

## Unemployment Insurance and Short-Time Compensation in the US and abroad

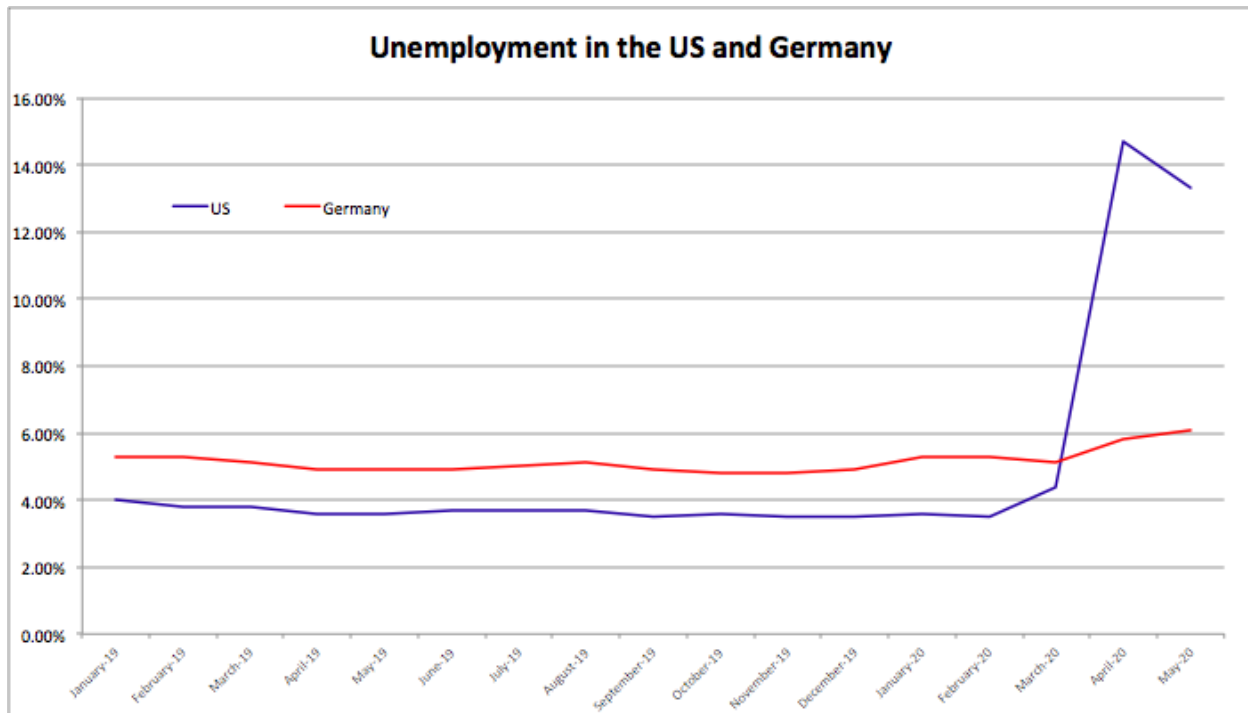
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Original post [here](#).

To address the COVID-19 pandemic, governments around the world recently placed restrictions on business activities, in many cases ordering non-essential businesses to close and workers to stay at home. In many countries this led to a rapid decline in labor demand. In the US the Bureau of Labor Statistics (BLS) reported the highest unemployment rate since the Great Depression in April with a national rate of 14.7, an 11 percentage point increase from the historical low of 3.5 percent reported two months before. Nevada reported the highest rate in the country at 28.2 percent, up from 6.3 percent in March, while the lowest rate was reported in Connecticut at 7.9 percent, still more than a twofold increase from 3.7 percent reported in March. In May, the labor market began to show the first signs of recovery as some states reopened their economies; the unemployment rate dropped to 13.3 percent.

Initial jobless claims across the nation peaked at 6.8 million during the [week ending March 28](#), ten times higher than the numbers reported at the height of the 2007-2009 global financial crisis (GFC). Between March 1 and April 30, a total of 28.5 million new claims for unemployment insurance payments were filed. Unemployment insurance provides workers who involuntarily lose their jobs with replacement income based on previous earnings; amounts and terms of benefits vary across states, which fund the benefit. In many states, mass layoffs due to the lockdown resulted in overwhelmed unemployment systems and significant delays in payments. The CARES Act sought to address some of these shortcomings by expanding state unemployment benefits and adding a weekly payment of \$600.

