

# An Unemployment Insurance Scheme for the Euro Area?

## A Comparison of Different Alternatives using Micro Data

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September 11, 2015, Vienna

# More fiscal integration in the Eurozone?

**Aim:** Improve macroeconomic stability in EA through fiscal risk sharing

- absorb shocks which hit the EMU member states asymmetrically ([Asdrubali et al. 1996](#))
- smooth income fluctuations over time and across regions ([Fatás 1998](#), [Forni and Reichlin 1999](#))

## Concerns:

- Permanent redistribution from high to low income countries/households ([Persson and Tabellini 1996a](#))
- Moral hazard (at the individual level, with administration and economic policy) ([Persson and Tabellini 1996b](#))

# Possible characteristics of an EMU-UI system

Scope: (Partly) replacing or complementing national systems

- Basic EMU-UI: ensure that minimum standards are guaranteed
- Extended Benefits: increase insurance effects in prolonged recessions (in the US: large federal UI extensions in the Great Recession)

Financing: With or without 'experience rating', 'claw-back mechanisms'...

Benefits: 'all-time' or 'trigger'-based

- Non-contingent benefits: EMU-UI permanently in place
- Contingent benefits: EMU-UI kicks-in only in severe economic crises

- Counterfactual simulations of unemployment shocks in EA member states over the period 2000-13 linking EU-SILC and LFS micro data
  - Simulate a sample of repeated cross-sections for EA18 member states reflecting changes in (short-term) unemployment, earnings, size and composition of labor force (re-weighting for 18 socio-demographic population groups)
  - Impute information from EU-LFS and AMECO
  - Introduce a basic EMU-UI that partly replaces national UI systems
- Interpretation of the analysis: what would have happened if an EMU-UI had been created in 2000?

## Key features of the simulated UI scheme (Baseline):

- EMU-UI 50% of previous gross earnings
- Scheme is calibrated so that it is revenue neutral (at EA level) over the period 2000-13. Total contribution rate for EMU-UI: proportional payroll tax of 1.6% on all employment income
- Eligible for EMU-UI benefits are all new unemployed with previous income, up to 12 months

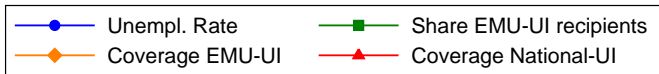
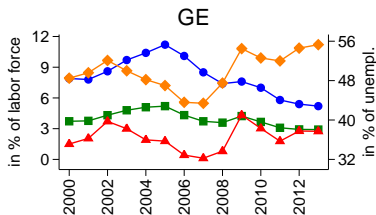
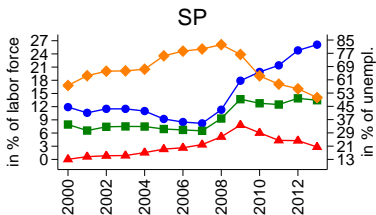
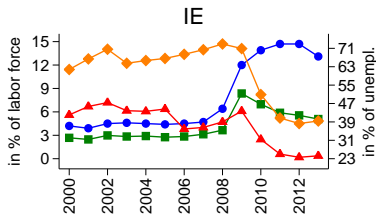
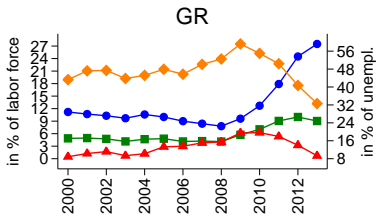
## Alternative scenario:

- 'Contingent' benefits: trigger-based
- (Experience rating, different coverage rates and generosity levels)

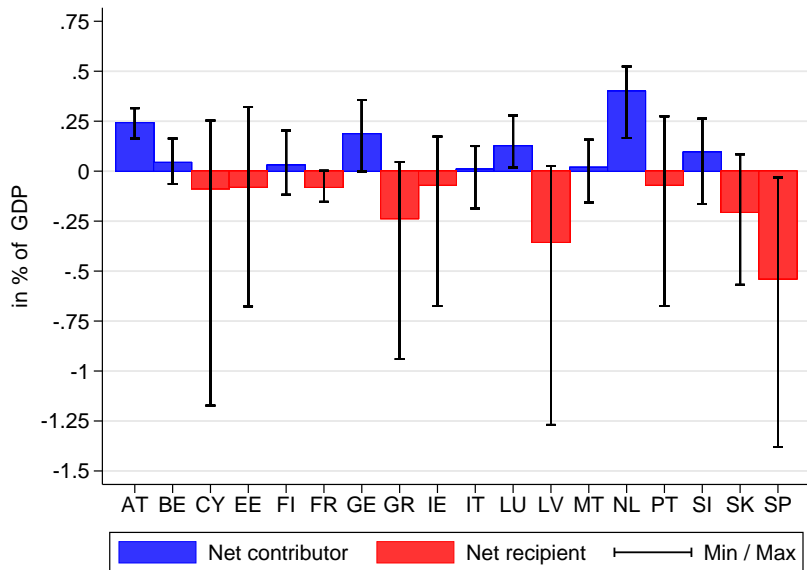
## Main simplifying assumptions:

- Partial equilibrium analysis: does not take into account general equilibrium effects of EMU-UI
- No behavioral responses: individual, government+administration  
→ 'First-round' effects
- Interaction between EMU-UI and national UI systems: national UI systems are cut back, but top-up EMU-UI scheme if national UI system is more generous
- 'Fixed' EMU: analysis as if EA18 had existed from 1999 onwards

# Coverage rates of EMU-UI and national UI



# Average yearly net contributions 2000-13





- Household income stabilization (Dolls et al. 2012):

$$\tau_{hh} = \frac{\sum_i \Delta SIC_i - \sum_i \Delta B_i}{\sum_i \Delta Y_i^{EMPL}} \quad (1)$$

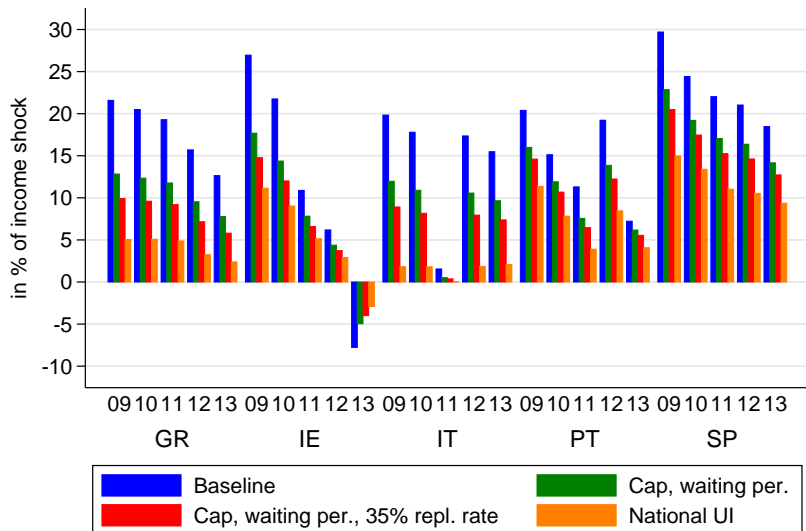
- Government budget stabilization:

$$\tau_{gov} = \frac{\sum_i \Delta B_i^{NAT} - \sum_i \Delta B_i^{NAT, dual-ins.}}{\sum_i \Delta Y_i^{EMPL}} \quad (2)$$

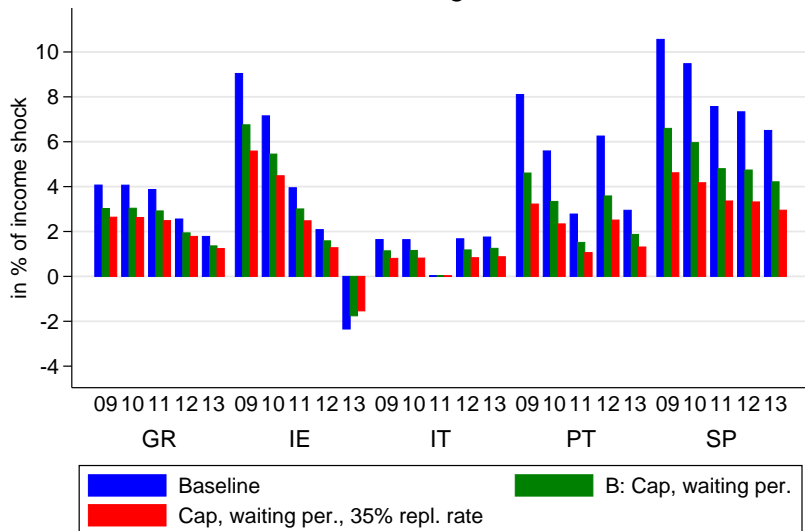
- Total stabilization:

$$\tau_{tot} = \tau_{hh} + \tau_{gov} \quad (3)$$

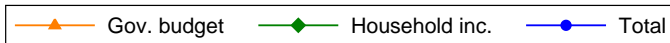
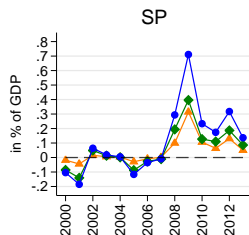
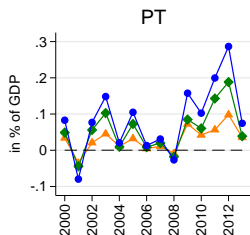
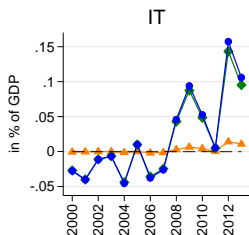
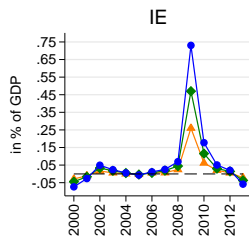
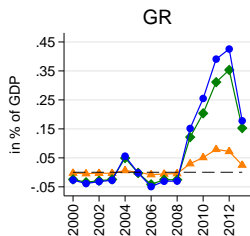
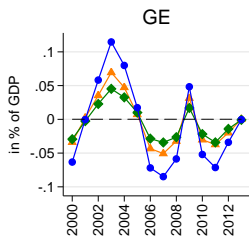
## Household income stabilization



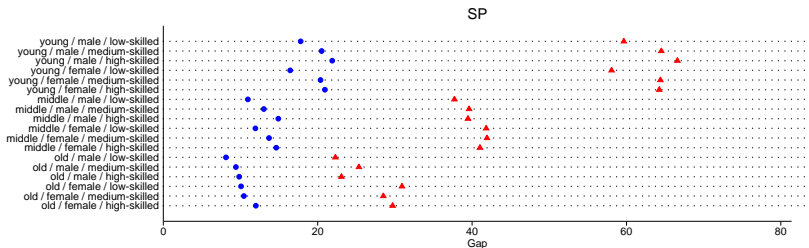
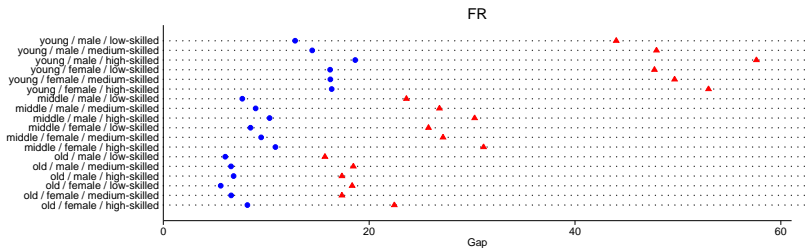
## Government budget stabilization



# Automatic fiscal stabilization

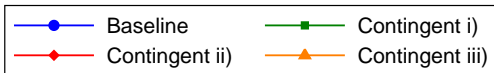
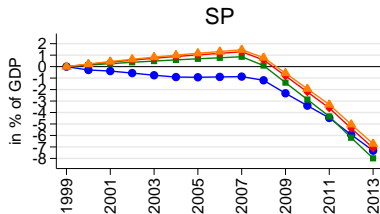
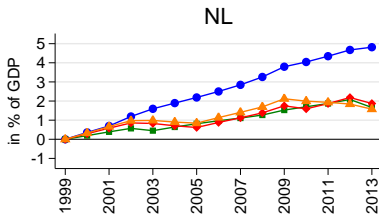
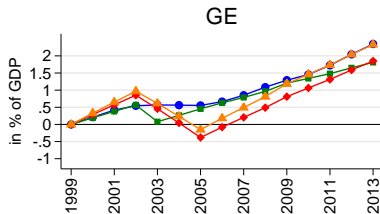
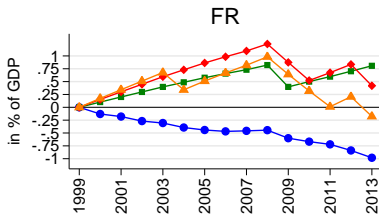


# Within-country heterogeneity



● Stabilization gap ▲ Coverage gap

# Contingent benefits - Cumulative net contributions



- **Budget:**

- A significant EMU-UI scheme could be achieved with a relatively low overall budget (47 bn euros per year over the period 2000-13)

- **Income redistribution:**

- No permanent redistribution *ex-ante*. But: *ex-post*, 4 member states of the EA18 would have been net contributor / recipient in every year
- Experience rating possible way to address this issue
- Contingent benefits would lead to less redistribution (and stabilization), more targeted transfers to MS with deteriorating labor market conditions

- **Automatic stabilizers:**

- Significant short-term stabilization, but effect diminishes the longer the crisis lasts
- Trade-off between automatic stabilization effects and degree of cross-country redistribution

Thank you for your attention!

