

For a federal European Unemployment Insurance Scheme

INTRODUCTION

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The economic crisis has highlighted the fundamental flaws of the European Economic and Monetary Union. Stabilisation by the market, on which the euro was funded, proved ineffective in the face of a deep downturn and the erosion of political trust. The Eurozone requires automatic stabilisers able to effectively manage the impact of asymmetric shocks to the European economy. The idea of a European Unemployment Insurance Scheme (EUIS) has become popular among politicians and scholars, but discussions are still marked by deep divergences regarding the extent, scope, purpose and structure of any such system.

This paper strives to identify how an EUIS could benefit the euro area and which characteristics it should have. It begins by examining the US Unemployment Compensation system, providing considerable insight on the stabilising effects that could be expected from an EUIS, as well as illustrating how a federal-level system can be conciliated with a variety of state social regulations.

An overview of the major contributions to the discussion on the establishment of an EUIS illustrates the potential for such a scheme to prevent or cushion future sovereign-debt and economic crises in the Eurozone. This would be achieved by relieving Member States' social systems when their finances most need it and by providing anti-cyclical stimulus.

The paper concludes by proposing the creation of an EUIS fully managed at the European level, able to cover a significant part of short-term unemployment benefits. A European Fund financed through a common tax rate and hosting European and national accounts would help address the potential for moral hazard. Finally, this construction should be complemented by an institutional overhaul of the EU, giving it exclusive competence in dealing with unemployment resulting from serious economic downturns. The European Commission's legitimacy should be improved in order to allow it to carry out the harmonisation of a part of national social policies. ■

“Unemployment insurance is a federal-state system of shared responsibilities and powers. These powers and responsibilities should be shared in the most effective possible manner. Whenever appropriate, state governments should assume broad responsibilities for determining the elements of their Unemployment Insurance programs. The federal program should assume responsibility primarily in those areas in which both an essential national interest exists and states’ interest may diverge from those national interests. [...]” (Findings and Recommendations: Defining Federal and State Roles, in: Advisory Council on Unemployment Compensation, Collected Findings and Recommendations: 1994-1996, Washington, DC, 1996)¹

THE SCOPE OF A EUROPEAN UNEMPLOYMENT INSURANCE SCHEME

In the 1930s, US President Franklin D. Roosevelt promoted three federal policies to address the high level of unemployment resulting from the Great Depression that the states acting alone were unable to reduce: 1) a public investment policy aimed at creating jobs, of which the Tennessee Valley Authority is amongst the most relevant examples; 2) a federal civil service for the young; 3) a country-wide federal unemployment insurance scheme. This reflection paper analyses this final policy with a view to the introduction of a European federal unemployment insurance scheme.

The European Commission's reports “Economic and Monetary Union 1980” (also known as the *Marjolin Report*) of 1975 and the McDougall² Report of 1977 already indicated that the establishment of an Economic and Monetary Union (EMU) would require the creation of a European unemployment benefit scheme. Such a scheme would not only foster EU citizens’ support for the European project; it would also allow the impact of structural reforms required by the single market and the single currency to be mitigated through European measures, avoiding placing the

burden on the individual Member States. Almost 40 years later the same recommendation was restated by the European Commission in its 2012 *Blueprint*³, by the European Council's 2012 report on a Genuine Economic and Monetary Union⁴ and by the European Parliament⁵ and, more recently, by the Italian Finance and Economy Ministry⁶.

The Commission and the European Council reports proposed a fiscal union among euro-area countries as a first step towards an additional genuine own fiscal capacity for the Eurozone.

¹ In: Advisory Council on Unemployment Compensation, Collected Findings and Recommendations: 1994-1996, Washington, DC, 1996.

² Commission of the European Communities, *Report of the Study Group on the Role of Public Finance in European Integration*, Volume I, Brussels, April 1977.

³ European Commission, *A blueprint for a deep and genuine economic and monetary union: Launching a European Debate*, COM(2012) 777 final/2, November 30.

⁴ Van Rompuy, H., *Towards a Genuine Economic and Monetary Union. Report to the European Council*, in collaboration with Barroso, J. M., J.-C. Juncker and M. Draghi, 5 December 2012.

⁵ European Parliament, *Common unemployment insurance scheme for the euro area*, September 2014. Juncker and M. Draghi, 5 December 2012.

⁶ European Unemployment Insurance Scheme, in: www.mef.gov.it/documenti-allegati/2015/note_unemployment/note_unemployment_insurance_2015_5OCT.pdf and Politi J., *Italy pushes for Eurozone jobless insurance scheme*, in: Financial Times, 5 October 2015.

In particular, one of the measures proposed was the establishment of a European Unemployment Insurance Scheme (EUIS). The rationale for such a proposal is at least twofold. On the one hand, national governments, even with sound public finance, hesitate to implement expansive policies, although, given the high level of economic integration between their markets, expansive fiscal policies would largely benefit other Member States.

Therefore measures such as granting benefits to unemployed workers must, at least partially, be promoted at the European level. On the other hand, in Europe wage rigidity is higher and inter-regional mobility lower than in the United States. For this reason, the real variables (employment and production) are the main adjustment factors in case of economic crisis in Europe, instead of the nominal variables, such as the level of prices or nominal wages⁷. The adjustment cost at the national level is consequently higher than in the presence of European compensatory policies, and increasing unemployment rates cannot be seen only as the result of bad policy practices in Member States.

The “house-in-order” doctrine, upheld in particular by Germany, does not consider this cost for Member States. Indeed this doctrine, criticised by Tommaso Padoa-Schioppa⁸, does not take the reciprocal economic, financial and commercial links between European States into consideration, ignoring by the same token the

necessity of a supranational level of government aimed at managing such interrelations. In the social field, these interrelations would lead to a situation where if one government pursued public-finance consolidation through pro-cyclical policies as a result of an economic downturn and at the same time another country did not want to see its sound balance sheet affected by expansive measures, the aggregate result would not only lead to increased European unemployment, but also to a sensation among European citizens that national sacrifices are not compensated by a European policy, leading to a dangerous growth in anti-European feelings.

The objective of the European project is the establishment of a European policy based on solidarity between European citizens and Member States. As a potential spin-off, a European Unemployment Insurance Scheme could act as a regional anti-cyclical stabiliser and support the public finances most affected by an economic crisis. It is therefore essential to support a European policy meeting EU citizens' demands for social security, which national governments, handcuffed by consolidation policies, are failing to provide.

However even if it is well known that the establishment of a European political union is a very

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different endeavour compared to the creation of a nation state, the debate about the transfer of competences to the European level is often framed in the terms of a bureaucratic and centralised nation state. This is why, for instance, in the field of defence, the creation of a European army is envisaged as a replacement for national armies. By contrast, any European unemployment insurance scheme would only partially replace existing national systems. However as the birth and development of the American federation shows, the transfer of competences to a federal authority is done at a slow, if not very slow pace, and instead of being a linear process, it takes a rather tortuous path. The US Advisory Council on Unemployment Compensation sheds some light on the terms that should frame the debate about the establishment of a federal European unemployment insurance scheme (hereafter EUIS). While the European nation states should still carry the main responsibility of granting unemployment benefits, the European level should endorse responsibilities pertaining to the general European interest, should it differ from that of the individual Member States.

At this point it is necessary to present two considerations that will be further developed in the following paragraphs. First, the issue at stake is not to set up an EUIS which would play the role of an *automatic* stabiliser for economic cycles. In the US, such a system only has considerable

⁷ Beblavy M., Ilaria Maselli (2015), *The case for a European unemployment benefit scheme*, CEPS Commentary.

