RESEARCH

Special Series on COVID-19

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Options to Support Incomes and Formal Employment During COVID-19

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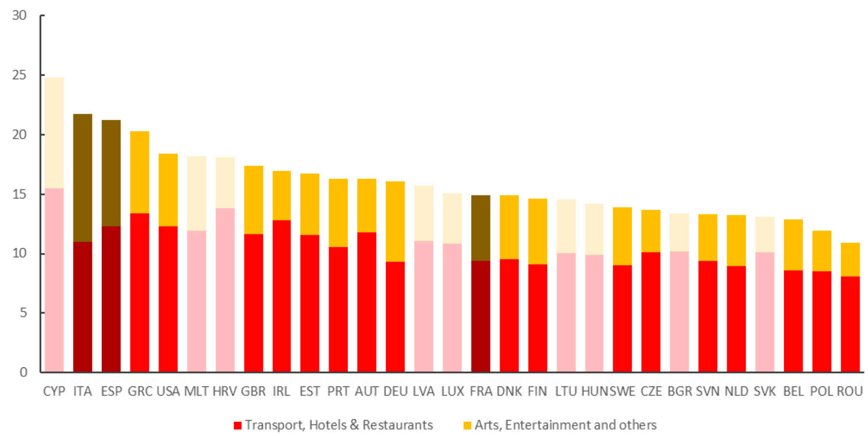
This note reviews policy options to mitigate the (formal) employment impact of COVID-19, many of which are being deployed by governments. The immediate priority is to preserve jobs and laid-off workers' incomes, which calls for short-time work subsidies and scaled-up unemployment insurance—primarily easier eligibility criteria. As activity resumes, wage and hiring subsidies, as well as activation policies, should play a growing role. Clear phasing-out mechanisms are needed at the outset to ensure that these tools do not impede the eventual recovery, including reallocation of workers towards new jobs.

I. CONTEXT

The direct labor market impact of COVID-19 will be severe for two reasons: the most affected industries account for a large share of total employment—between 12 and 25 percent excluding the wholesale and retail trade sector (Figure 1), and between 25 and 40 percent including it, in advanced economies; non-standard jobs, such as temporary contracts that can be discontinued quickly at low cost to the employer, account for a sizeable fraction of total employment in some countries (Figure 2), and are predominant in some of the affected industries such as recreational services or hotels and restaurants. Measures to dampen the impact of COVID-19 on employment and incomes cannot only mitigate the hardship on affected workers but also: i) reduce the broader macroeconomic impact of the shock by mitigating second-round effects from massive employment losses, which reduce consumption both directly— especially from laid-off, credit-constrained workers that lack savings—and indirectly—by encouraging employed workers to increase precautionary saving; ii) dampen more permanent consequences for productivity and output from discontinuing highly-productive job matches that embed a lot of specific human capital.

[1] For more information, contact rduval@imf.org. For complementary IMF notes on how to deliver support to informal workers in emerging and developing economies with large informal sectors, see in particular "Reaching Households in Emerging and Developing Economies: Citizen ID, Socioeconomic Data, and Digital Delivery" and "Digital Solutions for Direct Cash Transfers in Emergencies". Public support to firms, such as subsidized credit to SMEs and self-employed workers, also benefits workers, see for example "Public Sector Support to Firms."

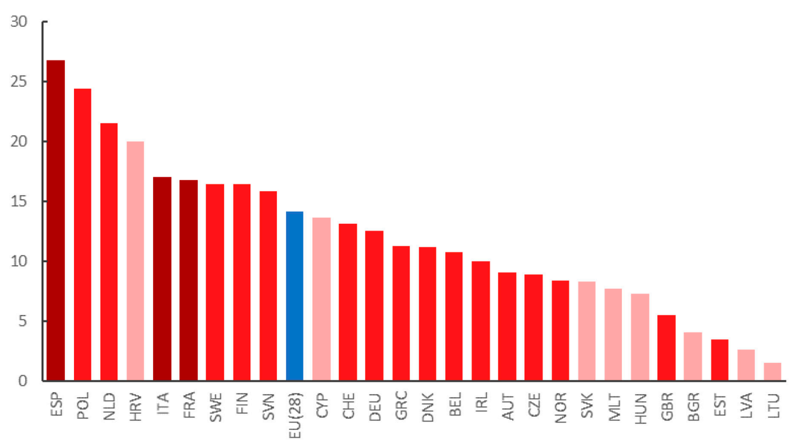
FIGURE 1. Total Employment Share in Transport, Hotels, Restaurants, Arts, and Entertainment, 2017



