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BENEFITS AND DRAWBACKS OF EUROPEAN UNEMPLOYMENT INSURANCE

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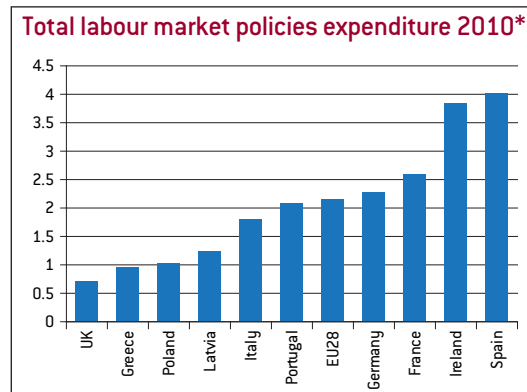
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THE ISSUE Unemployment in Europe has increased to high levels and economic growth has remained subdued. A debate on additional policy instruments to address the situation is therefore warranted. Fiscal stabilisation mechanisms have not provided adequate fiscal stabilisation during the crisis in some countries nor in the euro area as a whole. Different preferences and historical developments mean that national labour markets are differently organised, which sometimes hinders the efficient working of the monetary union. European Unemployment Insurance (EUI) has been proposed as a measure to contribute to fiscal policy management and improve labour markets.

POLICY CHALLENGE

European Unemployment Insurance is one option for stabilising country-specific economic cycles thanks to risk sharing, but it would not substantively influence the area-wide fiscal stance. Moral hazard problems are significant but can be reduced by a less generous design and more harmonisation of labour markets. The former would, however, reduce the scheme's stabilisation effect. Reform and harmonisation of labour markets would improve the functioning of monetary union, but would



Source: Bruegel. * in % of GDP. See Figure 2.

undermine long-standing preferences and ideals which the subsidiarity principle guarantees. The complexity of the design and implementation of EUI and the question of the right legal base suggests that it would be a long-term project and not a measure to help quickly the millions currently unemployed.



SHOULD THE EUROPEAN UNION create a European Unemployment Insurance (EUI) scheme, in the context of the significant increase in unemployment in Europe from 7 percent in 2009 to 10.8 percent in 2013? The idea would be to move parts or all of national unemployment insurance to the European level to create a new European mechanism to better stabilise the economy and thereby to reduce unemployment. EUI would also be a mechanism to improve the functioning of European labour markets.

On average, EU countries spent 0.9 percent of GDP on unemployment benefits in 2007. During the crisis, this increased to 1.3 percent in 2009 and then fell back to 1.1 percent in 2011. There are significant differences between countries, which result from different unemployment rates and reflect substantial differences in the generosity of schemes, as well as different economic situations¹. Generally, automatic stabilisers in eastern and southern European countries are much weaker than in central and northern European countries².

Unemployment insurance is not only important from a macroeconomic point of view. It is a central element of social policy. The creation and design of national schemes was intrinsically linked to industrial, economic, social and political developments in different countries. In many countries, social partners play an important role in the management and design of unemployment insurance schemes. Unemployment insurance in different countries therefore comes with different

replacement rates, durations and benefits (Table 1).

Behind the EUI debate is the realisation that other stabilisation mechanisms that typically exist

Table 1: Heterogeneity of national unemployment benefit systems

	Max. duration (months)	Replacement rate (%)	Coverage ratio (%)
Austria	12	55	49
Belgium*	48	65	58
Bulgaria	12	60	23
Croatia	15	70	23
Cyprus	6	50	25
Czech Rep.	5	65	36
Denmark	48	60	49
Estonia	12	50	41
Finland*	16	45	56
France	36	75	49
Germany	24	60	82
Greece**	12		29
Hungary	3	60	31
Ireland**	8		
Italy	14	75	16
Latvia	9	65	29
Lithuania**	9		29
Luxembourg	12	80	36
Malta**	6		
Netherlands	38	75	
Poland**	12		17
Portugal	12	65	41
Romania**	12		18
Slovakia	6	50	19
Slovenia	25	80	28
Spain	24	70	41
Sweden	14	80	25
UK**	6		33

