

The Determinants of Employer Use of Temporary Contracts in the Frictional Labor Market

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Abstract

This paper focuses on the two major reasons why employers use temporary contracts: to flexibly adjust employment (a buffer stock) and to screen workers. How employers choose between these purposes has not drawn theoretical attention. We construct a theoretical model based on a search-matching framework that addresses employers' endogenous choice regarding the reason to use temporary contracts and identifies the conditions under which each purpose will be realized. The main result obtained in this paper is that flexible employment adjustment is more preferred when unemployment compensation is generous, employment protection on regular contracts is stringent and the labor market is tight. However, if the situation is reversed (that is, lower unemployment compensation, weaker employment protection and lower labor market tightness), temporary contracts are likely to be used as screening tools by some or all employers.

Keywords: temporary contracts, regular contracts, firing costs, screening

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