

# An Unemployment Insurance Scheme for the Euro Area

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## Van Rompuy: Towards 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 labour 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.*

## Literature

- Stabilization by automatic transfers in a fiscal federation: e.g. Bayoumi and Masson (1995), Asdrubali et al. (1996), Andersson (2008), Balli et al. (2012)
- Optimal fiscal transfers in a currency union and potential insurance in EMU: Forni and Reichlin (1999), Fatás (1998), Evers (2012), Bargain et al. (2013), Dolls et al. (2013), Farhi and Werning (2013), Feyrer and Sacerdote (2013), Furceri and Zdzienicka (2013), Jara and Sutherland (2014)
- Policy proposals for EMU: Allard (2013), Dullien (2013), Enderlein et al. (2013), Gros (2014)

## Possible designs of a fiscal capacity:

1. **European unemployment insurance**
2. European fiscal equalisation mechanism (many different designs, might condition on output gaps, may also be related to ‘structural reforms’)
3. European tax and transfer system (and the right to incur debt - probably something for the ‘US of E’)

## Options for design of a Eurozone wide UI scheme :

- ‘Bismarck’ vs ‘Beveridge’ type
- With or without ‘experience rating’
- (Partly) replacing or complementing national systems
- **Basic insurance, national systems may ‘top up’.**

# **Simulation experiment and key results**

## Empirical Approach:

- European tax benefit calculator EUROMOD: harmonized 2007 household micro data and tax and transfer systems for the EA17
- EUROMOD allows for counterfactual simulations:
  - Simulate a sample of repeated cross-sections for each country over the simulation period 2008-2013 reflecting changes in unemployment, short-term unemployment and earnings
  - Assumption: structure of the new (un)employed equal to total population
- Interpretation of the analysis: what would have happened if a common unemployment insurance scheme in the euro area had been created in 2007?

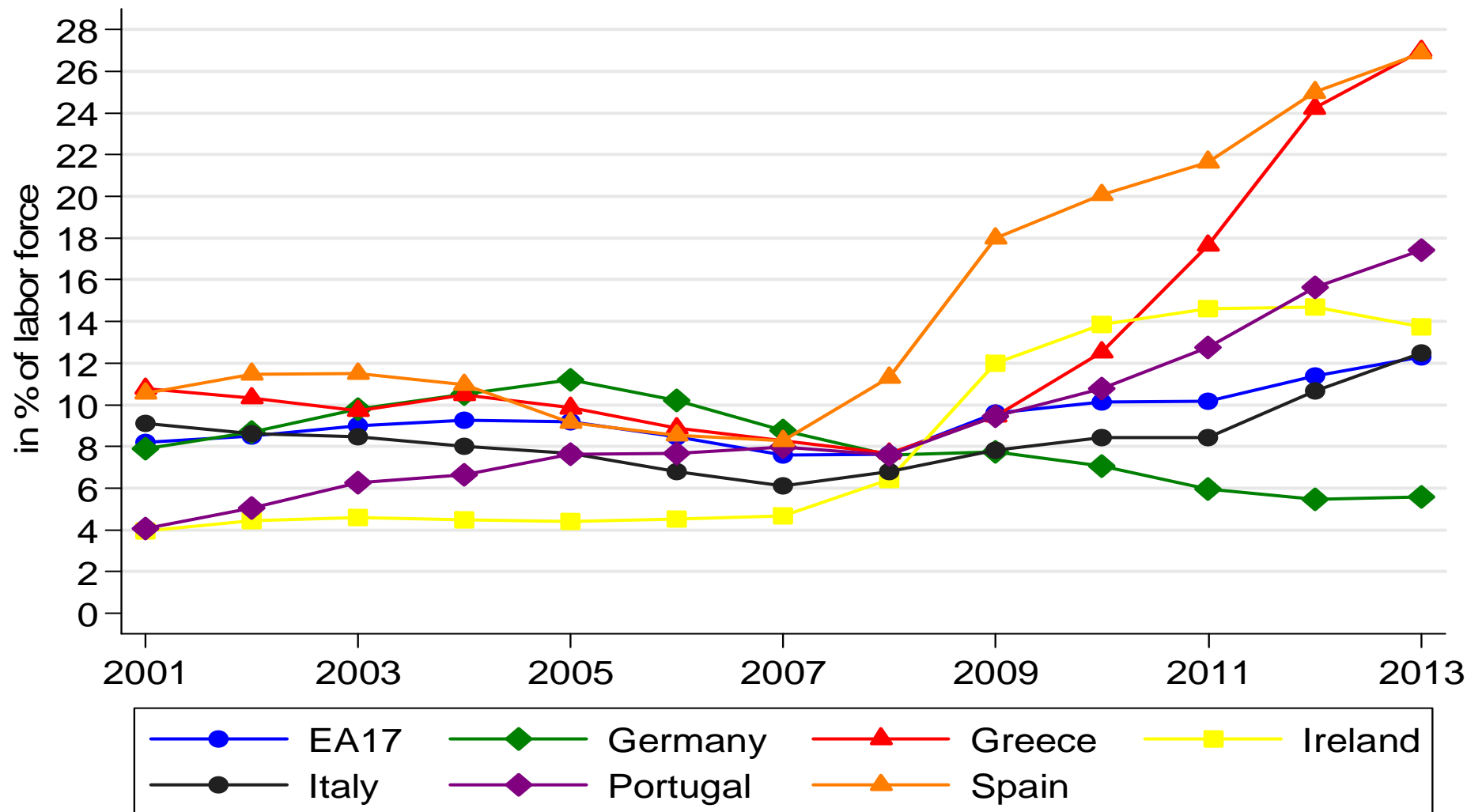
## Key features of the simulated UI scheme:

- EMU-UI 50 per cent of previous earnings
- Scheme is calibrated so that it is revenue neutral over the period 2008-2013. Total contribution rate (i.e. sum of employer and employee SIC) for EMU-UI: proportional payroll tax of 1.9 % on all employment income
- Eligible for EMU-UI benefits are all new unemployed with previous income, up to 12 months
- Total volume at EMU-level: 365 billion euros over the period 2008-2013



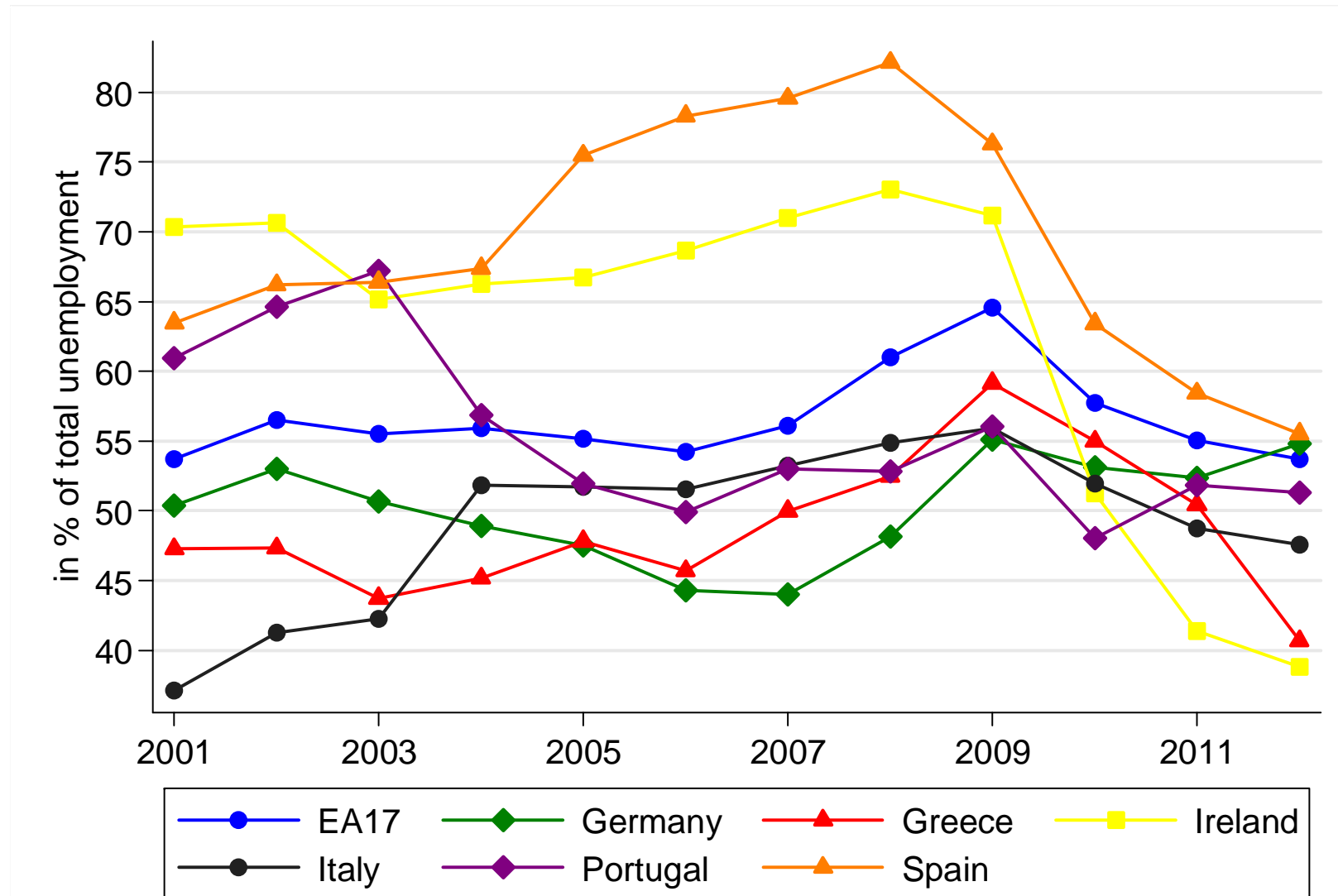
## Unemployment rates and coverage 2008-2013