⁸ Tommaso Padoa-Schioppa, *La veduta corta*, il Mulino, 2009.

stabilising effects when the emergency *discretionary* programmes are triggered. In the case of the Eurozone, the objective is to establish a European mechanism based on a relationship of solidarity between European citizens, complementing national unemployment insurance schemes. The European Commission, the European Parliament and the Council should be able to decide, under the Ordinary Legislative Procedure, to launch an extraordinary programme

of assistance to unemployed European citizens, should the economic and financial stability of the Eurozone be at stake. In the United States this is done through the adoption of the Emergency Unemployment Compensation by Congress.

Secondly, efforts should not be made to build a perfect EUIS, able to overcome all of the objections that some Member States may formulate today, but rather to establish a scheme able

to meet a series of minimum European criteria. As in the United States, where 80 years after the adoption of the 1935 Social Security Act, the functioning of the federal insurance scheme is still subject to debate, only time and experience will allow an eventual European scheme to be adjusted step by step. ■

NATIONAL UNEMPLOYMENT INSURANCE SCHEMES ACROSS THE EUROZONE: ESSENTIAL FEATURES

Policies aimed at supporting the income of unemployed citizens are two-fold containing both welfare and insurance dimensions. The first is designed to avoid the risk of poverty that may arise from unemployment and is therefore aimed at the long-term unemployed, those who have insufficient financial means or have exhausted the initial unemployment benefits they were entitled to. It may also be addressed to those unemployed citizens who do not meet the criteria entitling them to unemployment benefits. The second, the insurance dimension, concerns the unemployed who have occupied a job and paid contributions for long enough to be entitled to unemployment benefits. The following paragraphs will focus on this second dimension and, taking the debate

about the establishment of a European fiscal union into account, they will refer to the Eurozone exclusively.

Unemployment insurance schemes are among the examples of provisions of public goods where the differences between national preferences are most evident. European national systems draw inspiration from diverse models, the characteristics of which are measured against three parameters: their eligibility criteria (duration of contributions), the level of benefits (wage replacement ratios and duration of benefits) and the funding of the system⁹. Eligibility is defined as a minimum number of weekly contributions to the insurance scheme within a specific frame of time¹⁰. The number of weekly contributions varies from 17

in France to 156 in Slovakia, while the most common qualification period is of 50-52 weeks (as in Austria, Belgium, Estonia, Germany, Italy, Malta and Slovenia). In addition, as already noted, the aggregate duration of the contributions is not the only distinctive features between national systems, since those contributions must have been paid within a specific frame of time. France requires 17 weeks of contributions within the 24 months preceding unemployment¹¹, Spain 360 days within the preceding six years, Italy 13 weeks within the preceding 4 years and Germany 12 months within the preceding 24 months. In substance the French and the Spanish systems (and now the Italian too) tend to take care of seasonal workers and, more generally, of occasional workers.

⁹ The data reported hereafter was drawn from a study carried out by the European Commission and refer to 2010 (Esser Ingrid, Tommy Ferrarini, Kenneth Nelson, Joakim Palme & Ola Sjöberg, *Unemployment Benefits in EU Member States*, European Commission, Directorate-General for Employment, Social Affairs and Inclusion, July 2013).

¹⁰ During periods of high unemployment, eligibility criteria are more restrictive regarding the qualification period, i.e. the number of weeks of contributions required to be entitled to benefits is raised. This reduces the rate of eligible workers and the number of unemployed people benefiting from benefits.

¹¹ After the adoption of the Jobs Act, Italy is now the country where conditions are most favourable, with just 13 weeks of contributions required.

As regards the level of benefits, the calculation method is the main element. According to the country, it may be a percentage of the average gross income

received by the worker within the period preceding unemployment, or of the net income during the same period. The benefits may also be a fix amount, irrespective of the wages earned. In the Euro-

zone countries the most common replacement ratio ranges between 50% and 60% of the average gross income (Belgium, Estonia, Finland, France, Greece and Italy), the minimum being paid in Malta (20%) and the maximum in Luxembourg (80%)¹². The second parameter which impacts the level of benefits is their maximum duration. It may vary from a few weeks (21 in Latvia) to an indefinite period going on until the age of retirement (like in Belgium). The most common allowance period is of 12 months (Estonia,

Germany, Greece, Ireland and Luxembourg), while for the Eurozone countries together, the weighted average duration is 15.8 months.

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between the contributions made by workers, employers and the State. According to a study carried out by the European Commission, the differences are not significant. With the exception of Luxembourg (where the unemployment insurance scheme is fully funded by the State) and Latvia (where it is fully funded by the employees), Eurozone countries tend to have systems where the shares funded by the employers and the employees converge, with partial exceptions such as Finland, Ireland, Italy and Spain.

The other differentiating feature is the funding method of the insurance scheme and the nature of the spending used to support the income of the unemployed. In general, there is a differentiation

However, contributions by employees and employers to the funding of the insurance scheme do not cover all the expenditure actually made. Indeed, in most Eurozone countries, insurance schemes record negative balances and the State must intervene to cover the deficit. Only in Estonia, France, the Netherlands and Portugal is the State not required to intervene.

Finally, the amount of the expenditure made to support the income of the unemployed ranges between 0.5% of the GDP in Cyprus, Estonia, Lithuania, Malta and Slovakia and close to 4% in Belgium (in France and Germany the figure is approximately 1.5%)¹³.

With the goal of creating a European unemployment benefit scheme against a background of quite heterogeneous national systems, it would not be realistic to consider conferring exclusive competence in this field to the EU. Rather, it may be useful to study a big federal system such as that in the United States of America. ■

THE AMERICAN UNEMPLOYMENT INSURANCE SCHEME¹⁴

The experience drawn from the United States' policy of income support for unemployed people has been

considered by the German economist Sebastian Dullien, who has tried to identify a possible point of reference

for the establishment of an EUIS. Dullien has assessed the strengths and the weaknesses of the American system,

¹² If benefits are calculated as a function of the net income, their amount would likely be higher.

¹³ The European Commission's document refers to 2010, and therefore it does not reflect the jobs market reforms that some European countries (Greece, Ireland, Portugal and Spain) introduced in the following years.

¹⁴ This synthesis is based on the following reports: Julie M. Whittaker, *The Unemployment Trust Fund (UTF): State Insolvency and Federal Loans to States*, CRS Report RS22954, 20 September 2012; Benjamin Collins, *Trade Adjustment Assistance for Workers*, CRS Report R42012, 17 December 2012; Katelin P. Isaacs, *Unemployment Insurance: Consequences of Changes in State Unemployment Compensation Laws*, CRS Report R41859, 30 October 2013; Katelin P. Isaacs, Julie M. Whittaker, *Unemployment Insurance: Programs and Benefits*, CRS Report RL33362, 12 February 2014 (retrieved in July and August 2015).

without taking a definitive position. However, in his last study he considers that the federal unemployment insurance scheme has failed to ensure economic stabilisation, as it does not provide for solidarity between the states. Although this statement is arguably correct from the point of view adopted by Dullien, it should be reconsidered. Through the Social Security Act the US federal government set out to introduce a new federal public good: assistance to the unemployed. The law defined the general criteria that the states needed to apply but left them free to choose the means of implementation. Seeking to incentivise the creation of a Federal-State system of unemployment insurance, the federal government established a gross federal unemployment tax rate on a liable employers' taxable payroll. The Act allowed employers a 90% credit against the federal tax or payment of their state unemployment insurance contributions (initially the gross federal tax amounted to 1% and after the Second World War it reached the current level of 6%). The limited federal income was only enough to cover the administrative costs of the scheme at the federal and state levels. There were no federal or inter-state transfers to finance unemployment benefits. Federal competence was finally recognised in this field in 1958, when for the first time Congress approved emergency transfers to assist the unemployed. It was only in 1970 that the unemployment benefits scheme became a shared competence between the federal level and the states with the establishment of the so-called *Extended Benefits*, financed in equal parts by the federal government and the states. The macroeconomic stabilisation function that Dullien refers to

should therefore be assessed only in the cases where Congress approves emergency interventions or when the *Extended Benefits* are activated. In all other cases the stabilising effects of this policy are indeed limited.

