Should We Insure Workers or Jobs During Recessions?

Giulia Giupponi
Bocconi University

Camille Landais
LSE

Alice Lapeyre
CREST

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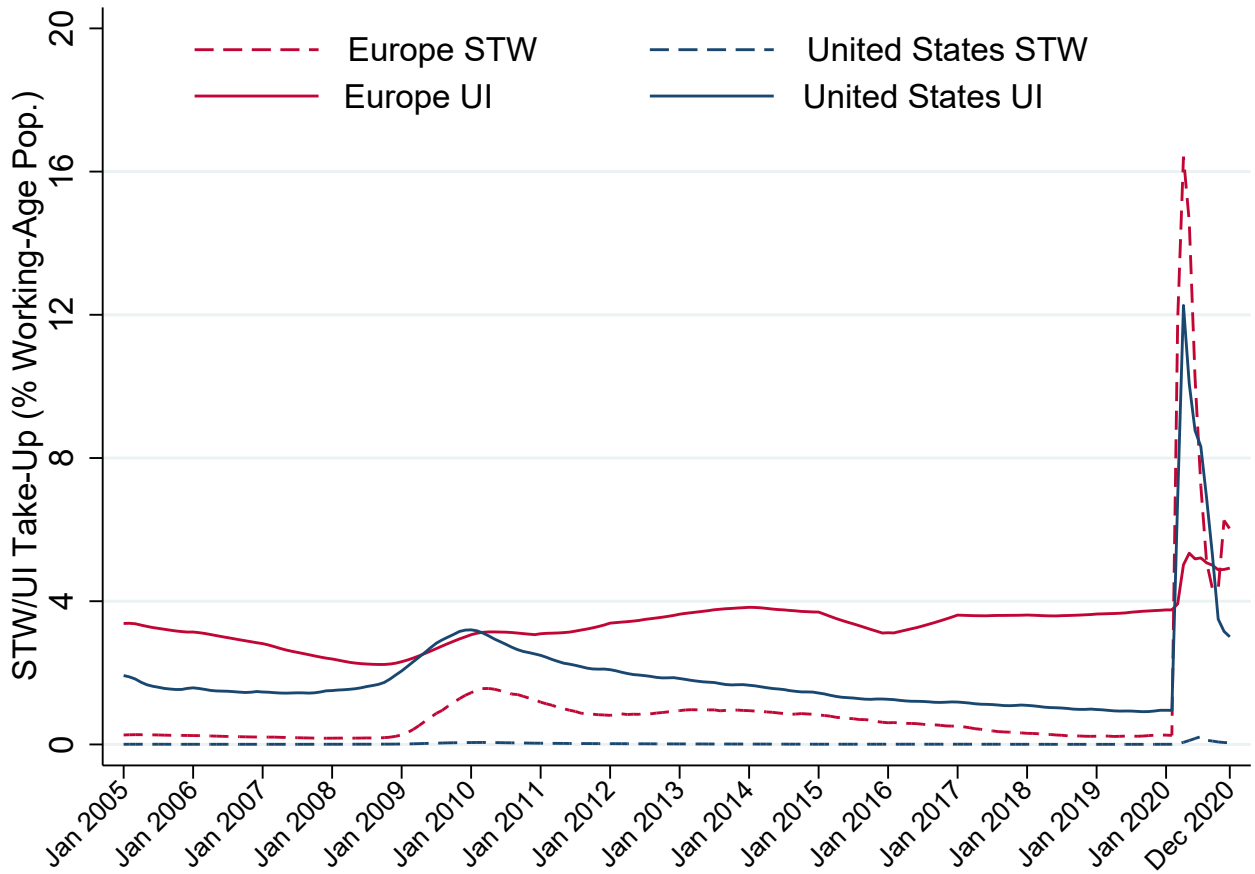
Labor-Market Policy Response to COVID-19: US vs Europe



Note: Europe is weighted average of Germany, France, Italy and the UK, weighted by their working age population.

