“Responding to Employment Shocks”

2022 ESRI International Roundtable

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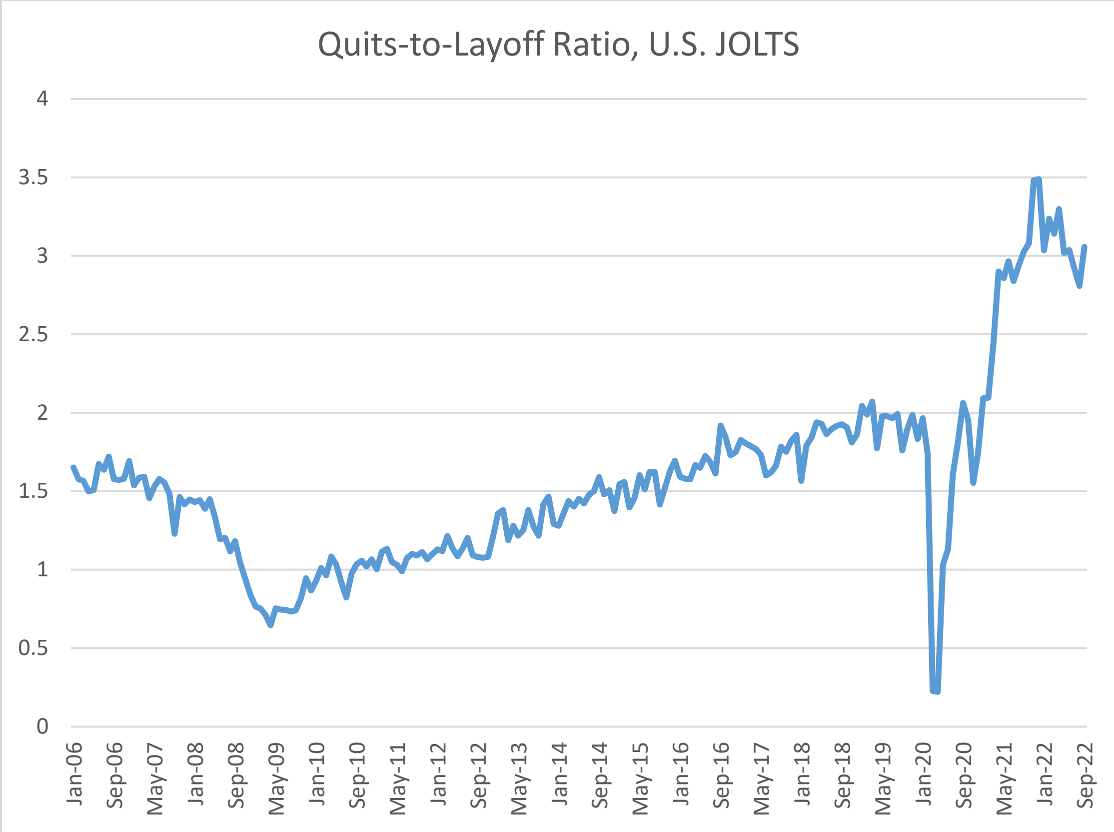
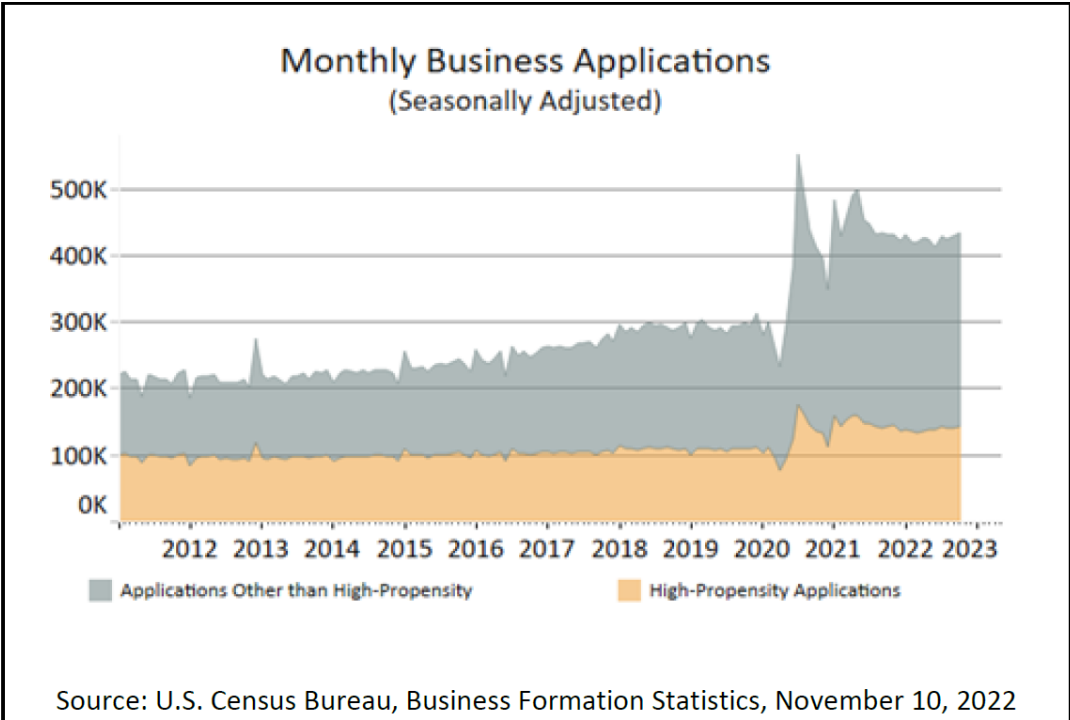
Q. Was it better during the COVID pandemic to subsidize firms to retain employees or instead provide income support to laid off workers?