Source: The EU's Mutual Information System on Social Protection (MISSOC) comparative tables for duration and replacement rate; Bruegel calculation using Eurostat's Labour Force Survey for the coverage ratio. Note: * provide an indefinite unemployment stipend after other benefits have been exhausted; ** provide flat rates of insurance coverage (Greece: €360/month, Ireland: €188/week, Malta: €12.35/day, Portugal: €190/month, Romania: €130/month). Replacement rate: unemployment benefit as a percent of previous wage. Coverage ratio: the number of short term unemployed receiving benefits to total number of short-term unemployed (%).

in monetary unions, such as financial market risk sharing, have not played their roles fully³. Also, worker mobility in the euro area has been less than optimal from a currency-union perspective⁴. There is also a realisation that differently functioning labour markets are particularly difficult in a monetary union because of different wage-setting mechanisms.

It has been argued that an EUI scheme would be a way to achieve greater solidarity among Europeans. While the European treaties foresee solidarity as an important element of European integration (Preamble and Articles 2 and 3 of the Treaty on the Functioning of the EU), they also aim to prevent fiscal transfers between the countries of the monetary union (Article 125 of the TFEU).

We assess the main arguments for and against EUI. In favour are the possible contribution of EUI to macroeconomic stabilisation and the contribution it can make to achieve greater convergence of labour market institutions. Arguments against EUI include the moral hazard that could arise from the creation of a common insurance system, the technical complexity and the fact that labour market heterogeneity reflects country preferences. We then highlight ten choices that EU policymakers need to make if they wish to move ahead with an EUI scheme.

EUI PROPOSALS

EUI would either replace or supplement national unemployment insurance. EUI could either be administered centrally or at the

1. Expenditure in Romania amounted to only 0.2 percent of GDP, while in Spain, with the highest rate, expenditure was 3.1 percent of GDP in 2010. An unemployed person in Romania receives €108/month (2012); in Denmark it is €1909 (Source: DG Employment, European Commission).

2. Dolls, Mathias, Clemens Fuest and Andreas Peichl (2010) 'Automatic Stabilizers and Economic Crisis: US vs. Europe', *Working paper* 16275, NBER.

3. Sapir, André and Guntram B. Wolff (2013) 'The neglected side of banking union: reshaping Europe's financial system', Bruegel contribution to informal Ecofin, September.

4. Krugman, Paul (2013) 'Revenge of the Optimum Currency Area', in Daron Acemoglu, Jonathan Parker, and Michael Woodford (eds) *NBER Macroeconomics Annual 2012*, University of Chicago Press.



national level. If administered at national level, the scheme would foresee payments between national administrations. Ideally, financial flows would go from countries with low unemployment to countries with high and increasing unemployment.

One often-proposed scheme (the ‘all-time’ variant) would cover a large percentage of the previous income of a person losing a job for the first 12 months of unemployment⁵, replacing fully or partly the current national systems. The revenues would come – as in the national case – from contributions paid by employers and employees. Countries could supplement the EUI scheme if they wish to increase payments to the jobless above the EUI payouts. The EUI scheme might be allowed to borrow on markets to deal with a recession affecting all countries. Simple mechanical simulations suggest that such a scheme would lead to flows towards countries in heavy recession of 0.5 percent to 1.5 percent of their GDP⁶. The flows typically end after three years if country-specific contribution rates are adjusted upwards to prevent permanent transfers.

Another variant of the scheme (the ‘catastrophic’ variant) would provide support to countries in case of a negative shock large enough to have a major negative impact on public finances⁷.

EUI AS AN INSTRUMENT OF FISCAL STABILISATION POLICY?