Short-Time Work vs Unemployment Insurance

Unemployment insurance (UI)

- When hit by a shock, employment relationship is severed
- If eligible, worker can claim unemployment benefits $\rightarrow$ **worker is insured** against cost of job loss

Short-time-work (STW)

- When hit by a shock, firm can temporarily reduce labor demand and decrease number of hours worked by its employees
- Firm pays for the hours worked, while STW subsidizes hours not worked
- Employment relationship is preserved $\rightarrow$ **job match is insured**

$\rightarrow$ **Should we insure workers or jobs?**

Outline

1. Conceptual Framework

2. Empirical Evidence

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Welfare Trade-offs of STW vs UI

- Standard public finance framework: **optimal generosity** of social insurance transfer balances its insurance value against its fiscal externality
  - **Insurance value**: social benefit of transferring \$1 from good to bad state
  - **Fiscal externality**: cost of transferring \$1 due to behavioral responses
- Extend this framework to assess the **relative** optimal generosity of social insurance
- Imagine to increase generosity of social insurance by \$1. Should we increase STW or UI?

Optimal STW/UI mix

Relative value of STW/UI transfer $=$ Relative fiscal externality

- Value of transfer: $\mathbf{E}_{STW}[u'(c)] - \mathbf{E}_{UI}[u'(c)] \gtreqless 0$
- Fiscal externality: $\mathbf{FE}_{STW} - \mathbf{FE}_{UI} \gtreqless 0$

Optimal STW/UI mix

Relative value of STW/UI transfer $=$ Relative fiscal externality

$+$ Relative correction of LM externalities

- Value of transfer: $\mathbf{E}_{STW}[u'(c)] - \mathbf{E}_{UI}[u'(c)] \gtreqless 0$
- Fiscal externality: $\mathbf{FE}_{STW} - \mathbf{FE}_{UI} \gtreqless 0$
- Correction of **labor market inefficiencies**: social insurance can amplify or hamper pre-existing distortions
  - Inefficient separations, e.g. due to liquidity constraints
  - Search inefficiencies, e.g. rat-races for jobs during recessions
  - Inefficient reallocation, e.g. cleansing effects

