Box 1. Labour market adjustments. Where do short-time work schemes fit in?

The COVID-19 sanitary crisis and the measures taken by the authorities to contain its spread led to significant contractions in GDP, likely to entail, sooner or later, the necessary labour market adjustments. Implementing schemes to support the economic agents (both firms and employees) affected by the new economic reality was one of the priorities of the public policies adopted at the peak of the crisis. However, their long-term suitability and sustainability are becoming a concern, especially given that the degree of uncertainty about the path to recovery in activity to pre-pandemic levels remains extremely high, as there is a risk that resources could be allocated inefficiently.

In Romania, authorities opted for measures encouraging job retention, offering financial support to firms in the economy. This approach is in line with the general trend observed at European level, i.e. resorting to short-time work schemes, which is essentially a social security system wherein employers are allowed, for a limited period of time, to adjust their labour force along the intensive margin in case of a recession. This implies a partial or total decrease in the number of hours worked (suspension of employment and furlough) and maintaining the payroll in both cases until the shock has been overcome. The benefits of workers covered by these programmes are generally established as a percentage of wage and are supported by the state. Their objective is to avoid layoffs (adjustment along the extensive margin) as much as possible and to mitigate employees' loss of income, concurrently with adapting the working hours to unfavourable demand conditions, with the benefit of maintaining the labour force that is already skilled and familiarised with the firm's operations. Therefore, companies can retain human capital, avoiding the costly layoff process during a recession, followed by re-employment and training in the recovery phase.

This box aims to provide a brief overview of the short-time work schemes implemented in Europe amid the pandemic, of the theoretical bases and reasons that determined firms to resort to this strategy of labour force adjustment, as well as of the advantages and disadvantages they imply.

Labour market adjustments

Initially, economic theories assumed economic agents' preference to adapt their production process to short-term demand fluctuations by changing the labour quantity, given that capital is fixed and difficult to adjust. In time, it has been proven that, when a shock occurs, firms are inclined to first resort to the intensive margin, i.e. to lower labour utilisation. The extensive margin, namely labour force adjustment via job destruction, is fallen back on only after a certain period of time, when firms perceive the changes in activity to be permanent, because this strategy may prove to be more costly (expenses incurred by the firing process, followed by the search, employment and training of new employees). One implication of this reality is that companies' strategy to adjust labour along the intensive or extensive margin depends on the flexibility of the labour market, which, in turn, is influenced by the institutional architecture and by the structure of each economy. The third significant strategy available to companies, namely wage adjustment, is more difficult to

put into practice, amid the downward rigidity of this income, caused both by institutional factors, such as the minimum wage policy or the coverage of collective agreements, and by economic factors, referring to the negative impact of wage adjustments on labour productivity.

Although labour market flexibility is an oft-discussed topic, it is still a rather vague concept. The definition proposed by Pissarides (1997) brings to the forefront the capacity and speed of the labour market to absorb shocks, which are the most often assessed based on employment developments. For instance, the gradually increasing flexibility of the US labour market (less stringent regulations for the hiring and firing process) led to a change in the behaviour of economic agents over the past decades, the adjustment of labour to shocks via the extensive margin (layoffs) becoming prevalent and fairly fast (Fernald, 2015). From this standpoint, the coordinates are different on the European labour market, where the accent falls on "flexicurity" measures, aiming at combining employers' need for flexibility with the need for job security, which is important for employees. Thus, at least in the short term, European firms choose, to a significant degree, a strategy for decreasing labour costs via the intensive margin (reducing working hours).

How the labour market adjusts to shocks can have implications for the magnitude and duration of the business cycle, as well as for the potential output[1], the latter influence in fact motivating the use of short-time work schemes, assuming that these would mitigate the hysteresis effects[2]. However, their miscalibration may hinder the efficient allocation of resources in the economy, limiting the transfer of labour from less productive firms to the best performing ones and from sectors where fundamentals would justify a contraction to those that, for similar reasons, should witness an expansion.

Short-time work schemes at European level

Short-time work schemes were already well-established in countries such as Germany, Austria, Belgium or Switzerland, yet the fast spread of the COVID-19 pandemic and the awareness of potential unfavourable effects on economies led to them being implemented at a large scale in the EU. Extremely relevant for this decision was the prospect of financial support offered by the European Commission under the SURE programme (Temporary Support to Mitigate Unemployment Risks in an Emergency). This temporary instrument will have at its disposal approximately EUR 100 billion, will remain operational until 31 December 2022 (with a possible extension as needed), and will offer credit to national short-time work systems under favourable cost conditions.

