Wage inequality between permanent and fixed-term contracts: a firm-level analysis†

Marta Silva (Banco de Portugal, BRU-IUL, DINÂMIA'CET-IUL)

and

Luis F. Martins (ISCTE-IUL, BRU-IUL)

This paper empirically studies the effects of extending the maximum legal duration of fixed-term contracts on the distribution of the within-firm wage gap between permanent and fixed-term contracts. We use Portuguese linked employer-employee data to estimate a quantile regression with fixed effects. Our results show that fixed-term and open-ended contracts are close substitutes at the bottom and at the median of the intra-firm relative wage distribution and imperfect substitutes at the top of that distribution. Moreover, in the period in which the maximum legal duration of fixed-term contracts was extended, wage inequality increased at the median and 75th quantiles of the conditional relative wage distribution. We interpret these results as potential evidence that the relative wage may reflect the primary use that firms assign to fixed-term contracts. Finally, we find that although the effect of the change in legislation does not differ between firms in tradable and non-tradable sectors, the former pay higher relative wages to permanent workers at the top of the conditional relative wage distribution. The results in this study draw attention to the importance of promoting the conversion of fixed-term into open-ended contracts to tackle labour market segmentation and reduce intra-firm wage inequality.

Keywords: Employment Protection Legislation, Fixed-term Contracts, Relative Wages, Tradable Sector, Quantile Regression, Fixed Effects

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