# Unemployment rates in selected EA member states



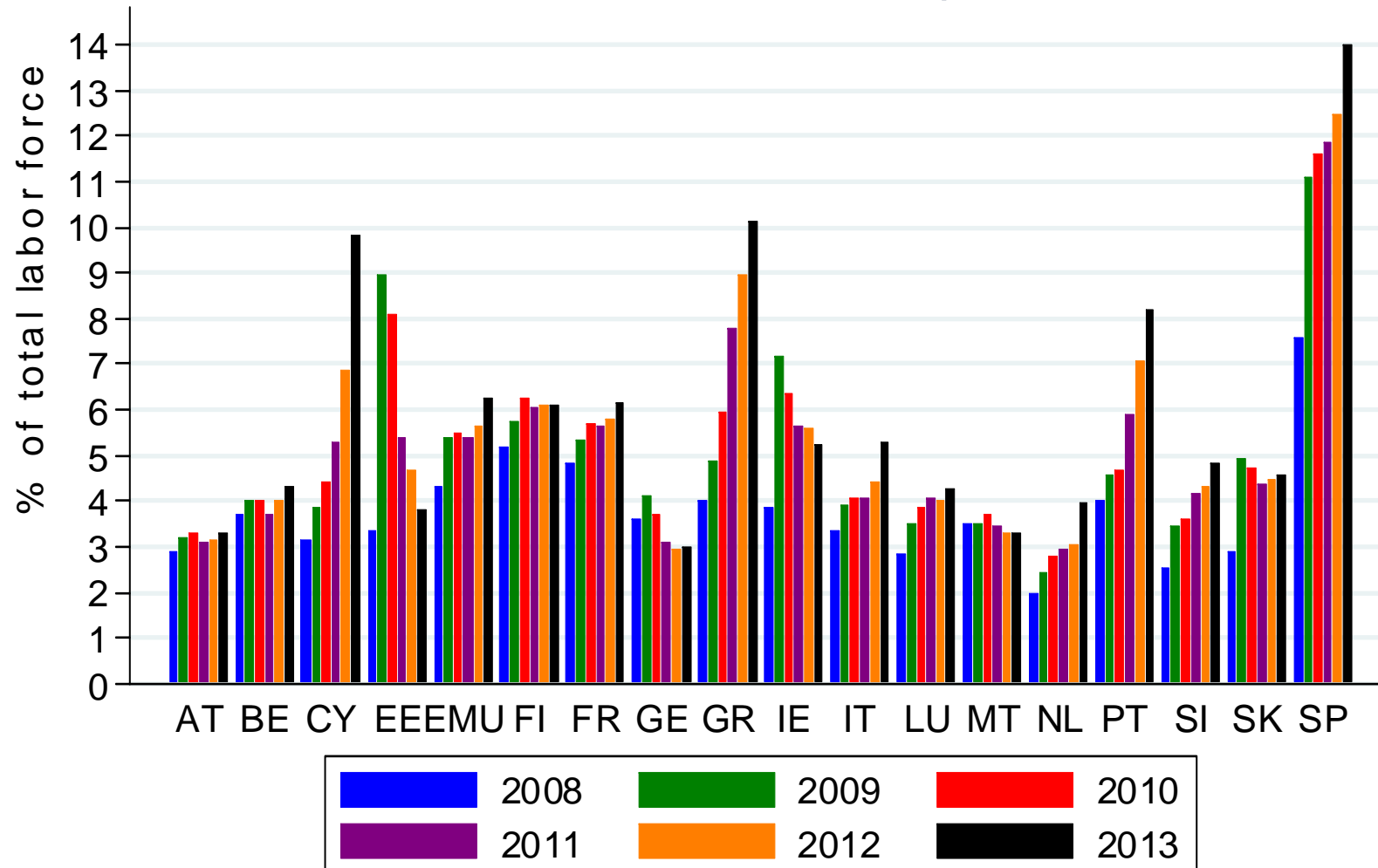
Estimate for 2013  
