I Z A Institute of Labor Economics

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IZA COVID-19 Crisis Response Monitoring

The Second Phase of the Crisis

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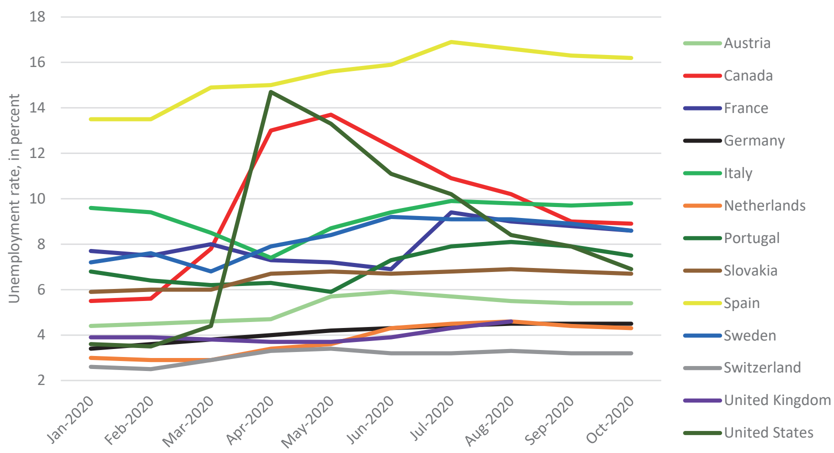
Revisiting crisis responses

As the pandemic continues and countries experience a massive second wave, labor markets continue to be heavily affected. At the same time, countries have started to extend, but also adjust stabilization measures initially introduced at the outset of the crisis. As of today, three main elements of crisis response require particular attention: the further development of short-time work schemes, ad hoc income protection for the self-employed, and the specific difficulties labor markets are currently facing. This overview addresses focusses on these three essential issues.

Labor markets in the second phase of the crisis

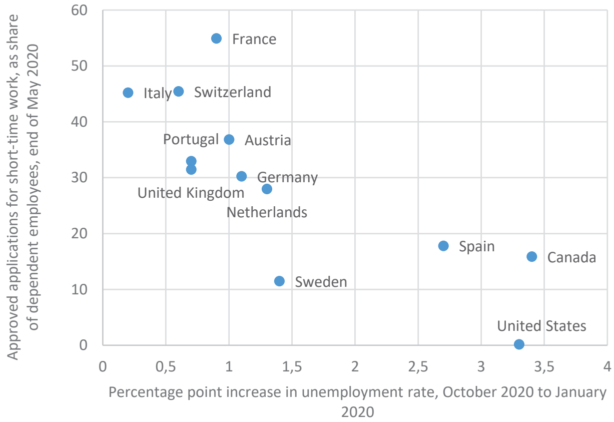
Regarding the labor market and considering the development of unemployment during the course of 2020, there has been a massive increase in countries as diverse as Austria, Spain or Sweden. However, this increase has been even larger in the United States, while other countries saw a rather moderate reaction of unemployment, e.g., France, the UK or Italy. Some countries have seen a massive decline in working hours in general, and in particular a massive increase in notifications for and take-up of short-time work or job retention schemes although there is a lack of up-to-date data on actual use, while national data show some decline in the second half of 2020. This points at important institutional factors in explaining labor market reactions. Hence, countries can be mapped along the following two dimensions: a) the increase in unemployment, and b) the extent to which short-time work is used, based on broadly comparable data available. Figure 2 provides the general picture, which points towards an inverse relationship between the early expansion of short-time work and changes in unemployment. The United States is the most prominent case of a steep initial unemployment increase with some improvement later on. To date, many other countries see a relatively stable development of unemployment (and employment). This is partly caused by declining labor force participation (e.g., Italy), but mostly by a steep increase in short-time work in the first half of 2020, with a decline afterwards.

Figure 1: Monthly unemployment rates, 2020



Sources: OECD.Stat, Monthly Unemployment Rates; amstat.ch. Note: Switzerland: data for unemployment rates are based on national databases; end point for UK is August 2020.