Analysis:

- Make two arguably plausible assumptions:
  - Either approach could replace workers’ pre-pandemic wages equally well
  - Government faces the same social cost of funds for either approach
  - Thus only difference regards future value of continuing employment relationship versus the future value if it breaks up
- Usual notion is to “support the worker, not the job”
  - Why? Jobs’ values change when technology or demand shifts; if no externalities, we want employment link to respond to these signals (including perhaps break up)
  - Does the pandemic create enough other factors to change this logic?
- Typical consideration of employer-employee match focuses on the relationship’s “solvency”; if its present value is positive (negative), it should continue (stop)
- But “liquidity” can matter; a short-run crisis can make employer default on wage payments even for relationships with positive present value
- Normally, solvency is the dominant force in layoffs
  - But in a pandemic, liquidity can matter a lot too—subsidy to firms saves this loss
    - Loss from illiquidity rises with workers’ employer-specific sunk capital
  - Plus, while in principle firms could be subsidized separately from their workers, practically, if workers go, so do firms and their sunk capital (e.g., intangibles)
- On the other hand, locking employees to their current employers reduces gains from reallocating workers to higher-value alternatives
  - Costs the workers potential future wage gains and limits the ability of new/better firms to expand
  - Reallocation might be especially valuable if COVID shock has permanent effects
- To quantify these countervailing effects, we need to know size of workers’ employer-specific human capital, sunk capital of firms that exit, and the productivity-enhancing effect of market reallocation
- Evidence:
  - Quit rates indicate more beneficial worker reallocation as COVID wanes, jump in new firm entry, no obvious signs of zombie firm apocalypse. So firm subsidies did not greatly hinder reallocation (though might have slightly delayed it)
  - But high quit rates also imply firm-specific human capital probably not that big. Hard to know how big saved firm sunk intangibles are. And there was perhaps a fair amount of inframarginal subsidy expenditures; income support to laid off workers would not involve inframarginal expenditures





Source: U.S. Census Bureau, Business Formation Statistics, November 10, 2022