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IAB Short Policy Report

Up-to-date analyses by IAB

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In brief

- Fixed-term employment contracts became less important in recent years and the chances of transitioning into permanent contracts were good. However, since 2024, with the weak and uncertain economy, permanent contracts are on the decline and fixed-term contracts are more relevant again.
- In terms of labor market policy, fixed-term contracts are controversial because they are associated with poor career and wage development.
- However, a recent IAB study shows that fixed-term contracts are not necessarily associated with wage losses. Neither the transition from fixed-term to permanent employment nor vice versa leads to wage reductions. In addition, both types of contracts offer the unemployed similar opportunities for integration.
- It is also clear that the wage effect of a fixed-term contract is more related to an employee's future career trajectory than the contract itself.
- When evaluating temporary job offers, it is not only the direct wage differences that are relevant, but also the potential for future career development.

Fixed-term employment contracts

No negative wage effects in the transition to temporary employment

by Christian Hohendanner and Jonathan Latner

Compared to permanent employment contracts, fixed-term contracts are less attractive. However, a recent IAB study shows that fixed-term contracts are not necessarily disadvantageous, even if permanent contracts are preferable from the employees' point of view. The decisive factors are less related to the contract type and more related to an individual's career and professional development. Particularly in economically uncertain times, it is worth taking another look at the various forms of employment.

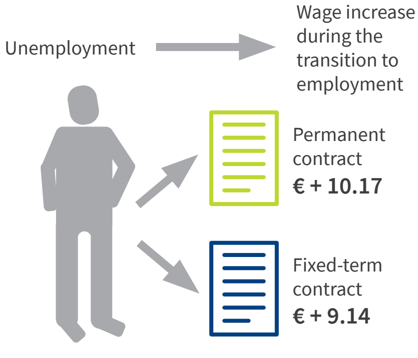
Current development

Fixed-term employment contracts became less common in Germany in recent years. One possible reason is a shift in labor market conditions: employers now face greater competition for workers, rather than being able to choose from a large pool of applicants as in the past. When filling vacancies becomes more difficult, employers are more likely to rethink their hiring strategies (Hohendanner/Gerner 2010).

According to the IAB Establishment Panel (see Infobox on page 4), around 3.2 million employees or 8.3 percent of the workforce held a fixed-term contract

A1

Both types of contracts have a similar effect when starting a job



Source: Own illustration. © IAB

in 2018. By 2023, that number fell to 2.4 million, or just 5.8 percent. Hiring on fixed-term contracts also declined since 2018. In 2023 and 2024, less than a third of contracts (31.3 % and 31.4 %) were initially fixed-term, compared to 44.1 percent in 2018 (see Figure A2). Nevertheless, these hiring rates show that fixed-term employment contracts continue to play an important role in the labor market.

A look at internal transitions from fixed-term to permanent contracts also indicate that labor market conditions worsened slightly in 2024. The share of fixed-term employees who received a permanent contract fell from around 50 percent in 2023 to 43 percent in 2024. At the same time, extensions of fixed-term contracts increased from 29 to 34 percent, and staff departures rose from 21 to 23 percent. Fewer transitions into permanent employment and more extensions of temporary contracts likely contributed to the rise in the overall share of fixed-term contracts, which increased from 5.8 to 6.3 percent.

Fixed-term contract, lower salary?

The time series in Figure A3 (page 3) show that fixed-term contracts often lead to permanent employment. However, there is always a risk that the contract is neither extended nor converted. From a labor market policy perspective, it remains important to examine how fixed-term contracts affect employment trajectories. This includes not only the question of whether fixed-term jobs serve as a stepping stone to permanent employment or trap workers in unstable careers, but also whether they have an impact on wages.

