Labor Markets in the Time of a Pandemic: North America vs Europe

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Highlights

• Both North America and Europe are experiencing massive labor market shocks. However, both have employed different policy responses which have led to drastically different outcomes.

• The U.S. and Canada have taken a hybrid approach by providing support through employment insurance and wage support but have failed to prevent large unemployment increases. European countries have primarily relied on wage subsidy schemes which have helped keep unemployment relatively stable.

• Wage subsidy schemes seem to be the antidote to large scale lay-offs as they allow for the employer-employee relationship to remain intact despite economic disruptions. At least in theory, such schemes limit the shock to demand from high unemployment and reduce the likelihood of permanent job losses, thereby assisting economic recovery.

• While stronger labor force attachment could give Europe a leg up over North America during the recovery phase, we also put forward some reasons for skepticism.

Labor markets across the world have been ravaged by pandemic induced disruptions. Global labor markets today are characterized by sharp jumps in unemployment rates, steep drops in employment and in some cases, mass exits from the labor force. Just to put things in perspective, the global decline in hours worked in the first quarter of this year compared to the last quarter of 2019 was equal to the loss of 130 million full-time jobs.1 The decline in the second quarter is expected to be equivalent to more than 300 million full-time jobs.

That being said, one striking development during the pandemic is the extent to which unemployment rates have surged in North America relative to those in Europe (Chart 1). More specifically, headline jobless rates in the European Union (EU) and the Eurozone compared to pre-virus levels in February have increased by only 0.3 (to 6.7%) and 0.2 (to 7.4%) percentage points, respectively. This contrasts with the U.S. where the jobless rate has gone from record lows of 3.5% to 11.1% in a matter of months. Canada’s unemployment rate – much like the U.S.—also jumped to a staggering 12.3% in June from just 5.5% at the beginning of this year. There are three factors that have contributed to the relatively benign increase in Europe’s unemployment vis-à-vis the U.S. and Canada:

1. Wage subsidies are Europe’s weapon of choice against labor market disruptions: The U.S. and Canada have opted for a hybrid of employer subsidy programs and direct emergency benefits to households. However, wage subsidy schemes have been European countries’ main tool of support for the labor market and were introduced at the onset of the pandemic. The

![Chart 1: Unemployment Shoots up in North America, Unlike Europe](image-url)

Source: Eurostat, Statistics Canada, BLS, Istat, BBK, TD Economics
Note: June unemployment data only available for the US, Canada and Germany. UK May data is unavailable and is presented as a 3-month moving average.
schemes are targeted towards businesses that have kept workers on their payrolls, allowing workers to receive support through their employers without severing ties with their workplace. Previous experience with such schemes allowed for a quick scaling-up this time round and prevented businesses and workers falling through the cracks. Without such schemes, the unemployment rate in Europe would have been much higher.

2. EU’s method to calculate unemployment masks labor market disruptions: EU’s method to calculate unemployment differs from North America. This also makes an apples-to-apples comparison of unemployment in Europe vs U.S and Canada difficult. For example, European workers who are on a wage subsidy scheme and get furloughed, are counted as employed. European workers on an indefinite leave (social distancing reasons, sickness etc.), are also counted as employed. In contrast, workers in the U.S. and Canada that are on ‘temporary layoff’ – i.e., expect to be rehired within the next 6 months – are counted as unemployed. This is reflected in the sharper drops in productivity in Europe versus North America (Chart 2). Also, to be counted as unemployed in the EU survey, a person must actively seek work and be ready to start a new job within the next two weeks. Business shutdowns, factory closures or childcare needs may have compelled people to hold off on looking for jobs.

3. Collective bargaining schemes are more prevalent in Europe: Collective bargaining agreements (rarely used in the U.S.) make firing more difficult in Europe. This is unlike the U.S., where the traditional labor market structure allows for quick hiring and firing and a greater ease of declaring redundancies.

Wage subsidies in Europe are far more generous

European wage subsidy schemes cover a large portion of the cost of employees’ salaries in crisis periods and rely on employing workers on shorter hours, rather than laying them off and rehiring them later. This can help prevent large-scale layoffs and potential labor market mismatch issues when it comes to rehiring workers during a recovery phase. The use of wage subsidy schemes in Europe tends to reduce the reliance on unemployment claims. For example, France, Germany, and Switzerland saw little increase in unemployment benefit claims.

European subsidy programs are modeled on the German Kurzarbeit wage subsidy scheme, which was an important factor behind Germany’s job miracle. Between 2008–09, Germany kept unemployment broadly stable. According to some estimates, with Kurzarbeit, German employment in the second half of 2009 was 580,000 higher than what it would have been in its absence. German employment fell by 1% during the GFC despite a 7% peak-to-trough drop in GDP, whereas U.S. saw a 5.4% drop in employment despite only a 4% contraction in output. Kurzarbeit’s ability to prevent job losses is also one of the reasons why Germany recovered quickly after the GFC.