At the same time, many European countries did not experience a similar surge in unemployment as a result of their lockdown. In May, Germany's unemployment rate stood at just 6.1 percent, up from 5.1 percent one month earlier, a stark contrast to the US numbers as shown in the chart below. The country has avoided mass layoffs by relying on its Kurzarbeit or short-time work scheme to maintain workers employed through the downturn. Kurzarbeit allows employers to reduce employees' hours and compensation while maintaining them on payroll; employees then receive government benefits to compensate for the wage reduction. Since March, the [German federal labor agency](#) has received applications to participate in the program from over 750,000 employers, potentially covering 10 million workers. Similar work-share programs exist in other European countries and are also being heavily used during the current downturn.



Note: The unemployment rate in Germany is reported by the Federal Labor Agency (Bundesagentur für Arbeit). The agency does not follow international guidelines defined by the International Labor Organization (ILO) and typically produces estimates above ILO levels. The most recent estimate available rate using ILO standards is 3.1 percent, reported in December 2019.

Short-time compensation (STC) programs that operate similar to Germany’s Kurzarbeit are in place in 26 states and the District of Columbia in the US. However, these programs have not encountered nearly as much utilization as abroad, with American employers resorting to layoffs and furloughs instead. This post discusses different unemployment systems and their use during economic downturns. The discussion is structured in 4 parts:

1. An overview of STC policies implemented in the US and abroad
2. A discussion of the benefits of STC during economic downturns
3. An overview of STC in recent legislation in the US
4. A discussion of the use of STC in the US

#### 1. STC policies in Germany and the US

STC allows employers to keep their employees on payroll in times of low demand. Under the program employers decrease an employee’s hours by a certain percentage and provide wages in proportion to the hours worked; employees then receive government benefits to offset a portion of lost wages. Different programs can be distinguished by the application process for employers, the calculation of benefits to be paid, restrictions placed on minimum and maximum adjustments to hours worked, and the maximum duration of the program.

[German](#) employers are required to document the cause of a decline in labor demand and submit a justification to the local employment agency; over 163,000 employers did so in March, 587,000 in April. Once the reduction has been approved, companies can apply for STC benefits that replace 60 percent of lost wages for employees working fewer hours, employees with children collect 67 percent of lost income. To be eligible, at least one third of a company's workforce needs to face a decrease of at least 10 percent of hours worked. However, there is no upper bound on the reduction, employers can decrease hours by up to 100 percent.

In response to the COVID-19 pandemic [German authorities](#) have expanded the program. In particular, the minimum reduction to be eligible for STC has been lowered to a 10 percent reduction for one tenth of the workforce, instead of one third. Additionally, the replacement rate for hours lost has been increased to 70 percent after employees received STC for three consecutive months and 80 percent after six months (77 and 87 percent for workers with children). Introduced almost a century ago, the German policy served as a model for many STC programs introduced in other European countries.

US states were first authorized to implement similar STC programs under the Tax Equity and Fiscal Responsibility Act of 1982. Currently 26 states and WDC have a STC program in place. Essentially these programs are designed to fulfill the same purpose of maintaining workers on payroll through a downturn. Employers submit an [application](#) to the state's Department of Labor including a breakdown of the hours to be worked by each employee. If the application is approved, workers collect wages in proportion to hours worked and weekly unemployment benefits in proportion to hours lost. An employee whose hours have been decreased by 20 percent will thus collect 80 percent of his full-time wages and 20 percent of the unemployment benefit he would have been entitled to had he been laid off.

All programs impose a minimum decrease in hours worked to be eligible for the program. Most states require hours to be decreased by at least 10 percent, although some require a 20 percent decrease. Moreover, in most states, hours cannot be decreased by more than 40 percent; a few states allow decreases of up to 50 or 60 percent. In response to the COVID-19 pandemic, some states have loosened these requirements. Arizona and Michigan both recently extended the upper bound on reduced hours to 60 percent.

In the US, usage of STC programs has historically been limited. The dominant system is the unemployment insurance system under which eligibility for benefits is contingent on the loss of employment. The amount and duration of payments vary widely across the 50 states and WDC, with many maximum benefits capped at a level that would be below 100 percent of lost income for many workers.

## 2. STC during economic downturns

By protecting workers from layoffs STC programs can prevent an increase in unemployment in the immediate aftermath of an economic shock, as reflected in the recent unemployment data discussed above.

If successful, STC programs can alleviate many of the costs of unemployment and offer advantages to both employers and employees. The policy can prevent skill erosion for workers as they maintain part-time employment. Maintaining ties with an employer can also protect workers from psychological costs related to unemployment and prevent discouragement by eliminating the need to engage in a costly job search process following the downturn. Finally, in

countries like the US, where many benefits including healthcare are tied to employment, maintaining these benefits can prove crucial for workers and their families. For employers, the policy eliminates search and training costs during recovery. STC also allows employers to flexibly increase their workforce to meet demand as the economy recovers. STC programs in most states allow employers to adjust each worker's hours on a weekly basis.

