Accepted Manuscript

The Sources of Wage Variation and the Direction of Assortative Matching: Evidence from a Three-Way High-Dimensional Fixed Effects Regression Model

Sónia Torres, Pedro Portugal, John T. Addison, Paulo Guimarães

PII: S0927-5371(17)30048-9
DOI: 10.1016/j.labeco.2018.06.004
Reference: LABECO 1664

To appear in: *Labour Economics*

Received date: 24 January 2017
Revised date: 10 May 2018
Accepted date: 11 June 2018

Please cite this article as: Sónia Torres, Pedro Portugal, John T. Addison, Paulo Guimarães, The Sources of Wage Variation and the Direction of Assortative Matching: Evidence from a Three-Way High-Dimensional Fixed Effects Regression Model, *Labour Economics* (2018), doi: 10.1016/j.labeco.2018.06.004

Highlights

- This paper uses a large longitudinal matched employer-employee dataset spanning 26 years to assess the contribution of three sources of variation in wages and to explore the nature of assortative matching.
- Worker permanent heterogeneity is the most important source of wage variation, accounting for one-third of the wage variance, while firm fixed effects contribute another one-quarter. For their part, job title fixed effects having a basis in real-world occupational diversity and the impact of collective agreements explain a still considerable one-fifth of wage variance.
- There is strong evidence of wage sorting, with high wage workers tending to match with high-paying firms. The lack of stronger evidence supportive of this type of matching in the literature can squarely be laid at the door of finite sampling and limited mobility bias.
- Positive wage sorting is not to be confused with positive assortative matching, as the generosity of firms' wage policies cannot be taken as evidence that they are more productive.
- To assess assortative matching, firm-specific measures of productivity extracted from production functions were linked to wage worker fixed effects.
- High wage workers do tend after all to match with more highly productive firms.
- Yet the degree of positive assortative matching, no less than wage sorting, declines through time.
- This weakening in positive assortative matching arguably reflects downsizing among large firms and possibly the outsourcing of the jobs of less qualified workers.