Source: IMF

# Share of short term unemployed 2001-2013



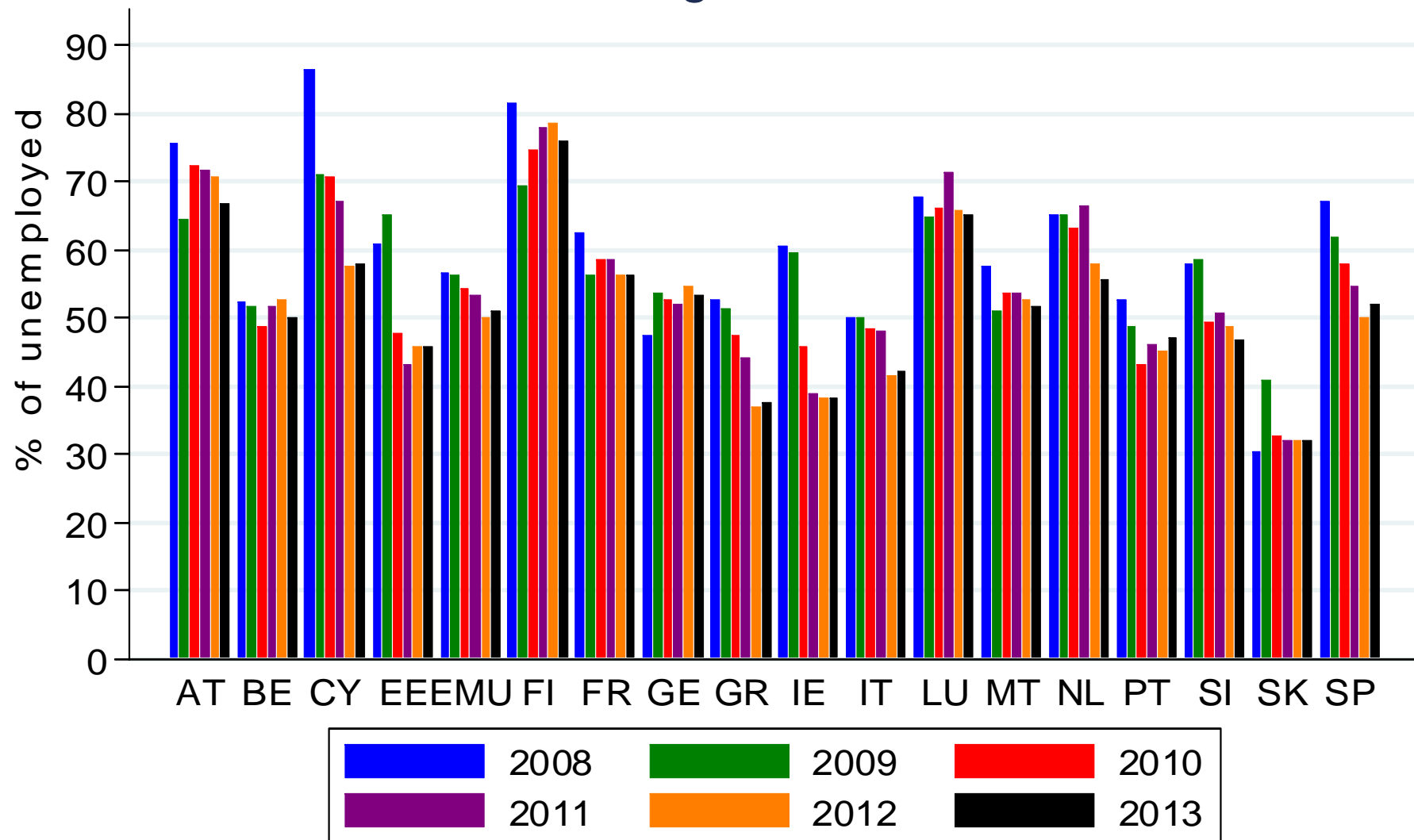
Source: Eurostat