However, the critical question policymakers must answer is whether STC can prevent job destruction in the long run, rather than just postpone layoffs. Empirical evidence collected from programs used in Switzerland, Italy and France during the GFC indicates that the answer depends on the type of shock firms are facing. STC systems implemented in these countries are similar to the German *Kurzarbeit*, providing employees with a certain percentage of wages lost.

[Switzerland](#) entered the GFC with strong employment and GDP growth, before facing a short V-shaped recession in the final quarter of 2008 and the first half of 2009. The downturn mostly affected exporting firms faced with a decrease in global demand, the recession was milder in domestic sectors. Under these conditions, evidence suggests that the wage subsidies paid under the STC program contributed to preventing permanent layoffs by allowing firms to maintain workers on payroll until global demand recovered.

The conclusions are different for the STC program implemented during the same period in [Italy](#). Evidence from Italian firms indicates that the policy had a large short-term effect on employment but did not prevent layoffs in the long run because firms with low levels of productivity prior to the recession were significantly more likely to select into the program. The authors of the study also measure the policy's effect on reallocation in the labor market. Since participating firms have the ability to hold on to workers through a downturn, the policy can limit non-participating firms' ability to hire, preventing the correction of imbalances and potentially leading to labor market inefficiencies.

In [France](#), researchers conclude that the policy preserved employment during the recession. However, only about 1 percent of French firms participated in the program at the height of the GFC, limiting the program to a small segment of the economy and preventing a larger effect on labor market reallocation.

Overall, the literature suggests that STC is an appropriate tool for firms forced to lay off workers due to a temporary deterioration in conditions. The policy can prevent costly layoffs for firms experiencing a temporary decrease in demand or credit and liquidity constraints. In cases where an activity is not viable in the long run, STC can only postpone layoffs and may have the harmful effect of limiting or delaying workers' transition to more productive sectors of the economy.

The current global downturn is a result of various lockdown policies implemented by governments to prevent the spread of COVID-19. As such, it provides a textbook example of a temporary downturn resulting from an exogenous shock, rather than an internal imbalance requiring some form of market correction. Currently European economies with a tradition of providing STC to their workers during downturns boast unemployment rates vastly below the rates reported in the US. Although these are still short-term effects, given the nature of the crisis, we can expect these policies to produce a stable labor market as countries exit the lockdown and re-open their economies.

### 3. STC in recent US legislation

STC has recently received renewed attention from policymakers in the US. Under the expanded unemployment protection in the CARES Act, the federal government covers all payments made to workers under an STC program until December 31, 2020. This offered a strong incentive for states to promote the use of STC over conventional unemployment insurance as these benefits are not covered under the Act. However, as the discussion below shows, this incentive had no sizable effect on participation in the program. In addition to the benefits distributed under their state's STC program, workers are also eligible for [the full \\$600 per week payment](#) provided under the Federal Pandemic Unemployment Compensation (FPUC) while on STC. Under these conditions a worker's income under STC will almost certainly be higher than their full-time compensation. The expanded benefits under the Act thus would provide more than a replacement of lost wages. In the context of STC, the FPUC can be seen as a measure to stimulate economic activity by temporarily increasing the purchasing power of individuals who receive it, similar to the \$1200 direct payment made to all individuals.

The HEROES Act passed in the House and recently introduced to the Senate would extend full federal funding for STC benefits until January 31, 2021. The CARES Act also provides incentives for states without STC to roll out a program. Per the Act the Treasury will fund half of the benefits distributed under a newly implemented STC program until December 31, 2020. The HEROES Act proposes to extend this date to January 31, 2021 as well.

The Paycheck Protection Program (PPP) of the CARES Act is another program intended to replicate some of the benefits of STC for workers employed by small and medium enterprises (SMEs). Although the program excludes large firms with 500 or more employees and/or revenue above \$1mn, the program has the potential to affect employment outcomes for a large sector of the economy as [49.2 percent of private-sector jobs](#) are provided by SMEs. The program, operated by the Small Business Administration (SBA), allows SMEs to obtain loans to cover payroll and other expenses. Initially loans would be forgiven by the federal government contingent on 75 percent of the funds being spent on payroll within eight weeks of the funds being received. [A recent amendment](#) to the program updated these requirements to allow small businesses with large fixed costs beyond payroll to be eligible for loan forgiveness. Under the amendment loans are forgiven if 60 percent of the total is spent on payroll, the timeframe within which funds have to be used was extended to 24 weeks. If not forgiven, loans have a maturity of two years at 1 percent interest.

