. While in the short run it may indeed reduce their costs, it is also the case that intensive users are under investing in training, and thus in the development of the human capital of their employees, as well as in innovation and know-how, further decreasing their productivity – a pattern documented in several parallel studies.<sup>5</sup> Moreover, the positive short-term cost and flexibility gains achieved from employing temporary labour are often outweighed by longer-term productivity losses. These losses can stem from the lower productivity associated with the high turnover of temporary staff, the negative spillover effects on the productivity of standard workers from using non-standard workers, and the high transaction costs involved in the management of a blended workforce (where standard and non-standard workers work side by side).

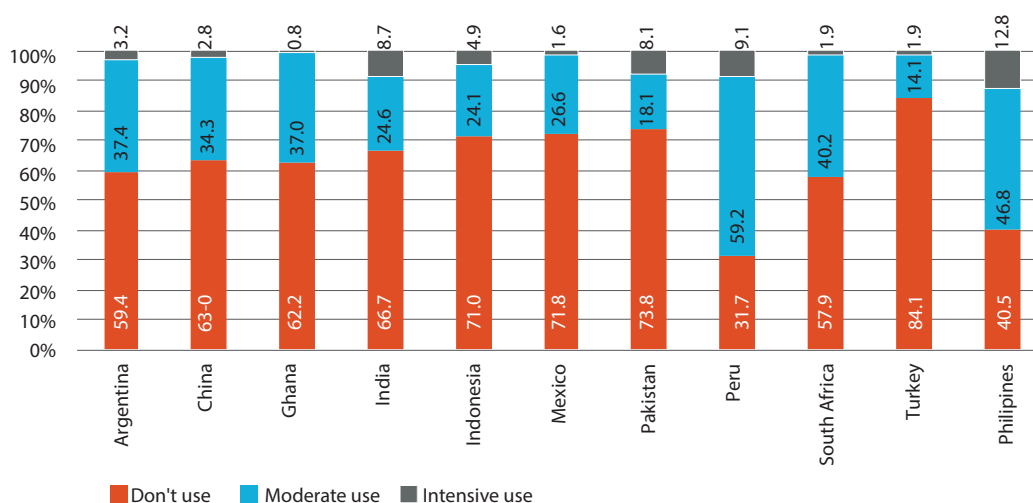
Some of the motivations for employing workers under temporary arrangements may be constructive; for example, it allows an enterprise to screen its new workers, or to focus on its "core competencies" through a moderate use of temporary labour. However, when undertaken with the sole objective of reducing costs, it may ultimately have negative consequences for the productivity of the firm, the sector or the economy. This

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4 Where productivity is measured as sales per employee.

5 For a review, see ILO, 2016.

**Figure 1. Incidence of temporary employment, as percentage of total wage employment, in the private sector, circa 2010**



Source: ILO calculations based on the World Bank Enterprise Survey, 2015.

is particularly true if it leads to complacency among businesses in terms of their competitiveness or to the undercutting of responsible employment practices of other companies.