Hence, in Europe[3], the number of employees for whom applications for short-time work were submitted exceeded 50 million, with over 42 million in EU-27 (2020),

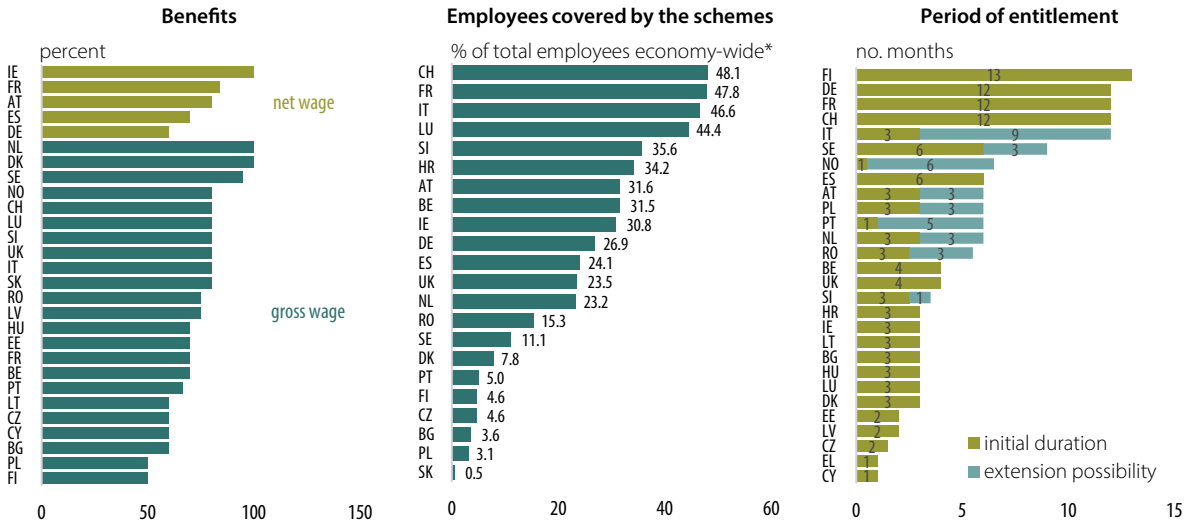
1 The box mainly discusses the economic behaviour specific to the private sector, yet it should not be overlooked that, from the perspective of the whole economy, the response of the public sector is also important. Usually, it is more rigid in adjusting labour costs in the event of negative shocks at aggregate level (although public income is also affected), a behaviour which may lead to demonstration effects on the private sector and possibly to hampering the process of economic recovery.

2 The extension of an individual's job seeking period decreases the chances of success, as a result of skill deterioration of said individual and loss of contact with the labour market, as well as of the changes in firms' requirements.

3 EU-27 (2020), United Kingdom and Switzerland.

thus reaching a historical high. Although the schemes' objective is the same in all countries, there are differences in the manner of implementing them, which mainly concern the benefits granted (the minimum and maximum amount, the percentage of net or gross wage, which varies depending on country and duration), the period for the application, as well as eligibility (circumstances allowing firms' access to such schemes[4]) (Chart A).

Chart A. Characteristics of short-time work schemes in Europe during the COVID-19 crisis



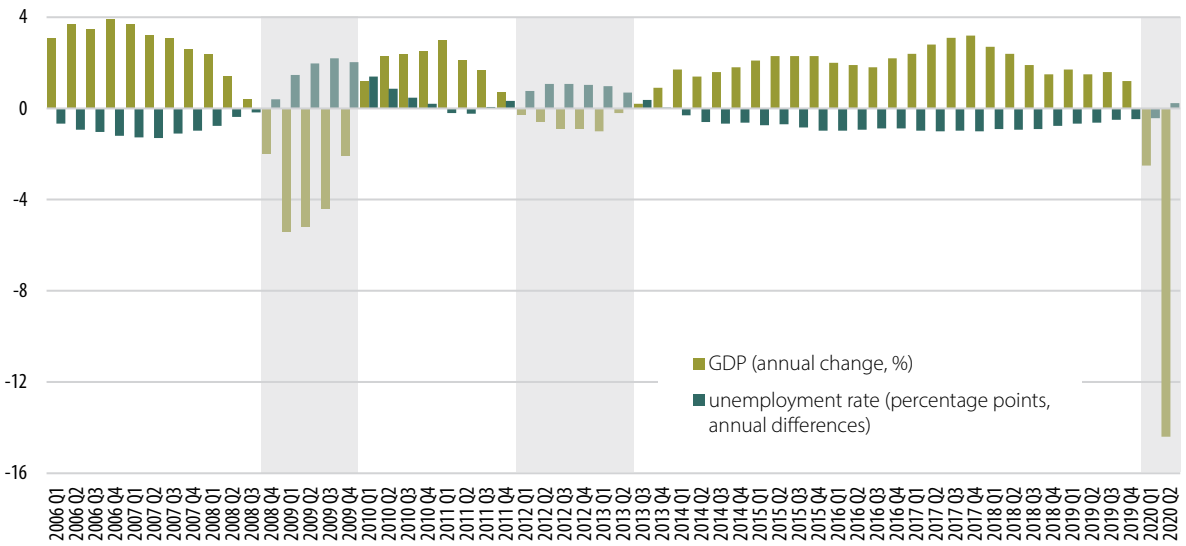
*) according to the EU labour force survey (LFS)