Figure 2: unemployment/short-time work, latest



Sources: OECD.Stat, Monthly Unemployment Rates; OECD Employment Outlook 2020, Figure 1.8; amstat.ch. Notes: Regarding short-time work, some countries only provide notifications that are not necessarily identical with the number of individuals actually taking up short-time work at a later stage. Switzerland: data for unemployment rates are based on national databases; end point for UK is August 2020.

Extended income stabilization via short-time work

The initial crisis response in the first half of 2020 included in virtually all covered countries a version of short-time work schemes. While short-time work is an established policy tool in several countries, others implemented new schemes. The rapid diffusion indicates that the pandemic has facilitated policy learning. Moreover, countries with existing schemes typically introduced temporary expansions to make them more inclusive and to lower residual costs for employers. Prima facie, the measures seem to serve their goal of keeping unemployment low. As shown in Figure 2, countries with strong reliance on short-time work have experienced weaker growth of joblessness. Particularly in countries with strict employment protection, short-time work is an attractive form of adjustment for firms which would otherwise need liquidity for separation costs. At the same time, short-time work has incurred considerable cost for public budgets. This is why policy debates in many countries have revolved around how long the measures should be kept in place.

Hence, while short-time work remains a crucial policy tool, some countries have begun or plan to phase out at least parts of it. These plans were obstructed in many cases by the second wave of the pandemic. The UK, for instance, introduced the new Coronavirus Job Retention Scheme, which compensates 80 percent of the salary of workers who are send leaves by their companies. This scheme was planned to be phased out from May onwards. However, in the face of re-surging case numbers, this decision was recently revoked and the scheme was extended until March 2021. In France, the temporary expansion of short-time work (limited until the end of 2020) initially abolished all residual costs to employers. Since June, employers in most sectors have to pay ten percent of the short-time work benefit. The Dutch government introduced a new temporary scheme in March. It recently decided to extend it until June 2021, while the initially very high replacement rates of 90 percent are gradually reduced to 60 percent. Also, eligibility for firms will be tightened in January 2021. Austria follows a different approach by defining a maximum budget (not reached yet) and by regularly extending short-time work if necessary. In October, eligibility was tightened by narrowing the allowed reduction of working hours to a range from 30 to 80 percent (previously ten to 90 percent). In addition, stronger requirements to combine short-time-work benefits with training were introduced. In Switzerland temporary expansions of short-time work expired in August, but were partly re-instated in November when the second wave hit the country. Also the German and Spanish governments decided to prolong the crisis-related expansions into 2021.

In sum, the common trend across countries is that planned expiry dates of new or expanded schemes are postponed because of the second wave. This reflects the fact that many governments and experts view short-time work as an effective policy response to the crisis. However, in many countries concerns about costs and deadweight losses are growing, which in some cases is reflected in adjustments towards lower generosity.

There is a general concern regarding job retention or short-time work schemes that becomes more serious the longer the crisis lasts. The longer firms and workers rely heavily on (generous) short-time work schemes, the less likely appears a full return to the "old normal" before the crisis as markets and business models change. A long period of 'passive' short-time work may keep unemployment low for the time being, but also make further adjustments in employment more difficult. Rather, the main challenge is to prepare for either changing job requirements when firms undergo internal restructuring in an increasingly difficult economic environment or for a move to other employers, sectors or occupations if external mobility on the labor market is the only viable option in the medium and long run. This makes retraining (during short-time work) essential, ideally combined with work experience in firms, sectors or occupations with better employment prospects. It might make sense to stipulate that advice on future job options, related training and acquiring some real-world work experience (e.g., via internships, posting, or qualified secondary education) are established as general requirements when extending public short-time work support. In a way, this would imply a partial detachment of long-term short-time workers from their employer even when the employment relationship continues to exist. Current policies in most countries do not effectively move in that direction and neglect the training and mobility component in short-time work. Training elements are not very strong in short-time work schemes at the moment although some countries are beginning to move in that direction. Providing mostly "passive" short-time work support for a longer period, e.g., as in the German case, is not a sustainable solution. A stepwise strengthening of the co-funding share borne by employers that continue to rely on short-time work would also be essential as to create a stronger incentive to reconsider the viability of jobs stabilized through job retention schemes.

