The Center for Growth and Opportunity at Utah State University

U.S. Labor Market Policy Should Take a Page Out of Europe's Book

Megan Greene

May 2020
COVID Recovery Symposium 2020.003

In the six weeks up to April 11, around 26 million people in the United States applied for unemployment benefits. The jump in jobless claims over the past month and a half has been so sharp; the charts look like someone just hardcoded an error into them. Economists expect unemployment to peak as high as 25 to 30 percent in the U.S. as a result of the COVID-19 pandemic.[1] But the ifo Institute for Economic Research in Germany expects unemployment only to reach around 6 percent there. This isn't because the U.S. has been hit so much harder by COVID-19 than Germany. It is because the U.S. and Europe have adopted different labor market policies in response to COVID-19. If the U.S. had to choose just one approach to labor market policy, then it has chosen the best one to suit its economy. The good news is the U.S. does not have to choose and could have the best of both worlds by following in Europe's footsteps as well.

The U.S. and Europe have broadly the same labor market policy levers in place to respond to a downturn. They just tend to pull on different ones. European governments often pay employers to keep workers on the payroll, while U.S. policymakers rely mainly on unemployment insurance to help those newly out of work. This makes the unemployment rate an unfair indicator to judge the U.S. response because we aren't trying to minimize unemployment; we are primarily aiming to mitigate it. In response to COVID-19, the U.S. has boosted its support to workers through unemployment insurance, loosening the eligibility criteria and paying claimants an additional $600 per week for two months.

Relying on unemployment insurance works well when the industries hit the hardest have low productivity and high turnover under normal circumstances. According to the March employment data and more recent jobless claim data from individual states, a large percentage of jobs lost so far in the U.S. has come from such sectors, including leisure and hospitality, retail, and temporary business services.[2] The beefed-up unemployment insurance benefits are relatively generous. Average weekly unemployment insurance last year was $378, and now with the extra $600 from the COVID-19 relief law, the average unemployed worker can collect $978 in unemployment benefits each week for two months.[3] According to the Labor Department, the median weekly earnings for full-time workers was $957 in the first quarter of 2020, so roughly half of full-time workers can collect more with unemployment insurance over these two months than they could earn in their jobs.[4] This offers support to employees in the food industry, for example, at a time when there is virtually no demand for dining out.[5]

Relying on unemployment insurance to support workers allows those who have no work to seek opportunities in other industries, improving labor market flexibility. Certainly, some companies and sectors that employed a lot of Americans before this crisis, such as restaurants, retail, airlines, and hotels, may not fully revive, and keeping workers connected to those jobs does neither them nor the economy a service. The sooner workers move on to healthier industries, the better.

That flexibility in the labor market has always been a hallmark of the American system. It creates more opportunities for workers, usually leading to a faster recovery from recession. It's a big reason job creation has been more dynamic, and unemployment lower in the US than in Europe. During the Global Financial Crisis, the United States lost 5 percent of its jobs, compared with 3 percent in Europe. Afterward, it took 119 months, or just under 10 years, for the U.S. unemployment rate to reach its pre-crisis monthly low of 4.4 percent.[6] U.S. unemployment had fallen to 3.5 percent in February before COVID-19 started impacting the labor market data. By contrast, eurozone unemployment still hasn't returned to its pre-crisis low of 6.9 percent, 151 months later. By February, eurozone unemployment had declined only to 7.3 percent.

Unemployment insurance exists in Europe, too, but it is not usually the primary tool used to protect workers. European law tends to have more labor protections built in, which makes it more difficult for firms to fire and hire.[7] Workers who lose their jobs there may have a harder time finding employment than their counterparts in the U.S. Given that, it is usually better for European workers to maintain a connection to their employer when demand falls rather than relying on unemployment insurance.

To do that, most European countries rely mainly on government wage guarantees and work-sharing programs, whereby the government helps subsidize employees who work reduced hours. The UK government announced it would guarantee 80 percent of wages in response to COVID-19, and countries such as Germany, France, Italy, Belgium, and the Netherlands have employed work-sharing programs for decades. Following the Global Financial Crisis, for example, 16.9 percent of workers in Italy, 11.3

percent in Belgium, and 4.1 percent in Germany benefited from work-sharing programs, according to the Urban Institute.[8] This compares with only 0.2% in the U.S. during the same period.

Maintaining a connection with employees and reducing employee turnover can cut costs considerably for firms and accelerate the recovery. Wage guarantee and work-sharing programs mean European companies can avoid having to recruit, hire, and train new employees and so can ramp production back up quickly once demand returns after a temporary drop. This is particularly important for high productivity sectors that require more skills.

If the shock to demand lasts longer, the European approach may have other advantages to the U.S. reliance on unemployment insurance. According to the theory of duration dependence, a person's probability of finding new employment tends to fall the longer he or she is out of work. If this downturn lasts a few quarters rather than a few months, relying only on unemployment insurance could be detrimental for workers. If they become detached from the labor force, participation rates and potential growth will fall, and the risks of social problems such as alcoholism and opioid abuse may increase.