Insufficient macroeconomic stabilisation in the EU and the euro area in particular is often given as

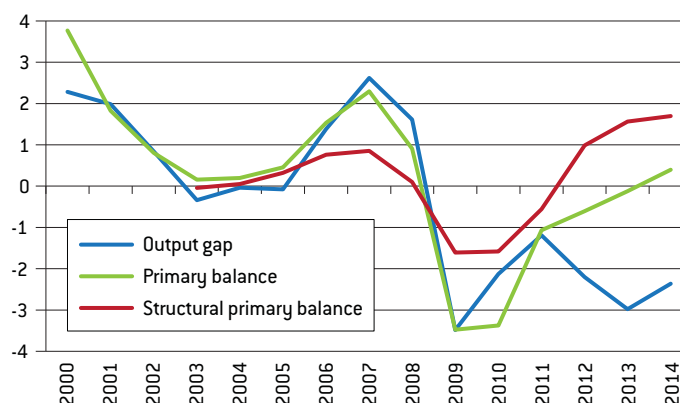
a reason why the EU should create an EUI scheme. The founders of Europe’s monetary union allocated the role of fiscal stabilisation to national budgets without any European counterpart. With prudent fiscal policy in good times, it would be possible to let automatic stabilisers operate freely and to implement discretionary stimulus in crisis times, thereby dampening the impact of a recession. This strategy broadly worked in most EU countries during the recent crisis, but there were two problems, which will likely reappear in future downturns:

- Inadequate stabilisation at EU/euro-area level and the lack of a European instrument to influence the European fiscal stance. Member states implement the policy deemed appropriate for their own economies, subject to the constraints of the European fiscal governance framework. During 2011-13, the sum of national fiscal policies led to a

European fiscal stance that was not optimal given the downturn in the business cycle. Figure 1 shows that, following the 2008-09 stimulus, fiscal consolidation followed in parallel with the narrowing of the output gap. However, after 2010 the output gap widened again in Europe while fiscal policy continued to consolidate. Therefore, the aggregate fiscal stance did not address the widening output gap and fiscal policy became pro-cyclical⁸.

- Several countries ran out of fiscal space and were forced to implement pro-cyclical fiscal tightening in a deep economic crisis. This was especially critical in euro-area countries where changes to a country-specific exchange rate cannot help the adjustment. Though one can argue that the lack of fiscal space in some euro-area countries during the recent crisis was the consequence of inadequate pre-crisis policies, it was difficult to identify vul-

Figure 1: Output gap and general government primary budget balance in the euro area (% of GDP), 2000-14



Source: European Commission May 2014 forecast. Note: The primary budget balance does not include interest payments. The structural primary budget balance measures the underlying position of the primary budget balance by eliminating the impact of the economic cycle and one-time expenditure and revenue items. The output gap measures the difference between actual and potential GDP.

5. Andor, László (2014) ‘Basic European unemployment insurance as an automatic fiscal stabiliser for an EMU 2.0’, Speech/14/485, conference on ‘Economic shock absorbers for the euro zone’, Brussels, 20 June.

6. See Dullien, Sebastian (2013) ‘A euro-area wide unemployment insurance as an automatic stabilizer: Who benefits and who pays?’, Paper prepared for the European Commission (DG EMPL); Lellouch, Thomas and Arthur Sode (2014) ‘An Unemployment Insurance Scheme for the Euro Area’, *Trésor-Economics* 132, Direction Générale du Trésor; Claeys, Gregory, Simon Ganem, Pia Hüttel and Thomas Walsh (2014) ‘Do it yourself: European unemployment insurance’, Bruegel blog, forthcoming.

7. Insurance for large shocks based on budgetary transfers linked to the output gap is proposed by Wolff, Guntram B. (2012) ‘A budget for Europe’s Monetary Union’, *Policy Contribution* 22/2012, Bruegel. A ‘contingent’ unemployment benefit scheme, which would be triggered only in case of



major negative shocks is proposed by Epaulard, Anne (2014) 'Contingent vs. Non-Contingent Unemployment Benefit Scheme for the EMU', presentation to conference on *Economic shock absorbers for the Eurozone*, Brussels, 20 June.

