In support of an EU-wide unemployment insurance programme

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In this paper, Cian Devine Prendergast tackles the issue of introducing a bloc-wide unemployment insurance programme in the European Union. Such a programme would harmonise unemployment benefit policy across the EU, a move that Prendergast views as both economically beneficial, in that it would have significant capacity as an automatic stabilization mechanism, and conducive to fostering a greater sense of solidarity amongst the populaces of EU member states. Both the advantages and possible drawbacks of such a policy are considered, and a comparison with an alternative policy (standardising national unemployment insurance programmes across the EU) explored. Ultimately, in weighing up the pros and cons, Prendergast finds that an EUIP would have a net positive impact on both the economy and the social unity of the European Union.

I. Introduction

In this policy report I shall evaluate the need for an EU-wide unemployment insurance programme (henceforth, EUIP). I will perform this evaluation by firstly outlining what it is we are to understand by an EUIP. I shall then outline the likely benefits of an EUIP to the European Union, putting particular emphasis on its capacity to act as a stabilisation mechanism against macroeconomic shocks, as well as its propensity to foster a greater sense of solidarity within the Union. Against these benefits, I shall consider two arguments typically made against the implementation of an EUIP: firstly, that it would represent too great a moral hazard risk, with the potential for irresponsible government; and secondly, that it would be politically unfeasible. I shall eventually come to reject these arguments on the grounds that these concerns would be mitigated by the structure an EUIP would likely take on. I shall finally come to consider the question of whether the benefits of an EUIP cannot be more easily attained by simply introducing federal legislation that standardizes all national unemployment programs. Here I will argue that the standardization of national unemployment programs is insufficient to achieve the stabilisation benefits of an EUIP, and on this basis shall conclude that an EUIP should in fact be implemented.

II. What would an EU-wide unemployment insurance programme look like?

Before delving into the question of whether there ought to be an EUIP, it is first necessary to clarify what exactly such a programme would entail. At present, unemployment insurance programmes across the EU are determined on a national basis, with nationally elected governments establishing programmes which tend to differ from each other in terms of eligibility, generosity and duration (Beblavý, Marconi & Maselli, 2017). As many as eighteen different proposals for an EUIP have been made to the European Commission, however commentary on all within the confines of this report would prove impossible, and I will as such focus only on the model provided by Dullien (2013), which has been lauded as the leading proposal in this field. Dullien proposes that all national unemployment insurance schemes within the EU be replaced by a single EUIP, financed by a fund drawn from the wages of workers within the EU. Under this system, eligible beneficiaries within the EU would receive individual benefits from the EUIP fund, with this level being set a at common minimum level relative to a country's wage level (ibid.).

III. Arguments in favour of an EUIP's implementation

3.1 The EUIP as an ideal automatic stabilization mechanism

Perhaps the most obvious benefit of an EUIP would be its capacity to provide a strong and seemingly well-needed automatic stabilization mechanism[1] for the EU. The EU's need for such a mechanism became clear to many in the aftermath of the Great Recession, during which it was revealed that the EU was uniquely ill-equipped to deal with asymmetric shocks[2] that can cause widespread unemployment and subsequent social unrest in affected areas (Beblavý & Lenaerts, 2017). Federal unions like the EU typically deal with asymmetric shocks through a combination of market mechanisms (e.g. the newly unemployed simply leave adversely affected areas and migrate to more fruitful, unaffected areas), and monetary policy, whereby interest rates may be lowered to stimulate growth and reduce unemployment in affected areas (ibid.). Neither of these mechanisms, however, are available to the EU: cultural and linguistic diversity within the Union has contributed to an immobile EU workforce, such that the unemployed in affected areas are unlikely to move to areas of lower unemployment, and the EU's common monetary policy means that reducing interest rates is as likely to lead to a deterioration in the conditions of unaffected areas via over-heating[3] as it is to significantly improve conditions in affected areas (ibid.). Furthermore, the EU would appear unable to remedy asymmetric shocks via the individual fiscal policies of its member states, for empirical evidence has shown us that fiscal policy tends to be pro-cyclical both across countries and over time, rather than counter cyclical as a remedy to an asymmetric shock

1 An automatic stabilisation mechanism is an economic policy that would offset fluctuations in member state economic activity without the need for government intervention (Dullien, 2013).
2 An asymmetric shock is an economic shock that adversely affects one part of the Union without impacting others (Dullien, 2013).
3An economy is said to be over-heating when it can no longer meet the demand of consumers, firms and government (Beblavý & Lenaerts, 2017).

would require (Alcidi & Thirion, 2016).