Outline

1. Conceptual Framework

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Relative Insurance Value

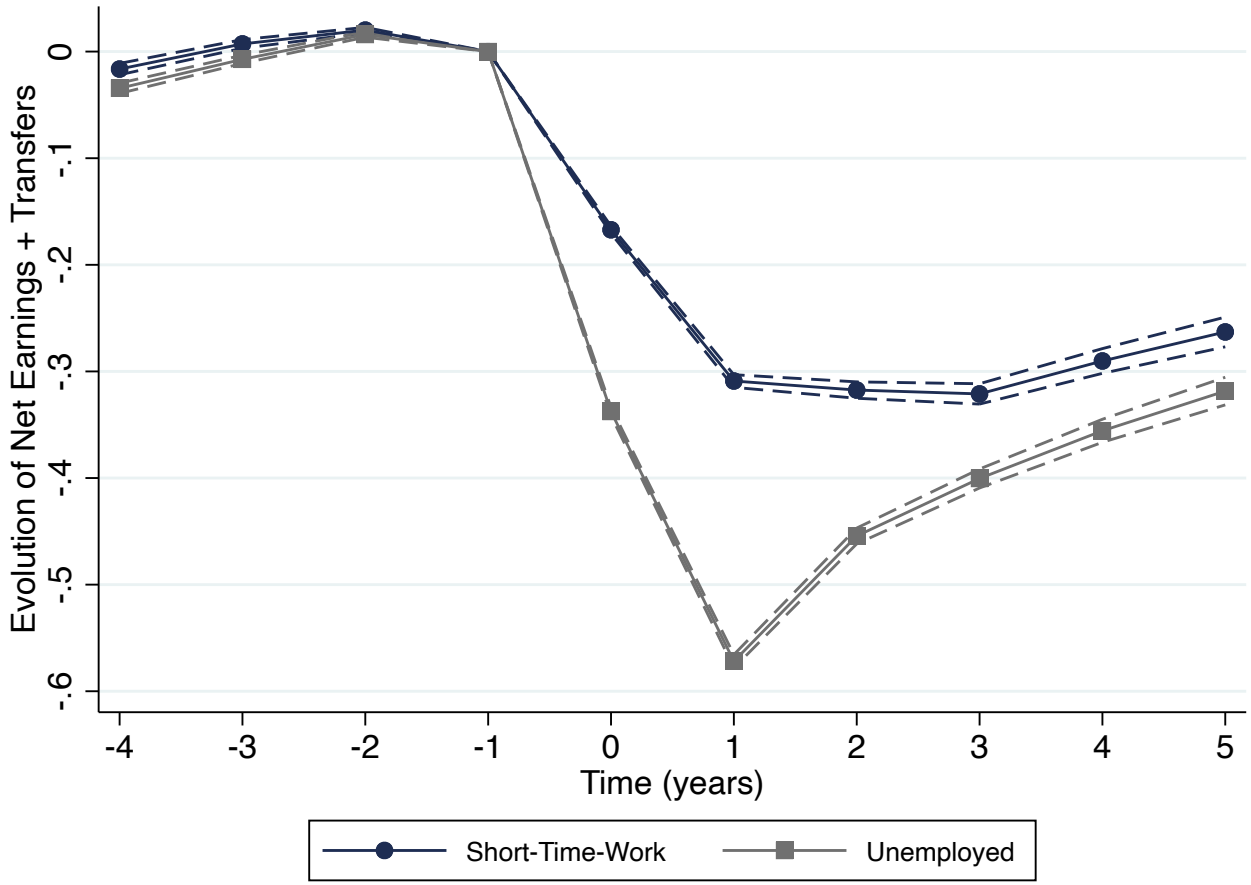
- Value of insurance depends on:
  - How workers value insurance, i.e. their level of **risk aversion**
  - Whether they have other means of **consumption smoothing**
  - The **size** of the shock
- Little empirical attention to value of social insurance
- Value of UI (++), strongly heterogeneous
- Little evidence on the insurance value of STW specifically and how it compares to UI, but they tend to insure:
  - Different **populations** (risk aversion, consumption smoothing)
  - Different **shocks**
- Likely $\mathbf{E}_{STW}[u'(c)] - \mathbf{E}_{UI}[u'(c)] << 0$

Evidence from the IAB-HOPP survey data

	Employed (not in STW)	STW	Unemployed
Female	0.513	0.428	0.432
Age 18-34	0.230	0.216	0.253
Age 35-54	0.513	0.522	0.353
Age 55+	0.257	0.262	0.394
University degree	0.453	0.320	0.301
Has partner	0.712	0.684	0.491
Partner not working	0.119	0.113	0.167
Monthly household income	4,248	3,638	2,083
MPC	0.323	0.335	0.393
Life satisfaction (1-10)	8.035	7.579	6.408
Obs	21,338	2,303	1,110

Evidence from the Great Recession in Italy

Evolution of earnings and transfers around STW/job-loss events



Source: Giupponi and Landais (2021)

Relative fiscal externality

- Extensive literature on moral hazard effects of UI
  - Consensus that **fiscal externality of UI is relatively large**: cost of \$1 of UI ranges from \$1.5 to \$2.5
- Limited evidence on moral hazard effects of STW
  - STW made conditional on well-defined shock prevents MH
  - Evidence from Great Recession (Kopp and Siegenthaler [2019]; Giupponi and Landais [2020]) points to **limited moral hazard**, e.g. in Italy, additional \$1 of STW cost \$1.07
  - But massive **extension** of STW schemes can fuel MH
- Likely $\mathbf{FE}_{STW} - \mathbf{FE}_{UI} < 0$

