Contingent vs. Non-Contingent Unemployment Benefit Scheme for the EMU

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Aim of the study

Comparing 2 unemployment benefit schemes at the EMU level that differ because:

- in the first one, benefit payments are contingent to the macroeconomic situation of the country (contingent scheme)

- in the other, benefits payments are not contingent to the macroeconomic situation of the country (non contingent scheme)

Overview of the methodology

– Design of 2 schemes (identical in term of benefit payments except for the contingency)

– For each scheme, calculate the contribution rate (annual size of the scheme) that balances the scheme over the period 2000 – 2015

– Perform simulations on past data to measure the stabilization properties of the 2 schemes

– Build forward looking scenarios to study the long term financial sustainability of the 2 schemes

Designing the <u>Contingent</u> Unemployment Benefit Scheme

- An insurance against big negative shocks
- Workers pay an annual contribution to the scheme in exchange for :
  - The payment of part of their unemployment benefits when their country is hit by a massive shock (large increase in short term unemployment) **Trigger**
    - Example of trigger : 3-12 month unemployment rate <u>above its 5 year average + 1p.p.</u>
    - The level of 3 -12 month unemployment rate that triggers the payments of benefits is **country specific and time dependent**
  - Payments stop when the consequences of the shock start to vanish (or, alternatively, after a given number of years) **Sunset Clause**
    - Example of sunset clause : when the 3-12 month unemployment rate <u>less than 5 year average</u>
    - The level of 3 – 12 month unemployment rate that stops the payments of benefits is **country specific and time dependent.**

- European Unemployment Benefit paid to unemployed individuals after 3 months of unemployment and up to their 12nd month of unemployment
- Based on previous earnings
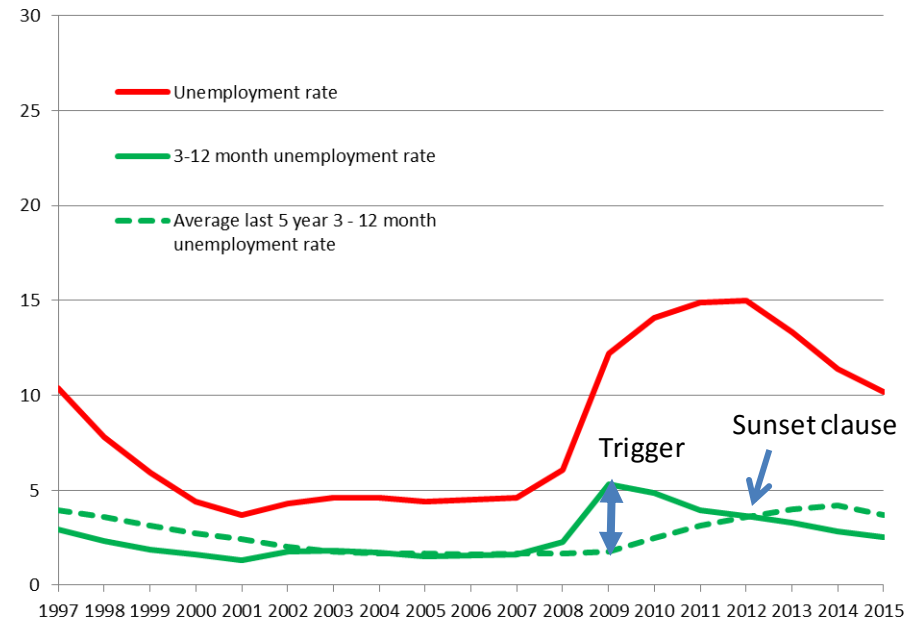- The domestic unemployment benefit can top-up the EZ unemployment benefit