Realising the inadequacy of the above tools, it becomes clear that the EU sorely needs an automatic stabilisation mechanism if it is to avoid the consequences of an asymmetric shock, and it is here that we see the true utility of an EUIP. Elmendorf and Fuhrman (2008) have suggested that macroeconomic stabilisers should be timely, targeted and temporary if they are to produce desired affects, and an EUIP would appear to fulfil all of these criteria. It is timely in that it kicks in as soon as the business cycle is negatively affected and people become unemployed; it is targeted in that it supports the unemployed who would otherwise bear the costs of an economic shock; and it is temporary in that it ceases once the business cycle recovers and those laid off as a consequence of the shock regain employment (Dullien, 2013).

3.2 The EUIP as a solidarity-inspiring force

The next argument I shall put forth in favour of an EUIP is concerned with its potentially beneficial impact on solidarity within the EU. Fundamental to the European Project is a belief in and trust of European institutions: the task of integrating 28 economies while simultaneously allowing the national governments which reside over them a significant degree of independence comes almost by definition with a large degree of risk, and a sense of solidarity amongst EU citizens and governments is thus crucial to its successful operation (Beblavý & Lenaerts, 2017). However, trust in EU institutions has come under significant duress following the Great Recession, pointing us towards the notion that solidarity within the EU presently rests more so upon the economic well-being of its member states than on any true sense of European identity held by its citizens (European Commission, 2017). Many have speculated that it has been the EU's failure to interact with its populaces in meaningful ways that is responsible for the delicate state of institutional trust within the Union, arguing that solidarity will always be hard-built if the public do not see anything the Union does for them with their own eyes (van der Cruijsen et al., 2010). It is in following this line of reasoning that we come across yet another potential benefit of an EUIP, for such a programme could put a “human face” on an otherwise abstract European project, giving the EU an opportunity to interact with its public as they face times of hardship, thus sending to them a clear signal of solidarity (Wood, 2017). That an EUIP would truly have this benefit is further attested to by the survey data of Wood (2017), who finds that 32% of European citizens answer that an “EU social welfare system harmonized between member states” would strengthen their feeling of European citizenship, leaving little room for doubt as to an EUIP’s capacity to positively impact solidarity within the EU.

IV. Typical Objections to the introduction of an EUIP

4.1 The moral hazard risk of an EUIP

Many have argued that an EUIP should not be implemented on the grounds that it carries too great a moral hazard risk. It is reasoned that with an EUIP in place, governments of member states would appear to face incentives misaligned with their providing optimally responsible governance. Under this programme they would be aware that the costs of their bad governance would be covered not by them, but by an EUIP fund, and that the EU would likely be reluctant to punish them in response to their irresponsible governance for fear that their increased costs were in truth due to some external factor (Beblavý & Lenaerts, 2017). Thus, it is concluded, irresponsible governance is a likely outcome of the implementation of an EUIP.

Against this, however, I argue that institutional moral hazard risk should be of little concern to any debate over the utility of an EUIP, for the impact it has on the incentives of member state governments can be significantly mitigated by punishment mechanisms built into the foundation of the EUIP. Dullien (2013), for example, proposes a claw-back mechanism in which the contribution of each country to the EUIP fund is tied to the net balance of past contributions that each country has made towards the EUIP, such that countries are punished for extended periods of negative net contribution. For example, a country's contribution rate might increase by 0.03% of GDP if its net contribution has been negative for over 4 years (ibid.). In this way, the institutional moral hazard risk carried by an EUIP could be greatly reduced, for each national government within the EU would face strong incentives to minimize its own social risks such that its net contributions towards the EUIP fund remain positive.

It could of course be argued that the imposition of such a mechanism would diminish the beneficial capacities of an EUIP as an automatic stabiliser, punishing the employed population of a country with already wide-spread unemployment. However, simulations run by Dullien (2013) on the impact of an EUIP with a claw-back mechanism within the EU have shown that, in reality, a claw-back mechanism would have only a minor impact on the stabilization capacity of the EUIP.