8. Several factors might have contributed to the widening of the output gap after 2010, such as euro break-up fears, confidence effects, the difficulties in the banking system and insufficiently expansive monetary policy.

9. To strengthen the surveillance mechanisms in the euro area; see http://ec.europa.eu/economy_finance/articles/governance/2012-03-14_six_pack_en.htm.

10. Details on other options available to create a fiscal stabilisation tool can be found in Wolff (2012; see note 7) and Pisani-Ferry, Jean, Erkki Vihriälä and Guntram B. Wolff (2013) 'Options for a euro-area fiscal capacity', *Policy Contribution* 2013/01, Bruegel.

11. Micro simulations, focusing on the effectiveness of a basic European scheme to act as an insurance

nerabilities when policies were adopted and the European surveillance framework also failed to foresee that a crisis might come and lead to fiscal constraints. Even countries that had low pre-crisis public debt levels and budgetary surpluses, such as Spain and Ireland, faced major fiscal constraints during the crisis.

It is unlikely that these two problems will be sufficiently resolved by the reformed EU economic and fiscal governance framework. While the EU's two-pack regulations⁹ will enable the European Commission to assess the *ex ante* change in the aggregate fiscal stance of the EU and to advise countries to change their stances, the Commission has no direct control over deficits. Both European and national fiscal rules exclusively consider fiscal targets at the national level, disregarding the area-wide fiscal stance. The scope to use national fiscal policies in a number of euro-area countries is also hampered by the already high debt levels and the potential negative market reactions. Therefore, the sum of national fiscal stances will likely deviate from what would be optimal for the whole area.

Fiscal policy constraints during a crisis might also re-emerge. True, the Macroeconomic Imbalances Procedure should help to identify private-sector vulnerabilities leading to fiscal constraints. The banking union and the new bail-in rules (Bank Resolution and Recovery Directive – BRRD) should help to limit future bank rescue costs for governments. The European Central Bank's Out-

right Monetary Transactions (OMT) programme or other possible arrangement should help to contain interest rate increases. However, it would be naïve to believe that there will be no future economic and financial crises and that if there is one, no government would face a fiscal constraint.

Overall, the euro area needs to contemplate additional fiscal instruments that could help stabilisation during area-wide crises. Moreover, it could be desirable to have an additional instrument to ensure that countries running out of fiscal space do not have to cut automatic stabilisers in a procyclical manner. Whether or not EUI would be the right and easy option¹⁰ is a big question.

In normal times, EUI would not influence the aggregate fiscal stance, because it would just replace national automatic stabilisers with a European automatic stabiliser. The scheme would provide more fiscal resources to countries heavily affected by an increase of unemployment. However, countries would have freedom to decide what to do with the additional resources and the fundamental problem of fiscal policy coordination would therefore remain, even if the EUI scheme can borrow on the markets.

On the other hand, EUI would contribute to the aggregate fiscal stance if several countries were becoming fiscally constrained and were to use the additional resources for spending. EUI could thereby allow them to limit procyclical cuts in spending or even to use discretionary fiscal policy

for other purposes. But they could also run smaller fiscal deficits in which case the area-wide stabilisation effect would be small or non-existent. A benefit in this case might arise from the reduced public debt level and the consequent positive confidence effect.

The effectiveness of EUI schemes in stabilising income very much depends on the design, but typically, simulations show that the effects are not very large¹¹.

IMPLICATIONS FOR LABOUR MARKET INSTITUTIONS AND SYSTEM DESIGN

National labour market institutions in the EU are characterised by great heterogeneity, making it difficult to design an EUI scheme and raising the possibility of significant trade-offs. An eventual EUI scheme would have major implications for national labour market institutions.

