

# Recessions give businesses time to improve — if governments let them



The Covid-19 lockdowns brought a huge drop in demand for goods and services and unprecedented levels of excess productive capacity – idle factories, machines, and workers. Excess capacity is normally harmful, but there can be a silver lining. When machines and workers are idle, their time can be put to alternative uses. In a healthy economy, time spent on training, innovation, and efficiency improvements comes at the expense of producing, selling and other normal day-to-day operations. During a recession, [these opportunity costs fall](#).

About 40 million U.S. workers are unemployed. In the five largest European countries, some 45 million have applied for government support. Many of those still employed are working fewer hours. If a fraction of this idle time could be used for development, the benefits would be substantial.

Our research on the 2008-09 recession showed how Norwegian firms responded to increases in excess capacity. While two-thirds of those firms saw less demand for their products and services, about 80% maintained or increased their [investments in R&D and innovation](#), and almost 90% kept or added to their [training programs](#). Firms modestly affected by the recession were more likely to boost development spending than firms unaffected or severely affected. Unsurprisingly, firms [facing strict financing constraints](#) resorted to [layoffs instead of reallocation](#).

Can we expect a similar response to Covid-19 regarding development activities like innovation, efficiency improvements and training?

The answer depends on the benefits and costs of retaining and reallocating employees. Shifting idle workers to new tasks can create value, but it depends. An idle engineer probably creates more value from moving to an innovation project than an idle line worker, while a large firm with an internal labour market has more opportunities for reallocation than a mom-and-pop. Today's jobs and tasks are [increasingly knowledge-intensive](#) and workers highly trained, so the potential benefits from internal reallocation are particularly high. Retaining idle employees also preserves organisational culture, respects the “psychological contract” between employees and firms, and protects firm-specific knowledge.

However, the costs to retrain and reallocate workers are likely to be higher today than in the last recession. Mandatory business closures and shelter-at-home orders, as well as voluntary social distancing, put firms in survival mode. Despite a host of government subsidies, many are unable to retain idle employees and allocate excess capacity to development activities. When firm survival is at stake, the immediate cost-saving from layoffs takes priority over longer-term improvements in productivity.

Unfortunately, government policy exacerbates the problem, incentivising firms to sit out the storm rather than put excess capacity to good use. Worker-protection laws in most countries make it illegal to work when furloughed. Such workers have few incentives to invest in education and training, though this is one of the few work-related activities they can legally perform. No one wants to work for free, but letting workers participate in innovation, competence development, retraining and other forms of efficiency improvements, even while furloughed, is good for firms and can benefit workers in the long run with higher wages and better jobs once the crisis passes. Similarly, most unemployment schemes prevent beneficiaries from using their time to start a business, volunteer for a company, or study to improve skills and competences.

There is time to change course and implement policies that support long-term performance improvements. Tax incentives or subsidies for firms that retain workers could include competence and business development requirements instead of limits to work hours. Furloughed employees could be allowed to work on development projects, innovation, and retraining programs in their current firms, even if they are not providing services or generating revenues. Unemployed or furloughed employees could be encouraged to develop new skills as a condition of additional support payments.

Finally, the potential benefits from using excess capacity to invest in productivity enhancements could be considered in evaluating the impact of lockdowns on firms, industries and regions. Our research found that knowledge-intensive and innovative firms are most likely to benefit from excess worker capacity, suggesting that other firms might receive higher priority for reopening.

Ultimately firms, not policymakers, should decide how business can best weather Covid-19 and the measures designed to stop it. Policymakers must not stand in the way of firms that want to do more than maintain the status quo.

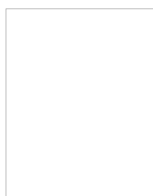


#### Notes:

- *This blog post expresses the views of its author(s), not the position of LSE Business Review or the London School of Economics.*
- Featured [image](#) by [ThisisEngineering RAEng](#) on [Unsplash](#)
- *When you leave a comment, you're agreeing to our [Comment Policy](#)*



**Peter Klein** is a professor of entrepreneurship at Baylor University and a former senior economist with the Council of Economic Advisers. He is affiliated with NHH's Center for Strategy, Organization, and Performance.



**Eirik Sjøholm Knudsen** is an associate professor of strategy and management at the Norwegian School of Economics (NHH), and is affiliated with NHH's Center for Strategy, Organization, and Performance.



**Lasse Lien** is a professor of strategy and management at the Norwegian School of Economics (NHH), and is affiliated with NHH's Center for Strategy, Organization, and Performance.



**Bram Timmermans** is a professor of strategy and management at the Norwegian School of Economics (NHH), and is affiliated with NHH's Center for Strategy, Organization, and Performance.