Source: ETUI Policy Brief No 7/2020, NBR adaptation

Implementing such schemes at EU level hindered the rise in unemployment rate in the critical phase of the crisis, unlike at the beginning of the previous recession, when these programmes were not used as intensely, and unlike other countries where such practices are rarer (Charts B and C). In the latter case, worth looking at is the response of the US, which in this period relied largely on the unemployment insurance system, whose coverage and amount of benefits have been recently supplemented, insofar as some of the unemployed received higher income than that when employed, which may affect their motivation to seek a job. Companies' different strategies for labour adjustment basically indicate their adapting to market characteristics where they conduct activities (institutional architecture, legal framework, economic structure), and the effectiveness of each approach depends mostly on the nature of the shock: transitory or persistent. Economic recessions triggered by temporary exogenous shocks usually require a limited reallocation of resources, where job retention policies can be a more appropriate action for both protecting employees and ensuring the quick resumption of firms' activity when the shock fades out. Conversely, if shocks impose a considerable reallocation of production factors, implementing such strategy may prove unviable in the long term, and it is preferable to resort to the unemployment insurance system, which facilitates resource optimisation.

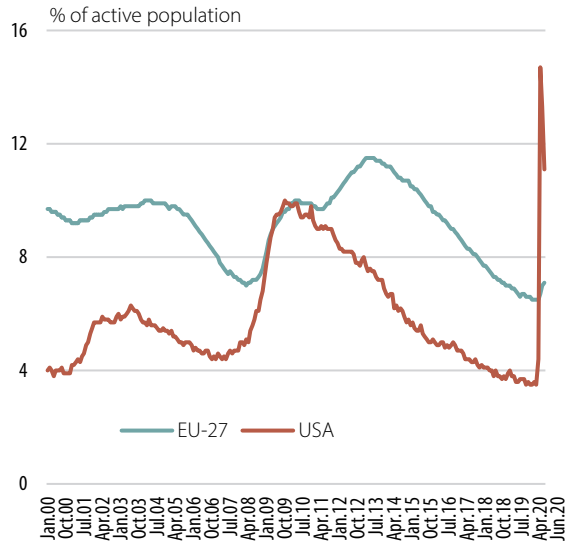
4 For further details, see ETUI Policy Brief No. 7/2020.