Employment protection legislation varies significantly in different EU countries: in some countries, such as Ireland, the UK or central and eastern European countries, flexibility prevails; in other countries, such as France, Germany and Italy, employment protection is more prevalent.

Unemployment policies also differ with distinctive ways of organising public employment services and training schemes for the unemployed. Unemployment benefit schemes also vary greatly in terms of duration of benefits (from three months in Hungary to no limit in Belgium), replacement rates and coverage ratios (see Table 1 for definitions). Eligibility



criteria¹² and financing of unemployment benefits also differ significantly (totally financed by contributions or partly subsidised by the national government).

Such differences were reflected in related public expenditure during the crisis (Figure 2). In badly-hit Spain and Ireland, public expenditure related to labour market policies (LMP) increased to about 4 percent of GDP, well above the EU average, suggesting that in these countries the unemployment insurance system was effective in automatically stabilising the economic downturn. But in the EU's hardest-hit countries, Greece and Latvia, such expenditure amounted to about or just slightly more than 1 percent of GDP, suggesting that automatic stabilisation through unemployment insurance hardly worked¹³.

Therefore, an important trade-off emerges. If the EUI scheme were designed to match the least generous among the current national systems, then it would provide very limited payments and

thereby an insignificant contribution to stabilisation. If instead it was based on an EU or euro-area average, countries with less generous national unemployment insurance systems will have to accept a more ambitious system with larger contributions than their citizens in employment currently pay.

Another major difference between countries is the degree of involvement of social partners. In some countries, unions and employer associations play a central role in the definition of unemployment benefits; in other countries, such decisions are shared with or even taken by the government alone (see Table 2 on the next page).

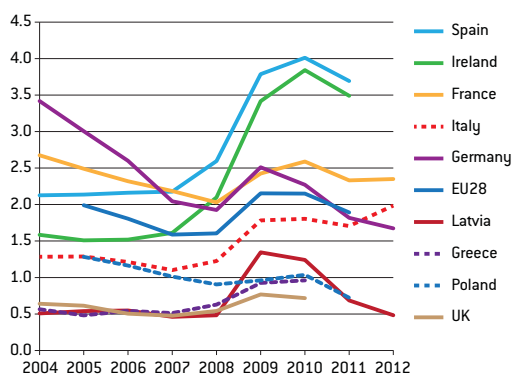
Significant differences between countries also exist in terms of corporate governance, which might impact frictional unemployment (and therefore short-term unemployment) and on wage levels. Figure 3 shows that short-term unemployment in proportion to total unemployment was substantially different in different

countries even before the crisis. For instance, France and Germany had similar unemployment rates in 2007, but the share of short-term unemployment was greater in France, probably reflecting the different functioning of labour markets. Other differences in unemployment result from policies, for instance, a large part of the 2008-09 shock was mitigated in Germany by labour market institutions such as short-time work or working-time accounts. Such differences make it harder to design an EUI scheme, and could require different contribution rates in different participating member states, depending on the functioning of their labour markets. Furthermore, EUI could affect short-term unemployment patterns because of changed incentives, as argued by Dolls *et al* (2014; see note 11).

Differences in labour markets and the generosity of unemployment benefits are no accident but are the result of heterogeneous preferences in different countries, and reflect historical divergences

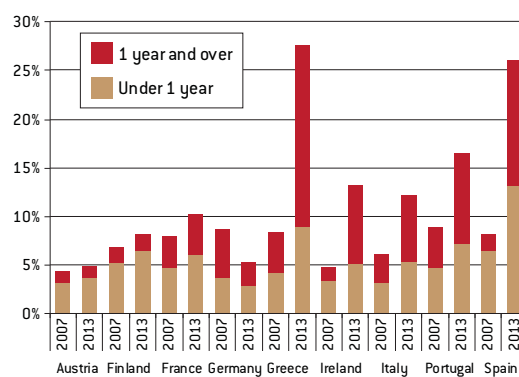
device are run by Dolls, Mathias, Clemens Fuest, Dirk Neumann, and Andreas Peichl (2014) 'An unemployment insurance scheme for the euro area: evidence at the micro level', forthcoming working paper. They find that with a relatively small annual budget, net benefits would have stabilised incomes in several countries, but overall, its growth-enhancing effects would be moderate.

