Economic Research:

European Short-Time Work Schemes Pave The Way For A Smoother Recovery

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Key Takeaways

- The unprecedented use of short-time work schemes in the eurozone's largest economies has so far prevented a surge in unemployment, which rose only 0.1 percentage point in March to 7.4%.
- Given that 27% of Europe's workforce is now on short-time work, the schemes have clearly helped protect jobs and household income and will likely encourage consumption as lockdowns are loosened. Despite these measures, we still expect unemployment to rise to 8.5% in 2020.
- Short-time work schemes are also likely to cost less than unemployment benefits to governments as the burden of lower economic activity is shared with firms. Plus, the schemes allow for a quicker economic recovery because they keep workers tied to their firms--therefore maintaining the productivity of the human capital and avoiding a large, permanent rise in precautionary savings.
- However, phasing out short-term work schemes as the economy recovers will prove difficult because some sectors, like tourism and hospitality, are likely to see a much slower recovery.

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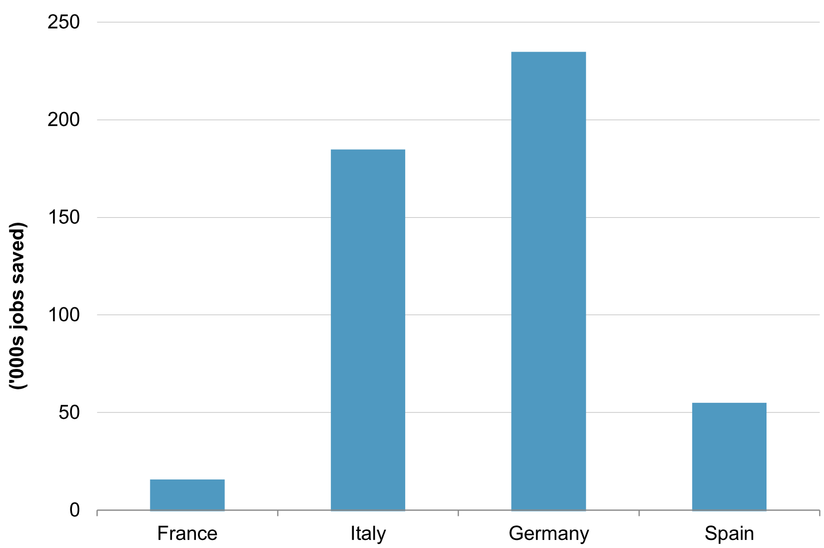
The U.S. unemployment rate has soared in the past two months, but has risen only moderately in Europe. What accounts for the difference? S&P Global Ratings credits the contained increase in European unemployment to the use of extensive short-time work schemes in the region's largest economies, as an alternative to massive layoffs, as lockdowns constrain economic activity. While the U.S. unemployment rate rose 11 percentage points in just two months to stand at 14.7% in April, in the eurozone it rose by only 0.1 point in March to stand at 7.4%. Regional data coming from Spain and Ireland suggest another increase in April, while the claimant count in the U.K. points to a rise in the unemployment rate of less than 2.3 points in April.

Germany, followed by a few other countries, introduced short-time work during the last financial crisis. The OECD estimates that these schemes saved half a million jobs in the four largest EU economies during that time (see chart 1). However, the coronavirus pandemic marks a turning point in the use of short-time work. Initially designed to manage fluctuations in demand in certain sectors of activity such as industry or construction, short-time work has been extended to all employees in all sectors, with much looser eligibility criteria. This is linked to the non-economic origin of the shock. Lockdown policies in European countries are largely viewed as temporary measures to reduce the spread of COVID-19. Before the crisis, the economy was not suffering from major dislocations.

