An Unemployment Insurance System for the EURO Area as an Automatic Stabilizer: Feasable and Desireable?

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A particular worm welcome goes to economic stabilization policies (i.e. smoothing the economic cycle) which seem to be back at the EU stage after having been away for more than two decades. Surprise, surprise! What has happened?

I.) Rompuy Report to European Council meeting on 13/14 December 2012

The Gang of Four (van Rompuy, Barroso, Juncker, Draghi) will present a roadmap "*Towards a Genuine Economic and Monetary Union*" to the Head of States and Government on Tuesday/Friday this week. Under the heading "*Improving the resilience of EMU through the creation of a shock-absorption function at the central level*" they propose, among other things, an insurance system against country-specific shocks. In the microeconomic approach (i. e. unemployment insurance) "*the level of contributions/benefits from/to the fiscal capacity would depend directly on labour market developments. In this scenario, the fiscal capacity would then work as a complement or partial substitute to national unemployment insurance systems. Transfers could, for example, be limited to cyclical unemployment by covering only short term unemployment*." (van Rompuy, 2012, p. 9). In the report, arrangements of a contractual nature on structural reforms and asymmetric shock absorption are explicitly linked to each other. And: "*Elements of fiscal risk-sharing … should be structured in such a way that they do not lead to unidirectional and permanent transfers between countries, nor should they be conceived as income equalisation tools. Over time, each euro area country, as it moves along its economic cycle, would in turn be a net recipient and a net contributor of the scheme.*" (op. cit. p. 10)

II.) In principle a good thing, but …

In case of strong idiosyncratic shocks a risk-sharing instrument working as an automatic stabilizer would be a good thing, of course. But let´s have a closer look to this EURO unemployment insurance in a version that might have served as a blueprint for Rompuy, proposed by Sebastian Dullien[1]: It should be a basic insurance for short term unemployed with spells no longer than 12 months and a benefit level of some 50% of previous earnings. The Euro-system should be financed by national contributions via taxing wages. National unemployment insurance could top up the benefit level and finance long term unemployment. In the period 1999-2011, this European unemployment insurance would have worked with yearly revenues/expenditures of some € 55 billion (0.75% of EURO-GDP) which could be financed by taxing gross wages by some 1.7%. Looking at the US-experiences with their insurance system, Dullien stresses the point of stabilization effects: In Spain, some 25% of the decrease of GDP could have been avoided through this EURO unemployment insurance. In Ireland and Greece this effect would have been in the range of 10%.