## Share of EMU-UI recipients



Source: Own calculations based on EUROMOD

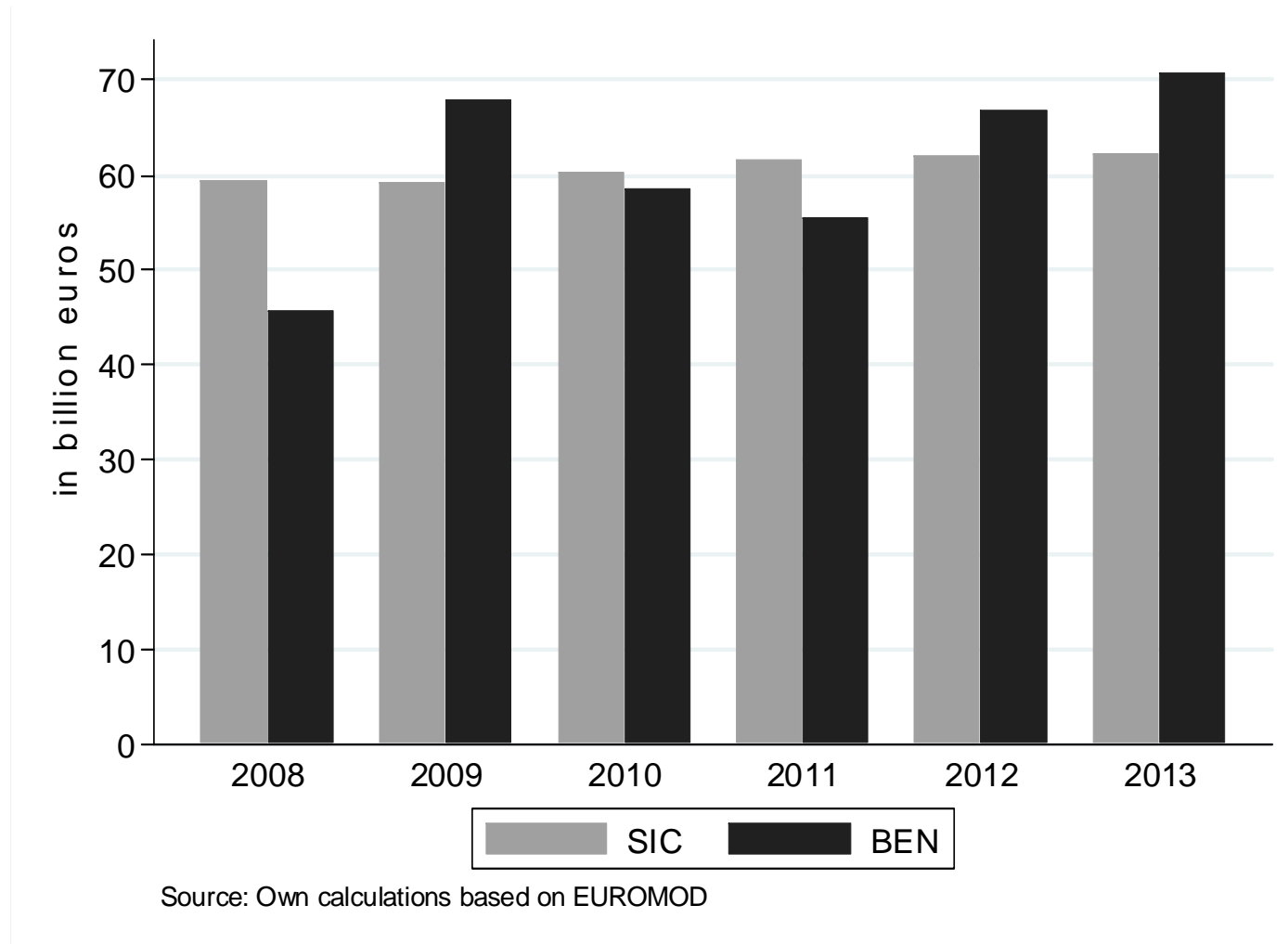