Figure 2: Labour market policies (LMP), expenditure as percent of GDP



Source Figure 2: Bruegel based on Eurostat. Note: About two thirds or three quarters of LMP expenditures relate to unemployment benefits ('Out-of-work income maintenance and support'). Other LMP expenditures are composed of: labour market services, training, employment incentives, supported employment and rehabilitation, direct job creation, start-up incentives, early retirement. The first two categories have a share of about 0.2 percent of GDP each in the EU28, the share of the third is slightly more than 0.1 percent of GDP, while the shares of the remaining four categories are below 0.1 percent of GDP each in EU28. Source Figure 3: Bruegel based on OECD Employment data.

Figure 3: Unemployment by duration in selected countries, 2007 and 2013



12. Details on eligibility criteria can be found in Venn, Danielle (2012) 'Eligibility Criteria for Unemployment Benefits: Quantitative Indicators for OECD and EU Countries', *OECD Social, Employment and Migration Working Papers* no. 131, OECD Publishing.

13. See the specific characteristics of the Greek unemployment insurance system in Malkoutzis, Nick (2014) 'The Greek crisis we don't see', *Macropolis*, available at <http://www.macropolis.gr/?i=portal.en.the-agma.1026>.



in social policies and significantly different views about how labour markets should be organised.

Alongside the implications for national labour market institutions, there would be a trade-off between the design features of EUI to limit moral hazard and the effectiveness of the system to provide stabilisation. EUI would be most effective as a stabilisation tool if eligibility criteria are loose, benefits are fully funded from the European level, duration of benefits extends beyond 12 months and there is no adjustment of national contribution rates following substantial increases in unemployment. However, such a system would create moral hazard issues at the level of individuals and national policymakers. Rapid convergence of all labour market policies would therefore be desirable. Proponents of EUI propose to limit the risk of moral hazard by limiting benefits and the duration of payouts, and by adjusting national contribution rates to avoid permanent transfers. Such measures would reduce the stabilisation

effects of the system.

Arguably, differences between national labour market institutions and national wage-setting mechanisms in particular are two of the most important reasons for the substantial divergences in unit labour costs and wages in the euro area. For example, nominal compensation per employee increased by 37 percent in Italy and by 17 percent in Germany between 1999 and 2011 even though the difference cannot be explained by productivity developments. These differentials in wage developments are not only a significant cause of concern for the employees in the different countries but they also make the conduct of monetary policy more difficult. The introduction of EUI could be a major opportunity to harmonise labour market institutions, which might limit differences in wage developments.

Overall, EUI could promote labour market harmonisation with convergence on the best practice models in Europe. Such convergence would also improve the

single market, foster labour mobility and make the conduct of monetary policy easier, but at the cost of undermining long-standing preferences and ideals, which the current subsidiarity of labour market institutions guarantees.

EUI: THE 10 KEY QUESTIONS

Policy makers will have to find answers to a number of questions if they wish to implement an EUI scheme. We wish to highlight upfront that this project cannot be embarked on without a prior agreement on fiscal risk-sharing. The following questions are central:

- 1 Is this a scheme to support those in need now or is it for the future? Agreeing even on a lowest common denominator could take a long time, and legislation and implementation would delay the introduction of such a system further. Therefore, such a scheme could be designed for the future. In the meantime, in order to help the currently unemployed, other options could be considered such as the implementation of