Triggers and sunset clauses for Spain and Ireland

Spain
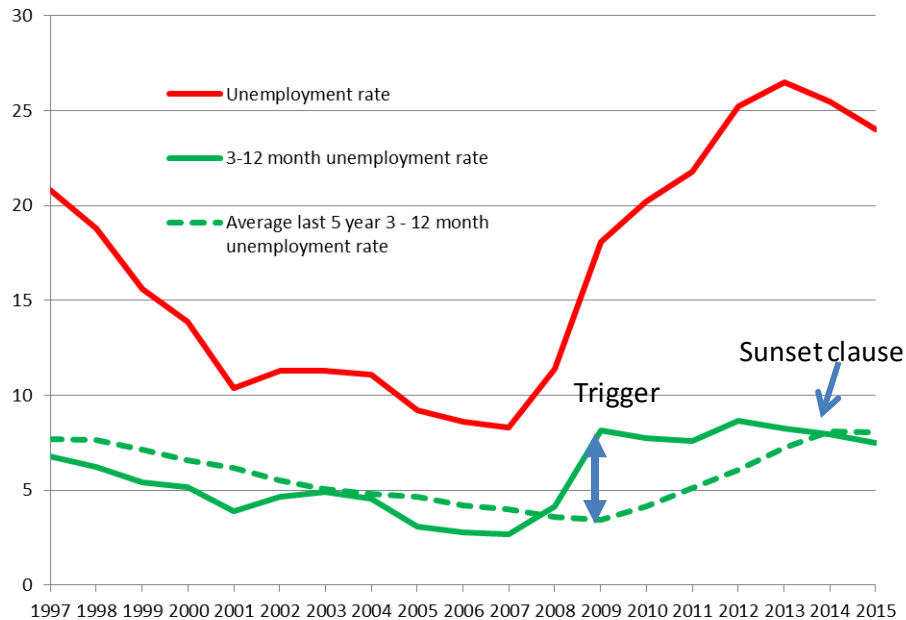
	2008	2009
3-12 month unemployment rate	4.1%	8.1%
Average over the last 5 years	3.6%	3.5%
Rate – 5 year average	0.5 pp	4.6 pp

Ireland

	2008	2009
3-12 month unemployment rate	2.3%	5.3%
Average over the last 5 years	1.7%	1.8%
Rate – 5 year average	0.6 pp	3.5 pp

Designing the <u>Non Contingent</u> Unemployment Benefit System

– Same as the contingent scheme except there is **no trigger nor sunset clause**

Simulation details

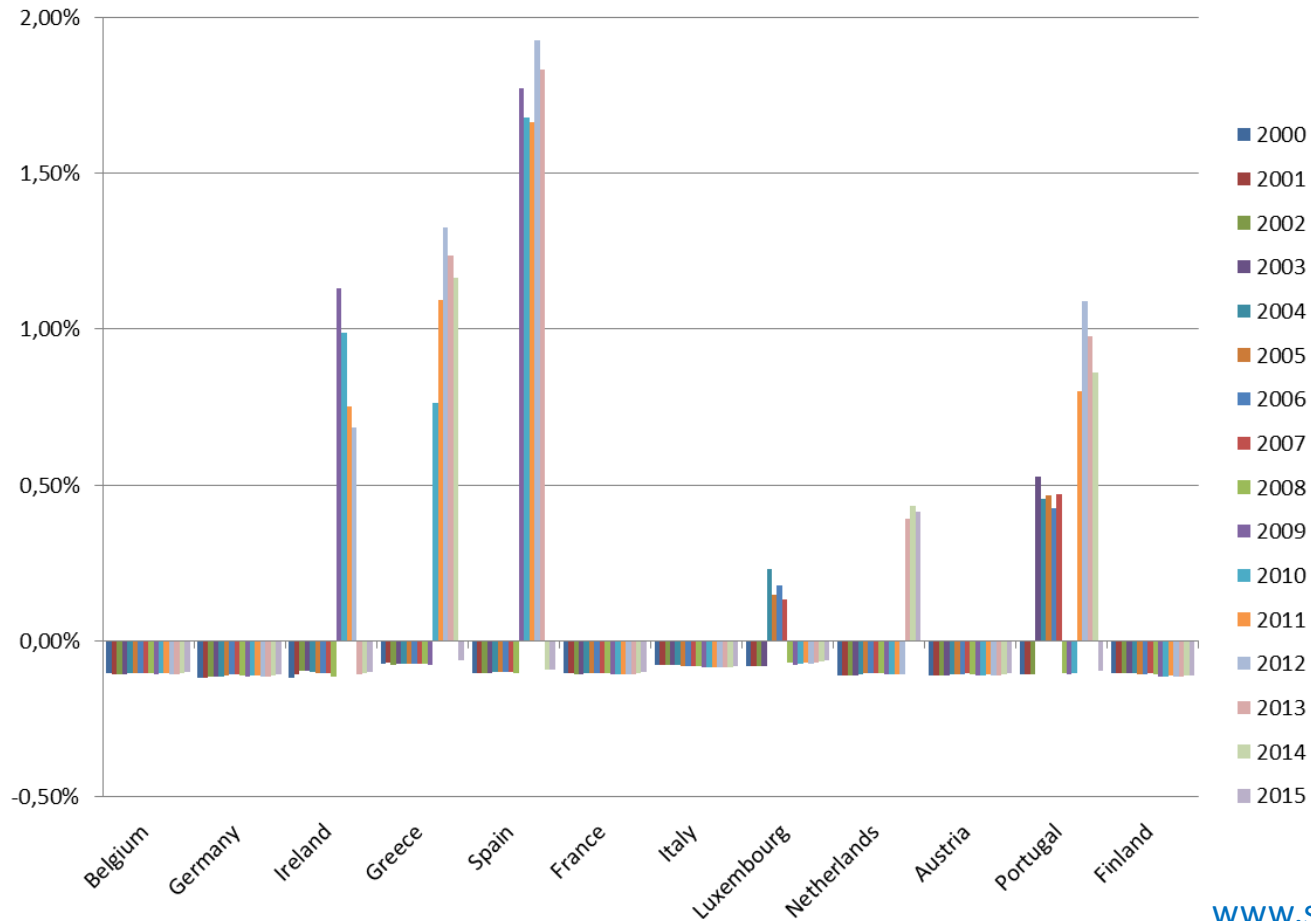|	Contingent Scheme	Non-Contingent Scheme
Trigger	3-12 month unemployment rate > its 5 year moving average + 1 pp	No trigger
Sunset Clause	3-12 month unemployment rate < its 5 year moving average	No sunset clause
Amount of benefit paid	50% of past earnings (measured as 50% of medium wage in the country)	
Beneficiaries	80% of 3-12 month unemployed individuals	
Contribution to the scheme	Contribution based on wages. Rate to ensure an EMU wide zero balance over the period 2000-2015	
12 countries	Belgium, Germany, Ireland, Greece, Spain, France, Italy, Luxemburg, the Netherlands, Austria, Portugal, Finland.	