Chart 1

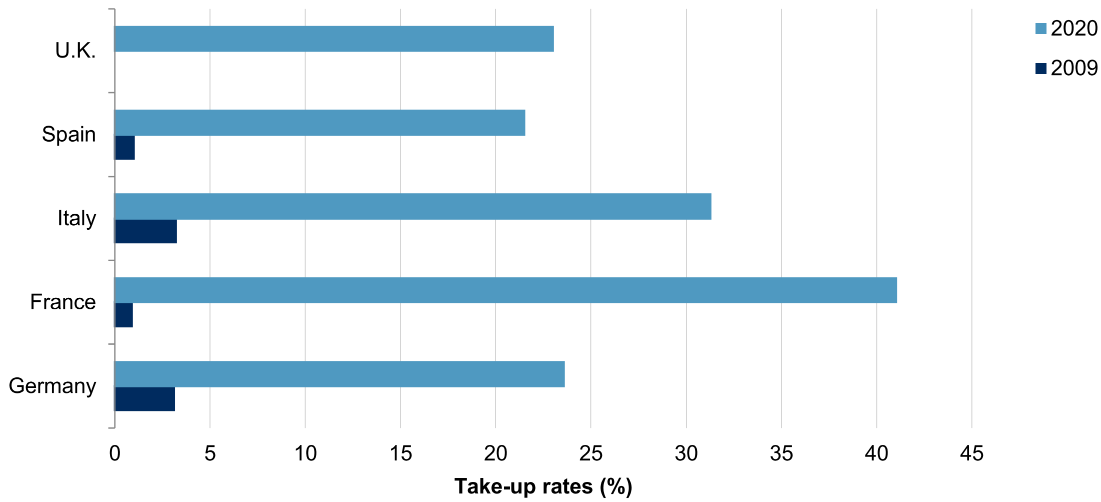
Short-Time Work Schemes Saved Close To Half A Million Jobs In The Four Largest EU Countries During The Financial Crisis



Note: These figures are an upper limit of the number of jobs saved, since they do not take into account jobs that would have been maintained even without the policy or those that would have been lost during or shortly after the end of the scheme. Sources: S&P Global Ratings, OECD.

Chart 2

Firms Have Been Quick To Use Short-Time Work; The Participation Rate Is Already Higher Than 27%, Far Above Level During Financial Crisis



Sources: S&P Global Ratings, national statistics.

The high participation rate in short-time work already exceeds 27% of the labor force, far above 2% during the financial crisis. That's not only because it covers all sectors, but also because of the amplitude of the shock—about one-third of economic activity has been lost under lockdowns and because services, a more labor-intensive sector than industry, are particularly affected. As a result, despite a 7.3% contraction in GDP in the eurozone, we expect a relatively small rise in the unemployment rate to 8.5% in 2020, only 1.1 points above its level before the pandemic (see "Europe Braces for a Deeper Recession In 2020," published on April 20, 2020).

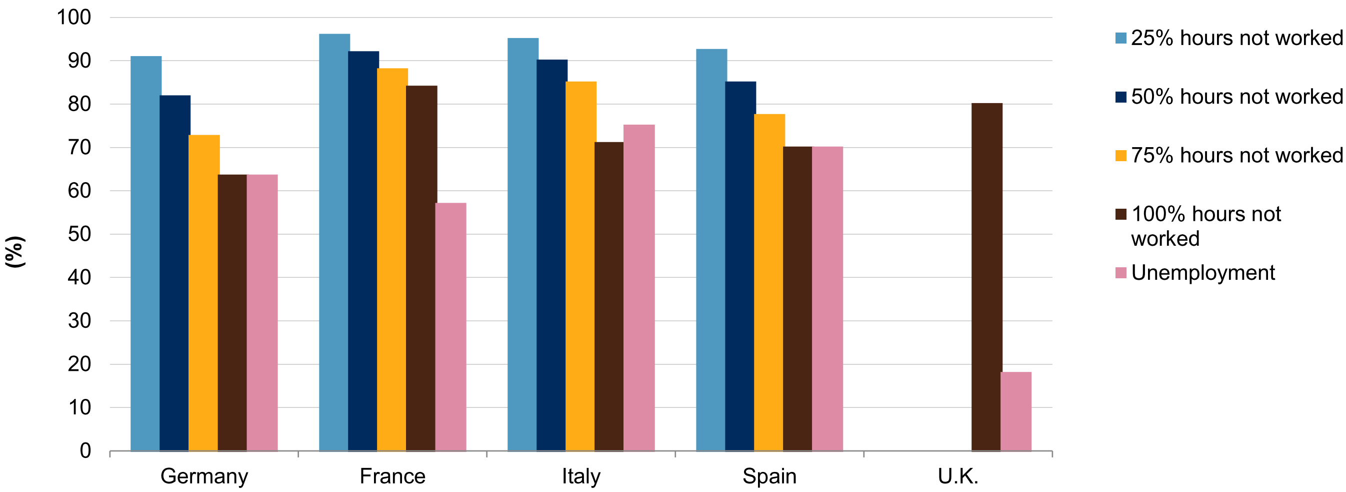
Short-time work schemes will support household income and consumption