Inefficient Separations

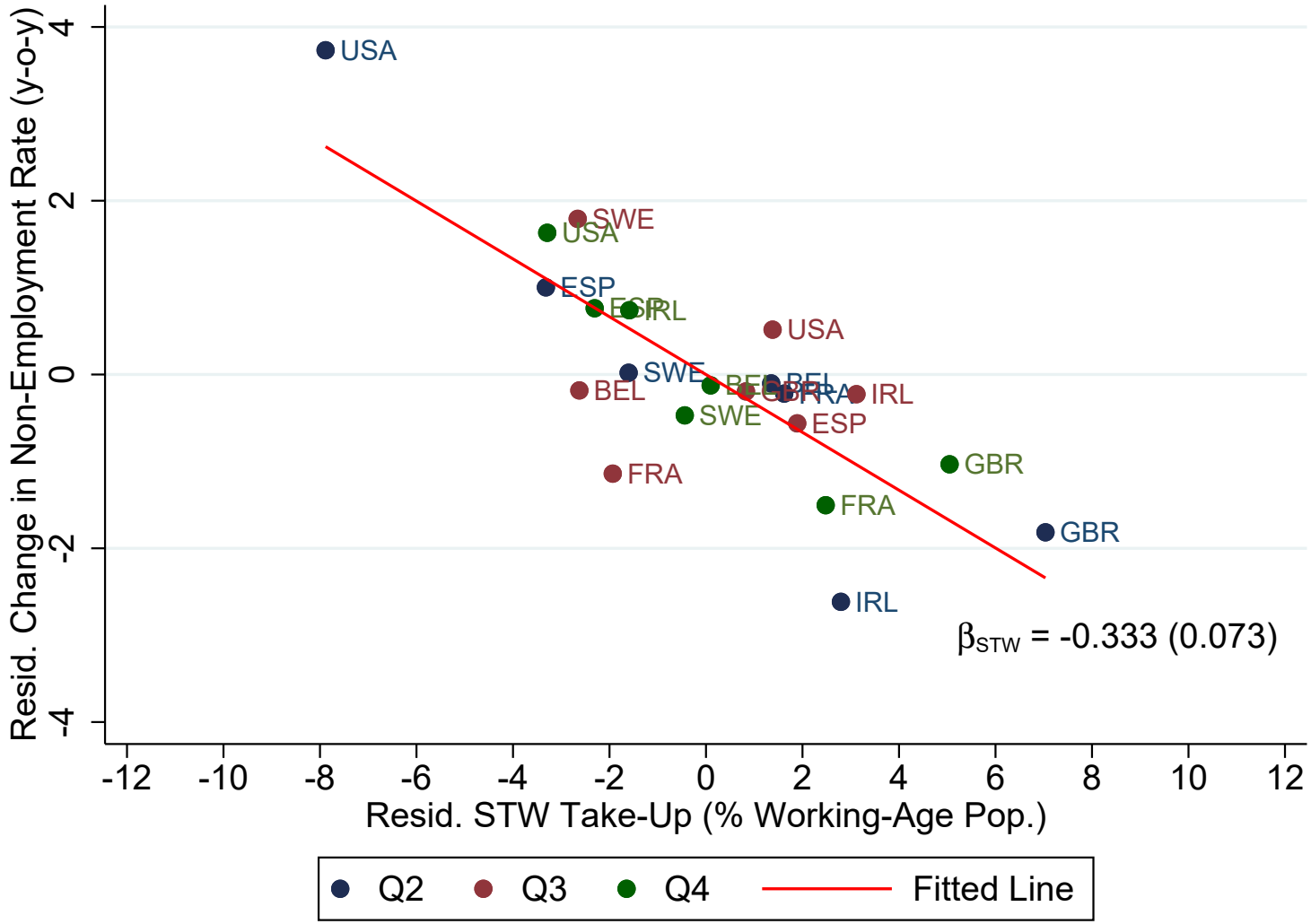
Does STW **save jobs**?

- Robust cross-country evidence from the current crisis
- Consistent with evidence from the Great Recession: Kopp and Siegenthaler [2019]; Cahuc, Kramarz and Nevoux [2021], Giupponi and Landais [2021]

Is this **efficient**? Would separations be *inefficiently* high absent STW?

- Liquidity constraints (Giupponi and Landais [2021])
- Bargaining frictions
- Generous and imperfectly experience-rated UI

Does STW save jobs?