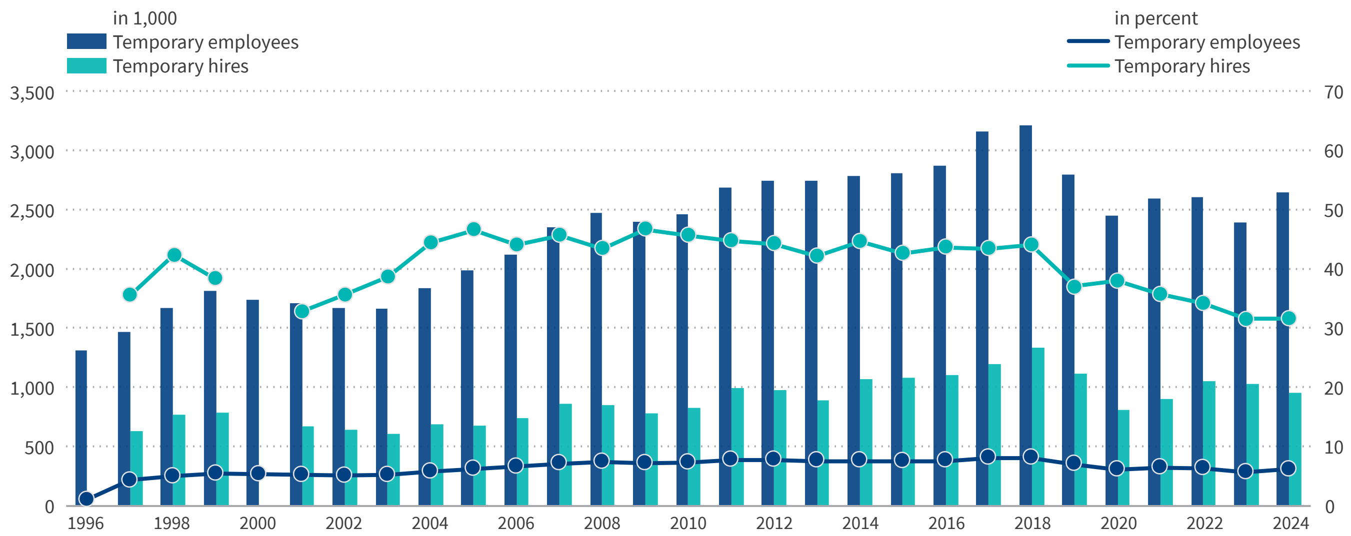
There are good reasons why fixed-term contracts might benefit employers. They make it easier to hire in uncertain situations and, in some cases, allow employers to test a worker's fit before offering a permanent position. At the same time, concerns persist about pay and working conditions for employees in fixed-term roles. These concerns often focus on whether fixed-term jobs actually lead to permanent employment and whether that transition comes with a wage increase.

Both perspectives – fixed-term contracts as a trap with negative wage effects or as a bridge to better opportunities – are supported by theory and empirical evidence. However, research findings remain mixed (Filomena and Picchio 2022; Latner and Saks 2022).

A2

Development of fixed-term employment and fixed-term hiring in Germany

1996 to 2024, absolute in thousands of people and shares in percent



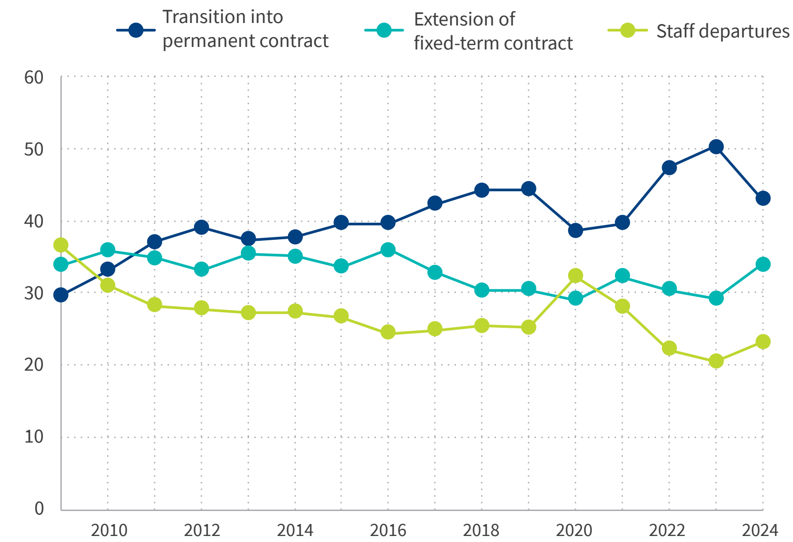
Notes: The proportion of fixed-term employment relationships relate to total company employment excluding trainees (1996 including trainees). In addition to blue-collar and white-collar employees subject to social security contributions, it also includes employees not subject to social security contributions (civil servants/candidate civil servants, active proprietors and family workers) as well as marginal and other employees. The proporrtions of temporary hires in relation to all hires apply tot he first half oft he respective year; no information is available for 1996 and 2000.
Source: IAB Establishment Panel, extrapolated values, for more information see Hohendanner (2025). © IAB

What does the theory say?