4.2 The political feasibility of an EUIP

It has further been argued that an EUIP would be politically unfeasible, for it would simply represent a permanent transfer of wealth from certain member states to others. It is argued that because certain member state economies are structured in such a way that they are less likely to produce unemployment than others, they would find themselves in a near constant position of net-contribution toward an EUIP fund, causing anger among their electorate and making an EUIP extremely unpopular.

This would at first appear a reasonable concern: many regional economies within the Union reliably produce high levels of seasonal unemployment via their reliance on agriculture and tourism, and if such forms of unemployment were to be covered by an EUIP, then an EUIP truly would constitute a permanent transfer of wealth from economies with low seasonal unemployment to economies with high seasonal unemployment (Dullien, 2012). Much like concerns over moral hazard risk however, concerns over the political feasibility of an EUIP can be alleviated by simply examining more closely the likely structure that an EUIP would take on. If, for example, workers were required to make continuous contributions to the EUIP fund prior to unemployment (over say 22 of the last 24 months), EUIP funds could be withheld from the seasonally unemployed who typically work only in short 3-6 month bursts, greatly reducing the likelihood of permanent transfers from certain member states to others, and making an EUIP a far more politically feasible policy (ibid.).

V. Weighing the benefits of an EUIP against an EU with standardized national unemployment insurance programs

I shall spend the final section of this policy report addressing concerns that the benefits of an EUIP could be more easily achieved by simply introducing legislation which standardizes national unemployment insurance programs across the European Union. This critique essentially claims that we can both mitigate the adverse effects of an asymmetric shock, as well as inspire greater EU solidarity, without having to overcome the political and legal challenges that an EUIP would imply by simply passing legislation at the federal level which would mandate high minimum standards across all member state unemployment insurance programs. It argues that with more generous unemployment insurance programs in place across the EU, workers would enjoy far greater conditions when made unemployed and would consequently be far less likely to contribute to social unrest in the event of the Union being hit by an asymmetric shock (Beblavý & Lenaerts, 2017). Furthermore, such legislation could prove beneficial to solidarity within the EU, as it would send a clear message to EU citizens that the EU has their protection in its interests (Wood, 2017).

Effective as this argument might seem on first reading, it ultimately fails to match up to the benefits of an EUIP, for, unlike an EUIP, this legislation would not allow for spatial smoothing in its defence against asymmetric shocks (Dullien, 2013). Crucial to the

EUIP's capacity as an automatic stabiliser is its ability to spread the costs of an asymmetric shock over a wide range of countries, many of which rely upon divergent factors for their economic well-being (ibid.). It is as such unlikely that a single shock could ever leave the EU in the position of being unable to fund an increase in the cost of its EUIP in the same way it could leave a national unemployment program: a national unemployment program is funded by the wages of its own citizens only, not the wages of EU workers in their entirety as an EUIP would be, and is therefore far more susceptible to financing issues in the face of an asymmetric shock, no matter what the program's mandated level of generosity (Beblavý & Lenaerts, 2017). We therefore see that, although mandating higher minimum standards for unemployment insurance across member states might come with less legal and political challenges than an EUIP, it would ultimately not provide the same benefits as an EUIP, for it would not prove as effective an automatic stabiliser in the face of asymmetric shocks.

VI. Conclusion

In conclusion, I have argued that the EU should implement an EUIP.I have arrived at this conclusion by firstly outlining the likely benefits of an EUIP, citing its capacity to act as an automatic stabiliser against macroeconomic shocks, as well as its capacity to inspire a greater sense of solidarity within the EU. Against these benefits I considered two commonly made objections to the imposition of an EUIP, analysing in turn whether it carried too great a moral hazard risk and whether it would be politically feasible. Both objections, however, were found to be either implausible or capable of being resolved simple structural designs in an EUIP. I finally came to consider whether the benefits of an EUIP could be more easily achieved by simply implementing legislation that would standardize all member state unemployment insurance programs, but eventually concluded that it could not, for such legislation would lack the stabilization benefits brought by an EUIP.

VII. References

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