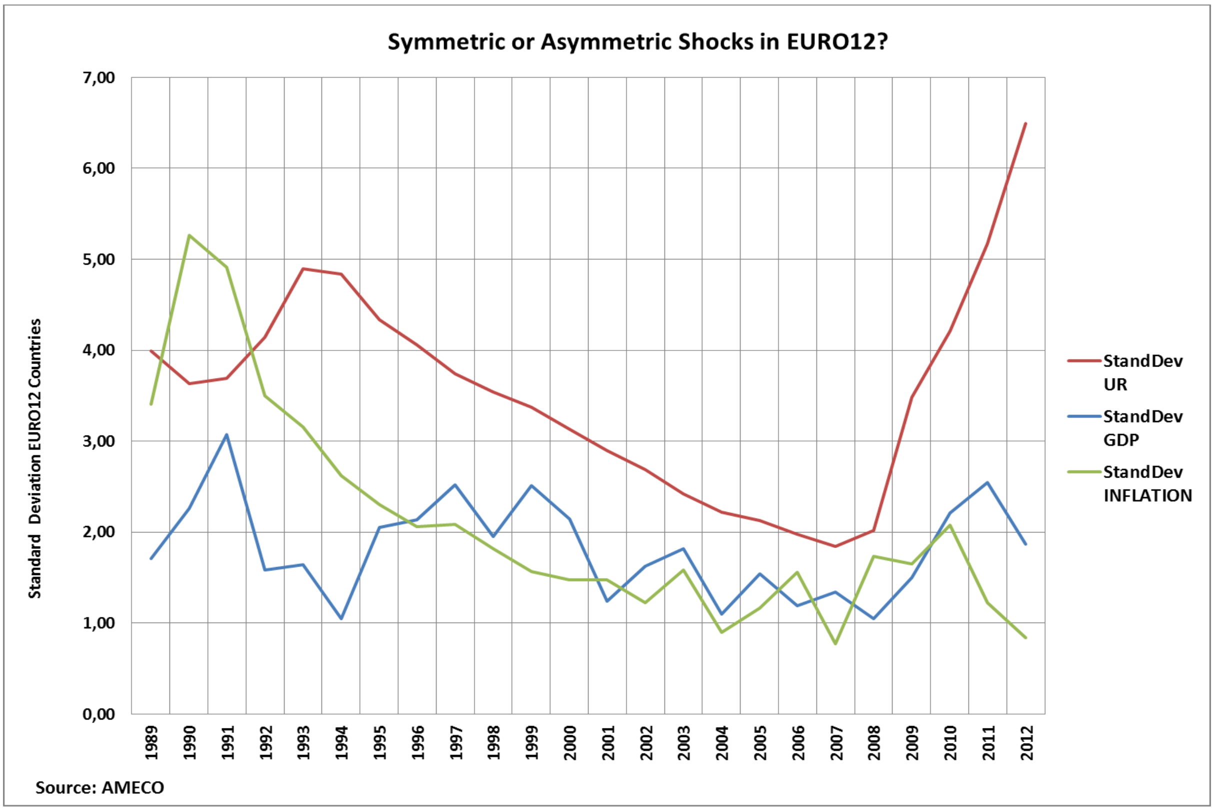
Critiques

- Why should be there stronger stabilization effects across Europe when we have an unemployment insurance fund in Brussels compared to national funds? At this point, the estimates done by Dullien are somewhat vague. Beyond that, why are the stabilization effects so different for the three scenarios (A, B, C with increasing "extended benefits") although the volume of the funds changes only marginally?
- The US unemployment system obviously serves as a role model. But this system is very different from many European systems in terms of eligibility criteria, replacement rates, benefit durations, etc. Just look at expenditures for passive measures (in % of GDP, OECD,

2010): 0.76% (USA), 0.34% (POL), 1.34% (GER), 3.14% (ESP); or coverage rates: some 38% of all unemployed are covered by unemployment insurance in the USA, in Poland less than 20%, in Germany 100% (including unemployment assistance), in Italy slightly more than 30%.

- Heterogeneity is obviously very high even within the EURO area which can be illustrated by another figure: In the Netherlands, unemployment benefit durations range from a minimum of 3 months to a maximum of 38 months. In Italy the range goes from 2-12 months. But for this kind of European unemployment insurance you need a minimum of harmonization between different regulations not at least for fairness reasons. But if you want to kill the whole idea, you should start a debate on harmonization!
- For example: If short term unemployment is to be financed at EURO level, 98% of the Austrian revenues will be transferred to Brussels because 98% of unemployment spells were finished before 12 months in 2010.
- The proposed new EURO unemployment insurance system works effectively only with so called "extended benefits" (in this case the unemployment duration could be doubled). But financing long term unemployment should not be done at EURO level, at least if the criteria posed by Dullien himself are regarded.
- Finally, it´s not clear at all, how permanent transfers from low unemployment countries to high unemployment ones can be avoided – the author explicitly excludes this.

III.) Symmetric or asymmetric shocks?



As can be seen in the graph, the variance of GDP-growth, unemployment rates and inflation decreased from the early 1990s onwards until the crisis in 2008; since then the heterogeneity increased again[2]. If you look at another variable to measure an "European economic cycle", namely, the correlation of Euro-country´s GDP, unemployment and inflation with the average of EURO12, you will find a diverse picture, again: Growth rates of larger countries moved closer with the averaged in the period 1989-2012, but the opposite is true for Portugal and Greece. Regarding unemployment rates, less correlation over time seems to be at work; some core EURO countries like Germany, Belgium, Finland, and Austria even have been negatively correlated with the average in the period 2009-2012. Therefore, there is no easy answer to a simple question, most relevant for an European unemployment system! But for the crisis year 2009 one could say: A symmetric shock with asymmetric consequences!

IV.) Proposal for a top-up insurance with fresh money

So, what about a new proposal: The EURO unemployment insurance is a strictly top-up scheme in case of crisis. By rule (and not political discretion), in times of low growth rates (e. g. between 0.5-1.5%) the unemployed get automatically an extra € 200 up to the median wage and beyond they will get € 100 per month. To preserve work incentives, the unemployed will get an even larger in-work benefit of € 300/200 in case of taking up a new job. Financing should come from new sources like financial transaction taxes or property taxes. Very simple, easy to handle, no harmonization!

V.) Conclusion

In general, economic policy debate at the EU level is highly driven by ECOFIN and its obsession for deficit and cost reduction, there is the danger of an hidden agenda: If ECOFIN would agree on what van Rompuy has proposed, which is extremely unlikely, harmonization of unemployment insurance regulation runs the risk of being an exercise to reduce benefit levels and make the existing systems even more restrictive!

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[1] See Dullien (2007, 2008) and DIW (2012).

[2] For details see Breuss (2009).