The program has been criticized for its [generous terms](#) and inability to allocate funds to the firms that needed it the most. Given the lack of restrictions to participate, the program became widely popular and exhausted its initial funding of \$350 billion less than a month after it was launched on April 3. To allow the program to continue the Senate approved an additional \$310 billion for the program.

As of [May 30](#), the program has given out more than 4 million individual loans totaling over \$510 billion. While the program prevented layoffs at a large number of SMEs, it did so at a high cost for the taxpayer - compared to a program that could have allocated funds to firms most likely unable to meet payroll without support. In order to be eligible, applicants had to certify in good faith that "current economic uncertainty makes [the] loan request necessary to support the ongoing operations of the Applicant." In [guidelines](#) issued on May 13, the SBA announced that all loan applications with principal amounts below \$2 million will be deemed to have been made in good faith, covering almost 80% of the outstanding balance as of May 30 or more than \$400 billion. With eligibility not being contingent on declines in cash-flows or operating profit, the

program provided funds to many businesses with the understanding that a large share of the total will not be paid back, the rest was provided loans under extremely generous terms.

#### 4. STC use in the US

Data on STC claims in the US suggests that participation is more pro-cyclical than conventional unemployment claims with large increases in participation during downturns. Note also that there are strong seasonal fluctuations in unemployment claims while STC claims appear to be less tied to seasonal variations. With over 98,000 first claims in April 2020, STC programs experienced the largest participation in the programs' history. In absolute terms, however, STC participation remains negligible relative to the size of the labor force. Initial unemployment claims reached 16.7mn over the same period. Given the low participation rate, there are no differences in unemployment rates in states with STC programs, compared to states that don't have a program.

In the wake of the GFC, Congress passed the Middle Class Tax Relief and Job Creation Act of 2012. The Act was intended to promote adoption of STC programs across the country by providing states with various financial incentives to implement and expand their programs. As required under the act, the Labor Department produced a [report](#) in 2016 and identified various factors that explain low participation. Factors included in the report are:

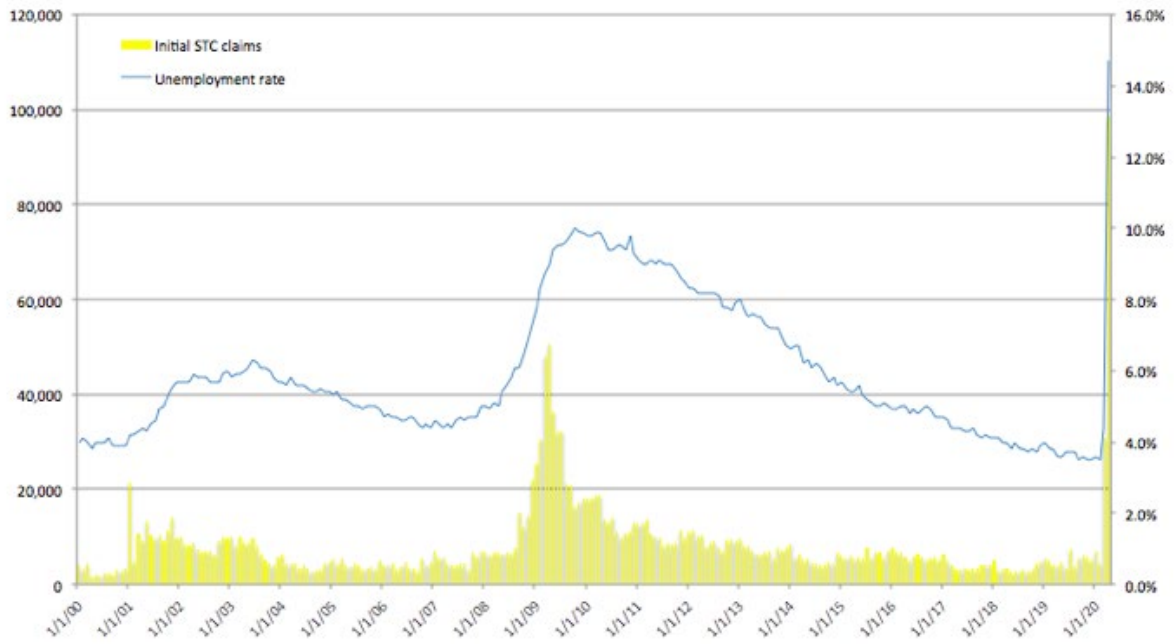
1. “antiquated IT systems that cannot support STC automation efforts
2. lack of preparation to efficiently manage the spike in STC activity during the recession
3. need for process improvements to make STC work better for employers and workers
4. lack of a common and recognizable “brand” for the STC program
5. the need for greater flexibility to meet employers' changing business needs.”