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# Appendix

# More fiscal integration in the Eurozone?

## Van Rompuy (2012): Towards a genuine economic and monetary union

- *One of the functions of such a new fiscal capacity could be to facilitate adjustments to country specific shocks by providing for some degree of **absorption at the central level.***
- *Moreover, low levels of cross-country labor mobility and structural impediments to price flexibility make economic adjustment mechanisms less effective than in other monetary unions.*
- *Asymmetric shock absorption at the central level would represent a form of **limited fiscal solidarity exercised over economic cycles**, improving the economic resilience of the EMU.*
- *Elements of **fiscal risk sharing** can and should be structured in such a way that they **do not lead to permanent transfers across countries** or undermine the incentive to address structural weaknesses.*

# More fiscal integration in the Eurozone?

## **Possible designs** of a fiscal capacity:

### *Macroeconomic* approach:

- Fiscal insurance mechanism: e.g. transfers according to relative output gap differences ([Enderlein et al. 2013](#))
- “Rainy-Day” Fund ([Furceri and Zdzienicka 2013](#))
- European fiscal equalization mechanism ([Bargain et al. 2013](#))

### *Microeconomic* approach:

- Unemployment insurance scheme ([Dullien 2013](#), [Feyrer and Sacerdote 2013](#))
- Contingent re-insurance mechanism ([Gros 2014](#))
- (Partly) integrated tax-transfer system ([Bargain et al. 2013](#))

# Comparison of different EMU-UI alternatives I

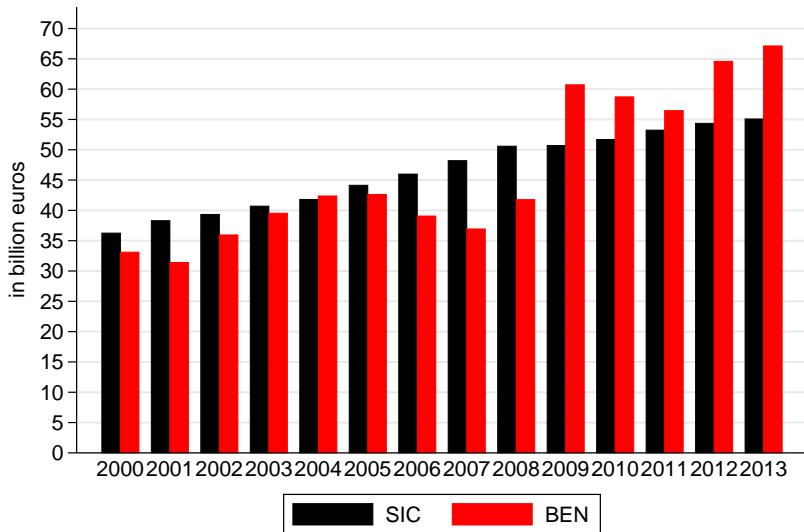
Option	Automatic Stabilization Effects	Redistributive Effects
Basic UI	<ul style="list-style-type: none"><li>- Timely</li><li>- Diminishing effect in prolonged recessions</li><li>- National UI systems could top up</li></ul>	<ul style="list-style-type: none"><li>- No permanent redistribution <i>per se</i></li><li>- Benefits targeted to cyclical unemployment</li></ul>
Extended Benefits	<ul style="list-style-type: none"><li>- In addition to national benefits or if national benefits expire</li><li>- Stabilization in prolonged recessions</li></ul>	<ul style="list-style-type: none"><li>- Risk of permanent redistribution could be higher if extended benefits cover also structural unemployment</li></ul>
Contingent Benefits	<ul style="list-style-type: none"><li>- Triggered if the level/change in unemployment above a certain threshold</li><li>- Only in severe crises</li></ul>	<ul style="list-style-type: none"><li>- Depend crucially on the choice of the trigger and if benefits are paid to the short-term or long-term unemployed (see above)</li></ul>

# Comparison of different EMU-UI alternatives II

Option	Moral hazard
Basic UI	<ul style="list-style-type: none"><li>- National governments would still bear the cost of long-term unemployment</li><li>- Incentives for governments to pursue active labor market policies such as short-time work?</li><li>- Administrative manipulation to increase the number of EMU-UI recipients?</li></ul>
Extended Benefits	<ul style="list-style-type: none"><li>- Cost of long-term unemployment (partly) borne by the common pool?</li><li>- Incentives for governments to cut national UI benefits because EMU-UI steps in?</li><li>- Administrative manipulation to increase the number of EMU-UI recipients?</li></ul>
Contingent Benefits	<ul style="list-style-type: none"><li>- See above</li></ul>

# Budgetary effects and financial flows

EA18



# Experience rating