Beyond temporary income support to the self-employed

The peculiar situation of self-employed workers has triggered the creation of tax-funded ad hoc support schemes that are hardly integrated into the regular unemployment insurance system. In some cases, access to means-tested income support was facilitated by lifting requirements. All these measures have a distinct temporary nature, and they are tax-funded as the self-employed are typically not covered by contributory unemployment insurance (except for some self-employed in Portugal, for example). Where there is unemployment insurance for the self-employed the coverage used to be very limited, e.g. in Germany or Austria, but also in Sweden where self-employed had to close down their business in order to claim unemployment benefits if insured on a voluntary basis. All in all, however, the social protection of self-employed workers was patchy at best at the outset of the crisis, so that emergency measures to close these gaps had to be undertaken.

They have taken different forms by way of temporary assistance programs (e.g. in Germany, the United Kingdom, the United States or the Netherlands) sometimes introduced as designated 'hardship funds' (e.g. in Austria, Switzerland or France) that provide self-employed experiencing significant earnings losses with one-off payments or a limited number of repeated monthly payments. Some countries granted lump-sum payments (e.g. in the Netherlands, Italy or Germany) while in some cases payments were related to earnings losses (such as in Austria, Slovakia, in the United Kingdom or Portugal), covering operating expenses and/or living cost as well as tax and contribution referrals. The duration of the measures was designed to correspond more or less to the duration of lockdown period(s). With hindsight, the early support schemes often did not cover operating expenses and entrepreneurial remuneration (living expenses) of the self-employed appropriately, leading to some difficulties in claiming and implementing them correctly (e.g. in Germany). While originally the ad hoc measures were expected to expire in early summer, most programs have been continued or reactivated in fall with the second lockdown period (see, for example, the Austrian hardship fund, TOZO in the Netherlands or SEISS in the UK). Some of the schemes look different now compared to the situation in spring 2020. Typically, they were designed to become more accessible and better targeted, trying to reach also subgroups of self-employed neglected before such as arts and culture freelancers. The generosity varies, and administrative implementation is still slow in some cases.

It is justified to support the self-employed through tax funded measures when their activity is banned or severely hampered during lockdown periods, e.g. in events and trade fairs, tourism, arts and culture, hairdressing, small shops and restaurants etc. Beyond the acute crisis, income fluctuations of self-employed deserve a more conceptual and fundamental consideration. To date, to design a regular and permanent system of unemployment protection for self-employed workers is still a pending issue. Taking into account the crises responses in individual countries, a more stable institutional solution in terms of a contribution-based unemployment insurance or an equivalent mechanism is not visible yet, but it will likely be an area for intensified debate during later stages of the pandemic and its aftermath.

Introducing a contributory unemployment insurance for the self-employed can be considered fair with regard to employers and employees contributing to unemployment insurance and the tax payers, reducing, first, the moral hazard of self-employed that do not save and are not obliged to, but can rely on collective support in times of crisis, and, second, labor cost arbitrage considerations of employers or clients that resort to outsourcing via formally self-employed contractors given their competitive edge. Design issues are quite complex in self-employed unemployment insurance, in particular regarding appropriate funding, benefit generosity, and the voluntary/mandatory character of the self-employed unemployment insurance. More or less subsidized voluntary unemployment insurance models for the self-employed typically only have low coverage rates, hence a mandatory insurance would allow for a better pooling of risks and could ensure a more substantial protection as well as more reliable funding.