In addition to saving jobs, short-time work schemes also help limit the drop in workers' incomes compared to unemployment benefits (see chart 3). In this way, they are more effective at supporting the liquidity of households, by helping them to meet obligations like mortgage payments. In a second stage, this will boost consumption when lockdowns are relaxed.

Short-time work also provides more job security, suggesting that consumers would less likely increase their precautionary savings during a crisis. As such, short-time income is likely to be higher than unemployment benefits as short-time workers obtain a full wage for the hours worked in their job. Meanwhile, the compensation for hours not worked under the state scheme is roughly equal to unemployment benefits in Spain, Italy, and Germany. In France, and most notably in the U.K., compensation for reduced hours is higher than unemployment benefits.

Chart 3

Short-Time Work Schemes Are Likely To Support Household Income More Than Unemployment Benefits
Income as a percentage of full wage



Sources: S&P Global Ratings, national statistics, S&P Global Ratings calculations for average national wages.

Short-time work schemes are likely less costly for governments

The cost of short-time work schemes in terms of public finances appears to be very high--€100 billion or more for the five largest European economies, but the cost would likely have been even higher if workers had been unemployed instead. As employees do work some hours under short-time work, the cost of reduced economic activity is shared between companies and the state. The greater the number of working hours maintained, the lower the fiscal cost compared with unemployment benefits. In Germany, Italy, and Spain, benefits for hours not worked are equal to unemployment benefits (see table). Thus, the cost of short-time work does not exceed the cost of a situation where workers would have received unemployment benefits.

Table 1

Short-Time Work Schemes Compared To Unemployment Benefits For Selected European Countries

	Unemployment benefits	Short-time Work Scheme Benefits
Germany	60% or 67% of the net wage depending on familial situation. Maximal allocation set at €2,805 for new landers and €2,625 for old landers.	60% of the missing net wage or 67% if the worker is parent. Allowance provided for monthly wages that do not exceed €6,500 in western Germany and €5,800 in eastern germany
France	57% of the reference daily wage (SJR) or 40.4%+12€ within the limit of 75% of the SJR. Maximum allowance set at €253 per day	84% of the missing net wage with maximal allocation set a €31.97 per hour
Spain	70% of the reference salary for the first 180 days and 50% from the 7th month. Maximal allocation set between €1,098 and €1,411 depending on familial situation	70% of the missing net wage. This allowance is capped at €1,098/month or €1,411 depending on familial situation
Italy	75% of the net wage, decreasing by 3% each month after the 4th month. Maximal allocation set at €1,328	80% of the missing net wage with maximal allocation set at €998 when the reference salary is lower €2,159 or €1,199 when the reference salary is higher than €2,159
U.K.	Lump sum, depending on the age of the person concerned: €65.80/week for a person under 25 years old and €83/week for a person over 25 years of age	80% of the net reference salary with a maximal allocation set at €2,500

