A European Unemployment Insurance Scheme?

An Interview with Sebastian Dullien

By Thomas Vendryes

First evoked in the 1970s, the idea of a European unemployment benefit scheme has recently become a topics of debate among academics and policy-makers, as it could constitute a way to deal with the macroeconomic imbalances within the EU and the Eurozone. In this interview, Sebastian Dullien presents how such a scheme could work, its potential economic consequences - and whether it would be politically realistic.

Books & Ideas: It seems there has been, over the last few years, a growing academic and political debate, partly stirred by the European institutions, about the development of a European-wide unemployment benefit scheme (UBS). Could you remind us of the birth and development of this debate? In particular: why has such a possibility recently become a topic of policy debate?

Sebastian Dullien: To my knowledge, the first detailed mentioning of the idea of a European unemployment insurance was in the 1975 Marjolin report of an expert group set up by the European Commission on necessary steps to achieve a European Monetary Union. The idea was based on the realisation that in a monetary union, member states lose their monetary policy autonomy and that an alternative instrument might be needed to influence the national business cycle. The European unemployment insurance was seen to provide just such an instrument.

When the European leaders became serious about creating a common currency in the early 1990s, again schemes along the line of a European Unemployment Insurance were discussed, but discarded, as the idea lacked political backing at that time and economists had grown confident that a monetary union could work without cross-border transfers and without a centralized fiscal budget. As this was a time when many economists believed in the supremacy of markets, the idea was that countries could self-insure through financial markets.

The new debate on a EUBS started after the onset of the euro-crisis in 2010, when it became obvious that the euro-area was not working as well as many had taken for granted. First, it became obvious that many member states had overspent in good times and they now had to cut expenditure in bad times as they risked losing access to financial markets to finance their fiscal deficit. At a moment when their economies were producing well below potential output, their fiscal policy was further weakening aggregate demand.

At that time, politicians looked at remedies for high and rising unemployment in some countries. The specific discussion on a European Unemployment Benefit Scheme was strongly pushed at the EU level by the European Commissioner for Employment of that time, László Andor. As I had written some papers on divergences in the euro-area and a potential European unemployment insurance in 2007/8, I quickly got drawn into this debate.

Today, the idea of a EUBS has a certain appeal as it could be one element of a fiscal capacity for the euro-area. It seems attractive as it could lead to rule-based transfers between euro-area countries which help stabilize diverging business cycles between the countries. In addition, unemployment insurance systems in Europe are usually perceived very positively by the population. If the European level could strengthen unemployment insurance, one could hope that people might judge the EU more positively again.

***Books & Ideas*: In your contributions to this debate, you stress that a European UBS could act as a macroeconomic stabilisation device. But could you explain how unemployment benefits contribute to macroeconomic stabilisation? And why are the existing national UBS not sufficient?**

Sebastian Dullien: Macroeconomic stabilisation would mean that booms and busts in the euro-area and especially in single countries are mitigated. An unemployment insurance could do so as it would drain purchasing power from a country in a boom (when the country pays higher contributions due to high employment growth) and would support countries in a downturn (as funds would be channelled to that country when unemployment increases).

National unemployment insurances usually cannot fully fulfil this purpose in the euro-area as their finances are part of general government accounts and hence subject to the fiscal rules such as the Stability and Growth Pact and the Fiscal Compact. What we have seen in the past years is that countries have cut unemployment benefits in the recession and cut unemployment contributions in a boom, actually reducing the stabilisation effect of national insurance system.

A European Unemployment Insurance would introduce a system of automatic stabilisation on the euro-area level which national politicians could not tamper with and which would not fall under the rules of the Stability and Growth Pact or the Fiscal Compact.

Books & Ideas: **Compared with the series of currently existing national UBS, a European-wide UBS would have to cover very different countries, with very different economic performances and labour markets, so how would it make sense to have a unified UBS?**

Sebastian Dullien: A number of models have been discussed. The model I have advocated for a long time would just provide a basic unemployment insurance. For every worker in the euro-area, employers would pay part of the wage into a common fund, and in the case of unemployment, he would get benefits depending on his former wage (for example 50 percent of former wage income up to 50 percent of median income in the country) for a limited period of time, say 12 months. National systems could then top up these benefits or prolong the duration with their own funds.

Such a system would only cover those who become unemployed out of former employment, and the pattern of unemployment among this group of workers is much more similar between euro-area countries than other characteristics of the labour market. For example, such a system would not cover large parts of youth unemployment (as most of the young unemployed come out of education, not out of former employment) which differs very much between euro-area member states as the education system is very different between the countries. A common insurance along these lines could well work.

Books & Ideas: **In your contributions to this debate, you've tried to assess and estimate the stabilisation impact of a European UBS. Could you present synthetically your methodology, as well as your results?**

Sebastian Dullien: What I did in my work was running historical simulations for the time since 1999, based on data on the number of unemployed, average wages and unemployment duration. Based on the estimated payment flows into and out of a hypothetical European unemployment insurance, I calculated how much recent recessions could have been reduced. While this is a rather rough estimate, I think the magnitudes from the simulation are about right.

