POLICY POINT

Short-time work to maintain employment

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Policy objective

The Covid-19 outbreak is quickly developing into an economic crisis. Maintaining employment and the ability of firms to recover quickly when the crisis abates is critically important given that labour markets in several European countries are yet to fully recover from the Global Financial Crisis (GFC) of 2008.

The Government has already taken steps to avoid this happening in New Zealand including multiple measures to help both firms and workers, including wage subsidies. These initially included wage subsidies of $585.80 per week for a full-time worker and $350.00 for part-time workers, limited to 12 weeks per employee and $150,000 per firm. Funding for these wage subsidies has now increased to over $9 billion.

However, these wage subsidies may not be the most efficient way to preserve jobs. Subsidies will likely flow to firms that do not need them and are an insufficient incentive for large struggling companies to continue operating due to the small size of the subsidy cap in relation to their total wage bill. A superior policy, known as short-time work (STW) has been credited with success in Germany during the GFC. This policy is now common among OECD countries and should be considered in New Zealand as a way of allowing certain firms to reduce costs above what is possible with current wage subsidies and better preserve employee-employer links.

What is STW?

Short-time work provides wage subsidies to firms, under certain conditions, to reduce their employees' working time rather than laying them off. In Germany for example, firms may apply to the Federal Employment Agency if they expect demand for their goods or services will be significantly below the norm. Upon approval, the firm can then reduce the working hours and wage payments of its employees by up to 100%. The Government then pays short-time allowances to affected workers to partially compensate for their wage loss, generally about two-thirds of the net wage loss depending upon family circumstance.

Larger firms - where a greater proportion of employment resides - are likely to find a STW scheme particularly beneficial. For example, a hotel with 200 employees running at 20% occupancy could reduce everyone's working hours to 20% and let the Government compensate the employees for a share of the rest. During a crisis, the hotel would need fewer cleaners, receptionists and chefs. When the crisis is over, employee hours can be lifted again as the hotel's operations ramp up, or even at a limited capacity during the crisis. Under the Government's current model, wage subsidies are unlikely to be enough to convince the owners to keep many workers on. As a result, they may choose to lay off all staff which would make restarting the business significantly harder.

The main purpose of STW schemes is to avoid excessive loss of jobs among workers during an economic downturn, especially where those jobs would have been viable in the

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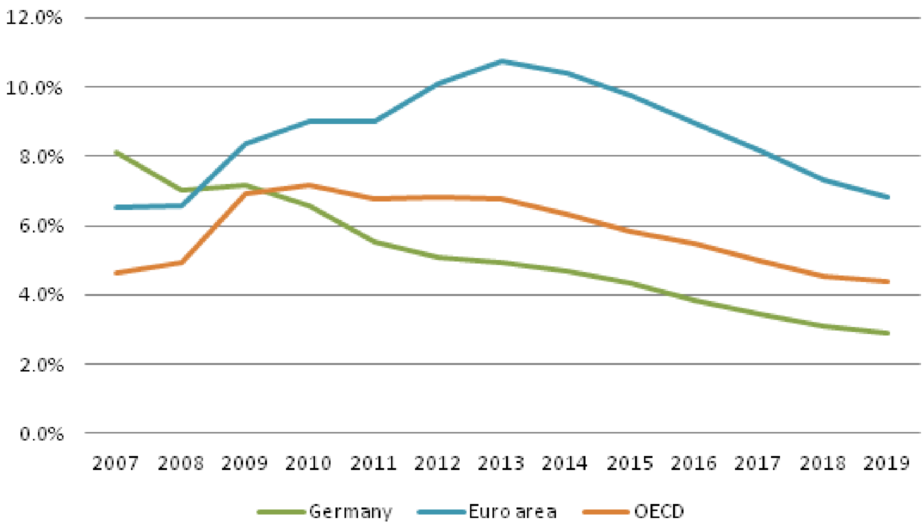
long-term. However, an additional benefit of STW schemes is that they improve equity by sharing the burden of adjustment more equally across the workforce.

Is STW effective?

Across the 25 OECD countries which had STW during the GFC, take-up increased from very low levels to over 1% of dependant employment in 2009, but vary significantly across countries. In Germany for instance, 4-5% percent of the workforce was covered by STW with an average working time reduction of 28%. Germany experienced only modest unemployment during the 2008 crisis compared to its loss in GDP and the unemployment increases of peer countries, especially given its relatively high initial level (Figure 1).

The Institute of Labour Economics (IZA) conducted more sophisticated empirical studies to assess the efficacy and potential benefits of STW schemes.

Figure 1: Unemployment rate of over 25's, 2007 to 2019



One such study uses data on 23 OECD countries between 2004 and 2010 considering differences in institutional settings across countries affecting the relationship between labour market outcomes and output. The study indicates increased flexibility in working hours from STW helps preserve jobs during a recession. The largest positive impacts were observed in Germany, Italy and Japan with employment numbers estimated to have been, respectively, 580,000, 130,000 and 445,000 higher in the second half of 2009 than without a STW scheme.

Two additional and more recent studies focused in greater detail on the experience of Germany and France. With respect to Germany, the STW became more efficient as the severity of the economic crisis rose, saving up to 0.8 jobs per short-time worker. However, this fell to 0.5 in a normal recession. When quarterly growth in GDP is above 0.5% the effect of STW on employment may even be negative.

In France, estimates suggest that for every worker on short-time work, 0.2 jobs are saved overall. However, while STW was a boost for employment and the survival of firms facing dips in revenue, there was no effect for other firms. Nevertheless, despite windfall gains to some firms in the form of subsidies for non-threatened jobs, the cost per saved job was estimated to be low, at 7% of the average labour cost in 2009.

The importance of good design

The design of STW schemes can also have a significant impact on their effectiveness. Ideally their timing would be limited to ensure they do not impede employment growth once a wider economic recovery commences. They would be most efficient, in terms of minimising the cost per job saved, if targeted at firms experiencing financial constraints due to significant revenue loss. However, this would then heighten the importance of good monitoring and enforcement of the rules of the scheme to ensure firms do not take advantage of subsidies to which they are not entitled.

Consideration should also be given to the conditions placed on both individuals and firms participating in the STW. For instance, it might be appropriate to require firms which place workers on the scheme to agree to maintain their employment for a certain time even after STW subsidies are no longer being received. Similarly, some countries require short-time workers to participate in various forms of education and work testing to ensure resources are matched to their most productive use, though in the New Zealand's situation these conditions might need to be applied creatively.

Conclusion

As New Zealand heads into a severe recession, policymakers are rightly implementing myriad measures to support people and firms over the coming months. Nevertheless, there remains plenty of room for better policies. One of those policies is a well-designed STW scheme. The programme should be carefully considered by the Government by assessing the lessons learnt in its application in other countries.