

# Comment on Pierre Cahuc and Stéphane Carcillo: Is short-time work a good method to keep unemployment down?

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Two main messages are put forth by Cahuc and Carcillo. First, there is some empirical support for the fact that short-time work (STW) schemes can preserve jobs and reduce unemployment in downturns. Therefore, countries which have not yet implemented these programs could benefit from doing so. Second, if these programs are implemented, they should include some experience-rating component so as to prevent inefficient reductions in working hours.

I find the study by Cahuc and Carcillo interesting and valuable as it brings new evidence of how STW can affect unemployment in an economic downturn. The paper takes cross-country studies of STW one step further by addressing problems with endogeneity in take-up rates. However, although the study puts forth new valuable evidence of the impact of STW on labour market performance, the last words on the issue are far from having been said. There are simply too few studies available. Moreover, the available studies are based on aggregate cross-country data (see Hijzen and Venn, 2010, Arpaia et al, 2010 and the current study). Thus, there is also a need for well-defined micro-based studies with firm-level data to verify the results found in cross-country studies. Moreover, as STW, in practice, was put into use during the current economic crisis, the

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available cross-country data only cover the current downturn (so far, there is no documentation of the impact of the policy in a recovery period). Thus, what do we know about the long-run consequences of STW?

Assume, as suggested by cross-country evidence, that unemployment does increase by less in a downturn if STW is used. However, is this necessarily good for the long-run economic performance? The rest of this comment discusses potential long-run consequences of this policy

## 1. Long-run effects of STW

Perhaps job destruction in a downturn is needed in order to improve long-run performance. And what happens in the upturn? Instead of hiring new workers, employed workers are likely to increase their work hours. Thus, one would expect that unemployment falls by less in the upturn than otherwise. Unemployment then varies less over the cycle. But can we expect the equilibrium rate of unemployment to be unaffected by the STW schemes? Moreover, will the speed at which unemployment returns to some normal equilibrium level be reduced by STW schemes?

### 1.1 Reallocation of jobs

A downturn may work as a necessary first real test for an economy inducing an efficient reallocation of jobs. On the other hand, a downturn may produce an inefficiently high level of job destruction. Short-time work compensation schemes, which moderate the effects of a downturn, could thus potentially have both a positive and a negative impact on long-run economic performance. STW could *improve* the long-run performance of the economy if, for example, productive matches are maintained, if loss of skill is prevented, and if truly productive firms are not forced out of business due to liquidity constraints in a downturn.

On the other hand, STW can *deteriorate* long-run economic performance if workers are locked into inefficient firms which are not closed down. There is thus a trade-off between preventing a waste of productive resources by use of STW schemes, and allowing for a reallocation of jobs by letting firms face the full consequences of a downturn.

As it is a priori difficult to know which effects are the most important for long-run economic performance, it is also difficult to know if it is optimal for the government to introduce a less than fully experience-rated STW scheme.

### *1.2 Equilibrium rate of unemployment*

How are wage formation and the structural equilibrium of unemployment likely to be affected by STW? One would expect STW policies to increase wage demands, as the schemes tend to favour insiders at the expense of outsiders. If a STW scheme is available for firms in case of a negative demand shock, workers will to a lesser extent view open unemployment as a threat in this situation. Instead, they will face reduced working hours while being fully, or partly, compensated for that. This is likely to lead to increased wage pressure.

In addition, STW schemes may also lead to higher wage demands if the competitiveness of the unemployed is reduced by the policy. As more workers remain in the firms, some which are now on STW schemes, the unemployment pool will to a larger extent contain workers with longer unemployment spells. This tends to reduce the competition for jobs among the unemployed. In fact, these are factors that are likely to cause a persistence in the unemployment rate. Although unemployment may be high, this is not fully taken into account in wage bargaining. In the presence of STW, wage-setting insiders know that even if they end up in the unemployment pool, they will mainly compete with long-term unemployed which are seen as less of a threat to their job-finding probabilities.

If STW leads to higher wage pressure for these reasons, the equilibrium rate of unemployment will most likely increase with the policy. However, STW may also have a direct favourable impact on job creation. As STW prevents job destruction by providing firms with an opportunity to maintain workers when hit by a negative shock, it becomes more profitable for firms to open vacancies. The risk of losing workers due to negative demand shocks is simply reduced with STW schemes, which implies that more firms find it worthwhile to look for workers to hire also when times are good. This tends to reduce the equilibrium rate of unemployment (Hedlin and Kolm, 2010).

There is thus a number of potential mechanisms through which STW could affect labour market performance. However, due to the limited number of studies, both theoretically and empirically, it is not clear what is the impact of STW on the equilibrium rate of unemployment. This highlights the importance of both more theoretical and empirical research on the impact of STW.

## 2. Rules or discretion?

Cahuc and Carcillo study the importance of stable rules designed under normal economic conditions. With stable rules, pressure groups pushing for generous STW schemes in turbulent times, which are difficult to eliminate later, can be avoided.

I agree that stable rules are usually preferable. However, with stable rules, it becomes even more important to know the long-run consequences of STW schemes. If STW leads to higher wage pressure, thus causing the equilibrium rate of unemployment to increase discretionary, STW policies may be preferable. If STW schemes are only used in exceptionally deep recessions, they will most likely not lead to higher wage pressure and higher equilibrium unemployment. But, on the other hand, firms anticipating that the government will share some of the risks in downturns by use of STW schemes will find it profitable to open more vacancies also under normal economic conditions. Considering this effect, stable rules are to be preferred to discretion.

## 3. Conclusions

The question in the title of the paper is: "Is short-time work a good method to keep unemployment down?". Using cross-country data, the authors provide valuable evidence that unemployment will most likely increase by less in downturns if STW schemes are used. However, it is difficult to know how equilibrium unemployment is affected. There are arguments for the fact that STW may increase wage pressure as the schemes tend to favor insiders. This could potentially lead to both higher equilibrium

unemployment and persistence of unemployment. Thus, it is not clear that STW schemes improve economic performance.

## References

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