A3

Transition into permant contract, extensions of fixed-term contracts and staff departures from fixed-term contracts

in percent



Note: The shares of transition/extension/staff departures relate to fixed-term contracts that converted into permanent contracts or extended within the company in the first half of the respective year or those that expired and resulted in a departure from the company.

Source: IAB Establishment Panel, extrapolated values, for more information see Hohendanner (2025). © IAB

Economic and sociological theories of fixed-term employment often focus on two contrasting explanations for wage differences between contract types. In the trap scenario, temporary jobs lead to unstable careers and lower wages over time. In the bridge scenario, they provide access to permanent jobs and upward wage mobility. However, when studying the wage effects of transitions into or out of fixed-term employment, a third theoretical approach may be more relevant. This is the theory of compensating wage differentials, originally developed by Adam Smith (1776).

This theory states that differences in job quality can be balanced through differences in wages or benefits. Theoretically, jobs with lower security or less favorable conditions can offer higher wages or additional benefits. Employers may offer fixed-term contracts at a wage premium to compensate for the uncertainty these contracts involve. In this framework, wage differences reflect a trade-off: workers accept less security in exchange for better pay.

Theoretical approaches that support the „temporary employment as a trap" scenario are based on the simplified assumption that the labor market is divided into two segments. The primary segment offers permanent contracts and higher wages. It is used by employers to cover the long-term demand for workers. The secondary segment offers fixed-term contracts and lower wages. Employers use it to regulate short-term fluctuations in labor demand. According to the theory, employees in the secondary segment send a negative signal to employers about productivity and employees are „trapped" in the secondary market.

Theoretical approaches that support the „fixed-term contract as a bridge" scenario are based on the idea of a flexible labor market with fewer barriers to hiring and dismissal. For employers, fixed-term contracts offer a way to adjust staffing levels and evaluate new employees before making a long-term commitment. For employees, temporary contracts provide a chance to gain experience, build a track record, and move into more stable and better-paid positions. According to the theory, matching processes make it easier for employers to find and retain qualified workers and also help employees to move into permanent jobs with higher wages.

However, the reality of these two theoretical approaches remains unclear (Latner/Saks 2022). In the trap scenario, it is not clear how fixed-term contracts can send a negative signal to new employers and thus increase the risk of being „trapped". Unlike other professional characteristics, contract type is not often stated on a resume and therefore not observable. In the bridge scenario, employers usually determine in advance whether a job advertisement is for a permanent position, a fixed-term position, or a probationary position (i.e. temp to perm). Therefore, a contract with an extended probationary period is usually a characteristic of the job and not of the person.

In contrast to theoretical approaches that lead to either the bridge or the trap scenario, the theory of compensating differences provides differentiated predictions about the wage effects of transitions into and out of fixed-term contracts. The basic idea of the theory is that the uncertainty of contracts is a negotiable good (Rosen 1986; Smith 1776).

Employees who switch from a permanent to a fixed-term job, i.e. who accept a higher level of employment uncertainty, should receive in compensation higher wages or higher wage growth over the course of their working career. Management positions, for example, are often temporary and highly remunerated due to the prominent nature of the job. However, the management positions mentioned by way of example only account for a small proportion of fixed-term contracts.

1

Data and methodological notes

- **The IAB Establishment Panel**

The IAB Establishment Panel is a representative employer survey on operational determinants of employment. The survey has been conducted annually in West Germany since 1993 and in East Germany since 1996 on behalf of the Institute for Employment Research (IAB). Currently, around 15,000 companies of all sectors and sizes are surveyed nationwide on a variety of employment policy topics. The survey takes place in the middle of each year. The resulting estimates from random samples are not exact due to administratively recoded values, and therefore contain a certain degree of imprecision.

For further information, see Hohendanner (2025).