Apart from the modifications, which will be discussed later, the general lines originally dedicated to the US system have remained unchanged, and they are well summarised by the address on social security delivered by Roosevelt to Congress on 17 January 1935: *"Three principles should be observed in legislation on this subject. First, the system adopted, except for the money necessary to initiate it, should be self-sustaining in the sense that funds for the payment of insurance benefits should not come from the proceeds of general taxation. Second (...), actual management should be left to the States subject to standards established by the Federal Government. Third, sound financial management of the funds and the reserves, and protection of the credit structure of the Nation should be assured by retaining*

*Federal control over all funds through trustees in the Treasury of the United States"*¹⁵. The American model does not follow the idea that in a federation the greatest expenditure

should come from the federal level: the federal intervention, with the exception of serious economic crisis such as the current Great Recession, is limited (10%-15% of the specific aggregate expenditure). Secondly,

in the US convergence between states' social legislations is relatively low, even in relevant sectors such as unemployment assistance. The autonomy that the states enjoy to establish their own insurance systems, even in the framework of federal minimum standards, has resulted in 53 different legislations (for the 50 states of the federation, The District of Columbia, Puerto Rico and the United States Virgin Islands). As a consequence, the states' systems differ in important aspects, such as: eligibility criteria and assessment methods (in general, being a function of the total amount of wages received and the length of the period of employment), the duration of the benefits, the minimum and maximum amount of the weekly benefits, the employer-funded state tax rate, and the tax basis on which the state rate is applied. For example, in 2013 the number of weeks required to be entitled to unemployment benefits ranged from 12 in Florida and North Carolina to the 26 recommended by federal legislation in most other

states. Meanwhile, Massachusetts with 30 and Montana with 28 weeks were further exceptions. The minimum weekly benefit varied from US\$5 in Hawaii to US\$132 in Montana and the maximum between US\$235 in Mississippi

and US\$674 in Massachusetts. Five states applied a minimum tax rate of 0%, while in Pennsylvania employers had to cover at least 2.8% of the system costs through their taxes. The maximum tax rates were equally

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divergent, from 5.4% in nine states to 12.27% in Massachusetts. Finally, the minimum yearly taxable income ranged between US\$7,000 (the threshold fixed at the federal level and applied by three states) and US\$39,800 in the State of Washington¹⁶.

The standard *Unemployment Compensation* (UC) programme was originally established by the *Social Security Act*, following a fierce struggle between the federal government and the states¹⁷. The act entered into force in 1939 and has been modified several times since. Currently it comprises three different programmes, two of which are permanent and one extraordinary. The degree of solidarity between the federal level and the unemployed people in each state varies significantly across the programmes. The first, (the standard UC programme), is fully financed by the states. The second, established in 1970, extends the duration of the benefits (*Extended Benefits*) and is triggered when the unemployment rate in a state exceeds specific thresholds. It is financed in equal parts by the federal government and the state concerned. The third and final extraordinary programme, the *Emergency Unemployment Compensation*, may be activated by Congress in cases of serious economic downturn. It is entirely financed by the federal government. It was activated for the first time in 1958 and it has been used on

seven other occasions since, the last of which was in 2008¹⁸.

It was possible to establish a federal system based on inter-state solidarity in the US despite the divergence between states' social security programmes. This was achieved by establishing an obligation to reach the financial balance in the short to medium term. The UC is financed through the *Federal Unemployment Tax Act* (FUTA), which defines the federal tax rate, and the *State Unemployment Tax Acts* (SUTA) which, in turn, define each state's tax rate. As provided by federal legislation, the programme is essentially financed by the states, which levy a tax against the employers that either pay a minimum amount in salaries and/or wages or employ a minimum number of people (more than one). The net federal tax established by the FUTA amounts to 0.6% for the first US\$7,000 received by each beneficiary of the unemployment scheme. However, the gross federal tax amounts to 6% and is used as an incentive to the states to ensure that their social security legislation complies with the minimum standards set at the federal level. Employers based in states which comply with federal legislation are entitled to tax credits of 5.4%.

The income from the federal tax is deposited in the *Unemployment Trust Fund* (UTF) and is used in order to

cover the administrative costs at the federal and state levels, as well as to finance the federal share of *Extended Benefits* and loans to insolvent states and other state services related to employment¹⁹. During the 2014 tax year proceeds from the federal tax are expected to amount to US\$5.3bn, while the tax rates applied in each state will generate US\$50.5bn²⁰. The UTF comprises 59 accounts in the US Treasury, of which 53 belong to the fifty states, the District of Columbia, Puerto Rico and the US Virgin Islands. Each state transfers the income from taxes imposed on payrolls to these accounts in order to be used to finance the *Unemployment Compensation* programme. Two other accounts belong to the *Railroad Retirement Board* and the four remaining to the federal level. From a political point of view, the most important federal account is the *Employment Security Administration Account* (ESAA), which is used to cover the administrative costs of the unemployment scheme. Up to 20% of the income of the ESAA is used to feed the *Extended Unemployment Compensation Account* (EUCA). The EUCA is the instrument used by the federal government to finance 50% of the costs of the *Extended Benefits Program*²¹. The third federal account is the *Federal Unemployment Account* (FUA), which is used to make loans to states that have exhausted the provisions of their respective accounts. The FUA is financed by the EUCA provisions

¹⁶ Whittaker, Julie M., Isaacs, Katelin P., *Unemployment Insurance: Programs and Benefits*, CRS Report RL33362, 12 February 2014.

¹⁷ Jansson, Bruce S., *The Reluctant Welfare State – A History of American Social Welfare Policies*, Brooks/Cole Publishing Company, Pacific Grove, 1993, pp. 148-199.

¹⁸ Whittaker Julie M., Katelin P. Isaacs, *Extending Unemployment Compensation Benefits During Recessions*, CRS Report for Congress RL34340, 2 May 2013.

¹⁹ Whittaker, Julie M., *The Unemployment Trust Fund (UTF): State Insolvency and Federal Loans to States*, CRS Report RS22954, 20 September 2012.

²⁰ These figures rebut the idea that the federal government assumes the greatest part of the costs generated by the unemployment benefits scheme, in fact the states contribute ten times more (except for in situations of high unemployment, which will be seen below).

Whittaker Julie M., Katelin P. Isaacs, *Extending Unemployment Compensation Benefits During Recessions*, CRS Report for Congress RL34340, 2 May 2013.

²¹ After adoption of the *American Recovery and Reinvestment Act* (ARRA), the federal government decided to assume 100% of the costs generated by the *Extended Benefits Programme* (EB) with EUCA funds until the end of 2013.

exceeding the insured remunerations by 0.5%. Finally, if the EUCA and the FUA present positive balances exceeding the insured remunerations by 0.5% or more, the surplus is redistributed between the states' accounts. The last fund is the *Federal Employees Compensation Account* (FECA) and pays benefits to former federal civilian or military staff. Should a state's UTF account fall into a negative balance, that state may borrow funds from the FUA. If such a loan was not repaid on time, federal tax credits to the defaulting state would be reduced until the debt was fully repaid.

The UC is complemented by the second standard programme consisting of the *Extended Benefits* (EB). The EB is automatically triggered when a state exceeds a predefined unemployment rate. In concrete terms, every state must grant additional unemployment benefits for 13 weeks when their respective *Insured Unemployment Rate* (IUR)²² has exceeded 5% for 13 weeks and 120% of the national IUR for the same period of time within the last two years²³. The EB is financed in equal parts by the federal government and the state concerned²⁴.

