“Fixed term contracts in Germany: low wages, poor prospects?”

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The 1985 Employment Promotion Act in Germany represented a significant and controversial attempt to increase labour market flexibility by facilitating the use of fixed-term contracts. Similar changes took place in other European countries. Critics of these legislative changes argued that they would lead to polarisation of the labour market, with temporary jobs associated with low wages and poor prospects. While ensuing years saw a rapid growth in fixed-term contracts in countries like France and Spain, this was not the case in Germany.

In this paper we consider the implications of this legislation for German employees, by examining the wages and transitions associated with fixed-term contracts using socio-economic panel data from the late 1990s. Moreover, we are interested in considering the modest growth of fixed-term employment in the context of a comprehensive system of vocational training. This seems important as the growth in fixed-term jobs in other European countries, notably France and Spain, affected young workers in particular. In Germany apprentices have always had such contracts even at considerably lower wages than regular workers. With this in mind, we explore whether temporary employment contracts are functionally equivalent to apprenticeships by comparing transition behaviour and by looking at the percentage found in temporary contracts after apprenticeship training.

We compare the wages of temporary workers with all permanent workers and those with short tenures. We use a fixed effects model to control for individual heterogeneity, and instrumental variables to control for endogeneity of the fixed-term variable. While we still find negative wage differentials controlling for observable and unobservable individual effects, these effects are considerably smaller for East and West German men than in the simple cross-sectional model, and vanish for women altogether. However arguably it is only if temporary workers earn significantly less in the long term, or are caught in a long run trap of repeated low wage contracts and unemployment spells, that lower wages should be cause for concern. Therefore we go on to study the dynamic consequences of fixed-term employment for wages and transitions. Looking at wage growth for 2-year, 5-year and 10-year intervals we further show clearly that on average West German male temporary workers with fixed term contracts in the base year have higher wage growth. West German women experience higher wage growth in the short run and East German men in the long run.

Drawing on the “bridges or traps” debate, we then look at transitions out of temporary work, i.e. the probability that a temporary contract leads to a permanent contract, unemployment or labour force withdrawal. We look at the labour market status of temporary workers one and four years later using multinomial logistic regression, and compare these transitions with those of apprentices. We find that a significant proportion of those on temporary contracts in Germany do move into permanent jobs, often with the same employer, supporting the idea that temporary employment is a screening contract. However, for some, temporary employment leads to unemployment, particularly those with low levels of human capital. We develop the idea of a two-tier labour market for temporary employment in Germany, while arguing that one cannot consider temporary contracts in Germany without also considering the role of apprenticeships.