## Coverage rate EMU-UI



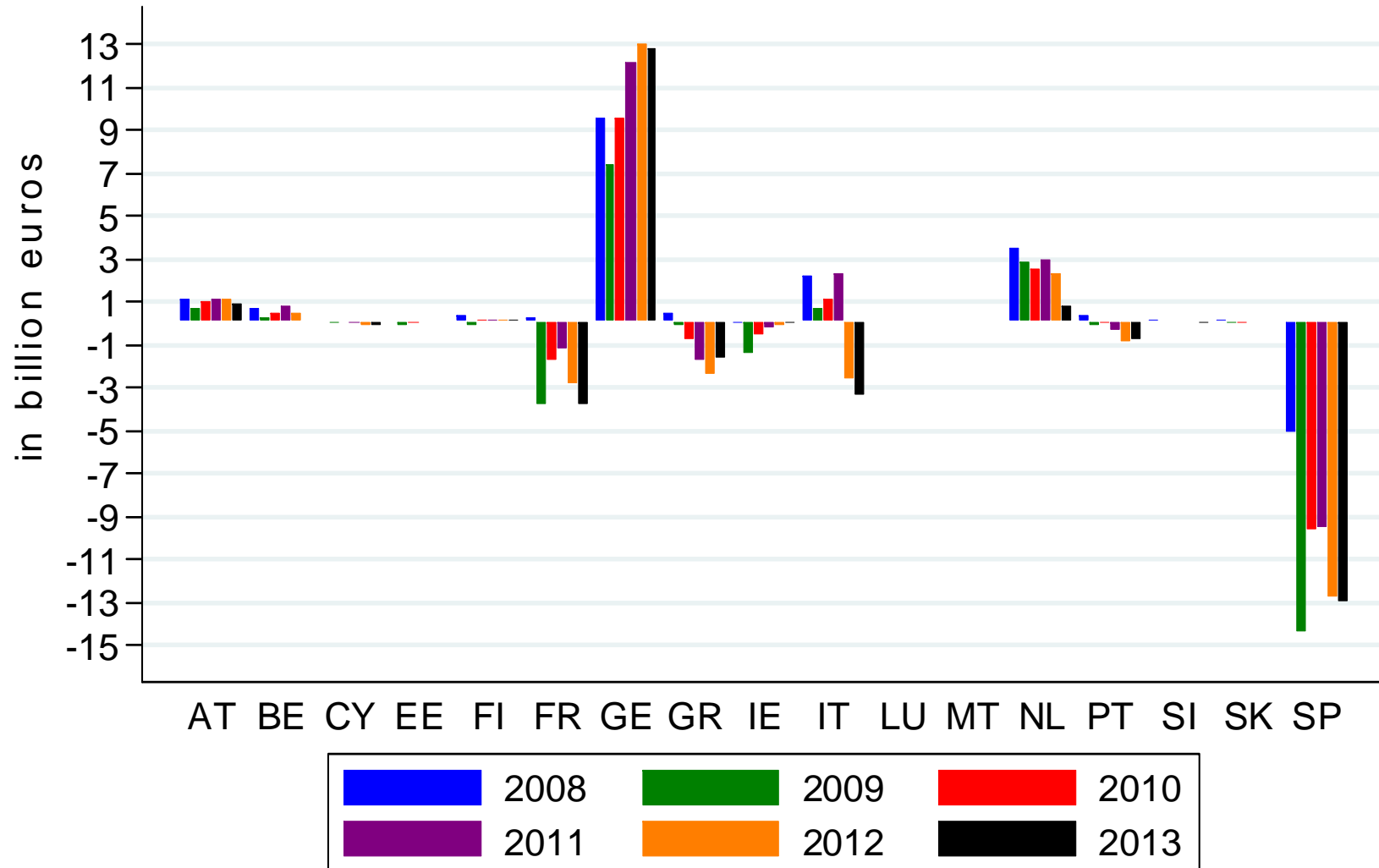
Source: Own calculations based on EUROMOD