## Policy considerations

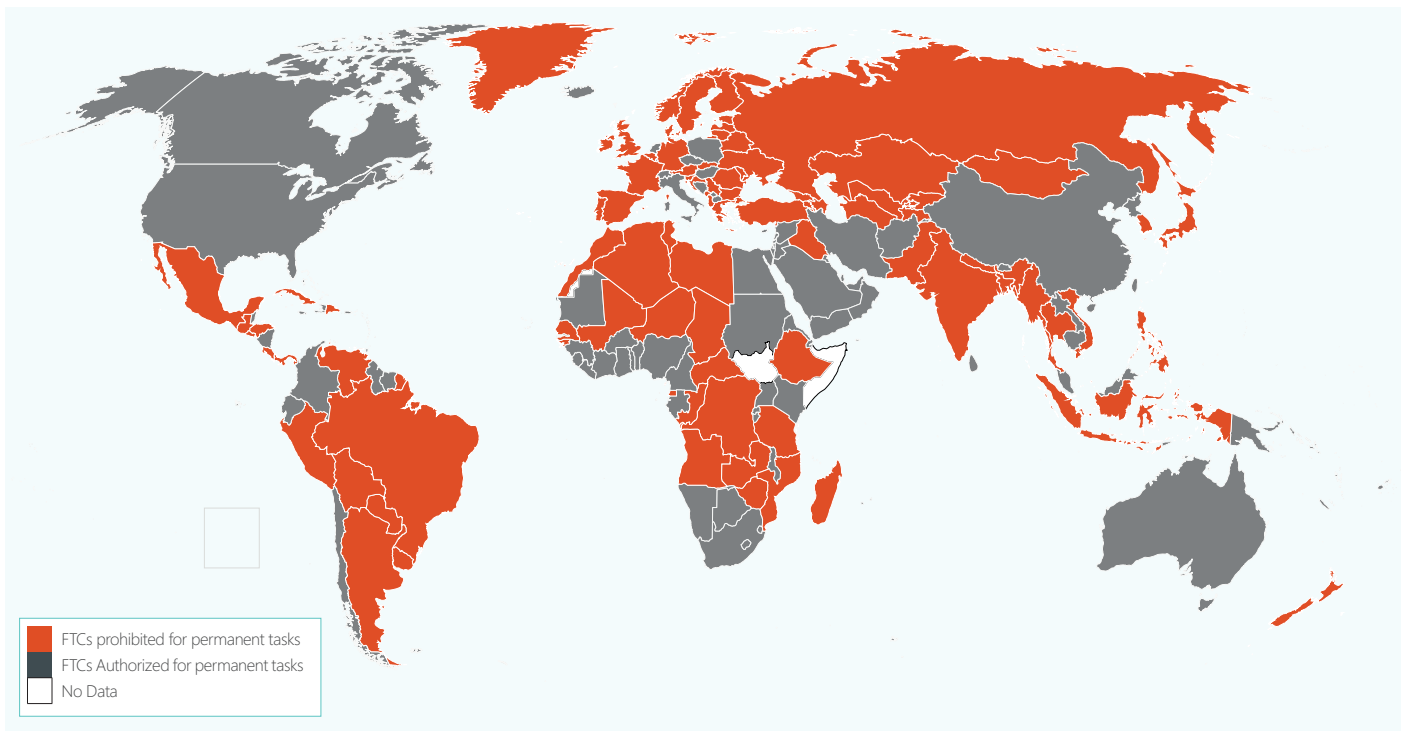
The duration and scope of temporary contracts is typically regulated through legislation, but it can also be the subject of collective bargaining agreements. At the international level, two international labour standards provide regulatory guidance on the use of temporary labour: the ILO Termination of Employment Convention, 1982 (No. 158) and its accompanying Termination of Employment Recommendation, 1982 (No. 166).<sup>6</sup> Their main provisions are reflected in the labour laws of many ILO member States. Specifically, numerous countries have implemented legislation to prevent abusive recourse to temporary contracts, including fixed-term contracts. Three major safeguards, used interchangeably or jointly, are: (i) prohibition of temporary contracts for permanent tasks (figure 2), (ii) limitation of the number of successive temporary contracts, and (iii) limitation of the cumulative duration of temporary contracts.

The ILO study shows that regulation of temporary employment does affect firms' decisions regarding the hiring of temporary labour, but that its effects differ depending on the type of firm. Legislation prohibiting the use of temporary contracts for permanent tasks has a statistically significant negative influence on the use of temporary labour among all types of firms. In contrast, for intensive users, regulations allowing unlimited use of temporary labour and regulations allowing for longer

probationary periods are also important, suggesting that such firms strategically take advantage of these regulations to maintain their high levels of temporary labour. At the same time, regulations on the termination of permanent contracts do not seem to affect the practices of intensive users. For moderate users, regulations on terminating permanent contracts – including specific legislation on severance pay or grounds for redress – are correlated with higher use of temporary labour. However, these firms disregard regulations that allow unlimited use of temporary labour when choosing whether to employ any temporary labour – most likely because they have no intention of taking advantage of these regulations and using temporary labour indefinitely. Interestingly, longer probationary periods do not spark more use of temporary labour by moderate users; if anything, they lead to lower use of temporary labour, possibly because the contracts are quickly converted into permanent contracts when genuinely used for probationary purposes.

From a policy perspective, these findings not only improve policymakers' understanding of business constraints, but also demonstrate how legislation can be used to modify business practices. The findings are also important in light of proposed regulatory reforms affecting both permanent and temporary contracts, because they indicate that the impacts of some reforms would be different for different types of firm. For example, changes to the regulation of permanent contracts would probably do little to curb the use of temporary labour by firms that have already built this practice into their production processes. In contrast, there may be merits in policies that are specifically targeted at intensive users of temporary labour, especially if there is evidence of abuse of the practice.

<sup>6</sup> For more explanation, see Aleksynska and Muller (2015).



## Further reading

**Aleksynska, M.; Berg, J.** 2016. *Firms' demand for temporary labour in developing countries: Necessity or strategy?* Conditions of Work and Employment Series Working Paper No. 77 (Geneva, ILO).

**Aleksynska, M.; Muller, A.** 2015. *Nothing more permanent than temporary? Understanding fixed-term contracts,* ILO INWORK and Governance Policy Brief No. 6 (Geneva, ILO).

**International Labour Office (ILO).** 2016. *Non-standard employment around the world: Understanding challenges, shaping prospects* (Geneva).

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