The findings suggest that both operational and communication issues prevent more participation in STC programs. Since STC claims require a weekly review of employee-level data on hours worked, programs can't reach an appropriate scale if processes are not automated. As of 2016, some states still relied on paper systems to review claims. Combined with a shortage of staff in charge of STC claims, these shortcomings constitute obvious barriers to reaching a scale sufficient to provide the benefits European countries are currently experiencing under their programs.

Beyond operational issues, STC programs suffer from the fact that many employers are not familiar with the program. This is accentuated by the fact that STC programs do not have a nationally recognized brand as states use different names for their programs such as Shared Work or Workshare. A survey among employers in four states with STC programs shows that while around 95 percent of non-STC employers are familiar with unemployment benefits, most are not aware of their state's STC program. In the four states surveyed, between 28 and 54 percent of employers were aware of the STC program in their state.

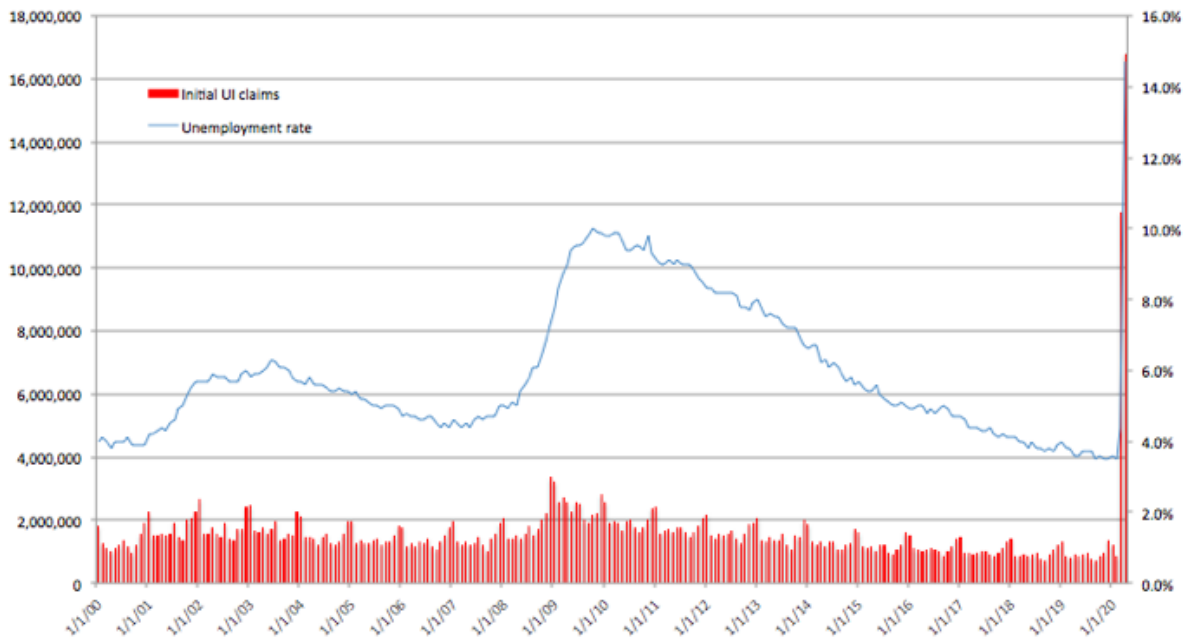
In May, the BLS reported a national [unemployment rate of 13.3](#), indicating that, as restrictions on business activity are lifted, the labor market is on the road to recovery. Meanwhile European countries that made extensive use of STC over the past months appear to weather the downturn without significant layoffs, paving the way for a swift recovery. The early evidence from many countries suggests that STC policies were able to reduce the effects of the pandemic on labor

Monthly initial STC claims and unemployment rate



Source: [BLS](#)

Monthly initial UI claims and unemployment rate



Source: [BLS](#)

market outcomes. However, further analysis of STC programs during the downturn will be necessary to provide a definitive answer. In the US, the experience of the last months could encourage policymakers to renew the effort started in the wake of the GFC, to promote STC programs as an alternative to conventional unemployment benefits during economic downturns.

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