INTERNATIONAL MONETARY FUND

EUROPEAN DEPARTMENT

DEPARTMENTAL PAPER

European Labor Markets and the COVID-19 Pandemic

Fallout and the Path Ahead

Prepared by Sakai Ando, Ravi Balakrishnan, Bertrand Gruss, Jean-Jacques Hallaert, La-Bhus Fah Jirasavetakul, Koralai Kirabaeva, Nir Klein, Ana Lariau, Lucy Qian Liu, Davide Malacrino, Haonan Qu, and Alexandra Solovyeva

Cataloging-in-Publication Data
IMF Library

Names: Ando, Sakai, author. | Balakrishnan, Ravi, author. | Gruss, Bertrand, author. | Hallaert, Jean-Jacques, author. | Jirasavetakul, La-Bhus Fah, 1984-, author. | Kirabaeva, Koralai, author. | Klein, Nir, author. | Lariau, Ana, author. | Liu, Lucy Qian, author. | Malacrino, Davide, author. | Qu, Haonan, author. | Solovyeva, Alexandra, author. International Monetary Fund. European Department, issuing body. | International Monetary Fund, publisher.
Title: European labor markets and the Covid-19 pandemic: fallout and the path ahead / prepared by Sakai Ando, Ravi Balakrishnan, Bertrand Gruss, Jean-Jacques Hallaert, La-Bhus Fah Jirasavetakul, Koralai Kirabaeva, Nir Klein, Ana Lariau, Lucy Qian Liu, Davide Malacrino, Haonan Qu, and Alexandra Solovyeva.
Other titles: Fallout and the path ahead | Departmental papers (International Monetary Fund).
Description: Washington, DC : International Monetary Fund, 2022. | March 2022. | DP/2022/004 | Departmental paper series. | Includes bibliographical references.
Identifiers: ISBN 9798400200960 (paper)
Subjects: LCSH: Labor market -- European Union countries. | European Union countries -- Economic conditions. | COVID-19 (Disease).
Classification: LCC HD5764.A6 A53 2022

Acknowledgments
This departmental paper was led by Ravi Balakrishnan and Nir Klein, under the overall guidance of Jörg Decressin. It has benefited immensely from review and comments by many IMF staff colleagues in the European, Fiscal Affairs, Strategy Policy and Review, and Research Departments. We gained many insights from participants at numerous presentations of this work, including at the European Commission, the European Central Bank, and several national authorities in the context of Article IV Consultations. Estefania Cohn Bech, Chun Jin, and Christine Rubio provided invaluable help with data management and document production. Thanks are also due to Houda Berrada for leading the editorial process.

Publication orders may be placed online or through the mail:
International Monetary Fund, Publication Services
P.O. Box 92780, Washington, DC 20090, U.S.A.
T. +(1) 202.623.7430
publications@IMF.org
IMFbookstore.org
elibrary.IMF.org

Contents

BOXES

FIGURES

TABLES

Executive Summary

In 2020, the COVID-19 pandemic caused by far the largest shock to European economies since World War II. Yet astonishingly, the EU unemployment rate had already declined to a record low by December 2021, and in some countries the labor force participation rate is at a record high. This departmental paper documents that the widespread use of job retention schemes (JRSs) has played an essential role in mitigating the pandemic's impact on labor markets and thereby facilitating the restart of European economies after the initial lockdowns. Nonetheless, it also highlights the daunting labor market challenges in the post-pandemic era, many of which are legacies from pre-pandemic days, including major structural changes that the pandemic has simply accentuated. Unless these are addressed, major job losses relative to a pre-pandemic baseline may well materialize. That said, European labor markets will likely exit the pandemic in much better shape than following previous recessions, providing policymakers a potentially crucial head start in navigating the structural transformations that lie ahead and in making sure nobody gets left behind. This opportunity should not be wasted.

A rapid and forceful policy response at both EU and national levels prevented labor market outcomes being much worse than initially feared. Indeed, the analysis in this paper suggests that the unemployment response to the historic pandemic-induced fall in activity was much more muted than previous economic cycles would have suggested. In addition to other policy support, this largely reflects the widespread use of JRSs that is estimated to have mitigated the rise in the euro area unemployment rate in 2020 by 2½ percentage points, keeping about 4 million workers in their jobs.