The third programme, for extraordinary circumstances, is approved by Congress through a decision adopted jointly by the Chamber of Representatives representing the citizens and the Senate representing the states.

The last emergency unemployment compensation programme, the 2008 *Emergency Unemployment Compensation* (EUC08), was approved in July 2008 together with an economic stimulus package, the *American Recovery and Reinvestment Act* (ARRA) and expired on 1 January 2014. EUC08 was fully financed by the federal government with income from general taxation. In order to use it, states with an unemployment rate exceeding a defined threshold had to conclude a federal-state EUC agreement with the federal *Department of Labor* (DOL)²⁵. Such agreements extend the duration of benefits and provide for four levels of intervention: one which concerns all the states and extends benefits for 14 weeks; the second extends benefits for an additional 14-week period if the *Total Unemployment Rate* (TUR) reaches 6%; the third extends the benefits for an additional 9-week period if the TUR exceeds 7%; the fourth

extends the benefits for another 10 weeks if the TUR exceeds 9%. However the federal intervention is not automatic and does not concern all the states, but only those registering unemployment rates above the levels mentioned above.

In any case, the maximum duration of unemployment benefits, obtained by summing up the standard programme (UC), the *Extended Benefits* and the extraordinary intervention (EUC), varies from 40 to 99 weeks. Thanks to the extraordinary intervention, the average duration of unemployment benefits in the US is longer than the average period covered by the ordinary programmes in Eurozone countries (with the exception of Belgium, France and Spain). From a financial point of view, there is a fundamental difference between the ordinary programmes and the extraordinary one. While the UC and the EB must record a positive balance, i.e. contributions levied against employers must always be higher than the total amount of the benefits paid to the unemployed, the EUC is funded through the general taxation system and the benefits are fully financed by the federal government. ■

²² In the framework of the implementation of the EC Programme, the states of the American federation can choose between two unemployment indicators: the *Total Unemployment Rate* (TUR), which is the ratio between unemployed workers and all workers (employed and unemployed) and the *Insured Unemployment Rate* (IUR), which is the ratio between beneficiaries of unemployment benefits and workers insured against unemployment.

²³ States can choose among two additional options: paying 13 additional weeks if the IUR reaches 6%, irrespective of the levels reached by this rate in the preceding two years; or paying 13 additional weeks if the TUR is of at least 6.5% and equal to 110% of the average TUR in the same 13-week period during the preceding 2 years, or paying 20 additional weeks if the TUR reaches at least 8% and counts for 110% of the average TUR during 13 weeks in the preceding 2 years.

²⁴ The economic stimulus programmes adopted in 2009 provide, temporarily, for full federal financing.

²⁵ States could initially decide whether they would avail themselves of the EB programme or of the EUC08. Since the adoption of an amendment in 2012 states must give priority to the EUC08 programme (Whittaker Julie M., Katelin P. Isaacs, *Emergency Unemployment Compensation (EUC08): Current Status of Benefits*, CRS Report for Congress R42444, 28 mars 2012).

MAIN PROPOSALS FOR THE ESTABLISHMENT OF AN EUIS

The major and most recent proposals for the establishment of a *European Unemployment Insurance Scheme* (EUIS) can be clustered in three groups: those which consider an EUIS as an automatic stabiliser, albeit with a limited effect; those which consider an eventual EUIS as a means to face serious economic crises; and those characterised by the concern of preventing any moral hazard, which tend to question the utility of an EUIS.

The first group of proposals analyses the establishment of a 'basic unemployment insurance' meeting a series of conditions²⁶. Such a basic insurance must not create any additional moral hazard at the level of the individual, in other words, it must not reduce incentives to find a new job. It should also not increase the bureaucracy at the European level and should therefore exploit existing national administrative structures²⁷. This basic insurance must not result in a redistributive policy between Member States in the medium to long term and should exclude seasonal work and long-term unemployment, for which national social security systems should remain

exclusively responsible. To meet these criteria while playing an economic stabilisation role, the European system cannot be based on Eurozone countries' current minimum levels of benefits, nor can it be too generous. The suggested compromise would be to grant short-term unemployment benefits (up to 12 months), which would partially replace existing national schemes. The benefits would be equal to 50% of the average monthly salary received during the 12-month period preceding unemployment and should be no higher than 50% of the average income in the country concerned.

“A European Unemployment Insurance Scheme should not reduce incentives to find a new job.”

These benefits would be funded by contributions imposed on the gross wages (up to a defined ceiling). Each national government would be free to allocate extra resources either by increasing existing benefits or by extending their duration.

Studies have also sought to solve questions about the EU's financial balance. Does the EU budget need to be balanced every year or over an economic cycle? This question is linked to the type of economic fluctuation which

should be brought to balance: an interregional fluctuation (*stabilisation in space*), or fluctuations of the Eurozone as a whole (*stabilisation in time*)? Interregional balance must be achieved at the end of every year and may require frequent adjustments in the rate of the contributions levied against the total wage bill. However if balance is sought by the end of the economic cycle, the system must be able to go into debt in years where all or almost all the Member States are subject to an economic downturn, which would erode the taxation basis while the number of eligible beneficiaries increases. Among other experts, Dullien has made the greatest contribution to answering this question. In a first study²⁸ he considers a hypothetical European system funded by a tax on the average wage of each country, based on a common tax rate (1.75%) which would be adjusted in order to ensure a balance between income and expenditure over the economic cycle. As it would be compensated by an equivalent decrease in national contribution rates, such a tax would not increase fiscal pressure and would be neutral as regards national budgets. The replacement rate would amount to 50% of the income received over the previous 12 months. In a first scenario, benefits would be granted for just one year and only workers having

²⁶ Becatti G., Di Domenico G., Infantino G., *Un'assicurazione europea contro la disoccupazione: contesto, analisi e proposte di policy*, Ministero dell'Economia e delle Finanze, Note tematiche, n. 1, gennaio 2015; Brandolini, A., Francesca Carta, Francesco D'Amuri (2014), *A feasible unemployment-based shock absorber for the euro area*, Banca d'Italia, Occasional papers, n. 254, November 2014; Lellouch Thomas, Arthur Sode (2014), *Une assurance chômage pour la zone euro*, Lettre n. 132, Trésor- Eco, June 2014; Dullien, S. (2013), *A Common Unemployment Insurance System for the Euro Area*, DIW Economic Bulletin, Vol. 3, n. 1, pp. 9-14; Dullien, S. (2013), *A euro-area wide unemployment insurance as an automatic stabilizer: Who benefits and who pays?*, Paper prepared for the European Commission (DG EMPL); Dullien S., *A European unemployment insurance as a stabilization device – Selected issues*, Paper prepared for brainstorming workshop on July 2, 2012 at the DG EMPL, Corrected version of 11 December 2011 (First draft from 17 June 2012); Dullien, S. (2007), *Improving Economic Stability in Europe - What the Euro Area can learn from the United States' Unemployment Insurance*, SWP, Working Paper FG 1, 2007/ 11, July 2007.

²⁷ Dullien Sebastian, *A European unemployment insurance as a stabilization device – Selected issues*, Paper prepared for brainstorming workshop on July 2, 2012 at the DG EMPL, Corrected version from December 11, 2011 (First draft from 17 June, 2012).