Source*:* EUKLEMS Database; WHO Coronavirus disease 2019 (COVID-19) Situation Report 56 (2020).

Note: Pink, red, and brown denote degrees of severity of COVID-19 infection (from low to high), measured as absolute number of cases, as of March 16 according to WHO Coronavirus disease 2019 (COVID-19) Situation Report 56 (2020).

FIGURE 2. Share of Workers Under Temporary Contracts



Source: OECD Employment Database; WHO Coronavirus disease 2019 (COVID-19) Situation Report 56 (2020).

Note: Pink, red, and brown denote degrees of severity of COVID-19 infection (from low to high), measured as absolute number of cases, as of March 16 according to WHO Coronavirus disease 2019 (COVID-19) Situation Report 56 (2020).

With these objectives in mind, this note draws the lessons from past experiences, including the GFC, with a range of labor market policy tools, focusing on four main labor market programs that can dampen initial job losses, support the incomes of laid-off workers, and foster job creation later on:

i) Short-time work schemes; ii) Unemployment insurance; iii) Payroll tax cuts/wage subsidies; iv) Hiring subsidies. In March and April 2020, many governments have announced measures in several of these areas, notably in advanced economies. Strengthening unemployment insurance and short-time work schemes is most valuable now, while activity is being slowed on purpose during the acute phase of the epidemics. In a second phase, as activity gradually resumes, targeted wage and hiring subsidies could be used to speed up the job recovery, as was the case during the GFC. At the same time, all these policy tools raise moral hazard issues—for example, a firm may collect a conditional subsidy now while still laying off its workers later on—and can create displacement effects. While these risks are quite limited for now given the specific and dramatic nature of the COVID-19 shock, they could become a concern if the outbreak and/or containment measures turned out to be persistent. This calls for carefully designing these tools at the outset, including by ensuring that they do not impede labor reallocation across the economy and be automatically phased out as the economy eventually recovers.

II. SHORT-TERM WORK SUBSIDIES

Short-time work subsidies can help save regular jobs during the early phase of the downturn, as they did during the GFC. They refer to a temporary subsidized reduction in working time—in other words, a partial unemployment benefit—aimed at maintaining an existing employer-employee relationship. These schemes, which were deployed in a number of European countries and Japan during the GFC (Figure 3), helped preserve permanent jobs, although some estimates suggest that their overall impact was moderate (below 1 percent of permanent employment in most countries, according to OECD, 2010). Short-time work subsidies are best-suited to alleviate temporary job losses, especially where these could lead to permanent loss of high-value firm-specific human capital—as such, together with other working-time reduction devices, they are credited as having alleviated high-skilled blue-collar job losses at some German car manufacturers during the GFC. On the other hand, they have not proven helpful in preserving jobs of temporary workers (Boeri and Bruecker, 2011), for which it seems more efficient to design specific unemployment benefit programs, which partly preserve their income and make them viable to be hired by industries with rising labor demand. The extent to which short-time work schemes succeed in preserving jobs will also vary depending on firms' size and liquidity buffers.