- **Data and sample of the study by Latner (2024)**

The explanation on the wage effects of transitions between different forms of employment are based on the study by Latner (2024), in which a panel data approach from 2000 to 2018 was used for eight countries. The empirical results for Germany were based on the DIW Socio-Economic Panel (SOEP). For this analysis, the study period for Germany was extended to the year 2022 (2000 to 2022). There are two main criteria for inclusion in the sample in the analyses. Firstly, only people of prime working age (25 to 54 years) are considered, as older and younger employees are more likely to have a fixed-term contract voluntarily. Second, individuals must participate in the survey for at least three consecutive years, so that we can observe them in the period before the transition, during the transition and at least at one period after the transition.

- **Methods**

The study by Latner (2024) is the first study to use an asymmetric fixed-effects model (AFE model) with a dummy impact function (DIF) to estimate the effects of temporary employment transitions on income (Allison 2019). In general, the advantage of fixed-effects models is that they control for all time-invariant differences within individuals, such as unobservable characteristics such as skills or motivation that could influence both employment transitions and wages. However, the disadvantage of standard fixed-effects models is that they assume parallel trends, ignore the direction and timing of transitions and do not model dynamics over time. The AFE-DIF approach addresses all three limitations and therefore provides a more flexible and informative framework for analyzing employment transitions over time.

- **Calculation of hourly wages**

All wages are adjusted for inflation and are based on the World Bank's price index. This allows income values from the period 2000 to 2022 to be converted into comparable euro amounts for 2010. For example, an hourly wage of € 9.14 in 2010 – multiplied by the inflation factor of 1.245 – corresponds to a value of € 11.40 in 2022. Even after this adjustment, however, the wages are below the current statutory minimum wage in Germany. One of the main reasons for this is the method of calculation: The hourly wage is calculated by dividing the annual wage by the actual hours worked in the year – not by the contractually agreed working hours. In the sample, in which outliers were excluded and only people with a working week of between 10 and 80 hours were taken into account, more than half of the respondents stated that they worked more than 40 hours per week. This result is consistent with previous studies, such as Barbieri and Cutuli (2018).

Theoretically, the opposite is also true. Employees who switch from a fixed-term to a permanent employment contract – i.e. a gain in employment security, should receive in compensation lower wages. Economic theory often refers to the concept of implicit contracts in this context. According to this, employees accept a lower wage as a hedge against the risk of losing their job, but there is little empirical evidence for this (Hagen 2002). Another possibility is that job security is exchanged for „human capital" and not for „wages". In other words, the employees receive greater job security on the basis of their skills and professional experience. This correlation also explains why permanent workers are more often overqualified than temporary workers (Ortiz 2010).[1]

It is known from numerous previous studies that workers in temporary jobs earn less than those in permanent jobs. However, these analyses did not take into account how people arrived at these jobs. For the study presented here, the wage effects of different career steps were examined, including the transition from unemployment to a temporary or permanent job and the change between temporary and permanent positions. By focusing on these transitions over time, rather than simply comparing employment contracts at a specific point in time, the analysis shown here provides new insights into whether fixed-term contracts actually lead to lower wages.

Positive wage effects even with temporary employment

The results in Figure A4a (page 5) shows that a transition from a fixed-term to a permanent job increases hourly wages by an average of 0.62 euros (see Infobox for the calculation of hourly wages). A transition in the opposite direction, from a permanent to a fixed-term contract, also leads to a wage increase, but to a lesser extent at 0.08 euros. The difference between these two effects is statistically significant. Therefore, even if the

[1] In this case, overqualification is defined as the possession of a higher educational qualification than the highest qualification required for a particular job. The level of education typically required for each occupational group is measured according to the ISCED classification (Ortiz 2010).

wage effect of transitions from a fixed-term to a permanent contract are more positive, transitions from a permanent into a fixed-term contract do not reduce wages.

Previous research indicated that fixed-term contracts lead to lower wages. However, the current results show that the negative effect found in previous studies is better understood as a difference between two types of transitions (from fixed- term to permanent and vice versa), neither of which are negative, but one of the two transitions (from fixed-term to permanent) is more positive effect than the other.

This can be illustrated with the following example: Assume that persons A and B start with an average gross hourly wage of 20.00 euros. Person A changes from a fixed-term to a permanent contract and their hourly wage rises to 20.62 euros. Person B changes from a permanent to a fixed-term contract and their hourly wage increases to 20.08 euros. Both persons record a wage increase, although the immediate wage increase is significantly higher for person A without taking into account the further employment career. This example will be referred to again later when the wage dynamics over time are examined.