Table 2: Social partners' involvement in unemployment benefit regimes in Europe

Type of involvement	Self-perceived influence	Countries
Institutionalised involvement and participation in stable tripartite (state, employers, employees) bodies (intervening in policy design/reform)	High	Austria, Bulgaria, Germany, Hungary, Latvia, Lithuania, Luxembourg, Netherlands, Portugal, Slovakia, Slovenia
	Low	Cyprus, Denmark, Greece, Poland, Romania, Spain
Institutionalised involvement and participation in bipartite (employers, employees) bodies	High	Belgium, France
Systematic involvement in <i>ad hoc</i> tri/bipartite committees	High	Finland
Not institutionalised involvement in information/consultation practices	High	Italy, Norway
	Low	Sweden, United Kingdom
Participation without involvement	Low	Ireland, Malta

Source: Bruegel based on European Foundation for the Improvement of Living and Working Conditions. Note: Institutionalised involvement of social partners refers to the existence of stable institutions.



- a substantial pan-European investment plan.
- 2 Should the scheme be for the EU or euro area only? While stabilisation, solidarity and labour market harmonisation issues apply to all EU countries, monetary union has specific stabilisation requirements given that its members can be affected by asymmetric shocks. One possibility would be to implement it at euro-area level and to give other EU countries the option to join, similarly to the banking union.
 - 3 Should labour-market institutions be harmonised and should the social dialogue be elevated to European level? As the eligibility criteria for the EUI scheme would have to be decided at the European level, it would be preferable that social partners play a role in their definition. Without harmonisation of labour market institutions, structural differences in labour market institutions should result in different contribution rates (ie contribution rates should be higher in countries with less efficient labour markets) which would undermine the stabilisation properties of the scheme. Harmonisation would instead require agreement on desirable standards. One option would be to start the EUI with country-specific contribution rates which would be adjusted frequently (eg yearly) to eliminate long-lasting transfers between countries participating in the EUI. As participating countries progress with labour market harmonisation, contribution rates could be harmonised too.
 - 4 Potential permanent transfers? If there is no willingness to accept permanent transfers, then contribution rates would need to be different for different countries so that countries balance their net payments to the EUI fund across the cycle. This would however make the scheme more complex and less countercyclical if country-specific contribution rates have to be revised from time to time.
 - 5 Would a common scheme require common administration? Without a common administration, implementation is likely to vary in different countries, creating potential moral hazard problems. In addition, efficiency gains from a reformed administration could be high and labour-market matching across Europe could be facilitated. However, this would constitute an extremely ambitious reform.
 - 6 What kind of democratic oversight? Labour-market legislation is at the heart of the democratic process and is of high relevance to citizens. The subsidiarity principle calls for such legislation to happen at the national level. The introduction of EUI could put numerous constraints on national democratic processes and would require agreement on appropriate European democratic foundations to legitimise the constraints.
 - 7 Borrowing facility or not? To play a stabilisation role in case of an area-wide shock, a borrowing facility would be needed (additionally, national discretionary fiscal policies should also be coordinated). In a system without a borrowing facility, transfers from a country in a mild recession to a country in a severe recession might be needed and countries facing fiscal constraints would find it difficult to subsidise the fund.
 - 8 All-time or catastrophic insurance? An all-time insurance scheme would redistribute even when there are small fluctuations in the economy, though the national unemployment systems were and will be able to handle small economic fluctuations. Catastrophic insurance, which would redistribute only in the event of large shocks, could be therefore preferable.
 - 9 What should be the main parameters? National systems vary greatly in terms of duration of benefits, replacement rates and eligibility. If the EUI scheme were designed to match the least generous among the current systems in member states, then it would contribute little to stabilisation. If instead it was based on an EU or euro-area average, countries with less generous national unemployment insurance systems will have to accept a more ambitious system with larger contributions than their companies and employed citizens currently pay. This also applies to those countries that are not yet euro-area members but have an obligation to join. There is thus a trade-off between stabilisation properties and respect for national preferences.
 - 10 What legal framework? Even though the EU Treaty sets an objective to deepen solidarity between European people and countries, it does not provide a

