

**‘Marginal Employment’: Stepping Stone or Dead End? Evaluating the German Experience**

‘Marginal employment’, i.e. employment with low working hours and earnings not covered by social security, has been gaining importance in the German economy over the past decade. There are two opposing views on this development among economists and policy makers. On the one hand, the existence of marginal employment (ME) has been seen as a means to improve labour market flexibility, to shore up financial incentives to take up low-paid work and to reduce labour costs for firms, thereby increasing the demand for low-productivity workers. On the other hand, critics are sceptical about the potential of marginal employment to enhance job creation and stress the danger of regular full-time jobs being substituted by subsidized ME. Studying the labour market impact of ME may therefore shed light on the issue of labour market flexibility and is also of substantial policy interest.

For various reasons, the German case is particularly interesting: firstly, while social security contributions weigh relatively heavily on low-productivity jobs, ME is partly exempted from this burden in Germany. Secondly, ME has grown substantially in Germany over the last couple of years, while overall employment has stagnated in this period. Thirdly, marginal employment has gained considerable importance in German labour market policy, which is illustrated by the fact that it has been subject to three considerable reforms during the last 10 years. Despite its increasing quantitative importance and policy relevance, there has been relatively little empirical research on the labour market effects of ME for Germany. In particular, to the best of our knowledge there are no empirical investigations on the policy-relevant question of whether ME acts as a “stepping stone” to regular employment or instead has to be viewed as a dead end locking people into marginal employment in the long run.

This paper aims to fill this research gap. The empirical analysis is based on a statistical matching approach making use of register data from the Employment Statistics of the Federal Employment Agency. We restrict the analysis to previously employed men who have experienced a minimum of three months of unemployment prior to taking up a job in marginal employment. The focus is on men because for women (conventional) part-time employment is quantitatively important and a likely substitution between part-time employment and ME cannot be adequately modelled within the confines of the statistical matching approach. The analysis distinguishes between eastern and western Germany because of prevailing pronounced differences in unemployment between the two regions. Furthermore, we also present results for older men because they are particularly hard hit by long-term unemployment and the question of whether ME may act as a stepping stone for this group in particular is of great relevance for labour market policy. Furthermore, we also investigate the extent to which ME is just a means to supplement unemployment benefit thereby prolonging unemployment and reducing incentives to take up regular employment.

The consistent estimation of the effects of taking up ME on the outcome variables of interest in the group of people who actually chose this option (“average treatment effects on the treated“) depends on the Conditional Independence Assumption (CIA) which, for the following reasons, we consider to be valid in the present case: firstly, we both condition on a individual’s employment status in the quarter before entering unemployment and restrict the analysis to unemployed people who experience an unemployment spell lasting at least 3 months. We thus compare relatively homogeneous groups of people. Secondly, we match both on labour market outcomes from 2 years prior to the treatment as well as on the duration of the current unemployment spell, which further reduces differences in unobserved heterogeneity affecting both treatment status and outcome variables. And finally, we show that our matching procedure is very successful in balancing the differences between the observable characteristics of the treatment and the control group.

Our evaluation results show that, although ME does not on average significantly increase the treatment group's chance of entering regular employment during an outcome period of at least three years, it does reduce future unemployment for the treatment group relative to the control group. The treatment effect on future unemployment is substantial in both western and eastern Germany: during the three-year outcome period the total duration of unemployment experienced by the treatment group is reduced by about 9 months on average, relative to the control group. These results are robust with respect to our definition of the control group and to the inclusion of ME with earnings below the maximum threshold for receiving unemployment benefit. For people aged 50 or older, the average unemployment treatment effect amounts to a reduction in the cumulated duration of unemployment over the three-year observation period of about 1.3 years. However, the dynamic pattern of the estimated treatment effects indicates that the effect of taking up ME on unemployment declines over time and that average unemployment durations in the two groups converge towards the end of the three-year observation period. We also find that taking up ME also increases cumulated future earnings, even if this effect is relatively small on average, and slightly negative for men in western Germany.

From a policy perspective, our evaluation results suggest that exemption from social security contributions may be effective in reducing unemployment, especially regarding older men, even if ME does not function as a stepping stone to regular employment and its effect on unemployment is only transitory. Furthermore, our evaluation results do not support the hypothesis popular among critics of ME that it is just a means to supplement unemployment benefit, thereby prolonging unemployment and reducing incentives to take up regular employment.