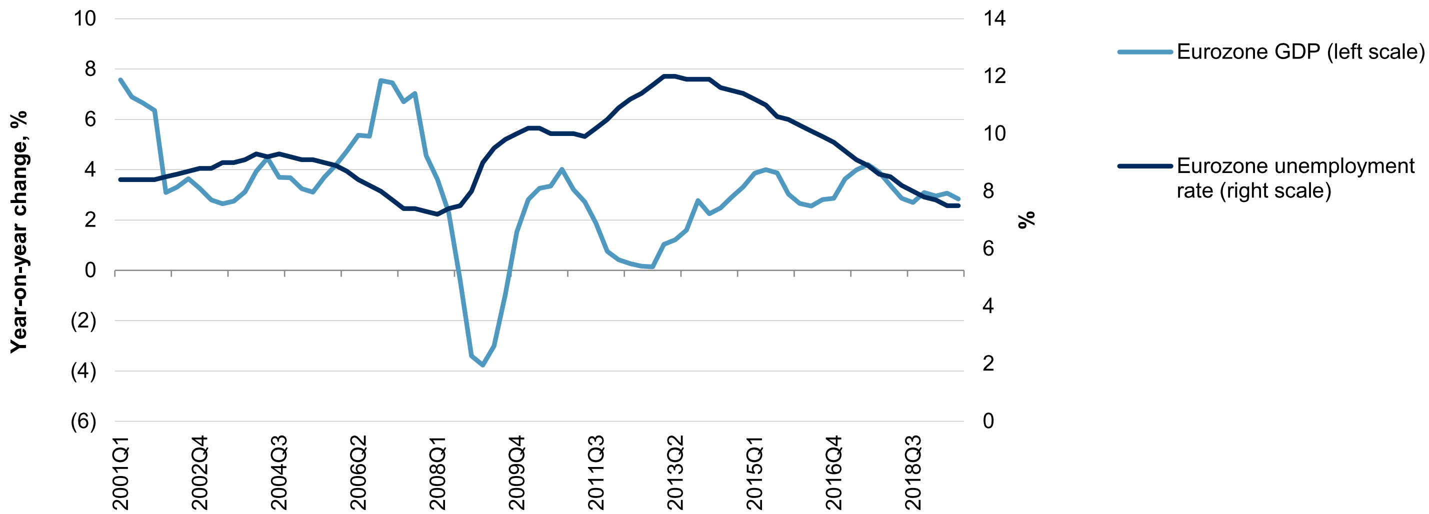
Sources: Unedic, national ministries of labor.

The trade-off is less clear cut in France and especially in the U.K. In France, hours not worked are compensated at a higher rate than unemployment benefits (84% against slightly more than 57% depending on the wage, see table). Still, for the cost of the scheme to exceed the cost of unemployment benefits, short-time workers would have to work on average less than 30% their normal hours. Meanwhile, the U.K. furlough scheme is more expensive, as it does not allow for reduced working time and is much more generous than unemployment benefits.

However, short-time workers are expected to return to work relatively quickly after lockdowns, while the unemployed are likely to remain without work for a longer period because job creation takes time (see chart 4).

Chart 4

When The Economy Is Expanding, The Fall In Unemployment Occurs With A Significant Time Lag



Sources: S&P Global Ratings, Eurostat.

Thus, even if short-time work schemes may cost more in the short term, costs are likely lower in the medium and longer term. This policy lays the foundations for a quicker recovery by keeping the link between employees and employers. Workers are not at risk of losing their skills, and both sides do not have to undergo a costly rematching process. This enhances the overall effect of the scheme while compensating for the higher short-term direct costs of the short-time work scheme for France and the U.K.