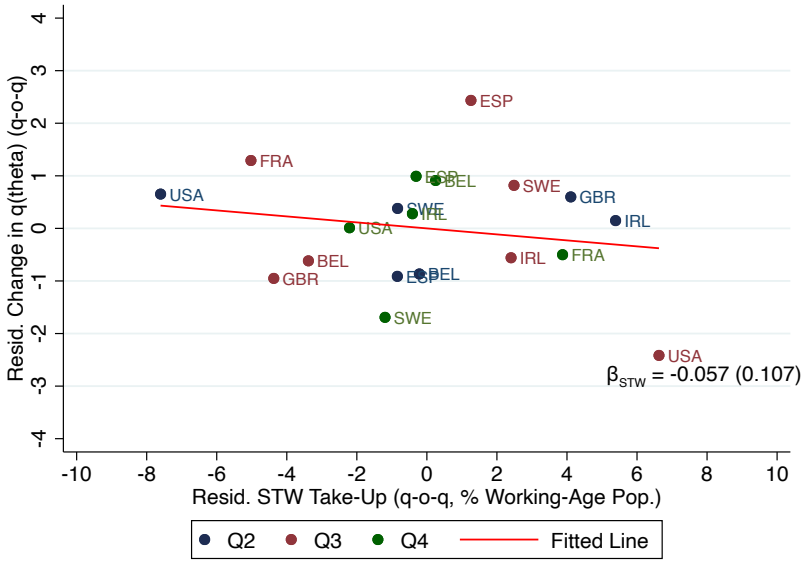


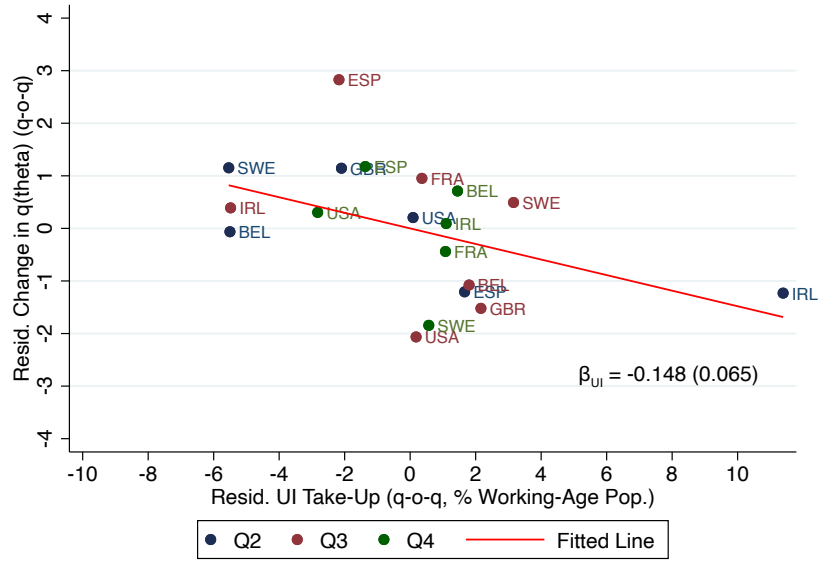
Search Inefficiencies

- Recessions are usually characterized by slackness (i.e. **low tightness**) in the labor market: many workers are searching for jobs and firms post few vacancies
- It can be **socially inefficient**: if jobs are rationed, search can become a rat race (Michaillat [2009], Landais, Michaillat and Saez, [2018a])
- **Social insurance** affects **equilibrium tightness** by affecting workers' search effort and firms' labor demand
- Welfare consequences depend on
  1. Direction and magnitude in which STW/UI affect tightness
  2. How inefficiently tight or slack labor market is to begin with

How does tightness respond to STW/UI?