²⁸ Dullien, S. (2007), *Improving Economic Stability in Europe...., Op. Cit.*

accumulated 12 months of work over the preceding 24 months would be eligible (thus excluding seasonal workers). In a second scenario, if European countries went through a period of serious economic downturn, apart from the first type of interventions, a system similar to the US *Extended Benefits* should be introduced, so that the duration of the benefits can be extended (see part 5 below). In the first scenario, the impact in terms of macroeconomic stabilisation is relatively limited. The second scenario offers a more significant macroeconomic stabilisation effect that would be even greater if it was applied to all the countries of the Eurozone and not just those most severely affected by high unemployment. In this case, the magnitude of the gross financing activated every year would grow from €54bn to €62bn. In a second study carried out for the European Commission²⁹, Dullien assesses the adequacy of this instrument against the same hypotheses formulated in the first study. The only partial difference is the national tax rate, which goes down to 1.66% for all participating countries. This tax rate would ensure the mid- to long-term balance (between 1996 and 2011) between revenue and expenditure at the consolidated level, with the exception of some short periods. Given that for some years the system would record a negative balance, it should be able to issue debt. In the second scenario, gross expenditure would reach between €49bn and €88bn and debt €24bn to €26bn. The

results in terms of GNP stabilisation are considerable (between 10% and 56%) in some Member States (seven), but not in all. In addition, across the different periods of the economic cycle net contributors alternate with net beneficiaries. However at the end of the period considered, the differences between net contributors and net beneficiaries are significant³⁰.

A study prepared by the French Treasury Administration adopts a similar perspective to Dullien's. In addition, it presents a proposal for an EUIS based on minimum European stand-

ards common to all countries, but to which each Member State could add according to its own preference. Their envisaged system would distribute benefits covering 50% of the past wages for a maximum period of 12 months. In order to avoid a policy of *net*, the study suggests the system be established through the intergovernmental method. In addition, eligibility criteria would be defined at the European level, which, according to the study, could consist of 9-12 months of salary-based contributions over the preceding 24 months. The system would not be funded by a single tax rate but by country-specific tax rates taking the average level of unemployment over the preceding five years into account. Such a funding

“To enable their revenue and expenditure to be monitored, each Member State should have an account at the European level.”

mechanism would allow the European system to be based on the principle of budgetary neutrality in the medium term. The amount of the contributions would then be revised every five years in order to avoid a situation where countries with low unemployment continuously finance those where the unemployment rate was higher. To enable their revenue and expenditure to be monitored, each Member

State should have an account at the European level. The idea of a differentiated tax rate taking account of the unemployment rate should also incentivise the introduction of reforms

aimed at reducing unemployment and bringing it closer to the European average. This would pave the way for the introduction of a uniform tax rate at a later stage. According to the French Treasury Administration's simulations, contributions would range from 0.5% for Italy to 3% for Finland. Contributions to the European scheme would replace contributions to national systems in order to prevent an increase in fiscal pressure. The study does not analyse the extent of the macroeconomic stabilisation generated by such system but notes that any additional stabilisation effect (over and above that already provided by national automatic stabilisers) would be noticeable only in the event of serious economic downturn. In this case, if a State

²⁹ Dullien, S. (2013), *A euro-area wide unemployment insurance...*, Op. Cit.

³⁰ Dullien appropriately recalls the difficulties in gathering the necessary data and assessing the strictly economic dimensions of the proposal: (a) the value of the multiplier (which would be low in case of interregional transfers in favour of States with high levels of public deficit); (b) the behaviour of national governments, which can use the funds that they are granted as unemployment benefits (which would not make any difference compared to current policies) or to make additional expenditure (in which case there would be a positive effect, but without raising public awareness of a European policy). Finally, according to Dullien, the EUIS, seen as a macroeconomic stabilising instrument, must be assessed against the type of structural divergences it rebalances between Member States. These imbalances are of three types: (i) one-off divergences, e.g. a demand-side asymmetric shock; (ii) cyclical divergences, which are due to the fact that the single interest rate in an integrated monetary zone may have different impacts on countries going through a period of recession and countries recording high growth; (iii) structural divergences, which in general are due to differences between social standards, policies or institutions (the most difficult to assess, also because it is the least studied). The EUIS could be used to mitigate the first two types of divergences, while there is no consensus yet on whether it could address the third type.

was subject to strong budgetary constraints, it could rely on the accumulated surpluses (or on the borrowing capacity of the European fund) in order to ride out the most acute phase of a crisis. Indeed, the French Treasury Administration argued that the establishment of an EUIS would contribute to avoiding a new sovereign-debt crisis. At the end of the 2000-2012 period, which the study examined, the consolidated flow would have been balanced (with a €4bn surplus in 2012) after having reached a maximum yearly expenditure of €19.5bn and a maximum income of €15bn (and an accumulated income of €68.8bn over the entire period). However, at the level of the individual Member State, some countries would have registered a negative balance (Finland, France, Germany and Italy) and some a positive one (Greece, Portugal and Spain) over the 12 year period. The net transfers between countries would be aggravated by a uniform tax rate. In sum, the proposal does not solve the problem of a 'Transfers Union', but the study attributed this result to the time period chosen as the reference for the simulation (1995-2000), and argues that

“The French Treasury Administration argued that the establishment of an EUIS would contribute to avoiding a new sovereign-debt crisis.”

a balance could be reached in the medium term.

The second group of studies considers an EUIS only activated in cases of serious economic downturn. This approach has been developed by the Centre for European Policy Studies (CEPS)³¹. After analysing the American and Swiss systems, they propose the establishment of a European insurance scheme supporting Member States only when they are subject to so-called 'major events' and their short-term unemployment rates exceed a specific threshold³². The system would thus consist of a 'European Reinsurance Fund' for national insurance systems, which would pay annual insurance premiums of 0.1% of their countries' GDP until the fund reaches 0.5% of the Eurozone's GDP (approximately €50bn). Once this target met, payments would be suspended until the total fell back below the threshold. In practice, if the Fund had a low intervention threshold in terms of unemployment rate, payments would be almost continuous, whereas a high intervention threshold would lead to a start-stop-type mechanism. In the

worst case scenario, referred to as a "Brussels tornado" in the study, the mechanism would be triggered 40 times in 12 years.

The third group of studies analyses the nature of the EUIS. In a nutshell, they discuss whether the EUIS would consist of a policy of solidarity in the strict sense of the word, or whether the idea of establishing this type of stabiliser would lead to a system of interregional redistribution. Such a position was notably adopted in a study published by the Bundesbank and is the product of two interrelated concerns. The first is that experience since the establishment of the Eurozone shows that the European system of monitoring public finances is ineffective, since the imposition of fines in case of rule breaches has proven unrealistic. The second concern is the *moral hazard* generated by such a system³³. The study analyses the eventual establishment of a minimum European insurance scheme granting unemployment benefits equivalent to 50% of the last wages earned, for a period of 12 months. Governments would be left the freedom to choose whether to integrate these benefits by extending the payment period or by increasing the amount of existing benefits. This would preserve national preferences in unemployment support systems. However, the study concludes that the system's establishment would

³¹ Beblavý M., Ilaria Maselli (2014), *An Unemployment Insurance Scheme for the Euro Area: A simulation exercise of two options*, CEPS Special Report, n. 98; Beblavý, M., Daniel Gros, Ilaria Maselli, *Reinsurance of National Unemployment Benefit Schemes*, CEPS Working Document, n. 401, January 2015; Beblavý M., Ilaria Maselli (2015), *The case for a European unemployment benefit scheme*, CEPS Commentary.

³² The mechanism would be triggered when short-term unemployment (measured as a function of the moving average of the short-term unemployment rate over ten years) exceeds the addition of the same rate and a multiple of its standard deviation (the multiple would range from 0.1 to 2 according to the different models studied).

