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Economic dilemmas about unemployment benefit in the context of the future European insurance system

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Abstract

Since June 2012, is under discussion in the European institutions the idea of moving towards a "genuine economic and monetary union" which includes the creation of an instrument of macroeconomic stabilization in the Eurozone based on an insurance system managed at central level. This project appears when the unemployment benefit has been subject to a double conditionality resulting from the reaffirmation of need to improve labour market flexibility and from the fiscal consolidation policies. The aim of this paper is precisely to discuss the European idea of this insurance system, having in account the framework of the unemployment benefit in the European policies of labour markets flexibilization, its theoretical conception, its role in the context of the architecture of the economic policies of the Eurozone and others alternative perspectives about unemployment benefit.

Keywords: unemployment benefit; labour markets; European economy; employment; macroeconomic policy

Introduction

The unemployment benefit framework in the European Union (EU) went through to a significant reconfiguration since the end of the 1990s with the launching of the European Employment Strategy. Unemployment benefit was since then broadly considered as a search subsidy and not as a replacement income and a macroeconomic stabilizer. This European perspective was reinforced in the context of the public debt crisis, mainly in relation to the countries with financial assistance programmes, since unemployment benefit became a component of public expenditure that governments want to reduce. Therefore, at present, the unemployment benefit is subject to a double conditionality: one derived from the reaffirmation of the need to improve labour market flexibility, and the other associated to the fiscal consolidation policies.

A new reconfiguration of the unemployment benefit is being delineated with the European project to the creation of a common insurance system managed at the central level. This system is seen as a complementary instrument for the *ex-ante* coordination of "structural reforms" where the improvement of labour markets flexibilization is included. This European project thus seems to be a step further to reinforce this double conditionality and simultaneously to limit the role of national automatic fiscal stabilizers and consequently the role of national fiscal policies.

The aim of this paper is precisely to discuss the idea of this European insurance system. Section 1 analyses the European labour market policies and especially the unemployment benefit policies since the beginning of the Eurozone, with reference to its theoretical principles and to its role within the context of the economic policies architecture. Section 2 discusses the contradictions of economic policy around unemployment benefits during the crises in 2008 and 2010. Section 3 debates the project for the setting up of the European insurance system. Finally, section 4 highlights several conclusions and ideas for an alternative perspective about unemployment benefit.

1. Theoretical principles of the European perspective on unemployment benefit

The perspective on unemployment benefit that prevails in the EU needs to be discussed, not only in view of the conception of labour market underpinning it, but also in terms of the framework it assigns to the labour market within the functioning of the economy. The main theoretical reference is the neoclassical model, more specifically, job search theory (McCall 1970), which developed out of the neoclassical model following the introduction of the imperfect information hypothesis. According to this, the effects of unemployment benefit depend on the strategy of each jobseeking agent.

An individual accepts a job as long as the wage received is greater than "reservation wage"[1] (this is equivalent to unemployment benefit), and reaches its optimal level when the additional gain from the higher wage equals the costs of prolonging the job search, or in other words, when the individual maximizes the net income of the job search activity. This means that the greater the "reservation wage", the longer the period of jobseeking and the period of unemployment, and the higher the wage established. Unemployment benefit is thus seen as something which reduces the marginal cost of jobseeking, causing it to become less intense. The entitlement period of unemployment benefit can also affect job search intensity: when the period is shorter, the jobseeking agent intensifies his activity because of the increased risk of losing connection with the labour market. According to this perspective, then, there is a moral hazard associated to unemployment benefit.

Job search theory has a somewhat partial view on unemployment benefit as it only considers the flows between unemployment and employment, overlooking flows between unemployment and inactivity (unemployment benefit may actually mitigate the latter and reinforce the flow in the opposite direction). What is more, it does not take account of the institutional framework (eligibility conditions, entitlement period, and the rules establishing the benefit amount), viewing unemployment benefit only as a "wage of the unemployed" (Atkinson and Micklewright 1991: 1688). That is to say, it only considers jobseekers' behaviour, which means that unemployment is understood to be the responsibility of the individual, irrespective of the macroeconomic context and the economy's capacity to create jobs. It also neglects the wage and the unemployment benefit as components of income and, therefore, as decisive factors of aggregate demand (Leclercq 1999). In fact, in macroeconomic terms, as unemployment benefit is a form of income (i.e. a replacement income for those without a job), it is a macroeconomic stabilizer with anti-cyclical properties. What is more, it also has an effect on precautionary saving, which is lower when workers know that there is a public system that will guarantee part of their income through periods of unemployment. These positive effects on aggregate demand, economic growth and employment also need to be taken into account.

[1] The term "reserve" comes from auction markets. When someone wants to sell something, they usually establish a minimum price for which they will sell the good. If the best offer is lower than this minimum price, the seller reserves the right to buy the good himself.

As job search theory is based on the neoclassical model of the labour market, it is pertinent to recall some characteristics of this market. The model not only reduces the wage formation to the market sphere, it also assumes that the labour market is a perfectly competitive market[2]. This means that workers and entrepreneurs are believed to be endowed with perfect rationality and oriented by methodological individualism. The market equilibrium is Pareto efficient and as such is a state of full employment. Thus, if unemployment exists, it is voluntary and individual in origin, as it depends on workers rejecting work below a specific wage, the "reservation wage".

In this type of labour market, unemployment benefit can cause a higher (real) wage and lower level of employment than that which occurs in a perfectly competitive market. In fact, if the equilibrium wage is lower than unemployment benefit (considered to be the "reservation wage"), this becomes a wage that cannot be reduced. As workers constantly arbitrate between working time and leisure time (this logic that is also present in job search theory) and supply labour only in certain circumstances, they limit the level of labour supply and therefore the reduction of wages.