What is the picture for the transition from unemployment to employment (see Figure A4b)? The estimated effect of a transition from unemployment into a fixed-term contract increases wages by 9.14 euros per month from unemployment with a wage of 0 euros (unemployment benefit or basic security benefits are not included as wages in the analysis). The estimated effect of a transition from unemployment into a permanent contract leads to a wage increase of 10.17 euros. The difference between the two values is statistically significant. For the unemployed, transition into a permanent contract are preferable to transitions into a fixed-term contract. However, the difference is not very large (1 € or 10 %) and decreases over time, as shown below.

Wage dynamics for transitions over time

Beyond the wage effects at the time of the transition from unemployment to employment or between a fixed-term and a permanent contract, it is also relevant how wages develop over time. It is conceivable that employees accept fixed-term contracts in anticipation of later wage increases.

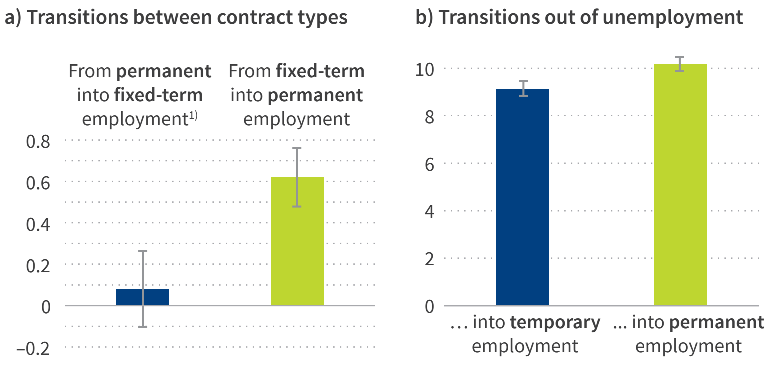
In the case of transitions between different types of contracts, wages continue to rise after both transitions, from fixed-term into permanent contracts and from permanent into fixed-term contracts (see Figure A5a, page 6). Therefore, four years after either transition, there is no negative wage effect. At the same time, wage effects over time are more positive for transitions from fixed-term into permanent contracts than transitions from permanent into fixed-term contracts.

Looking at the example of the two comparative persons A and B, it can be seen that after person A switched from a fixed-term to a permanent contract, their hourly wage rose from 20.00 to 20.62 euros in the year of the transition. Four years later, their wages rose by 6 percent to 21.20 euros per hour. Person B, on the other hand, switched from an permanent to a fixed-term contract and saw a slight increase in pay from 20.00 to 20.08 euros per hour in the year of transition. Four years later, their wages rose by 2 percent to 20.40 euros per hour. Therefore, even if transitions into a permanent contract has a more positive wage effect, transi-

A4

Estimated wage effects for transitions between different contract types and employment statuses

Change in hourly wages in Euros



[1)] The effect of transitions from permanent into temporary employment is not statistically different from 0.
Source: Latner (2024). © IAB

tions into a fixed-term employment relationship also lead to wage increases over time.[2]

Figure A5b shows the wage effects of transitions from unemployment into fixed-term or permanent contracts over time. There initially appears to be a decline in wages after the transition to a fixed-term or permanent contract, but this is due to the fact that many previously unemployed people become unemployed again after taking up fixed-term or permanent employment. While the wage difference between transitions out of unemployment and into fixed-term or permanent contracts is statistically significant, the overall gap remains modest, around € 1 or 10 percent. Yet, even a € 1 difference can matter in the low-wage sector, where poverty risks are high. Therefore, temporary contracts may not offer the same level of integration as permanent ones, but they still represent a meaningful opportunity for those previously unemployed.

[2] Whether person B was continuously employed on a fixed-term basis during this period or whether they transitioned into a permanent employment relationship remains open in this analysis. The focus is on the isolated consideration of a transition and its short-term wage effects. One could use a sequence analysis to descriptively evaluate different types of career patterns, such as repeated temporary („chain contracts"), but would limit the ability to make causal claims (Fauser 2020).

