Ministero dell'Economia e delle Finanze

European unemployment insurance scheme

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Measures to address the social cost of the crisis and enhance citizens' trust in the EU are needed. Adjustments, notably in the labour market, could greatly benefit from a common cyclical unemployment support that would amplify positive spillovers, impact and effectiveness of reforms. In addition, a positive signal on the irreversibility of the common currency would contribute to macroeconomic stability and anchor positive expectations. In a monetary union, in the absence of the instrument of the exchange rate, it is of paramount importance to adequately address the impact of adjustments on employment dynamics. The scheme should include an appropriate incentive structure in order to limit moral hazard and avoid permanent transfers from some countries to others. The advantage of the current proposal is the possibility of implementing it on the basis of existing Treaties. More ambitious initiatives could be envisaged in the future with Treaty changes.

1. Rationale

The proposal for the establishment of a European unemployment scheme has been explored for a while by European and international institutions as well as academics, think-tanks and policy makers[1] as a possible first step towards the establishment of a common fiscal capacity to tackle asymmetric shocks and as a means to strengthening the social dimension of the EU. It is part of the proposals made in 2012 by the Commission both in its Communication on the Social Dimension of EMU[2] and in the Blueprint for a Deep and Genuine EMU and it was advocated in the 2012 Report of the Four Presidents. However, while no substantial progress has been made in the policy debate since the proposal was first tabled, reasons for its implementation have further strengthened.

First of all, the depth and length of the crisis as well as its long lasting impact on growth potential, stress the need for a mechanism to smooth the fluctuations of the economic cycle. An insurance mechanism would help in building a consistent aggregate fiscal stance at euro level, ensure that countries under fiscal constraints do not have to cut automatic stabilizers during the crisis and therefore reduce negative spillovers in case of future crises. Moreover, even if targeted at cyclical employment dynamics it avoids cyclical downturns turning into permanent losses of output and employment. Even countries that do not directly benefit from the mechanism would gain in the medium term from a more stable macroeconomic environment, with strengthened demand and in the long run from better growth perspectives of the other countries. Finally, a full commitment of member states to a shared long term vision and to a consistent road map anchors economic expectations to perspectives of more prosperity and stability and has an immediate impact on the economy, even if the realization of the project is for the long run.

Secondly, far reaching common initiatives are needed to address the European social emergency and modernize our social model to promote and facilitate adjustments that are taking place, notably in the labour market, all across the EU. The establishment of an

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[1] See among others: Bruegel, *Benefits and drawbacks of European Unemployment Insurance*, presented at the Milan Informal Ecofin, September 2014; Bertelsmann Stiftung and EU Commission - conference on European Unemployment Benefit Scheme, October 2013; *Common unemployment insurance scheme for the euro area - Cost of Non-Europe Report* - European Parliament 2014*; Towards a Fiscal Union for the euro area* – Note by IMF staff - July, 2013 and technical notes from the French and Italian Treasury (*An unemployment insurance scheme for the euro area, Tresor-Economics,* n. 132/2014; *Un'Assicurazione europea contro la disoccupazione: contesto, analisi e proposte di policy - MEF, Note Tematiche* 1- 2015). Further work by CEPS is ongoing on a mandate from the Commission for a detailed assessment of *Feasibility and added value of a European unemployment benefit scheme* and reports should available shortly.

[2] COM(2013) 690, Brussels 2.10.2013

unemployment insurance scheme will enhance the implementation of reforms that are key for a better functioning of the EMU. It could stimulate convergence of different labour market institutions and add the European dimension which is necessary to achieve successful policy coordination. Far from being a way out for countries that are not accelerating reforms, risk-sharing could be a driving force behind reforms. It could provide incentives to national initiatives, as it is happening, for example, with the domestic reforms of the banking sector triggered by the Banking Union. On the contrary, separate national initiatives could end up being mutually inconsistent.

2. Design

The design of the scheme should be as simple as possible and involve gradualism of implementation. The scheme is meant to address future shocks, once a buffer of resources has built up.

There are of course substantial differences among national labour market institutions. The gradual implementation of the scheme would be an incentive for national and EU level reforms to foster mobility and create a truly single labour market. If properly designed, it could trigger gradual approximation of national institutions, smoothing the main differences and causes of segmentation. The scheme should include an appropriate incentive structure in order to limit moral hazard and avoid permanent transfers from some countries to others.

