European unemployment insurance: finding the golden mean

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Ever since Europe slipped into severe recession following the financial crisis in the U.S., people have been discussing how to make the European Union better equipped for such an economic collapse. In more concrete terms, the power of a community is supposed to prevent individual members from getting into significant economic difficulties which may even go as far as considering exit from the community. Rescue packages, banking supervision, Eurobonds, European unemployment insurance – all that reflects these debates. Ultimately it is about nothing more and nothing less than the future political and economic make-up of the European Union.

That is why each step should be carefully considered. Let us have a look at the most recent example of a European unemployment insurance concept. The idea is to insure all European workers for unemployment in a common system. Apart from the fact that it makes a strong impression of solidarity, it is about the macroeconomic stabilisation of all of Europe: When unemployment increases in countries that suffer from recession, financial capital in the form of insurance payments is automatically directed to such countries.

In itself, such a concept makes perfect sense. But let us have a closer look. National

unemployment insurance is already able to fulfil this function of stabilising the economy: build up reserves when times are good, pay out more benefits to the unemployed when times are bad. These benefits usually flow into consumption, thus directly stabilising aggregate demand. That function is virtually the very nature of insurance. It is therefore not necessary to make substantial changes to individual national social insurance systems, which have all grown separately and in very different ways, as would be expected with a European unemployment insurance system.

Nevertheless, effective stabilisation measures are still essential for a monetary union where exchange rate adjustments and independent monetary policies can no longer compensate for asymmetric developments The European crisis has shown that individual member states of the monetary union are unable to cope and may be compelled to make some steep cuts – with socially critical consequences. It would therefore make sense to have a set of balancing instruments in place in order to absorb strong asymmetrical shocks.

But that does not necessarily require the invention of a new insurance for hundreds of millions of individuals and 19 different and historically grown social security systems. The same effect could also be achieved by a European backup budget, financed by the member states, which could be tapped in case of need to provide stabilising benefits. That system could still be tethered to the labour market, with short-term unemployment as a relevant indicator, for example. It would even be possible to accurately recreate the financial transactions which would occur under a European unemployment insurance system. Notwithstanding, incentives for accurate funding of the national unemployment insurance – and thus for ensuring stabilisation – could be improved by reducing contributions to the European backup budget for countries building up sound reserves during economic expansion.

A fiscal instrument constructed along these lines could significantly strengthen the monetary union in times of crisis without weakening any well-differentiated national systems. It is exactly this combination of community and subsidiarity which can constitute the golden mean for a social Europe.