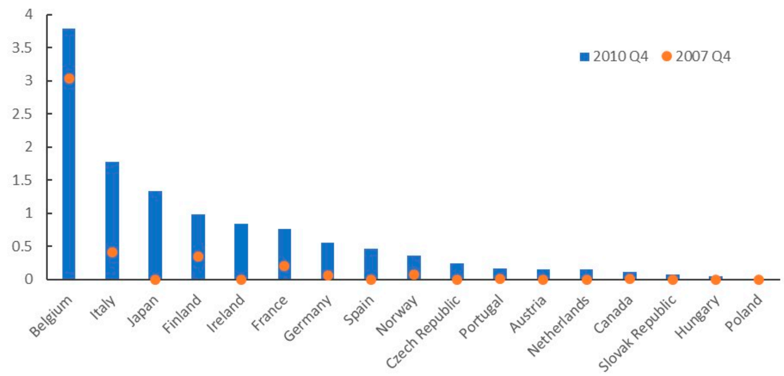
Short-time subsidies can be provided through dedicated schemes or through the unemployment benefit system ("partial unemployment benefits"). Past experience suggests that it is easier to strengthen the attractiveness of an existing short-time work scheme (as was the case in Germany with its Kurzarbeit scheme during the GFC) than set up a new one from scratch at the beginning of a downturn. Nonetheless, in countries that lack such programs, a possible substitute can be for the unemployment insurance system to grant unemployment benefits for non-worked hours to workers that become partially (or fully) unemployed in most affected sectors (e.g. recreation, restaurants, transport…etc), provided that they remain under contract with their employer (essentially a version of so-called "partial unemployment" in France).

Short-time work schemes need to be carefully designed, with clear phasing-out mechanisms, to minimize their drawbacks which include: i) moral hazard, whereby these arrangements may be used to subsidize the hours of workers who would have not been dismissed anyway; ii) hindering growth-enhancing job reallocation across firms and industries during the recovery phase, or alternatively if the contraction of those industries most affected by COVID-19 turned out to be durable. If these schemes were long-lasting, they would hinder required labor market adjustment at a fiscal cost. While not serious for now, these considerations could become material in the event of a more lasting health and economic crisis. Therefore, strict criteria should be enforced to ensure that take-up is temporary.[2]

[2] One possible way forward might be to build in a gradual rise in firms' contribution rates over time starting from a low (or even zero) level, and/or to condition such increases on indicators of recovery.

FIGURE 3. Short-Time Work Scheme Take-Up Rate in 2010 Q4

(percentage of employment)



Source: Hijzen and Martin (2013).

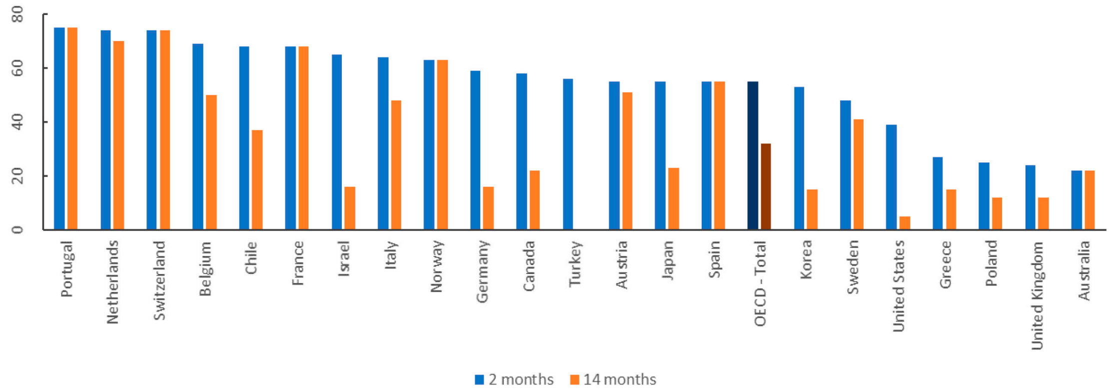
Private work-sharing agreements within firms can usefully add to (or substitute for) government-run short-time work schemes but cannot be fostered from scratch. In Germany, during the GFC, individual working-time accounts introduced in the mid-1990s were run down, and collective agreements were signed under which firms committed to preserving jobs in exchange for working-time reductions. Evidence suggests that these arrangements played a bigger role in preserving employment than the short-time work scheme (Kurzarbeit) back then. While firm- or industry-level working-time-reduction negotiations might be an option in those (mostly European) countries where collective bargaining is well-developed, it is likely to be difficult in most other cases.