This is where American policymakers can take a few pages out of Europe's book. Each region has chosen the policy tools that work best for their economy. But the U.S. does not have to choose just one approach. 27 U.S. states have work-sharing programs, but they aren't used extensively.[9] According to the jobless claims data, U.S. employers filed 62,297 work-sharing claims by April 11, up by 22,433 from the previous week.[10] This is compared with a jump by 9,467 in the same week in 2019 and is a drop in the bucket compared with the roughly 12.5 million Americans claiming unemployment insurance by April 11 under all programs. Take-up has been low in part because many businesses in those states are unaware of them.[11]

Research conducted during an economic expansion in Oregon and Iowa shows that some advertising of the work-sharing option for employers can dramatically increase their uptake.[12] The impact would likely be even greater if conducted now as millions are claiming unemployment benefits every week. The new CARES Act includes resources to support existing work-sharing programs and to encourage new states to set them up. States should take advantage of these subsidies to use or establish work sharing.

The new Paycheck Protection Program (PPP) also builds on the Europeans' playbook. It provides loans to small businesses that turn into grants for those firms that keep workers on their payroll, approximating a temporary wage guarantee system. But the PPP has had real problems—it was rolled out after many businesses had already shuttered, it is very likely still too small, and some firms have done the math and decided that a cheap loan is a better deal for them than a grant that requires them to carry a full payroll. The need for speed in setting up the PPP has led to a glitch-filled start. The PPP should be made permanent and should be an automatic stabilizer triggered by a jump in jobless claims or unemployment as a downturn begins.[13]

Salary guarantees and work sharing would enhance the U.S. safety net and enable the economy to better cope with demand shocks. Meanwhile, unemployment insurance should remain America's first line of defense for the jobless given the country's flexible labor market. Unemployment insurance can be made contingent on retraining and reskilling, to ensure workers are funneled away from industries that aren't ever going to revive and towards sectors presenting opportunities. This requires effective retooling programs, and so this should be a focus for policymakers once salary guarantees and work sharing are embraced. This would not only protect workers in the face of a sudden crisis but help them adapt to the new economy that will eventually emerge.

Megan Greene *is a Senior Fellow at the Mossavar-Rahmani Center for Business and Government at Harvard Kennedy School*

Endnotes

1. "US Relief Checks Begin Arriving as Economic Damage Piles up," *AP NEWS* (Associated Press, April 15, 2020), https://apnews.com/de34cfda724880a4451bc892b684b46c.

2. "Statement #2 from the U.S. Private Sector Job Quality Index ('JQI') Team on Vulnerabilities of Jobs to the Covid-19 Economic Shutdown," *U.S. Private Sector Job Quality Index*, April 17, 2020, https://www.jobqualityindex.com/#flashsection.

3. "Regular Benefits Information by State for CYQ - 2019.4," PDF (Employment and Training Administration, Department of Labor), accessed May 6, 2020, https://oui.doleta.gov/unemploy/data_summary/SummaryTables.pdf.

4. "Usual Weekly Earnings Summary," *Bureau of Labor Statistics*, April 15, 2020, https://www.bls.gov/news.release/wkyeng.nr0.htm.

5. "State of the Industry," *OpenTable*, accessed May 6, 2020, https://www.opentable.com/state-of-industry.

6. "Civilian Unemployment Rate," accessed May 6, 2020, https://www.bls.gov/charts/employment-situation/civilian-unemployment-rate.htm.

7. "OECD Indicators of Employment Protection - OECD," accessed May 6, 2020, https://www.oecd.org/employment/emp/oecdindicatorsofemploymentprotection.htm.

8. Wayne Vroman, "Short-Time Compensation and Job Preservation," Working Paper (Urban Institute, June 2013), https://www.urban.org/sites/default/files/publication/23746/412851-Short-Time-Compensation-and-Job-Preservation.PDF.

9. "Short-Time Compensation," *Employment and Training Administration, Department of Labor*, accessed May 6, 2020, https://oui.doleta.gov/unemploy/docs/stc_fact_sheet.pdf.

10. "Unemployment Insurance Weekly Claims," *Department of Labor*, April 30, 2020, https://www.dol.gov/ui/data.pdf.

11. Susan Houseman et al., "Demonstration and Evaluation of the Short-Time Compensation Program in Iowa and Oregon: Final Report," External Papers and Reports, 2017, https://research.upjohn.org/externalpapers/75.

12. Ibid.

13. Claudia Sahm, "Sahm Rule Recession Indicator," *FRED* (Federal Reserve Bank of St. Louis, April 3, 2020), https://fred.stlouisfed.org/release?rid=456.

14. "Short-Time Compensation," *Employment and Training Administration, Department of Labor*, accessed May 6, 2020, https://oui.doleta.gov/unemploy/docs/stc_fact_sheet.pdf.

15. "Unemployment Insurance Weekly Claims," *Department of Labor*, April 30, 2020, https://www.dol.gov/ui/data.pdf.

16. Susan Houseman et al., "Demonstration and Evaluation of the Short-Time Compensation Program in Iowa and Oregon: Final Report," External Papers and

Reports, 2017, https://research.upjohn.org/externalpapers/75.

17. "Short-Time Compensation," *Employment and Training Administration, Department of Labor*, accessed May 6, 2020, https://oui.doleta.gov/unemploy/docs/stc_fact_sheet.pdf.

18. "Unemployment Insurance Weekly Claims," *Department of Labor*, April 30, 2020, https://www.dol.gov/ui/data.pdf.

19. Susan Houseman et al., "Demonstration and Evaluation of the Short-Time Compensation Program in Iowa and Oregon: Final Report," External Papers and Reports, 2017, https://research.upjohn.org/externalpapers/75.