Contingent Scheme
Slightly less than 10 billions per year ; contribution = 0.27% on wages
Large net beneficiaries
No permanent (positive) transfer to any country
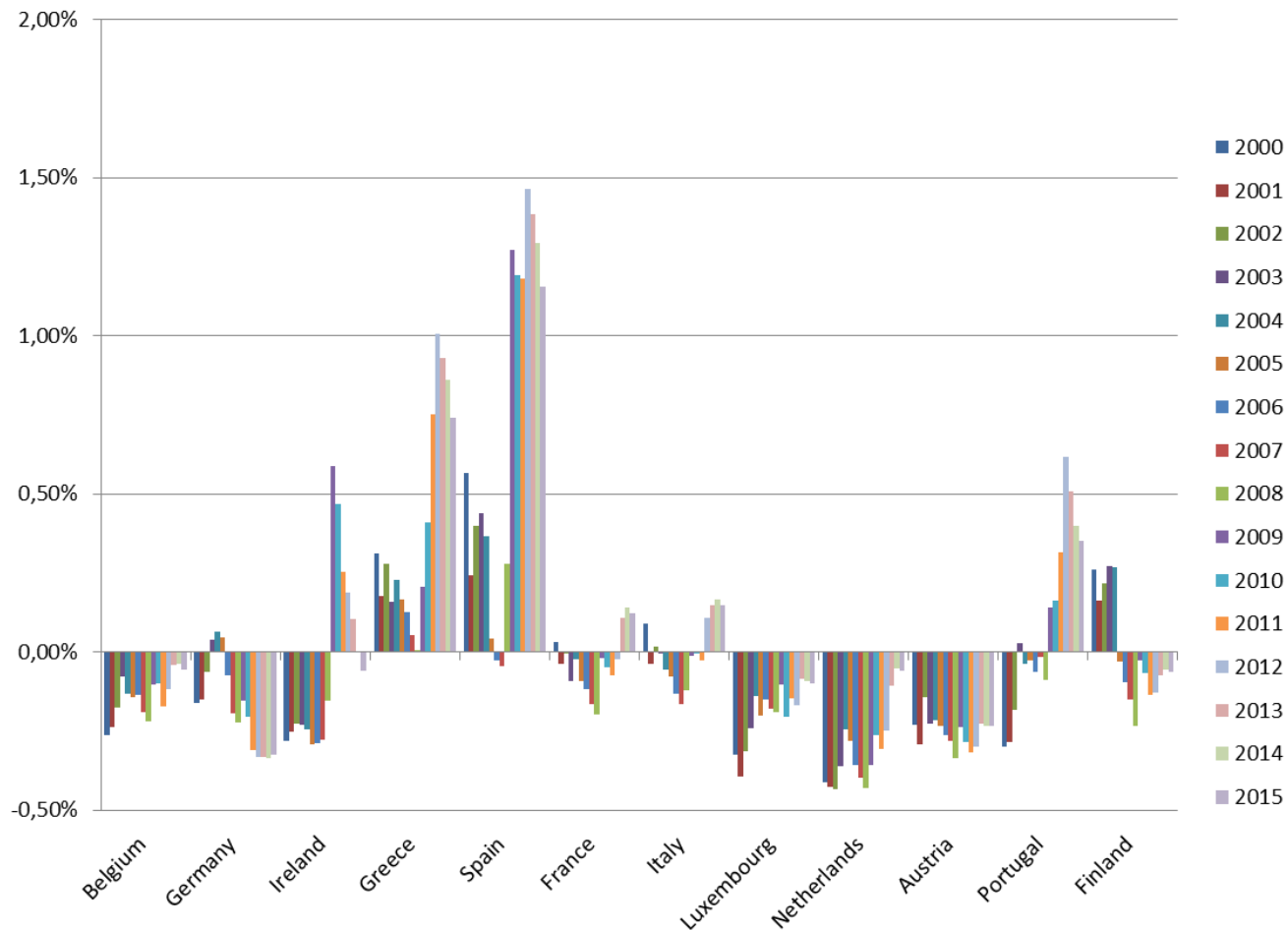
Net payments to country per year
2000 – 2015, % of country GDP