III. UNEMPLOYMENT BENEFITS

Relaxing eligibility criteria to unemployment benefits (UBs), and raising benefits where they are low, can help sustain consumption of laid-off workers and weaken precautionary saving incentives for remaining workers. Easing eligibility criteria may involve less stringent work history requirements and covering some of the self-employed in the most affected industries, for example. Unlike some of the tools discussed above, the administrative architecture for UBs is already in place in advanced economies, facilitating swift implementation. The temporary nature of the shock also provides a case for strong short-term insurance against workers' income loss risk. This may call for higher benefit replacement rates where these are currently low (Figure 4). In addition, while unemployment insurance has been identified as one driver of structural unemployment, there is some evidence that high benefit levels are less harmful than long benefit duration in this regard (Lalive, van Ours and Zweimüller, 2006).

FIGURE 4. Unemployment Benefit Replacement Rates

(Percent)



Source: OECD Social Protection and Well-being database.

Note: Unemployment benefit replacement rate for a single person without children, earning the average wage, without housing benefits.

If the crisis turned out to persist, one option might be to extend the duration of unemployment benefits, coupled with strong activation measures. A long-lasting crisis would durably raise unemployment and increase the share of long-term unemployed, steepening the trade-off between supporting the income of the unemployed and facilitating labor reallocation toward new jobs and industries—because high and long-lasting benefits can weaken job search incentives and raise market wages. One option to ease that trade off would be to extend benefit duration—which would otherwise be quickly exhausted in a number of countries (those with a large gap between replacement rates after 2 months versus 14 months of unemployment in Figure 4)—while strengthening active labor market policies, including public employment services that provide job-search assistance and training programs to maintain employability—a combination that proved effective in Denmark, for example, during the GFC.

IV. WAGE SUBSIDIES

Wage subsidies can help already now but would be most useful once COVID-19 containment measures are gradually eased, while generalized payroll tax cuts should be avoided altogether. Given that the shock is abrupt, temporary and affecting fairly well identified industries (hotels and restaurants, recreational services…etc), targeted wage subsidies can be a cost-effective way to preserve jobs and worker incomes. However, unlike short-time work subsidies, wage subsidies are *not* conditional on reducing hours worked which, yet, is needed during the acute phase of the outbreak. As such, wage subsidies would be most useful later on, when containment measures are eased and activity in the affected industries can resume, while firm balance sheets in the affected industries are dramatically weaker. In comparison, a generalized payroll tax cut would entail a much larger fiscal cost per job saved—because it would subsidize *all* jobs, the vast majority of which would not have been discontinued anyway, and private sector wages amount to at least a third of GDP and most often more. Should the crisis and the contraction of affected industries be more persistent than envisaged, it would also become important to facilitate the reallocation of workers within and across industries—for example, already now, even as restaurants are shedding labor, online (food and other) delivery services are expanding and providing job opportunities to laid-off workers. To this end, wage subsidies should be kept temporary, with clear sunset clauses.

V. HIRING SUBSIDIES

Should unemployment stay high for long—because of a lasting pandemic and/or a slow output recovery, hiring subsidies could be used to speed up the job recovery. Many countries implemented these measures after the GFC, when it became clear that higher unemployment was here to stay. The measures often targeted vulnerable job seekers, such as the long-term unemployed, younger and older workers (Table 1). For example, in the US the 2010 Hiring Incentives to Restore Employment Act provided a payroll tax credit to employers hiring an unemployed worker in the next 12 months, while in France the 2009 hiring subsidy ("*zéro charges*") targeted low-skilled workers in small firms. Evidence from these and other programs is typically positive—raising employment of targeted workers and firms by 1 to 2 percent in the French and US program cases, respectively (Cahuc, Carcillo and Le Barbanchon, 2019; Farooq and Kugler, 2015). Also, hiring subsidies for the private sector have been found to be more effective than public training or works programs in bringing the targeted workers into employment and keeping them attached to the workforce over the longer run. Also, *in principle*, hiring subsidies entail a lower fiscal cost per job created than wage subsidies, since they only subsidize new, additional jobs rather than existing ones. That holds particularly true for net hiring subsidies, which subsidize net, rather than gross, job creation.