One option would be to integrate people who are to a substantial extent engaged in self-employment into public unemployment insurance (and old-age insurance), at least after an initial start-up phase. By doing so, it would be possible to establish a clear link between benefits and contributions comparable to dependent workers. The self-employed would become liable to pay contributions, based on declared earnings, which would then lead to earnings replacement in case of an involuntary and final stop of business. Under certain conditions a partial unemployment benefit, similar to a short-time work allowances for employees, could be feasible, provided that the involuntary and temporary character of reduced activity can be proven. Of course, this would make self-employment potentially more expensive in terms of labor cost and bring self-employment more in line with dependent employment but this would also reduce the labor cost advantage of outsourcing to self-employed which can be understood as implicit subsidy of self-employment currently.

Postponed Challenges for Labor Market Entrants

The current crisis continues to pose significant challenges for labor market entrants in many countries. This group of typically young individuals with limited work experience will have to compete with many highly skilled, experienced and qualified job seekers in the foreseeable future. It is a well-established fact that graduating in a recession leads to significant long-term disadvantages in terms of wage and employment outcomes. In the current crisis, the situation is exacerbated by the fact that sectors that usually absorb part of the downturn employment shocks of recent crises are now precisely the most affected. It therefore remains of utmost importance to build bridges for young people leaving school or university that establish early contacts to employers and provide work experiences. However, in many countries the focus of crisis responses has been on supporting measures to stabilize existing employment relationships. This has been the case, for example, in Southern European countries such as Italy, Spain or Portugal where youth unemployment rates had been notoriously high already before the current crisis. But it also applies to countries such as the Netherlands, Sweden, the United States and Canada, which have so far also not implemented specific measures for young labor market entrants.

Other countries did implement specific measures for labor market entrants. For example, the French government launched a “youth plan” in July 2020 that involves hiring subsidies for firms as well as funded training opportunities for low-skilled young persons. The United Kingdom has announced initiatives aimed at training and retraining, which will however only start to be implemented in mid-2021.

Relatively smooth school-to-work transitions can generally be observed in countries with dual apprenticeship systems, such as Austria, Germany and Switzerland. However, given persistently weak labor demand, the potential problems of current graduates might be actually amplified in these countries. But according to preliminary evidence, the negative impacts in these countries appear at least less severe than initially expected; and these countries mostly also adopted specific measures to stabilize the apprenticeship market.

In Germany, for example, a substantial slowdown of the matching process between applicants and apprenticeship positions can be observed. But both supply and demand decreased simultaneously by about 8 percent compared to the previous year. This ultimately resulted in roughly 11 percent more applicants who had not been placed in 2020. Against this background, a joint federal support initiative to make apprenticeship capacities more resilient in times of crisis has been adopted. Similar developments can be observed in Austria and Switzerland.

Vocational training as a joint responsibility of public actors, employers and trade unions has been one key element of resilient youth labor markets in the past. It appears that this dual apprenticeship model continues to provide relatively smooth transitions, also due to the continued commitment of the involved stakeholders.

In countries where such a dual apprenticeship system does not exist, governments and social partners should thus try to establish functionally equivalent programs that help integrate young people into initial jobs along with the provision of relevant skills, after school or university. In the current situation this will require the increasing use of digital tools. The idea of the European youth guarantee may also be helpful in that respect, but it calls for a systematic implementation in countries and regions that are particularly affected, ensuring a sufficient quality of work and/or training offers.

Further stabilization efforts in the second phase

Many countries have undertaken unprecedented and continued governmental stabilization efforts with considerable fiscal implications, using a broad repertoires of instruments to mitigate income losses, avoid or postpone bankruptcies and dismissals. While many of the temporary emergency support schemes were initially planned to be phased out over the summer, the bulk of them was continued into fall and winter and announced to run until mid-2021. This shows the continued importance of income and employment stability during the current second wave of the pandemic. In some countries, these responses rely to a larger extent on automatic stabilizers, while the amount of additional discretionary measures is generally large. Nonetheless, the overall degree of policy innovation appears rather incremental than revolutionary – possibly with the exception of new or revised short-time work schemes in some countries and some ad-hoc schemes to support the self-employed. Yet, beyond the current emergencies, the further development of these policies is still a pending issue that warrants close observation over the next months.