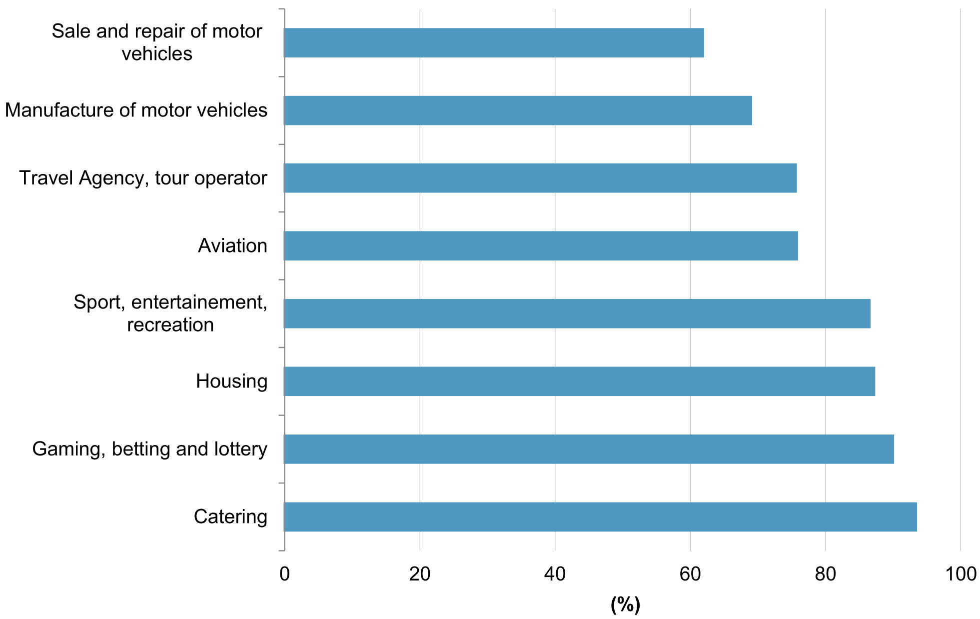
The efficiency of short-time work decreases as the economy recovers and for lower-skilled jobs

Although it is clear that large-scale use of short-time work is preventing a sharp rise in unemployment in Europe, it will become more costly and less relevant as activity picks up. When the economy recovers, firms will be increasingly able to retain viable jobs without public support, and the cost of retaining uncompetitive jobs will rise.

For sectors that will see a normal resumption of activity as lockdowns are loosened, short-time work schemes are likely to be gradually phased out. That said, the gradual loosening of lockdowns and the need for social-distancing measures suggest that some sectors such as transport, hospitality, and leisure will suffer from a slower recovery. Thus, a major challenge will be to maintain a system for safeguarding employment that does not hinder the reallocation of work to growth sectors. That's when conditional requirements will be more important. For example, during the financial crisis, some countries prohibited dismissals during or after the duration of short-time work, asked for a recovery plan, or demanded workers look for a job or get retrained during nonworking hours. Those measures reduced the chance that short-time work schemes kept jobs alive that were not viable without the subsidy.

Chart 5

Most Affected Sectors In Germany: Percentage Of Total Workforce On Short Time For Each Sector