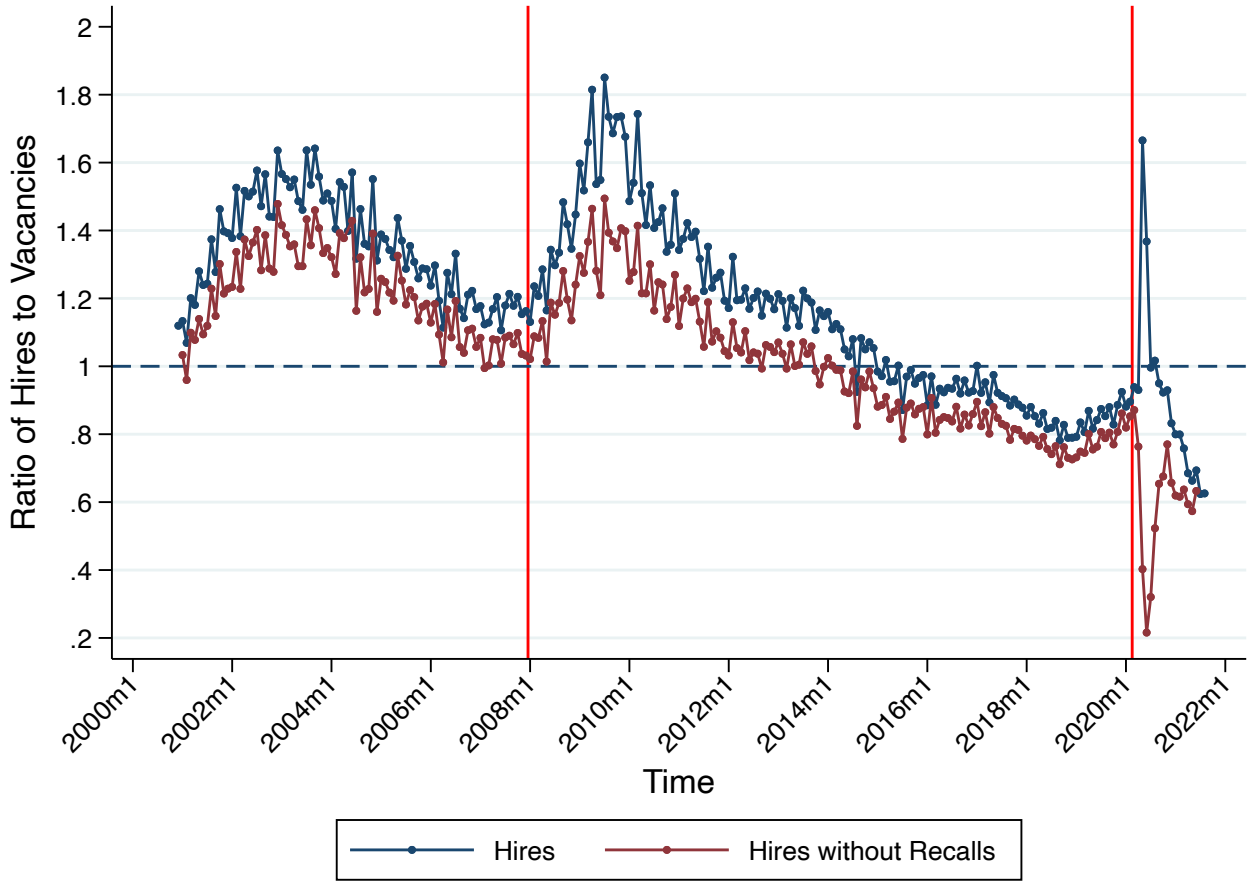
Vacancy-filling probability $q(\theta)$ and STW/UI take-up





- Both STW and UI usage correlated with decline in the job-filling probability, i.e. with increase in tightness ($\theta = v/u \cdot e$)
- Stronger correlation with UI: more effective way of alleviating search externalities?

Is labor market tightness too low or too high in recessions?



- Labor market tightness typically low during downturns
- We document sustained level of tightness in current recession in the US and Europe (generous UI/STW?)