Depending on specific parameters chosen, for example on the level of replacement payments, quite substantial stabilisation could have been possible. For example, it looks as if such an unemployment insurance could have reduced the Spanish recession from 2007 to 2009 by more than 20 percent, meaning that the drop in GDP experienced could have been reduced by one fifth.

The Brussels-based think tank CEPS ran similar simulations for different specifications of a European unemployment insurance, including models of a re-insurance, under which the system would not insure individual workers, but would provide transfers to national unemployment systems (see below). In a fully specified macroeconomic model, they looked at how a hypothetical European unemployment system both would have changed historical economic experiences and how it would react if specific macroeconomic shocks hit single member states. They also found quite significant stabilisation effects, at least for some specific variants of European Unemployment Benefit Schemes.

***Books & Ideas:* One consequence of a European UBS would probably be net financial flows running from European countries with lower unemployment to countries with higher unemployment. Would that be economically sound, and fair?**

Sebastian Dullien: As the system would not cover the long-term unemployed, flows could not be predicted as easily as you state. Remember that in a system with direct claims, unemployed would only receive benefits for a limited time, and only if they had been in insured employment for a certain time before losing their jobs. In countries with structurally high unemployment, usually only a small share of the unemployed fulfils these criteria. For example, despite high levels of unemployment, Greece at the moment would not receive much from such a system, as most unemployed there would have long exhausted their benefits. This also means that the system by itself would not create permanent transfer flows.

What the simulations show is that most countries would have been net recipients during some periods since 1999, and net flows over a longer time period would have been much smaller than feared by many. Germany, for example, would have received large net benefits in the early 2000s, when the country was dubbed the "sick man of Europe" and the number of unemployed reached 5 million. On the other hand, it would have had to pay in in net terms during the euro-crisis as it did very well during this time.

But if it is true that economic fate in the euro-area is shifting, and no country can be sure that it never will be at the bottom of labour market performance, an unemployment insurance is a good instrument to make downturns less painful.

This is both economically efficient, as it prevents even deeper recessions, and it is fair, as every country can be victim of an especially deep downturn.

Books & Ideas: What would the alternative solutions to a European UBS be?

Sebastian Dullien: First, one can think of different variants of a European UBS. One option would be a re-insurance, under which transfers are made to national budgets or national unemployment insurances based on some formula which takes unemployment rates into account. In this case, transfers would be made between the countries, but not directly from the European system to individuals. Such an approach would need much less administration than a proper, genuine EUBS with individual claims.

Another option would be some other transfer systems between national budgets. Here, transfers between member states would be based on some alternative statistical indicator other than the unemployment rates, such as the output gap estimation for each country made by the European Commission. A problem with such a system is that these alternative indicators seem much less reliable than the unemployment rate and that it would be politically difficult if some econometricians in Brussels decide that, let's say Spain has to pay €5 billion to Germany because of that calculation.

Alternatively, one could imagine a discretionary fiscal policy authority with a euro-area budget which can spend money in euro-area countries which are especially hard hit by a recession, for example by constructing new infrastructure. The problem with this proposal is that mutual trust between the different country groups in the euro-area seems to be rather low at the moment and it is difficult to come to a compromise on how the allocation of funds would be decided.

Some of these options, such as an investment budget, could also be enacted in addition to a EUBS.

Books & Ideas: A European UBS would imply a high level of solidarity between the different European countries and their citizens – and even maybe an expansion of the budget and financial autonomy of European institutions compared with the member states. So do you think a European UBS would be politically feasible in the current context?

Sebastian Dullien: In how far a European UBS would need a high degree of solidarity between member states depends very much on the specific details of such an insurance. French as well as German house owners routinely have insured their houses against flooding or fire with the French insurance company AXA. When a heavy flood hits Southern France, the fees from German households are used to cover the damage. Yet, no one would say that this requires a huge degree of solidarity between the German and French house owners. If you think of an unemployment insurance in a similar way, you do not need a lot of solidarity for being part of such an insurance system – such an insurance is then just a way to mitigate large risks.

Of course, a EUBS to a certain extent would mean an expansion of the power of the European level and hence a reduction of the member states' countries (after all, they could not cut benefits in their own country below the level paid from the European system). However, compared to the sovereignty ceded before, this would rather be a minor step.

In how far the introduction of such a system is politically feasible is another question. Some of the variants discussed seemed to be possible to introduce without changes in the EU treaty, while for others you would probably need treaty changes.

Anyway, you would need at least a consensus of the largest member states. Originally, after Emmanuel Macron was elected as president in France and Angela Merkel had hinted that she might be willing to discuss proposals for a euro-zone fiscal capacity, I was rather optimistic that some kind of European Unemployment Benefit Scheme, be it as a proper, genuine insurance or as a re-insurance mechanism, could be part of a grand bargain between Germany and France. After the German election and the prospect of the FDP (which is rather unconstructive when it comes to euro-area questions and lacks macroeconomic expertise) in a German coalition government, I am now much less positive, both for the EU and meaningful euro-area governance as a whole.

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