Summary and conclusion

The aim was to analyze current development of fixed-term contracts in Germany and examine the effects of fixed-term contracts on wages. Traditionally, two perspectives on these effects dominated the literature: The bridge perspective assumes that fixed-term contracts help people gain a foothold in the labor market and move up. The trap perspective assumes that fixed-term contracts are detrimental to long-term employment careers. This study takes a different methodological and theoretical approach by focusing on the wage effects of transitions into fixed-term and permanent employment based on the theory of compensating differences and using panel data.

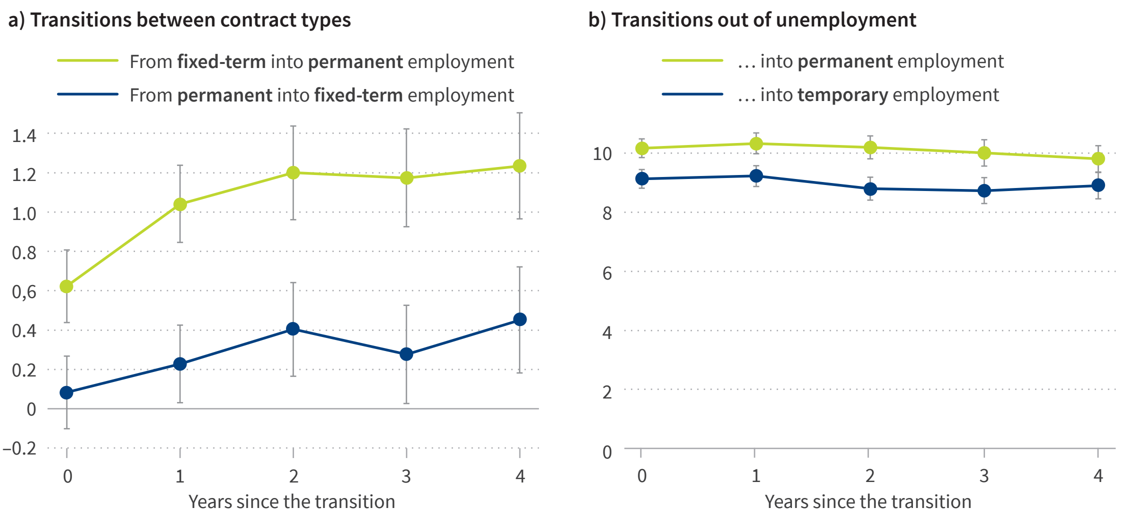
At the time of the job change, moving from a fixed-term to a permanent contract results in larger wage gains than moving in the opposite direction. However, neither type of transition leads to a wage loss. A similar pattern holds for transitions from unemployment into employment. Entering a permanent contract brings higher wage gains than entering a fixed-term contract, although the overall difference remains modest.

Over time, wages continue to grow after both types of transitions. Long-term wage gains are greater for those who move into permanent contracts,

A5

Estimated wage effects of different transitions over four years after the transition

Change in hourly wages in Euros



Quelle: Latner (2024). © IAB

but fixed-term contracts also show steady wage growth in the years that follow. The same applies to transitions from unemployment. Permanent contracts lead to more positive wage trajectories than fixed-term ones, but the difference remains relatively small.

The methods used in this analysis explains previous research indicating negative wage effects for fixed-term contracts. These effects are better understood as the difference between two transitions, neither of which results in a wage loss, even if one is more positve than the other. Transitions into permanent contracts bring a clear wage advantage, while transitions into fixed-term contracts do not lead to a disadvantage. Moreover, the initially small wage gains associated with fixed-term contracts tend to grow over time, even if the wage effects over time of moving into permanent contracts remain more positive.

Therefore, transitions into permanent contracts remain the preferable option, both at the time of the transition and over time. This result is consistent with previous studies. The contribution is that there is no negative wage effect in the transition to temporary employment.

Three important labor market policy findings follow from these results:

- For jobseekers, neither the transition from temporary to permanent employment nor the reverse is associated with a loss of pay. In addition, both types of contract offer comparable opportunities for unemployed people to (re)enter the labor market.
- For careers advisors, the results also show that the transition from a fixed-term to a permanent contract brings with it the strongest wage growth. This underlines the importance of guiding employees towards stable employment.
- For political decision-makers, the results show the need for regulations and interventions that facilitate transitions into permanent contracts. It is crucial for the stability of the labor market that fixed-term contracts do not act as a trap, but as a bridge.

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