TABLE 1. Examples of Hiring Subsidies and Public Sector Job Creation Schemes during the GFC

Country	Hiring Subsidies and Public Sector Job Creation Scheme
Australia	Hiring subsidy for firms hiring laid-off apprentices and trainees in 2009 and 2010.
France	Reduction in employer social contributions for firms with less than 10 employees hiring new low-wage workers in 2009. Suppression of employer social contributions for enterprises hiring apprentices.
Greece	Temporary expansion of job creation programs for employment and self-employment with some targeted at youth, unemployed or seasonal workers.
Hungary	Temporary new program of wage support for firms that hire workers laid off by other firms.
Portugal	Temporary hiring incentive payment plus exemption from employer social contributions for two years for new hires of long-term unemployed or youth in full-time, permanent jobs and support for integration of unemployed in non-profit institutions for up to one year. 50% reduction in employer social contributions for new hires of older unemployed.
Spain	New funding for job creation in 2009 for public work jobs carried out by local authorities and improvement of incentives for hiring part-time (less than one third of full-time hours). Reduction in employer social contributions for first two years of employment for new hires in 2009 and 2010 of unemployed people with children in full-time permanent contracts.
UK	New subsidized jobs program for jobseekers in areas of high unemployment to work with local authorities. New incentive payments for employers who employ and train unemployed with more than six months of unemployment.
USA	Employers are eligible for a payroll tax credit when the employer hires certain new employees after February 3, 2010, and before January 1, 2011. The employee must have either been unemployed for at least 60 days prior to hire or worked fewer than 40 hours for another employer during the previous 60 days. Employers do not pay the employer portion of social security tax on wages paid to eligible new hires. Employers receive a general business income tax break if they continue to employ the new hire for at least 52 weeks.

Source: OECD (2009).

Hiring subsidies should be well-targeted to mitigate moral hazard (or outright gaming of the system) and displacement effects, which requires solid administrative capacity. Hiring subsidies can lead to inefficient substitutions of targeted workers (such as the low-skilled) for others (such as medium-skilled ones), and to significant displacement costs, in that they may incentivize firms to lay off existing workers and hire them back to collect the subsidy—a risk that can be alleviated by *net* hiring subsidies, but these require cost-intensive monitoring and bureaucracy—or to lay off subsidized workers altogether once the subsidy expires. Targeting hiring subsidies to specific industries and worker categories can mitigate these risks while also reducing program costs—factoring in that industries can be affected by this crisis not just directly, but also indirectly through input-output linkages. Governments may also want to impose a few simple requirements—for example, that a firm has no recent record of dismissing workers of similar occupations to the subsidized one, or that subsidies cannot apply to workers previously employed at the same firm.

Public sector job creation—an extreme version form of hiring subsidy—may provide a last resort option under current circumstances, especially to support some of the most basic medical services. The current outbreak has generated unprecedented demand for regular and intensive care treatment, which governments should urgently meet—directly through public sector job creation or indirectly through large subsidies to the private sector, depending on the nature of the domestic health system. Other than relaxing the requirements for foreign medical and paramedical workers to operate domestically, and requiring retired medical and paramedical professionals to provide part-time services in hospitals, governments could consider extensive hiring of non-medical workers to address the maintenance and logistic needs that the current emergency brought. More broadly, temporary public works programs could support essential activities during the outbreak while mitigating financial hardship for a fraction of job losers.

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