## Budgetary Effects and Financial Flows

# Overall contributions and benefits 2008-2013



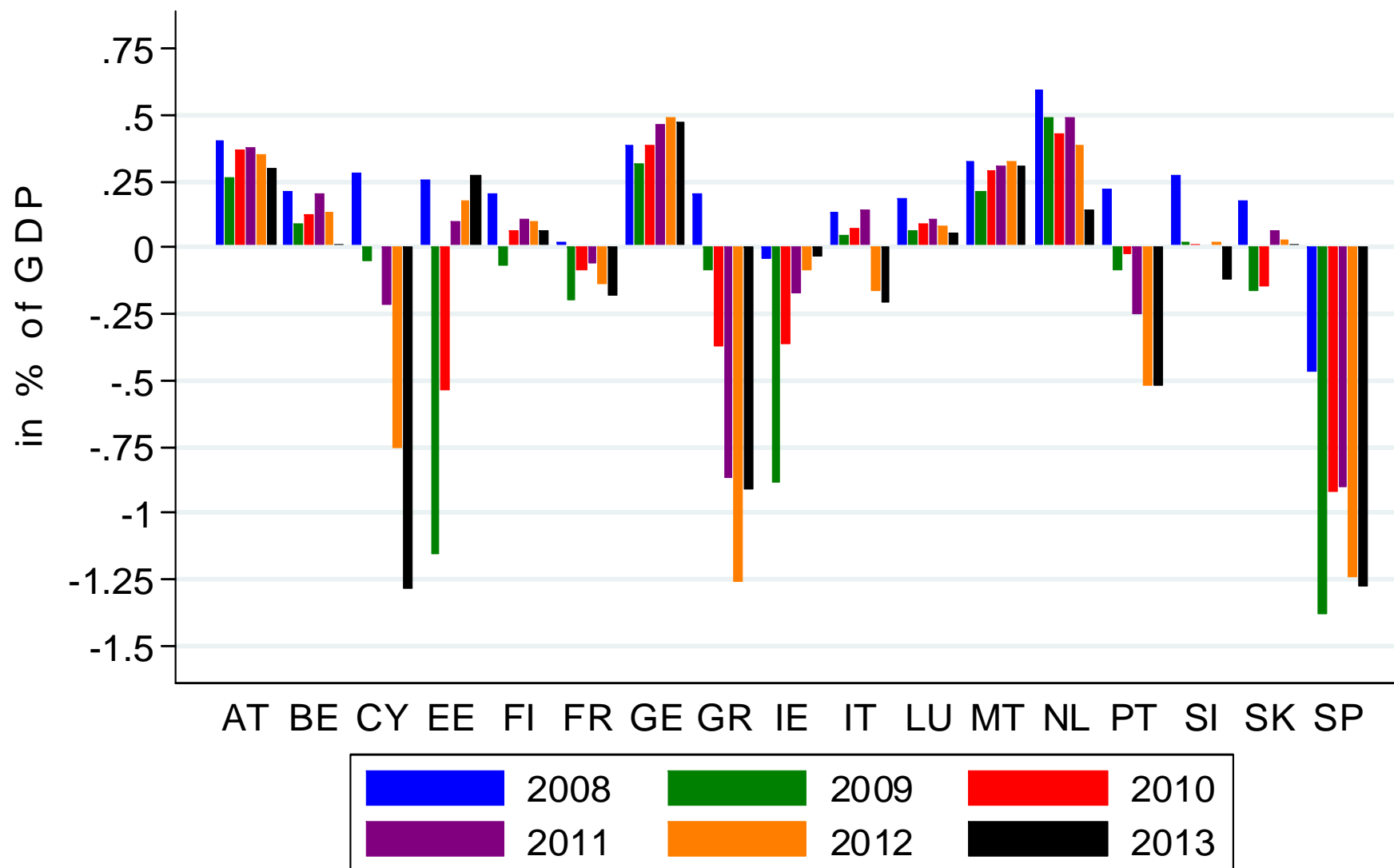
## EMU-UI Net contributions 2008-2013



Source: Own calculations based on EUROMOD



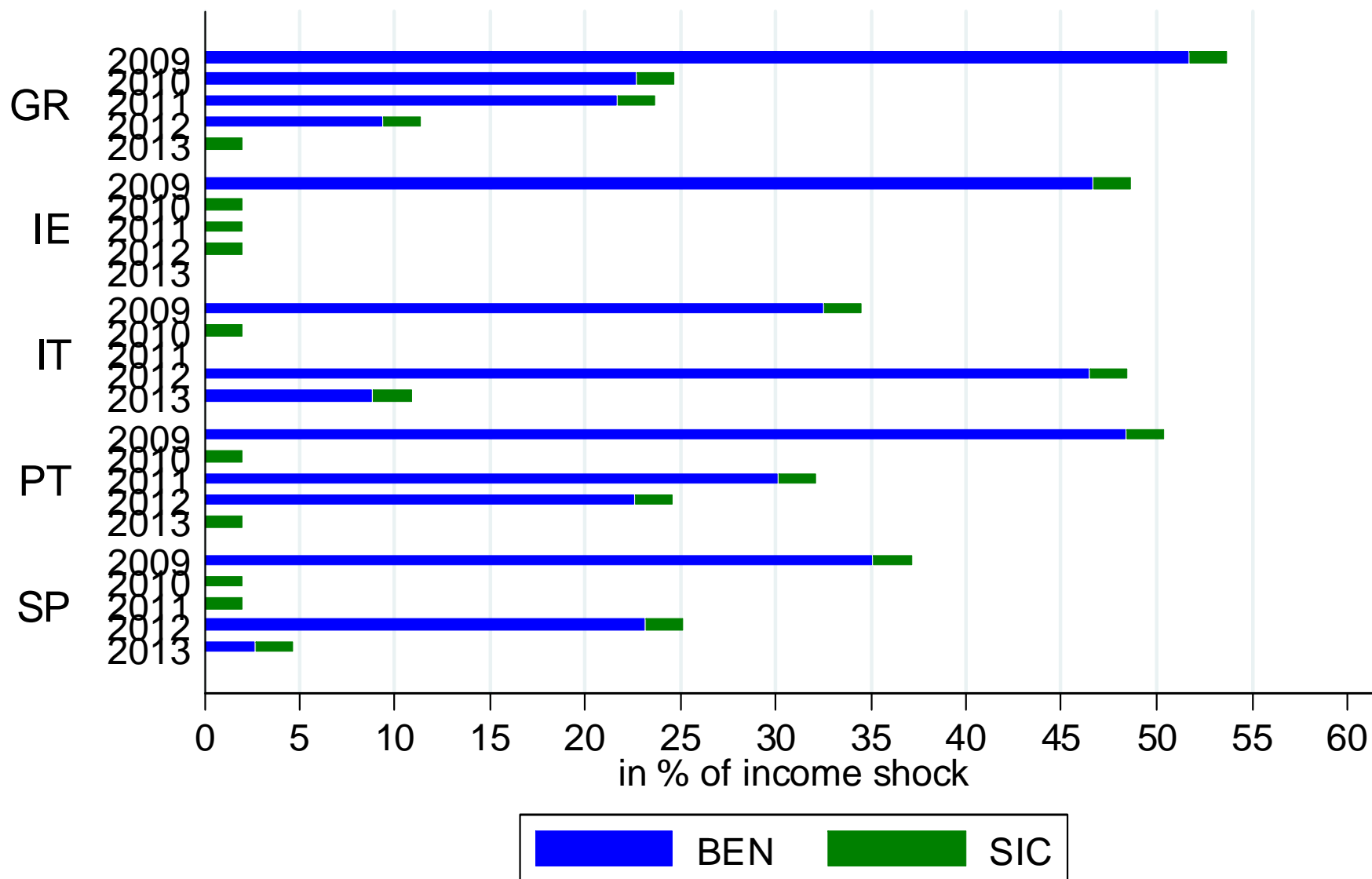
## EMU-UI Net contributions 2008-2013



Source: Own calculations based on EUROMOD

# Automatic Fiscal Stabilisation

## Income Stabilization EMU-UI BEN+SIC



Source: Own calculations based on EUROMOD

# Conclusions

- A significant Euro Area UI scheme could be achieved with a relatively low overall budget (61 bn Euros per year)
- Advantage: No permanent redistribution ex-ante, benefits related to wages
- How does a European Unemployment Insurance system perform in terms of stabilisation? Significant short-term stabilisation
- Raises many issues regarding design and administration that need to be addressed.

# Outlook and ongoing work

- Cover extended time period starting in early 2000s
- Sensitivity checks w.r.t. replacement rate, caps on benefits, waiting period and coverage
- Experience rating and claw-back
- Simulate US-style benefit extension program for the euro area and compare it with basic UI scheme



**Thank you very much!**  
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