Non-Contingent Scheme
Between 55 and 56 billions per year ; contribution = 1.55% on wages
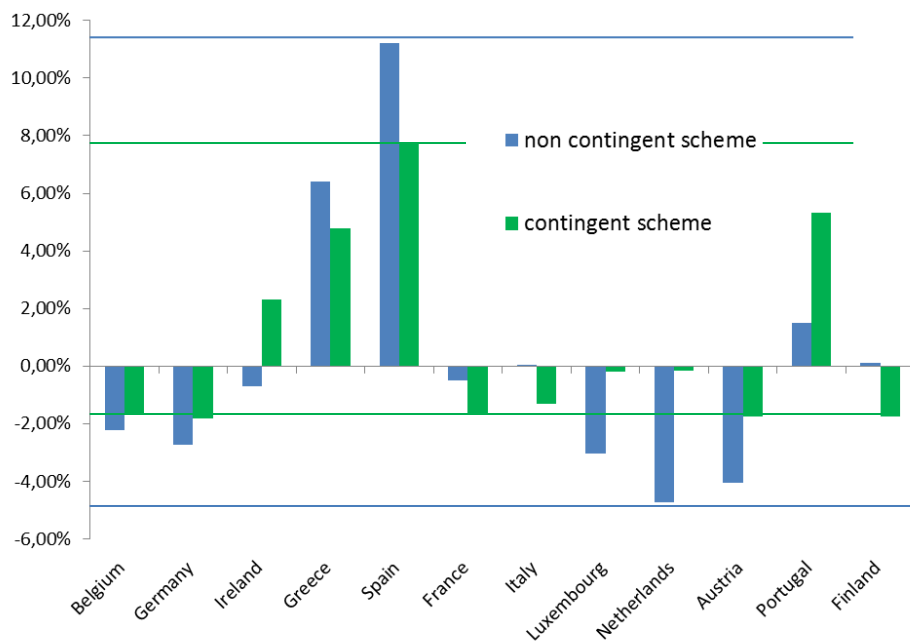## Large net beneficiaries
Some permanent (positive) transfers