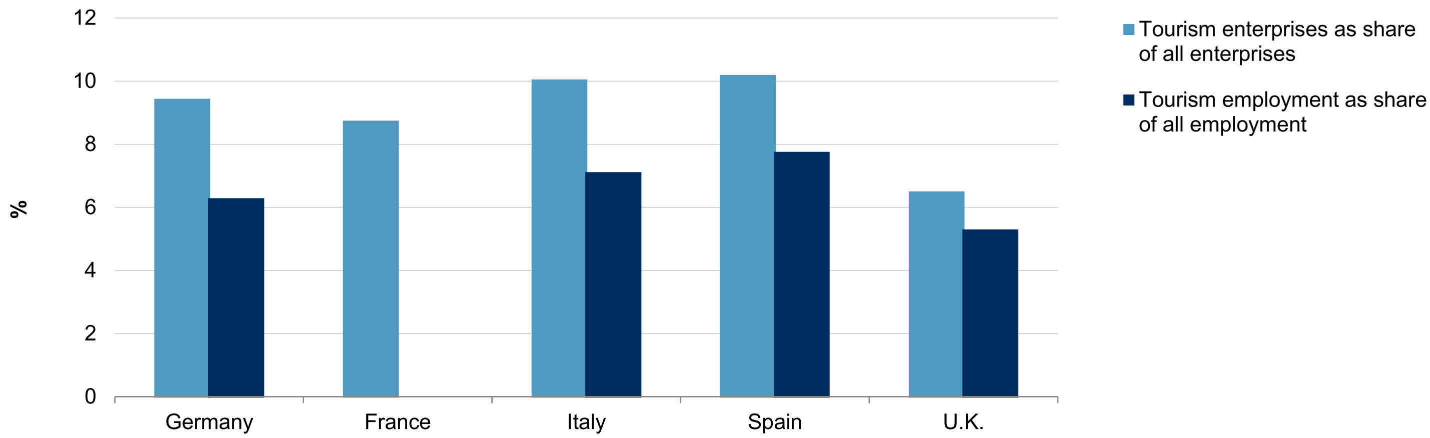
Sources: S&P Global Ratings, German Ministry of Labor.

Workers in the tourism sector will probably suffer the most from an early end to short-time work schemes, given that it will take many months before the sector can return to prepandemic levels of activity.

In view of the upturn in economic activity that has begun in recent days, some countries will certainly adjust their systems by limiting the number of subsidized hours of unemployment or by reducing the number of hours covered. The French government has announced that it will continue to subsidize jobs for companies closed by administrative decision. If the scheme were to disappear too soon, the rise in unemployment would be significant, as tourism employment comprises about 7% of total employment and about 9% of enterprises in the largest European economies (see chart 6). Even in Germany, tourism accounts for 3.9% of total gross value added, ahead of machinery and equipment manufacturing, retail, and financial services (according to Germany's Federal Ministry of Tourism Affairs).

Chart 6

Enterprises And Employment In The Tourism Industry In Selected European Countries, 2017

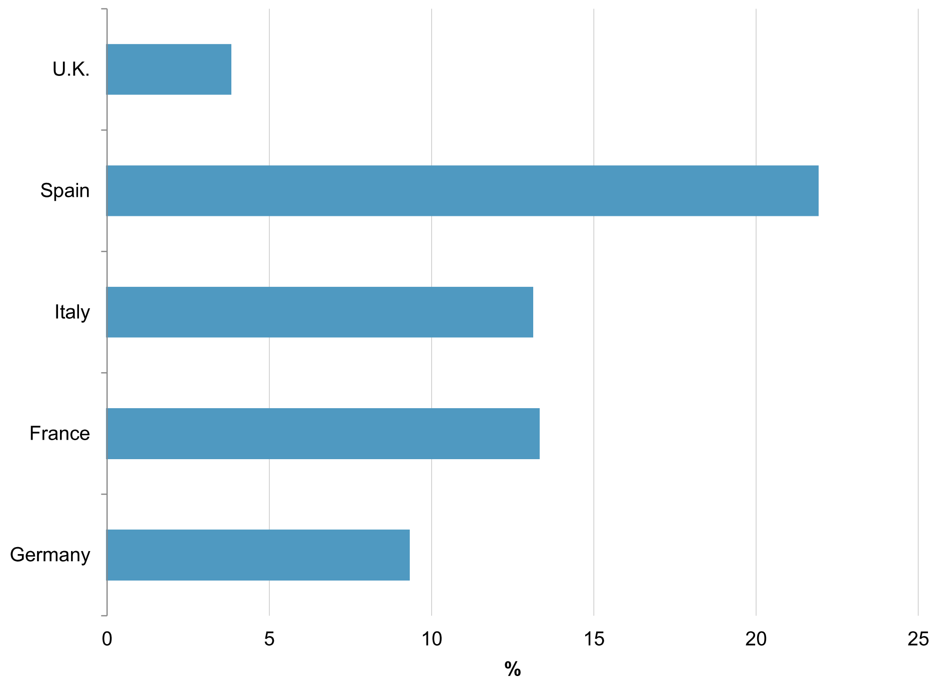


N.A.--Not available. Sources: S&P Global Ratings. Eurostat, S&P Global Ratings' calculations.