Reallocation Inefficiencies

- Recessions usually trigger significant reallocation - across firms / sectors - enhancing aggregate efficiency (e.g. see Barrero et al. [2020])
- UI and STW differ in the type of reallocation they hinder
  - **UI** is a brake to **aggregate reallocation**: $\downarrow$ aggregate search effort
  - **STW** is a brake to **sectoral/firm reallocation**: prevents workers in firms/sectors hit by productivity shocks to reallocate
- How serious are these reallocation effects in practice?
  - Little knowledge on reallocation effects of UI
  - For STW, evidence from the Great Recession in Italy suggests that – when shock is permanent – negative selection of firms into program can have negative reallocation effects
  - Magnitude of those effects small, but now massive extension of STW

What do we know about key elements of welfare trade-off?

	Value of Transfer	Moral Hazard / Fiscal Externality	Other Externalities		
			Layoff	Search	Reallocation
STW	?	+/-	- -	?	-
UI	+ +	+ +	?	- -	?

Note: The symbols refer to the magnitude of each feature/estimated effect: (+ +) Large positive, (+) Positive, (+/-) Both positive and negative, (-) Negative, (- -) Large negative, (?) No evidence.

Conclusion

- We provide general framework to think about welfare trade-offs between STW and UI
  - UI has greater insurance value, but STW likely entails lower fiscal externality
  - STW useful tool to prevent inefficient layoffs, with limited reallocation effects
  - UI probably more effective at reducing search externalities
- In countries with generous UI and/or strict EPL, strong cyclical programs like STW can be valuable complement of UI to respond to recessions
- We document that labor market is uniquely tight in current crisis. Research on drivers of high tightness needed to determine optimal path out of the crisis ⏩ Tightness US/FR ⏩ Search/Vacancies FR

Evolution of tightness in France and in the US

Source: authors' computation from Giupponi et al. [2021] and Michaillat and Saez [2021]

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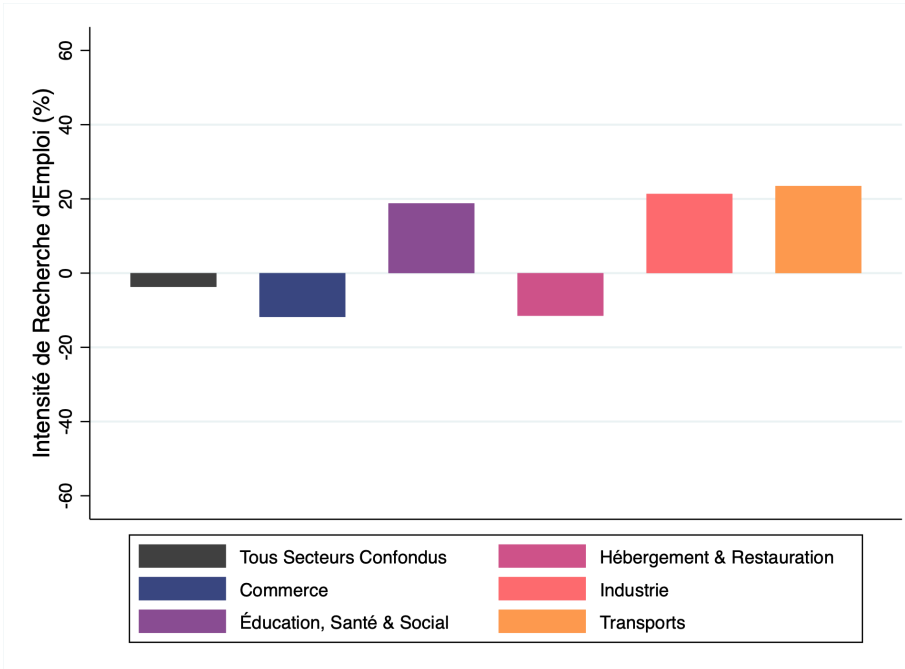
Search and Vacancy Posting in France during COVID-19

Evolution of job search and vacancy postings by sector between 2019 and 2021



Sources: ACEMO data for vacancies and Google trends for job search

- Pandemic hit the different sectors differently
- Frictions to reallocation: Δ job search effort $\neq \Delta$ vacancy postings
- Lower matching efficiency, increase in labor market tightness.

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