Net payments to country per year
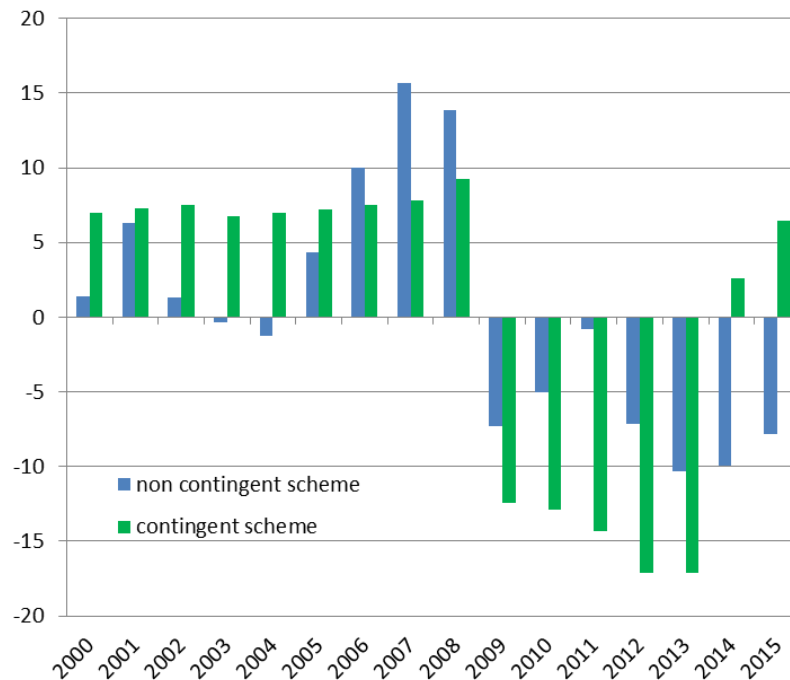2000 – 2015, % of country GDP

Under contingent scheme net payments to countries over 2000 - 2015 are significantly lower than under non-contingent scheme, but better concentrated on crises years.

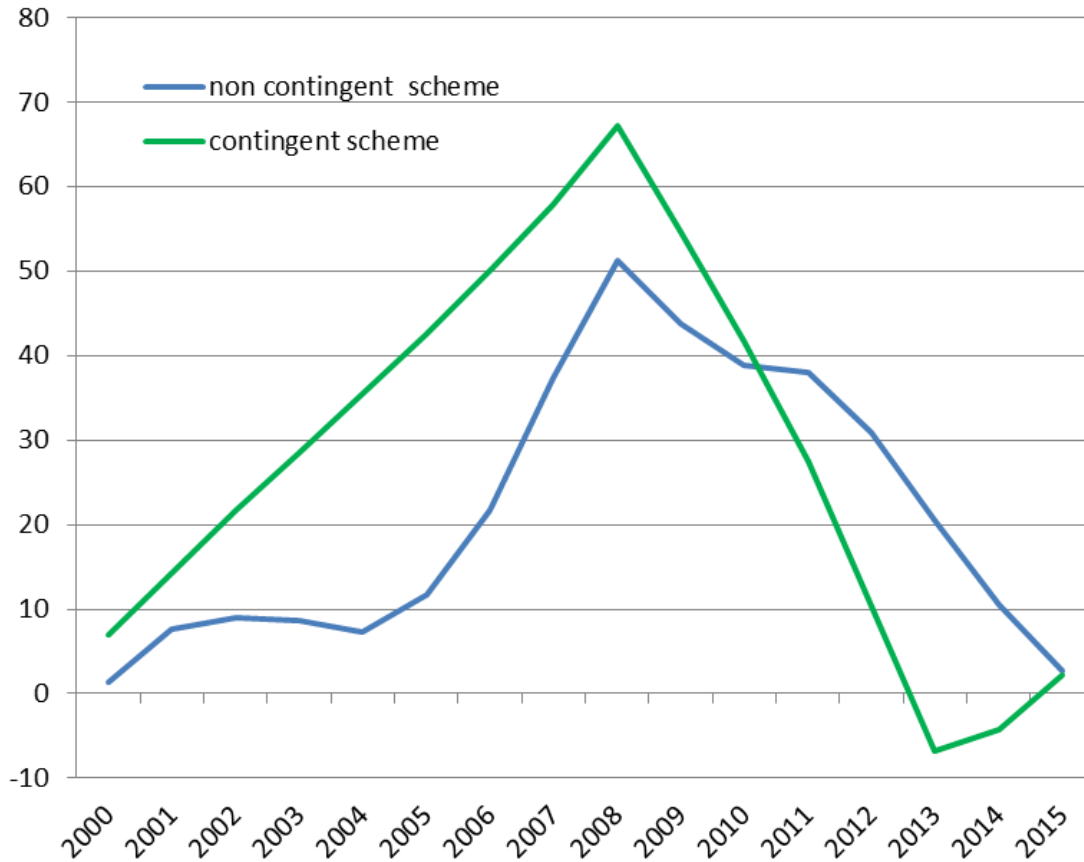## Net payments to countries
2000 – 2015, % of country GDP