Meanwhile, compared with permanent workers, freelance and temporary workers are much less likely to benefit from short-time work. It is also more likely they will lose their jobs in a downturn as hiring and firing costs tend to be lower for workers in temporary jobs. Spain is the most exposed to this risk, with the highest share of temporary contracts (see chart 7). Therefore, we expect that country to see a larger rise in unemployment despite its short-time work scheme.

Chart 7

Temporary Contracts, Percentage Of Total Employment For Selected European Countries, 2019

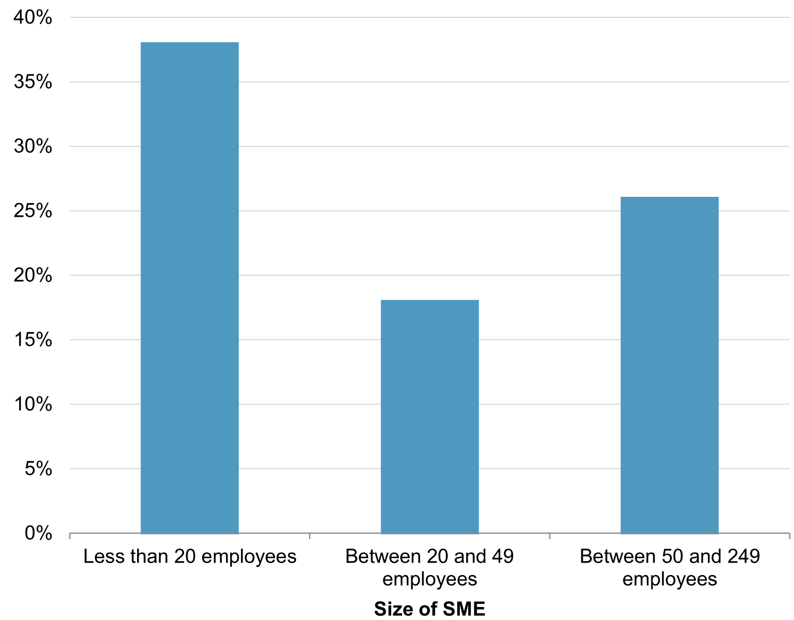


Sources: S&P Global Ratings, Eurostat.

It is also likely, as in the last recession, that many of the jobs retained by the scheme will be lost when it's phased out. The rate of conversion into unemployment is typically much higher than for other workers: In France after the financial crisis, a short-time worker was twice as likely to become unemployed than a worker not covered by the scheme, according to Dares Analyses (January 2012, No. 004). However, it is not clear how high this rate will be during this downturn, as it will depend on the duration of the scheme, access to credit for small and midsize enterprises, and how and when activity recovers (in France, 57% of requests for reduced working hours come from firms with fewer than 50 employees and limited access to credit, see chart 8).

Chart 8

SMEs Account For More Than 80% Of Short-Time Work Requests In France, With 38% Coming From Firms With Less Than 20 Employees



SME--Small and midsize enterprise. Sources: S&P Global Ratings, DARES, French Ministry of Labor.

The longer lockdowns last, the more likely it is in any case that firms lay off their workers, as there exist many kinds of financial burdens for closed businesses during lockdowns. According to the business impact of the coronavirus according to a U.K. survey (BICS, released on April 23), only 60% of businesses were confident they had sufficient financial resources available to survive the economic fallout from the pandemic.

This report does not constitute a rating action.