While Canada has a wage subsidy scheme of its own, it is not as generous as the subsidy schemes announced by European countries. Canada – unlike Europe – has relied on a hybrid approach to support its labor market with the

Chart 2: Sharp Productivity Declines in Europe Reflect Those Employed But not Working

Chart 3: Relatively Little Reliance on Short-term Work Schemes in North America
introduction of the Canada Emergency Response Benefit (CERB) and Canada Emergency Wage Subsidy (CEWS) (see report). The CERB was introduced well before CEWS, with the latter being implemented after some businesses had already laid-off staff. The popularity of CERB over CEWS is reflected in how the former has blown through its initial estimated cost. However, the lack of CEWS’s popularity is seen in its relatively weak uptake – only $13.3 billion – so far.3

Only 8% of the Canadian labor force is currently benefitting from wage subsidies, which is much smaller than those supported through wage subsidies in Europe (Chart 3). In addition to delayed program implementation, Canadian firms’ low uptake is likely linked to the condition that businesses experience a 30% drop in revenue to become eligible for wage subsidies. According to a recent survey of tech company leaders, 72% said they remain ineligible for the CEWS support. In Europe, however, there is no revenue drop criteria for businesses to become eligible for wage support (Table 1).

U.S. labor market policy response has been complex

U.S. labor market policies have been a patchwork of different programs which include stimulus checks, enhanced unemployment benefits and federally-backed government loans for SMEs to pay workers. Compared to Europe – and to some extent Canada – labor market support in the U.S. has been relatively complex with a multitude of benefits and subsidy programs oriented towards workers and businesses.

The U.S. CARES Act includes the Paycheck Protection Program (PPP) – a wage subsidy scheme – which only targets small businesses, precluding roughly half of American workers who are employed by large businesses.4 This is unlike Europe and Canada where all firms regardless of size are eligible for wage support. The support in the U.S. is in the forms of forgivable loans, unless businesses spend 60% of it on payrolls. This is also unlike Europe where the wage subsidy schemes are in the form of grants, not loans.

The PPP was popular when first introduced, with initial funds running out within two weeks. However, uptake has cooled considerably in recent weeks. Confusion surrounding the program details, especially regarding loan forgiveness may be one of the reasons for decreased demand. Since PPP is administered through private banks, they can reject any qualifying applicant (which they have). Administrative and procedural bottlenecks have also slowed the disbursement of cash to SMEs most in need. The Federal Pandemic Unemployment Compensation also made unemployment insurance more attractive by adding $600 in weekly benefits and relaxing eligibility conditions for Pandemic Unemployment Assistance. In fact, unemployment insurance benefits have often exceeded pre-pandemic earnings making the former more attractive and disincentivizing some to return to work despite efforts by the government to mitigate this risk.5 All these factors combined have led to mixed evidence on the effectiveness of PPP in prompting jobs recovery (see report).

Hours worked follow similar trends on both sides of the Atlantic

Wage subsidy schemes combined with different methods used to calculate unemployment make it difficult to estimate the true extent of labor market slack in North America and Europe. It is not enough to look at unemployment rates and/or labor force participation ratios. The number of

<table>
<thead>
<tr>
<th>Table 1: Summary of Wage Subsidy Schemes</th>
<th>Canada</th>
<th>France</th>
<th>Germany</th>
<th>Italy</th>
<th>U.K.</th>
</tr>
</thead>
<tbody>
<tr>
<td>Maximum coverage (% of salary)</td>
<td>75</td>
<td>84 to 100</td>
<td>67 to 87</td>
<td>80</td>
<td>80</td>
</tr>
<tr>
<td>Maximum amount per month ($)</td>
<td>2,493</td>
<td>6,113</td>
<td>7,685</td>
<td>1,296</td>
<td>3,225</td>
</tr>
<tr>
<td>Duration of support (months) starting March</td>
<td>6</td>
<td>24</td>
<td>12 to 24</td>
<td>5</td>
<td>7</td>
</tr>
<tr>
<td>Conditional on revenue drop (minimum, %)</td>
<td>30</td>
<td>No</td>
<td>No</td>
<td>No</td>
<td>No</td>
</tr>
<tr>
<td>Conditional on a drop in workforce (%)</td>
<td>No</td>
<td>No</td>
<td>10</td>
<td>No</td>
<td>No</td>
</tr>
</tbody>
</table>

Source: TD Economics
hours worked is the appropriate matrix in an age of lock-downs and physical distancing.