Surpluses and deficits of the scheme
2000 – 2015, billion of euros

To achieve a zero balance over the period 2000 – 2015, both schemes would have need to accumulate large surpluses before the crises

Accumulated surpluses and deficits
2000 – 2015, billion of euros
(no interest payments or revenues)

Both schemes would have delivered a limited overall stabilization at the Euro Zone level

Eurozone	Standard deviation of growth rate (2000 – 2015)	EZ annual growth rate (%) (2009 – 2011)		
		2009	2010	2011
Actual data	1.32%	-4.4%	2.0%	1.6%
Non-contingent scheme	1.27%	-4.2%	1.9%	1.6%
Contingent Scheme	1.30%	-4.2%	2.0%	1.6%

Under the assumption of a fiscal multiplier equal to 1 and constant over time

Both schemes deliver large stabilization to net receiving countries after 2008

Stabilization is significantly higher for the contingent scheme the first year of the crisis, with a large reversal when the country exits from the scheme

SPAIN	Standard deviation of growth rate (2000 – 2015)	Annual Growth rate (in %) (2009 – 2014)					
		2009	2010	2011	2012	2013	2014
Actual data	2.03%	-3.8	-0.2	0.1	-1.6	-1.2	1.1
Non contingent scheme	1.96%	-2.8	-0,3	0.0	-1.3	-1.3	1.1
Contingent Scheme	2.03%	-2.0	-0.3	0,0	-1.3	-1.3	-0.8

IRELAND	Standard deviation of growth rate (2000 – 2015)	Annual Growth rate (in %) (2009– 2011)		
		2009	2010	2011
Actual data	3.07%	-6.4	-1.1	2.2
Non contingent scheme	3.03%	-5.6	-1.8	1.9
Contingent Scheme	3.06%	-5.1	-1.2	1.1

What would happen to the schemes under various scenarios over 2016 – 2035?

Forward looking scenarios:

– Useful to gauge the overall financial sustainability of the schemes

– Not well suited to analysis country net payments and transfers, and stabilization impact

– Very fragile

3 Forward looking scenarios (2015- 2035)

1. Baseline (based on country forecast of the Ageing Working Group (AWG) of the Economic Policy Committee)

   - Regular convergence toward the AWG unemployment rate for 2035

2. An "historical" scenario

   - The 2000 – 2017 changes in total unemployment rates are repeated in 2018 – 2035.

3. A worst case scenario

   - Over the period 2018-2024, each country is getting half of the 2008 – 2014 unemployment shocks of the country that is just below in term of size

     – German unemployment over 2018-2025 increases by half of the increase in French unemployment over the period 2008 – 2015

     – France unemployment over 2018-2025 increases by half of the increase of Italian unemployment over the period 2018 – 2025

     – Italian unemployment …………………….Spanish

     – ……….

   - After 2025, unemployment declines at the same pace as in the baseline scenario after 2015.