14. To achieve this in a gradual way, one option would be to offer European labour contracts as an alternative to national labour contracts and link EUI only to the European labour contracts and not the national ones. See for example Delpla,



Jacques and Pierre-Olivier Gourinchas (2014) 'The Blue Labour Deal: An Incentive-Compatible Unemployment Insurance in the Eurozone', CAE Presentation, available at <http://www.ceps.eu/files/article/2014/08/Euro50March2014Delpla.pdf>.

15. For investment proposals, see Sapir, André and Guntram B. Wolff (2014) 'Memo to the presidents of the European Commission, the European Council and the European Parliament', in André Sapir (ed) *EU to do in 2015-2019: Memos to the new EU leadership*, Bruegel; Darvas, Zsolt and Guntram B. Wolff (2014) 'Memo to the Commissioner for economic and monetary affairs', in André Sapir (ed) *EU to do in 2015-2019: Memos to the new EU leadership*, Bruegel; and Szczurek, Mateusz (2014) 'Quantifying the macroeconomic impact of the European fund for investments', Bruegel blog, <http://www.bruegel.org/blog/detail/article/1428-quantifying-the-macroeconomic-impact-of-the-european-fund-for-investments/>.

legal framework for an EUI scheme. Therefore, either a Treaty change would be needed (which could be difficult to obtain), or an intergovernmental agreement would be required, which would establish a major institution outside the community framework and would raise questions about parliamentary control.

CONCLUSIONS

We have assessed various arguments for and against a European unemployment insurance system and the central policy choices that would have to be made. In the euro area and in the EU as a whole, fiscal policy was pro-cyclical during 2011-13 and some countries had to tighten fiscal policy because they reached the fiscal limits. Fiscal policy coordination has been inadequate and it is unlikely the sum of national fiscal policy stances will ever correspond to the optimal aggregate fiscal stance. In principle, a debate about additional European stabilisation instruments is warranted to complete Europe's monetary union.

An EUI system would direct financial flows to the unemployed and would temporarily support the economies of countries affected by major increases in unemployment. However, because it would replace a national automatic stabiliser with a European automatic stabiliser, EUI would not solve the

problem of defining and implementing an optimal aggregate fiscal stance. National policymakers would still be faced with the challenge of coordinating their fiscal policies. The scheme would, however, increase fiscal space in countries hit by a severe downturn. EUI can therefore be considered a tool to address country-specific shocks.

EUI cannot simply be analysed from a fiscal point of view. We have documented the substantial heterogeneity in labour market institutions in different EU countries and we have also shown that in many countries social partners are involved in unemployment insurance policies. An EUI scheme would have major implications for labour market institutions and social dialogue. This is both a challenge and an opportunity.

The introduction of EUI would be an opportunity to fundamentally reform European labour markets, foster mobility and create a truly single market. Converging on a model of best practice would increase efficiency and would make the conduct of a single monetary policy easier¹⁴. But it is also clear that this is not only a political and technical challenge that will take years to implement.

There will also be justified resistance to the harmonisation of labour laws in a context in which national legislation reflects both historical developments and fun-

damentally different preferences and economic models in the EU. EUI could also be important to bring a social dimension to the European project, which is often seen by citizens as oriented only towards technical matters. EUI could be seen as a way to create a direct solidarity link between European citizens.

Overall, we conclude that prior to embarking on this project, political consensus would be needed on fiscal risk sharing and further harmonisation and integration of labour markets and their associated institutions. Given its complexity, one should therefore not think of EUI as a contribution to macroeconomic management in the short term. Beyond EUI, other stabilisation tools such as European investment plan financed by joint borrowing would be more suited to influence the area-wide fiscal stance while being more quickly operational, but they would also come with difficulties¹⁵.

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