Most European countries do not report hours worked data frequently enough to be able to study the impact of the pandemic or to compare with the U.S. or Canada. The quality and frequency of labor market data in Europe pales in comparison to North American data. European data come with a considerable lag and lack the coverage seen in U.S. or Canadian data.6 Latest European hours worked data is only available for some countries and for the first quarter of this year, therefore not useful for our purposes. Chart 4 (using daily data) is a good proxy for the number of hours worked. The data report the amount of time spent at work, which addresses the issue of furloughed employees not working. Despite drastically different unemployment rates, hours worked in Europe and North America follow similar trends, which indicates similar supply-side disruptions in the labor market (the UK being an exception, where hours have suffered to a much greater extent).

Thanks to wage subsidy schemes in Europe, the sharp drop in hours worked in Europe did not translate into a sharp increase in unemployment. However, in the absence of a reliable wage subsidy safety net in North America, the steep drop in hours worked was matched by an unprecedented increase in unemployment.

Europe’s policies will aid in its post-pandemic recovery

In previous recessions, labor market flexibility in the U.S. allowed for faster recoveries. Labor market rigidities in Europe are often highlighted as one of the structural factors leading to relatively weak business dynamism in Europe. However, the strong(er) attachment between workers and employers in Europe – compared to North America – will limit the shock to demand from high unemployment and assist in Europe’s post-pandemic recovery prospects. The recent improvement in economic activity in Europe means that most furloughed workers would return to their jobs – albeit with reduced hours – rather than losing their jobs. There is some positive news already – the number of German workers relying on Kurzarbeit has dropped from 7.3 million to 6.7 million – as an increasing number of companies are now footing the wage bill themselves. For example, Volkswagen – a leading German carmaker – has stopped using the scheme after initially benefitting from it to support 80,000 of its employees.

And while wage subsidies have allowed Europe to navigate the worst of the crisis, there remains a big question mark on the fate of workers once countries start tapering off wage subsidy schemes or reach a policy cliff. It is difficult to establish the true impact of wage subsidy schemes until they come to an end. There is legitimate risk that these generous programs may create “zombie jobs” by keeping firms afloat and delaying layoffs. This risk is lessened but not eliminated by the relatively long program duration (note that France just extended theirs for two years). Ultimately, hiring plans will depend on recovery in demand. And while European economies have been showing some promise, they face no shortage of structural issues that may hinder their medium-term prospects.

Many North American furloughed workers that were on temporary unemployment were called back throughout May and June. However, the sharp increase in unemployment in U.S. and Canada carries another risk – the risk of layoffs becoming permanent.7 This is especially true for in-person service jobs, particularly those requiring low-skills and paying low-wages. In fact, about 42% of job losses in the U.S. may be permanent. This means that out of more than 47 million Americans that have so filed for jobless claims since March, about 20 million will have no job to return to.8 This is consistent with evidence from previous recessions which suggests that millions of workers will never return to their employer.

The employer subsidy programs discussed above are limited in that they do not explicitly cover non-payroll costs.
Therefore, self-employed workers had initially fallen through the cracks when the pandemic first hit. However, several European countries – unlike the U.S. and Canada – offer self-employed workers the option to participate in unemployment insurance schemes. Such support will assist European countries’ recovery, especially in countries like Spain, where self employment makes up about 20% of total employment.

Bottom Line

Pandemic induced disruptions have caused major labor market disruptions, both in North America and Europe. However, the labor market policy response to pandemic induced disruptions have varied on both sides of the Atlantic. A hybrid approach – as in the U.S. and Canada – has led to a reduced incentive for businesses to opt for wage subsidy schemes, resulting in large-scale layoffs. A flexible labor market strategy – used in most European countries – relying primarily on wage subsidy schemes seems to be the best antidote to prevent large-scale layoffs.

Wage subsidy schemes allow for the employer-employee relationship to continue despite economic disruptions. Such schemes reduce the risk of temporary layoffs leading to permanent job losses. Wage subsidies also limit the shock to demand from high unemployment, thereby assisting economic recovery. While these schemes have allowed Europe to navigate the worst of the crisis, the fate of workers in the medium-term depends on whether countries extend the subsidy schemes and to what extent. However, this time, unlike the GFC, Europe’s labor market policies may allow it to recover faster than the U.S. At the risk of sounding trite, this time may actually be different.
End Notes

2. Labor market mismatch refers to the gaps between the skills, interests and experience of job seekers and the types of workers businesses are looking to hire.
3. Canada has signalled an adjustment to CEWS going forward, although no details have been released. The CEWS cost estimate has also been increased to $61 billion.
4. 17 million is the low-end number as jobless claims at the time of writing were 41 million. We expect jobless claims to continue to rise in the near-term, leading to the actual number of people with permanent job losses higher than 17 million.
6. For example, compared to the U.S. and Canada, the EU and UK publish unemployment data with about a 4-week and 6-week lag, respectively.
8. 20 million is the low-end number as jobless claims at the time of writing were 47 million. We expect jobless claims to continue to increase in the near-term, leading to the actual number of people with permanent job losses higher than 20 million.

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