Unemployment rates under the 3 scenarios (2015- 2035)
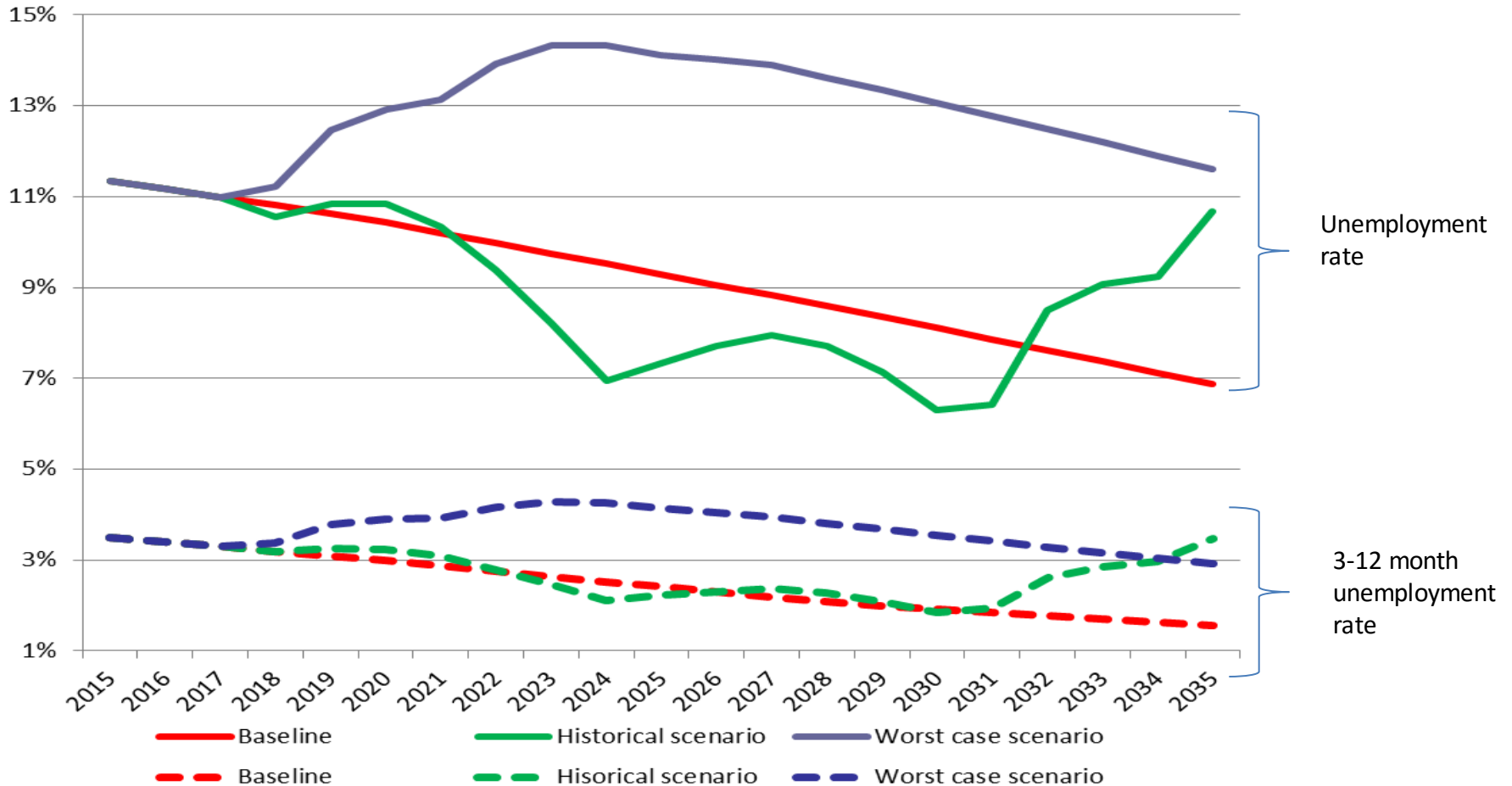
# Common assumptions to simulate the financial situation of the schemes

- — Evolution of the 3-12 month unemployment rate linked to the evolution of total unemployment rate (*based on rough econometric estimates)*

- — Inflation = 1.8% from 2016 onwards

- — Labor productivity growth as in AWG.

- — Real wages evolves in line with labor productivity.

- — No interest payments / revenues from the scheme

- — Contribution rate

  - Contingent scheme: 0.27%
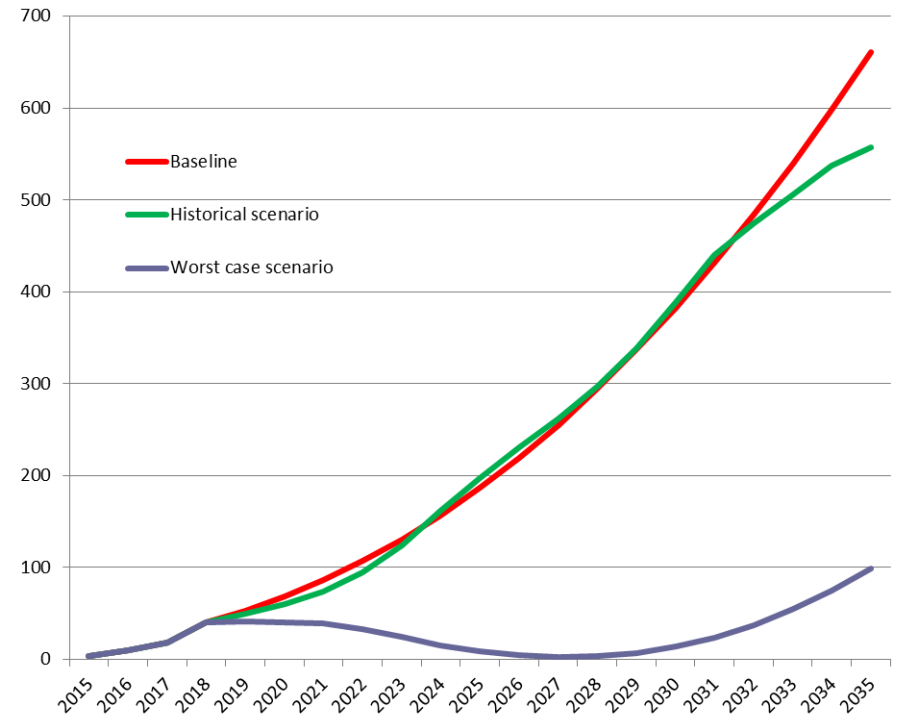
  - Non-Contingent scheme: 1.55%