To follow those objectives possible features of the mechanism include:

- *Scope*: the mechanism should be aimed at euro area member states and address only short term cyclical developments, notably cyclical unemployment – so that the use of the shared resources is largely outside the control of national governments while beneficiary countries still bear the responsibility of addressing structural unemployment. A timely intervention on short term unemployment, possibly complemented by effective active labour market policies, would help reducing the likelihood of an increase in structural unemployment.
- *Activation*: the benefit would be triggered only in cases of sufficiently negative large shocks, measured by an increase in unemployment rate (harmonized country data across the EU are available on a monthly basis).
- *Duration and size*: the benefit would be limited in time and in size, thus possibly being topped up by national benefits where appropriate. Length, coverage and eligibility should also be set in a way respectful of current national arrangements. It would therefore act as a basic insurance that could progressively evolve in time as the scheme triggers elements of convergence, (for example it could last 6-8 months, with a replacement rate of around 40-50%).
- *Eligibility*: eligibility could be linked to harmonized conditions of labour activation/job search activities. This would also trigger further steps towards harmonization of Public Employment Services and the establishment of truly European coordination on the matter (EURES). Progress in portability of entitlements and professional qualification would also be warranted.
- *Earmarking of resources*: while there should be no flexibility in the destination of resources – to be earmarked in connection with the unemployment situation – more resources would be available at national level for other anti-cyclical purposes, thus limiting pro-cyclical cuts.

- *Administration*: it should be implemented by a common administration, e.g. the Commission, in coordination with national authorities. Social partners at EU and national level should play a role in its definition and monitoring. This would improve awareness, ownership, and institutional convergence.

- *Financing options*: the mechanism could be financed with resources currently spent on a variety of national benefits, to be partly pooled in a common Unemployment Insurance Fund as the adjustments in labor markets kick in and unemployment is reduced. According to national systems and institutions this may involve state contributions as well as contributions of employers and employees. A similar option would involve earmarking a fraction of current domestic contributions (workers/employers) to the European insurance. The Fund would be limited in size. Corrective measures (as claw-back systems where contributions are adjusted according to the Member states' balance in the scheme) could be included after a certain threshold to prevent excessively lasting transfers. Possible developments include the financing through fresh own resources at EU /euro level. In the future it could also develop in a borrowing facility.

3. Legal basis

A new European Unemployment Insurance Fund, established through national resources of the euro area countries could be administered by the Commission and placed in a separate line within the existing EU budget. The current Treaties empower the EU institutions with the legislative means to tackle such a situation.

More in detail:

- First, the Council may adopt measures, specifically regarding Member states whose currency is the euro to strengthen the economic coordination pursuant to Articles 136 (and 121) TFEU, therefore restricted to the euro area countries. The scheme would be established as a complementary, albeit necessary, measure of economic coordination in the Eurozone to smooth negative spillovers of asymmetric shocks, foster convergence of economic performances, provide incentives to national reforms and maximize the benefits of the common currency.

- Second, under Article 175(3) TFEU, the EU may adopt '*specific actions*', even outside the existing Funds, deemed to be '*necessary*' in order to coordinate the Member States' economic policies. The specific actions could be aimed to the benefit of a part of the Union, (the Eurozone[3]), to pursue the objectives set forth in Article 174(1), – that is to say '*the overall harmonious development*' and namely '*the strengthening of its economic, social … cohesion*[4].

Therefore, Articles 136 and 175 TFUE appear to provide a sound legal basis for an envisaged legislation on an European unemployment insurance scheme, based on an ordinary legislative procedure, thus involving the European Parliament as co-legislator.

[3] See *e.g.* case C-166/07, para. 45. Article 175 '*does not set out the form which such specific actions can take*'; in this area, the ECJ continued, the EU can even adopt an '*independent … policy*' (*ibidem*, para. 46). After all, '*specific actions*' are not to be decided *a priori*, given that they may vary as a consequence of the evolving economic and social needs: '*The protean nature of economic and social cohesion and the general nature of the tasks given to that policy mean that it is difficult to define it exactly. It thus proves difficult to lay down the limits of the area covered by the policy because economic and social cohesion emerges as a broad overall concept with imprecise contours'* (conclusions of General Advocate Bot in the case C-166/07, para. 82). Therefore, nothing in principle prevents the EU from addressing the scheme under Article 175(3) TEU, for the benefit of a part of the Union: '*there is nothing in the wording of that article that rules out specific action for the benefit of one or more regions of the Community*' (*ibidem*, para. 92).

[4] Arguably, the latter expression includes any EU action aimed at promoting the harmonious development of the Union in terms of social cohesion, given that one of the Union's aim is to '*combat social exclusion*', and to '*promote economic, social and territorial cohesion, and solidarity among Member States*' (Article 3(3) TEU).