Chart B. Developments in GDP and unemployment rate in EU-27



Source: Eurostat, European Commission, NBR calculations

Chart C. Unemployment rate: EU vs. US



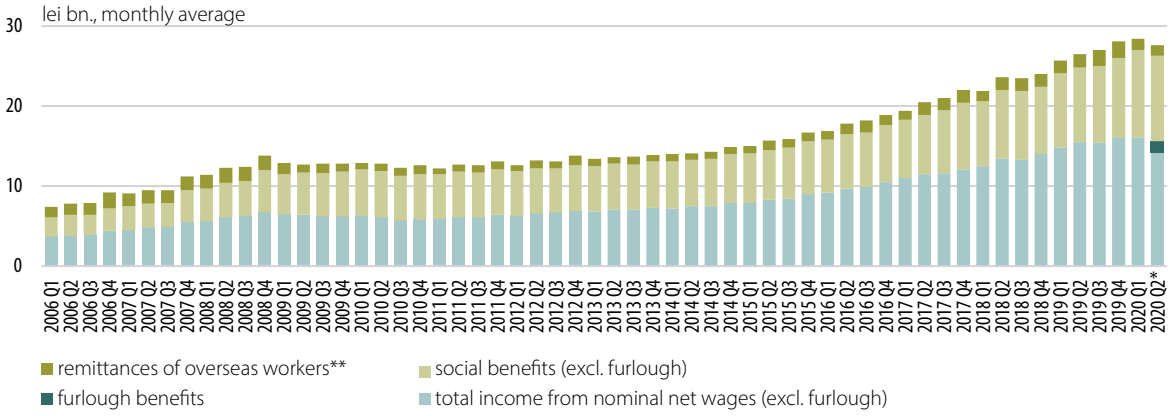
Source: Eurostat, OCDE

In Romania, more than 1 million employees (approximately 15 percent of employees economy-wide[5]) had their contracts suspended in the period from 16 March to 1 June 2020, taking advantage of this support scheme, wherein they received 75 percent of gross wage, however without exceeding 75 percent of the average gross wage economy-wide (the benefits are subject to social and health insurance contributions and to taxation). Specifically, wages recorded a downward adjustment, yet the support provided by the state to sustain disposable income, by preserving incomes and payrolls as much as possible, cannot be neglected, the data published by the Ministry of Public Finance showing that in April-May, approximately lei 2.3 billion were granted for paying employee benefits and another lei 400 million for other professionals and persons with individual labour agreements who stopped their activity in the critical period of the crisis (Chart D). Short-time work schemes may play the role of a fiscal stabiliser, mitigating the consumption shock via the financial resources injected by the state into the economy. In theory, such countercyclical policies are recommended during a recession, yet it should be taken into account that the government's intervention is conditioned by the existence of fiscal space, and the procyclical fiscal stance practised in Romania over the past years might bring again to the forefront the implications

5 According to the EU Labour Force Survey (EU LFS).

for public debt sustainability that this budgetary effort may have. At the same time, reducing income uncertainty can be an additional mechanism via which this measure contributes to alleviating the adverse effects of the COVID-19 pandemic on household expenditures and, implicitly, on aggregate demand.

Chart D. Developments in households' income in Romania



*) Apr.-May

**) net values starting with 2013 Q1

Note: Households' income is an NBR estimate of households' own monetary resources, based on the monthly series of average net wage earnings and the number of employees in the economy, social benefits expenditure and remittances of workers from abroad.

Source: NIS, MPF, NBR, NBR calculations

Looking ahead, the Romanian authorities extended the support measures beyond 1 June, and will pay 41.5 percent of the wage for three months for employees whose labour agreements are reactivated after being suspended at the beginning of the crisis. Moreover, a monthly stimulus was approved to be granted for one year, accounting for 50 percent of the employee's wage, but not exceeding lei 2,500, for hiring persons over 50 who lost their job during the state of emergency/alert, as well as young people between the ages of 16 and 29 registered as unemployed, and Romanian citizens who returned home after losing their jobs abroad. Subsequently, steps were taken for implementing a flexible work schedule for a limited time, wherein the state would pay much of the wage difference resulting from the fewer working hours, financed via the SURE programme. It should be mentioned that these facilities (both those already in effect and those under discussion) cannot be cumulated for the same employee.

A series of studies in the literature have shown that the short-time work schemes implemented in Germany in the previous recession had favourable effects on employment. This was illustrated by the results of Balleer *et al.* (2013) or Hijzen and Martin (2013), who assess that the schemes saved between 466,000 and 580,000 jobs, i.e. around 1.3 percentage points of the unemployment rate, or an employment rate higher by 2 percent than it would have been had this instrument not been used. By contrast, Cooper *et al.* (2017) show that there have also been negative consequences for the efficient distribution of employees on the German labour market, the output losses being estimated at approximately 1.5 percentage

points of GDP. Therefore, in order to mitigate the negative effects, it would be preferable to create a mechanism wherein firms would cover an increasingly significant part of costs, depending on the duration of participation in the programme, as the economy follows the upturn of the business cycle (Hijzen and Martin, 2013; Cahuc and Carcillo, 2011).

While initially the pandemic shock was perceived as temporary, the latest data suggest a prolonged health crisis (beyond the short-time horizon), with a high potential to produce/accelerate structural changes in economic activity globally. Hence, resorting to these support schemes may not completely yield the desired effect, as not only are they costly to maintain for a longer time horizon, but they may also be counter-productive, being likely to affect the efficient allocation of resources in the economy, which implies labour force migration towards firms and industries with more favourable growth prospects. For example, it is possible that the restrictions applied in certain fields – such as tourism, international passenger transport, food service – would persist longer, and consumer demand for these products would not recover any time soon. Concurrently, the sectors/companies with business models compatible with social distancing, such as online trade, courier services, activities than can be carried out at a distance using technology, or the health sector have a high growth potential. Therefore, apart from the measures already implemented for maintaining the labour force in the short term, it is desirable to have active policies capable of favouring a smoother transition to the new economic reality. These may be in the form of professional retraining programmes, training or facilitating the reallocation/optimisation of resources by developing online platforms meant to reduce labour market frictions and to ease the recruitment process and the matching of candidates with job vacancies.

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