Both schemes appear financially sustainable under the 3 scenarios

The non-contingent scheme would accumulate a large wealth under the baseline and historical scenarios

Accumulated Surpluses and Deficits
(billions of euros)
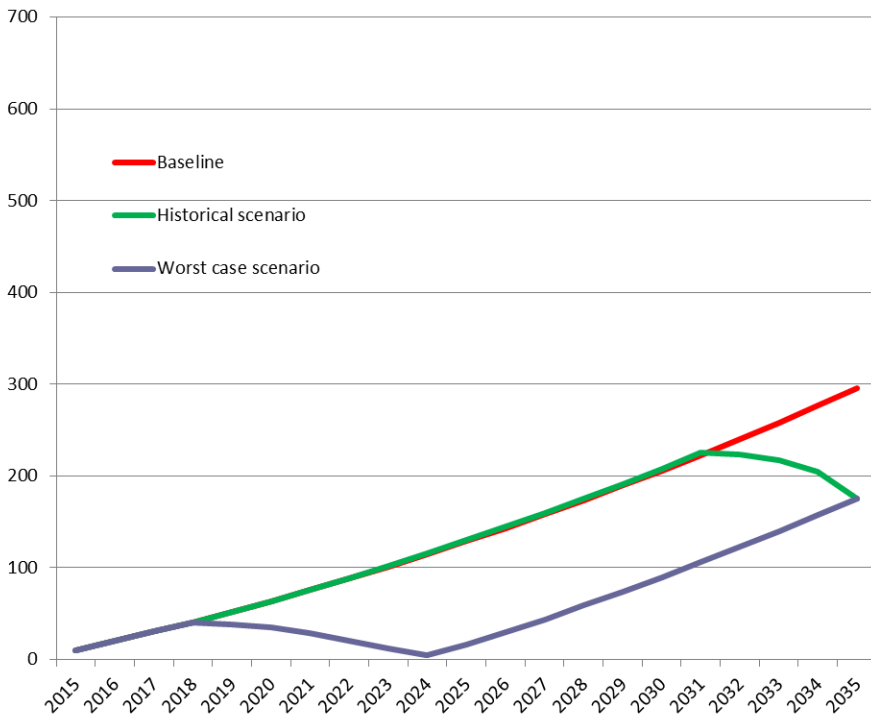
Contingent Scheme

Non-contingent scheme

Summing up

- Both schemes
  - Good at smoothing out big fluctuations at the country level
  - Not good at smoothing big fluctuations at the EZ level (but this is not what they are for)
  - Look financially sustainable in forward looking scenarios
- Contingent scheme (annual size 10 billion, contribution rate 0.27% on wages)
  - Significantly smaller
  - Less likely to generate positive permanent transfers (thanks to sunset clause)
  - On average less expensive for "lucky" countries (i.e. never eligible to the scheme) (exceptions : France, Italy, Finland)
  - Better at smoothing out large fluctuations in short-term unemployment
- Non-contingent scheme (annual size 56 billion, contribution rate 1.55% on wages)
  - Better at smoothing small fluctuations in short term employment rate
  - No abrupt reversal (thanks to no sunset clause)

3 Ways forward

Option 1: implement the contingent scheme

Option 2: implement the non-contingent scheme immediately (probably requires different contribution rates across countries)

Option 3:

- Implement the contingent scheme.
- See how it works
  - No sign of "gaming" the system?
  - Convergence in short term unemployment rates?
- If it works:
  - reduce the trigger level by steps and increase the contribution rate accordingly
- Final step: non-contingent scheme