³³ Vetter Stefan (2014), *Stabilisation, solidarity or redistribution? Does the eurozone need a common unemployment insurance scheme – and if so, for what?*, Deutsche Bank Research; Beer Christian, Walpurga Köhler-Töglhofer, Alfred Stiglbauer, *A Common European Unemployment Insurance – A Much Debated Route toward European Fiscal Union*, Österreichische Nationalbank, Monetary Policy & The Economy, Q4/14; Claeys Grégory, Zsolt Darvas, Guntram B. Wolff, *Benefits and drawbacks of European unemployment insurance*, Bruegel Policy Brief, n. 2014/06, September 2014. The moral hazard in Eurozone countries pointed out by the Bundesbank is comparable to the moral hazard that had to be addressed in Germany regarding the relationship between the federal government and local authorities. First, before the Hartz reform, local authorities had the responsibility to help unemployed workers in their job search. They often hired the unemployed for some time, until they met the eligibility criteria, and they dismissed them in order to put them under the responsibility of the federal unemployment insurance scheme. Secondly, when dealing with unemployed workers with partial disabilities, local authorities may use an administrative trick in order to classify them as fit for work, thereby also putting them under the coverage of the federal government's scheme (Vandenbroucke Frank, Luigjes Chris, *Unemployment benefits, activation and the interaction between levels of government - Experiences with moral hazard in multi-tiered labour market governance systems*, Center for Economic Studies, Katholieke Universiteit Leuven, Discussion Paper Series DPS15.02, January 2015).

require at least partial harmonisation of national social security systems. Even if new minimum standards were higher than the current lowest, harmonisation would cause adjustment problems. For example, in relation to the calculation of the replacement rate, which in Germany is based on the net income and in France on the gross. In some countries (Austria, Germany and Portugal) an individual is eligible after having paid 12 months of contributions during the preceding 24-month period, while in other countries (France, Italy and Spain) the requirement is less strict. Such a system would be difficult to introduce if a country had a high level of public deficit, offered high standards of social protection, was opposed to reforming its current system and in addition benefited from a high weight of influence in the European decision-making processes. The system would pose additional problems if all Eurozone Member States went through deep recession simultaneously and the resources of the Fund were rapidly exhausted. In such an event the system would need to be able to issue debt, but granting the EUIS debt-issuing powers may not currently enjoy consensus between Member States. However, any system should provide for effective sanctions, without which Member States could be tempted to establish or maintain more generous benefit schemes and delay necessary

“[...] the system's establishment would require at least partial harmonisation of national social security systems.”

structural reforms, since the costs generated would be supported by the other Member States. For this reason the system should be limited to granting benefits for periods of 9-12 months, although this limitation would also curb its stabilisation effect. According to the *Bundesbank* the stabilisation benefits would be concentrated in the initial phase of a strong economic downturn, since long-term unemployment increases over time (like, for example, in Greece, Ireland or Spain), which jeopardises the stabilising effect of the system.

On the other hand, a system based on the reinsurance of countries' schemes facing 'catastrophic' shocks (for example, in cases where the unemployment rate exceeded 15% or where countries registered sudden increases in short-term unemployment) would not be fiscally neutral. Indeed, during the last 15 years some countries never exceeded the European average unemployment rate while others were always above that level. In this hypothesis,

the challenge would lie in defining the concept of "serious recession"³⁴. Taking the actual evolution of unemployment in the Eurozone countries into account, the three definitions of "serious recession" proposed by the study would inevitably lead to fiscal imbalances, which would turn the scheme into a redistributive policy.

However the study concludes that a system of this kind cannot be assessed only against the concept of fiscal neutrality, given that the most important factor is the stability of the entire Eurozone and that serious recessions may be due to external causes irrespective of national policies. Therefore, a policy based on solidarity would be justified if two conditions were met: the intervention threshold should be fixed at a level high enough to make assistance rare (which is not the case in the study carried out by CEPS seen above) and that countries with a high level of structural unemployment do not exceed that threshold too often. Secondly, given that high unemployment rates may be due to structural weaknesses in the jobs market or to ill-conceived employment policies, the benefitting country should be legally bound to introduce considerable reforms. Should such a situation arise, the difficulty would lie in deciding who should monitor compliance with their implementation. Ideally, each country should take care of cyclical unemployment and the assistance should be granted only if the adjustment cost exceeded the financial capacities of the country. In any case, the *Bundesbank* points out that in case of a considerable increase in unemployment, a country should be able to manage the crisis on its own, as Germany did with the *Agenda 2010*. Other institutions, such as the National Bank of Austria or the think tank Bruegel have expressed similar concerns. ■

³⁴ A serious recession is defined in three different ways: when the unemployment rate in one country exceeds 12% or 15%; when the unemployment rate in one country exceeds the average or median European unemployment rate by five points; when the unemployment rate significantly exceeds the long-term unemployment rate (e.g. an increase of 20%-30% during two consecutive years, or an increase of 3%-5% in the long-term unemployment rate over a two-year period).

ASSESSMENT OF THE PROPOSALS FOR AN EUIS

Most of the studies presented above share the positive view of an EUIS as representing a significant step towards the establishment of a fiscal union between Eurozone countries. In some cases, they propose that each country should have its own account at the European level for the sake of transparency and to ensure mid-term balance of public finances. They agree that a European system should not undermine national preferences about social security.

However, these studies present limitations in their evaluation of the institutional architecture required for the establishment of an EUIS. The problems posed are obvious. First, they would consist of traditional intergovernmental mechanisms, based on financial flows between States, although in this case through a European fund. Secondly, none of the proposals presented seem to prevent the *moral hazard* at the national level, given that they do not suggest any type of control on the use of the funds granted. Finally, European citizens would not be aware they were benefitting from a European institution which radically changes their relationship with the Union. In fact, none of these papers consider the establishment of an autonomous fiscal capacity managed by the European institutions. Instead, they conceive of systems based on financial flows between States, and not directly between the EU and its citizens. These proposals do not explicitly analyse the adoption of a European tax, and less so the role that the European Parliament should play in its establishment.

Some studies, such as the one carried out by the French Treasury Administration, note that a system of this type could pose problems of democratic legitimacy, but they still support the idea of an intergovernmental mechanism.

The other major point of criticism is over the ability of the system to act

as an *automatic* macroeconomic stabiliser. One study has also assessed an EUIS's effect on stabilising disposable income and demand for consumer goods, comparing the Eurozone with the United States in case of a fall of 5% in GDP and an increase of 5% in unemployment³⁵. In particular, it makes estimations either based on the joint stabilising effect of income taxation and unemployment benefits or based on unemployment benefits alone. In case of a drop in Eurozone GDP the shocks on disposable income are absorbed by up to 38% and on the demand for consumer products by up to 23%, while in the US these figures are of 32% and 19% respectively. Should unemployment rise in the Eurozone, 50% of the shock on disposable income is cushioned, compared to only 34% in the US. When the assessment of the impact on disposable income is limited to the effect of unemployment benefits, shock absorption falls to 21% in the Eurozone and 7% in the US. The unemployment benefit's stabilising effect on demand is of 30% in

"[...] the establishment of an EUIS should not be assessed in terms of its macroeconomic stabilising effects, but rather its ability to introduce a European system of solidarity."

the Eurozone and of 19% in the US. If these assessments are correct, Eurozone Member States' national automatic stabilisers are already more effective than those in the US in terms of their impact on income and demand. In particular, the stabilising effect of unemployment benefits on disposable income is significant in Europe,

whereas in the US it is almost irrelevant. However, while the study allows an assessment of the impact of national measures in the Eurozone, for the US it does not distinguish between the stabilisation effect of state and federal measures. Nevertheless, as 90% of unemployment benefits are state competence, it is possible to deduce that the same proportion of income stabilisation may be attributed to the action of the states and that the rest is a result of the federal intervention. Therefore the macroeconomic stabilising effects related to an EUIS would be limited, and all the more so if it replaced the national systems only partially. According to Dullien, the effects would be more noticeable if all the participating Member States increased the duration of the benefits. In such a scenario, *the establishment of an EUIS should not be assessed in terms of its macroeconomic stabilising effects, but rather its ability to introduce a European system of solidarity.*

³⁵ Dolls, M., C. Fuest and A. Peichl (2012), *Automatic Stabilizers and Economic Crisis: US vs. Europe*, Journal of Public Economics, Vol. 96, n. 3-4, pp. 279-294.