More recently, as activity has recovered, labor market conditions have improved remarkably, albeit with a high degree of heterogeneity across countries. This turnaround has been much more rapid than following the global financial crisis (GFC) and European sovereign debt crisis. Nonetheless, concerns about important labor market scarring remain in specific sectors. Contact-intensive services have been disproportionately affected, and workers in these sectors, who tend to be low-skilled, young, with temporary employment arrangements have been hit harder, potentially exacerbating underlying inequality trends. Underemployment also remains elevated in some countries. Importantly and in large part reflecting the unknowns surrounding the pandemic's dynamics and legacies—as the recent emergence of the Omicron variant clearly underscores—the outlook for European labor markets is subject to a high degree of uncertainty, posing significant challenges to policymakers.

Looking ahead, as policy support measures are further phased out and firms adjust their operations to the post-pandemic era, some workers may be laid off, potentially creating limited near-term upward pressures on unemployment rates. Having said that, the recent unwinding of JRSs in some countries (for example, the United Kingdom) has not translated into higher unemployment rates so far, likely reflecting strong labor demand. But to the extent that it also reflects reversable transitions into inactivity and lags given notice periods, some unemployment pressures may merely be delayed.

Thinking longer term, our simulations demonstrate that the pandemic is likely to have further accentuated precrisis trends—including from digitalization, automation, and climate change policies—which were already expected to result in significant reallocation of workers across sectors and occupations. Under a pre-pandemic baseline, about 5 million jobs would have been created over the next 10 years in the largest four euro area countries, with the pandemic reducing this by up to 1½ million.

Taking all this together, there are three key policy areas to focus on: adjusting JRSs, facilitating job-to-job transitions, and minimizing scarring, and protecting the most vulnerable. Specifically:

- *Adjusting JRSs*. As the direct effect of the pandemic and containment measures on economic activity fades, countries should normalize the generosity of short -time work schemes (STWs) to precrisis standards and phase out wage subsidies. Remaining sector-specific support should be determined by health-related indicators and restrictions, with continued eligibility to generous STW conditions and access to wage subsidies increasingly restricted to sectors that are still facing temporary and significant revenue losses. Support through JRSs should become time-limited in all circumstances, with clear maximum duration limits linked to the normalization of the sanitary situation. Once the crisis is over and working hours normalize, countries that intend to maintain STWs as part of their regular policy toolkit should consider adopting experience rating schemes to avoid excessive use in some sectors and associated cross-subsidies.
- *Facilitating job-to-job transitions*. As always, high degrees of labor and product market flexibility and sound macroeconomic policies are essential to facilitating reallocation. Temporary and targeted hiring subsidies and wage-loss insurance could pave the way for job creation given lingering uncertainty among potential employers. Subsidies can also be used to incentivize workers to move to other areas with better labor prospects, addressing a well-documented information failure. Although challenging given previous experiences, policies should seek to address the likely rise in skill-mismatches by ensuring efficient reskilling and upskilling of the workforce, with a strong focus on digital skills.
- *Minimizing scarring and protecting the most vulnerable*. Providing educational and vocational programs to those who may find it difficult to transition to new jobs or enter the labor market would help them meet changing labor market demand. Moreover, the pandemic has shone a bright light on fault lines in social safety nets and social protection institutions. Ensuring that these adequately cover the vulnerable—young, temporary, low-skilled, and gig/independent workers—is critical.

Glossary

AEs	Advanced Economies
ALMP	Active Labor Market Policies
BLS	US Bureau of Labor Statistics
EA4	Euro area largest four economies (France, Germany, Spain, and Italy)
EEs	Emerging Economies
EPL	Employment Protection Legislation
CEDEFOP	European Centre for the Development of Vocational Training
FTE	Full-Time Employment
GFC	Global Financial Crisis
GVA	Gross Value Added
HS	Hiring Subsidies
ICT	Information, Communication and Technology
JRS	Job Retention Scheme
PPP	Paycheck Protection Program
SURE	Support To Mitigate Unemployment Risks in Emergency
STWs	Short-Time Work Schemes
UB	Unemployment Benefits
WSs	Wage Subsidies

This page intentionally left blank