The first group of studies presented above discuss the type of tax rate which should be levied against the wage bill. To summarise, they distinguish between a single and a differentiated tax rate. Dullien's working papers seemingly show that a uniform tax rate would not solve the problem

of net transfers and payments between Member States. Whatever period of time is taken into consideration, ten or fifteen years, there are always net contributors and net beneficiaries. Yet, as pointed out by the French Treasury Administration, the problem is also not avoided by adopting

different tax rates based on each country's level of unemployment. In addition, as the Spanish crisis in 2009 shows, should the tax rate need to be reviewed to take unemployment into account it would need to be raised, while the economic situation would require it be cut. ■

WHICH FEDERAL UNEMPLOYMENT INSURANCE SCHEME FOR THE EUROZONE?

When Roosevelt proposed the adoption of the *Social Security Act*, his intention was not to introduce an instrument of macroeconomic stabilisation or absorption of asymmetric shocks. Those subjects were discussed only in the years following the Second World War. Through the measure, Roosevelt intended to assert a political principle: a federal policy of solidarity for the people of the USA

"[...] the scheme would be complemented by an institutional structure allowing it to overcome the limitations of the intergovernmental configuration and the problem of permanent transfers between net contributors and net beneficiaries."

as US citizens, establishing minimum requirements at the federal level for insurance against unemployment and leaving the states the freedom to choose the means of implementation. Hence, when reflecting about the introduction of a *European Unemployment Insurance Scheme*, it is necessary to bear in mind that this component of the welfare state has

already been enacted by the Member States, and in some cases to an extent similar to the United States³⁶.

Two alternative options are presented below. When assessing their adequacy, the primary goal should not be their potential to have a stabilising effect, but rather the solidarity they would create between EU citizens. Both options consider the establishment of a 'European

Unemployment Insurance Fund' (hereafter, 'European Fund') to which the income from the tax rate levied against the wage bill would be transferred. During a transitional period the Fund would be a new budget line in the general EU budget, excluded from the ceilings of the *Multiannual Financial Framework*. When the *European Solidarity Mechanism* is included in the

Treaties, leading towards a *European Treasury*, it would host the Fund. A great advantage of this configuration would be that the *European Solidarity Fund* could issue debt at favourable interest rates and would be the institution responsible for the development of structural reform programmes for Eurozone countries.

As with most of the proposals presented above, the first option would be to establish a European system, complementing national systems, which would grant benefits equivalent to 50% of the insured average gross wages received during the 24 months preceding unemployment and for a maximum period of 12 months. Given that on average 80% of the gross salary is insured, the effective replacement rate would be of 40%. The eligibility criteria would match the widest-spread criteria in Eurozone countries. The cost of this measure would be between €49bn and €88bn and would be funded by contributions that Member States would transfer to a European Fund according to a uniform tax rate

³⁶ What is of interest here is how the functioning of the institutional system underlying the US unemployment insurance scheme may be a useful point of reference for the establishment of a similar system in Europe, consisting of the combination of national and European interventions.

levied against the wage bill (between 1.66% and 1.75%)³⁷. In this case, the scheme would be complemented by an institutional structure allowing it to overcome the limitations of the intergovernmental configuration and the problem of permanent transfers between net contributors and net beneficiaries. In addition, since the system would not establish a direct link between the EU and its citizens, democratic legitimacy at the European level should be reinforced. For these reasons, if an EUIS is to be established as a truly European instrument, it should be accompanied by institutional reforms. Such reforms should provide for the involvement of the European Parliament in setting the appropriate tax rate. A European Commissioner should be made responsible for the transparent management of the European Fund, compliance with fiscal rules in order to avoid the moral hazard and, above all, the link with EU citizens³⁸.

Yet this proposal contains a series of drawbacks. First, as seen above, it does not solve the problem of *net* interregional transfers. In order to be able to go beyond a system based on transfers between States, the system should be able to accumulate surpluses (which would generate net transfers) and, in case of an economic downturn affecting all Eurozone

countries, it should be able to issue debt. Secondly, some countries (Estonia, Germany, Greece, Ireland and Luxembourg) should transfer important parts of the unemployment element of their welfare system to the European level, while others (Austria, Italy, Malta, Slovakia and Slovenia) would not only transfer competences to the European level, but would need to adapt their welfare systems, and thus, their national systems of preference. Finally, as a relevant competence in the field of social policy would be transferred to the European level, social partners should be involved in the decision. As

the European scheme would modify, and in some cases largely replace national systems, it would be unthinkable that the decision to create such a scheme be made through the simplified treaty revision procedure. It would be necessary to call for a European

Convention. For the same reason, the revision of the Treaties should go hand in hand with the revision of Member States' legislation.

“The EU should adopt a repartition of competences similar to the one in the USA, where the management of frictional unemployment falls under the scope of competence of the states, cyclical unemployment is a shared responsibility of the states and the federal government and the unemployment generated by serious economic downturns is a fully federal competence.”

The second option draws inspiration from experience in the USA, and more concretely from the *Extended Benefits* programme. It would be co-funded in equal parts by the EU and the Member States and triggered when unemployment exceeds a particular threshold. This alternative would not constitute a permanent system in the strict sense of the word. The different levels of government, European and national, would have different responsibilities ac-

ording to the type of unemployment being addressed. *The EU should adopt a repartition of competences similar to the one in the USA, where the management of frictional unemployment falls under the scope of competence of the states, cyclical unemployment*

³⁷ In fact, this alternative could adopt two forms. Apart from the mechanism described above, the second would consist of granting unemployment benefits only when the short-term unemployment rate (three to twelve months) exceeds a threshold (see: Epaulard Anne, *Contingent vs. Non-Contingent Unemployment Benefit Scheme for the EMU, Conference Economic shock absorbers for the Eurozone*, Brussels, 20 June 2014). According to Epaulard, the trigger could be an unemployment rate exceeding the moving average of the preceding five years by 1% and benefits would cease when this rate goes under the moving average over the same period. The Fund would grant 50% of the gross income from the third month of unemployment for a period going up to the twelfth month of unemployment. National governments would be free to choose whether to integrate the assistance received from the European Fund to make the payment period longer or to increase the amount of the benefits. Beneficiaries would be the newly unemployed, while workers already unemployed at the entry into force of the mechanism would be excluded (except for those having lost their jobs recently). The cost of this measure is assessed to be €10bn and would be funded by an additional contribution levied against the wage bill at a rate of 0.27%. Apart from the limited cost of this mechanism, it would not produce any significant positive effect on the economy nor would it send the signal that the European institutions intend to take charge of the issue. If the European contribution replaced the national one, the extent of the assistance would be limited. Instead, if the interested governments had to combine national and European benefits, the mechanism would be unfair to those unemployed who would benefit only from national schemes.

³⁸ Given that the EUIS would replace national systems only partially, the European mechanism would work in the same way as the national ones, apart from in the eventuality of a sudden increase in unemployment in one country. Therefore, it could require European net own resources in order to meet the needs of additional expenditure which, in the absence of the European mechanism, would have been funded with debt. The funds saved by Member States thanks to the European intervention could be used for other purposes. However, according to Dullien, if Member States used the European funds in order to repay their debt, the mechanism would not work.

is a shared responsibility of the states and the federal government and the unemployment generated by serious economic downturns is a fully federal competence. In the framework of this proposal, Eurozone countries would fund supportive policies for frictional unemployment (assuming as such a level of unemployment of 7%), while the EUIS would intervene beyond that level. As suggested by Dullien, the mechanism could be made up of a combination of a fixed threshold of 7% (trigger) and the additional condition of an increase in unemployment of at least 115% in comparison with the average rate over the preceding two years. The extension of the duration of the benefits should not exceed 6 months. The two conditions (7% and 115%) would be recalculated on a yearly basis in order to prevent the Fund from financing structural weaknesses. The beneficiaries of the extension, who would receive 50% of their insured gross wages, would be people who had recently become unemployed and meet the European eligibility criteria (in essence, having paid contributions for 12 months in the 24 months preceding transition into unemployment and be actively looking for a job)³⁹.

Dullien's assessments for a European extended benefits scheme could be taken as a reference in order to gain an understanding of the potential expenditure of such a system. He calculates that the annual flow would reach between €10bn and €12bn. So, the European Fund could be funded

by a tax rate on the wage bill of 0.2%-0.3%. 50% of the revenue would be transferred to an account in the name of each country, while the other 50% would go to a European account. All the accounts would be managed by the European Fund. In addition, the Fund should be able to issue mid-term debt when the economic cycle erodes the income and increases the number of beneficiaries. In order to limit the impact on labour costs, the national and the European accounts could have a ceiling equivalent to 0.5% of the insured wage bill⁴⁰. At the initial stage, if the pressure on labour costs were judged unbearable, the [European Solidarity] Fund could be financed by the *Financial Transaction Tax*, also suggested by Dullien. However, in

that scenario, only countries having introduced this type of tax could benefit from the EUIS. In any case, it is important to bear in mind that the increase in labour costs would be absorbed by the recent devaluation of the euro and the increase in labour productivity (0.9%-1% per year). If the account of one of the Eurozone countries presented a negative balance due to a particularly serious economic downturn, it could resort to a loan granted

by the European Fund. This loan would be approved under condition that the Member State commits to increasing its tax rate in order to balance its account and return the funds borrowed within a period of 3 to 5 years. This way the problem of permanent transfers from one country to another would be solved.

There are some important observations regarding the extension of the duration of benefits that this proposal would lead to. First, according to the Indian economist Raghuran Rajan, the time necessary to return to the absolute unemployment level recorded during the pre-crisis period has lengthened considerably, reaching 36 months. Second, the proposed extension would in

“[...] when a serious economic crisis touching one or more Member States occurs, the European Parliament and the Council, on a proposal from the Commission, should be able to approve emergency interventions, financed by the income generated by a common tax.””

any case bring the average duration of the benefits in the Eurozone to 21.8 months, below the 22.8 months in the US. Third, benefits would be extended in compliance with the principle of balance between benefits and costs incurred⁴¹. There is a final remark. Some argue that the extension of the duration of the benefits could have adverse effects. According to some studies⁴², this extension could generate an individual *moral hazard*.

³⁹ Those who do not meet those eligibility criteria would be granted benefits by the national insurance or welfare systems, depending on the cases.

⁴⁰ This figure would reach a total of approximately €20bn in the European account and the same amount distributed among the accounts of the Eurozone Member States.

⁴¹ Raghuran Rajan, *Terremoti finanziari*, Torino, Einaudi, 2012.

⁴² Meyer, Bruce, *Unemployment Insurance and Unemployment Spells*, *Econometrica*, 58:4 (1990), pp. 757-82; Katz, Lawrence, Bruce Meyer, *The Impact of the Potential Duration of Unemployment Benefits on the Duration of Unemployment*, *Journal of Public Economics*, 41 (1990), pp. 45-72; Moffitt, Robert, *Unemployment Insurance and the Distribution of Unemployment Spells*, *Journal of Econometrics*, 28 (1985), pp. 85-101.

Indeed it could act as a deterrent for individuals in their search for a new job, which would increase the unemployment rate or maintain it at a high level. This conclusion comes from the empirical observation that the unemployment-exit rate increases considerably as the period covered by benefits comes to an end. Nevertheless two types of objections have been formulated against this conclusion. First, exiting unemployment does not necessarily mean that an individual has found a new job, since they may have just exited the labour force⁴³. An analysis of the Austrian unemployment insurance scheme, considered to be very similar to the American one, found that the unexpected increase in the unemployment-exit rate at the end of the subsidised period virtually disappears if only those having found a new job are taken into account, which reveals a very low re-employment rate. The hypothesis of the *moral hazard* effect is therefore unfounded⁴⁴. In fact other studies provide an alternative explanation for the relationship between duration of the benefits and duration of unemployment. Their thesis is based on the assumption that unemployment benefits would mitigate the liquidity constraint of the unemployed.

This statement comes from the observation that, at the moment of the transition into unemployment, not all the workers have cumulated enough savings in order to face an absence of income⁴⁵ (50% of workers who lose their jobs do not have any savings). Therefore, unemployment benefits provide job seekers with more time to better assess the job offers. A study estimates that 60% of the increase in the duration of unemployment following the extension of benefits is due to the liquidity effect⁴⁶.

The establishment of a European Fund to finance the extension of benefits would not require any compensation from the national level and would respect the balance between income and expenses. However, it should be accompanied by another institutional innovation, similar to the one implemented in the US. Briefly, *when a serious economic crisis touching one or more Member States occurs, the European Parliament and the Council, on a proposal from the Commission, should be able to approve an extraordinary budgetary allocation aimed at mitigating the costs generated by unemployment on the basis of a contractual arrangement*

concluded between the European institutions and the country or countries concerned by the intervention. This extraordinary intervention would be financed by the income generated by a common tax, which could be a portion of the *Financial Transaction Tax* or of VAT. It is essential to provide for the possibility of an extraordinary intervention to complement Member States' commitment not to reduce their expenditure aimed at supporting the income of people affected by cyclical unemployment. In this second alternative, national welfare policies are not modified but rather a European component is added. It would also require considerable institutional innovations, such as granting the European Parliament decision-making powers on fiscal matters, providing the European Fund with the capacity to issue debt and allowing the Commission, the European Parliament and the Council to co-decide on emergency interventions at the European level. Therefore this proposal could not be implemented through the simplified treaty revision procedure either. It would require summoning a European Convention or the conclusion of a new treaty. ■

⁴³ The studies reaching those conclusions refer to the rate of enrolment in the public employment services in charge of distributing unemployment benefits, and they do not give any indication of the actual status of workers once unemployment benefits cease (see: Fujita Shigeru, *Economic Effects of the Unemployment Insurance Benefit*, Federal Reserve Bank of Philadelphia, Business Review Q4 2010).

⁴⁴ Fujita Shigeru, *Economic Effects ...*, Op. Cit., and Card, D., R. Chetty and A. Weber, *The Spike at Benefit Exhaustion: Leaving the Unemployment System or Starting a New Job?*, *American Economic Review: Papers and Proceedings* 97 (2007), 113–118.

⁴⁵ Gruber, Jonathan, *The Consumption Smoothing Benefits of Unemployment Insurance*, *American Economic Review*, 87:1 (1997), pp. 192-205.

⁴⁶ Chetty, R., *Moral Hazard vs. Liquidity Constraint and Optimal Unemployment Insurance*, *Journal of Political Economy* 116 (2008), 173–234.

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ABOUT THE UEF

The Union of European Federalists (UEF) is a pan-European, non-governmental political organisation dedicated to the promotion of European political unity. Throughout the past 70 years it has been a leading voice in the promotion of European unity and an early campaigner for key milestones in the development of the European Communities and the European Union.

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