These theoretical results regarding unemployment benefit should be questioned from the outset for being based on a perfectly competitive labour market. As Polanyi (1975: 73) states:

> To allow the market mechanism to be sole director of the fate of human beings and their natural environment, indeed, even of the amount and use of purchasing power, would result in the demolition of society. For the alleged commodity 'labour power' cannot be shoved about, used indiscriminately, or even left unused, without affecting also the human individual who happens to be the bearer of this particular commodity. In disposing of a man's labour power the system would, incidentally, dispose of the physical, psychological, and moral entity 'man' attached to that tag.

But it is not enough to just question the market structure itself, it is also necessary to reflect on the labour market's framework within the economic system when it is assumed to have these characteristics. The model assumes full employment and that any unemployment that exists is voluntary in origin and the individual's responsibility; hence, the labour market is considered to be disconnected from economic

[2] As has already been mentioned, job search theory challenges one of the market's basic assumptions and assumes imperfect information regarding worker behaviour.

activity. This means that unemployment does not depend upon the level of this activity or on any other macroeconomic policy as this is assumed as unnecessary for its reduction. Only labour market policies which directly influence the behaviour of the unemployed (such as unemployment benefit policies) are considered effective for the reduction of unemployment. Hence there is no room for the existence of involuntary unemployment, which results from insufficient aggregate demand. The “natural” rate of unemployment model points in the same direction. This is also based on the same model of the labour market, but reinforces its conclusions by claiming that macroeconomic policy, besides being unnecessary, is also ineffective in reducing unemployment beneath a certain level (the “natural” rate of unemployment). Only the variables which directly affect the labour market (such as unemployment benefit) are considered fundamental for the reduction of unemployment.

2. Unemployment benefit and the flexibilization of European labour markets

In the EU, these theoretical principles have served as the basis for unemployment benefit policies, and generally for the promotion of labour market flexibilization policies. It is believed that unemployment benefit prolongs and disincentivizes jobseeking, affecting the labour supply, and that it constitutes a minimum level beneath which someone who is unemployed will not accept a new job. “Unemployed individuals facing decreasing unemployment benefits over time and limited duration may revise downward their ‘reservation wage’ (the lowest wage rate at which one would be willing to accept a job) and increase job search intensity as the expiry date of the benefits approaches” (European Commission 2010: 119). This conception clearly devalues unemployment benefit as a replacement income for someone that loses a job, and instead sees it as a mere search subsidy. It also considers it to be an exogenous “imperfection” of the labour market, impeding directly downward wage flexibility and indirectly by limiting the labour supply (that is, by not permitting the labour market to operate in accordance with the mechanisms of perfect competition). Because of these characteristics, unemployment benefit has been seen as limiting the macroeconomic flexibility of the labour markets (i.e. the capacity of wages to respond to labour market imbalances) in the EU. This means that, within the Eurozone, unemployment benefit has limited the capacity of labour markets to be a macroeconomic adjustment channel in the case of economic shocks. Moreover, it is assumed that unemployment benefit conditions downward wage flexibility, irrespective of the situation of the labour market.

Belief in the need for a flexible labour market has been present since the launch of the single currency project. By 1992, the European institutions had already acknowledged their preference for making macroeconomic adjustments through the labour market rather than through fiscal policy when stabilization was required, and also called for "wage moderation" in the name of price stability (Commission of the European Communities 1993). Since the 1990s, labour market flexibility and wage flexibility have gradually been included into broad economic policy guidelines as a goal of political and economic policy. In the context of the Eurozone's macroeconomic policy, by defining price stability as the main objective of the common monetary policy to which all other policies have to defer, and by conditioning national fiscal policies by enforcing a public deficit-to-GDP ratio of no more than 3% and a public debt-to-GDP ratio not exceeding 60%, the labour market was effectively assumed as the market through which macroeconomic adjustments would be processed in the case of asymmetrical shocks, once the devaluation option was removed. Wage is therefore considered to be a macroeconomic adjustment variable, and perceived as essentially a component of production costs, which influences the employment rate, price stability and the competitiveness of Member States.

The European Employment Strategy, which was created in 1997, is a clear manifestation of this understanding of the supposed role of the labour market in the EU and, more specifically, in the Eurozone. In other words, this was the strategy required to guarantee the labour markets the necessary flexibility to enable them to serve as a channel for macroeconomic adjustment. The main objective of this strategy, formerly instituted through Article 145 of the Treaty on the Functioning of the European Union, is precisely to create labour markets which are "responsive to economic change". In 1998, the European Commission (Commission of the European Communities 1998: 13) warned of the need to implement "structural reforms" in the European labour markets:

Given insufficient progress in the implementation of structural reforms in product, service and, especially, labour markets in most Member States, continued and intensified efforts are required to remove often deeply seated structural deficiencies. This need is made all the more pressing by the introduction of a single currency. Member States' adjustment to country-specific economic disturbances will have to rely to a considerable extent on the flexibility and adaptability of their markets for products, services and factors of production.

Thus, from the beginning of this strategy, with regards to unemployment benefit, a set of guidelines was drawn up calling for Member States to enact policies based on the idea that stimulus for paid work is not enough, because the levels of replacement income disincentivize jobseeking or lead to reject jobs because their expectations are disappointed regarding their new net income. The objective of these policies is to create incentives to accept jobs and, in accordance the neoclassic labour market model, Member States are advised to review their benefit systems. This type of policy helps to mitigate some of the "imperfections" of the labour market, such as unemployment benefit, increasing the labour supply and lowering the "reservation wage", which in accordance with the same model enhances downward wage flexibility.

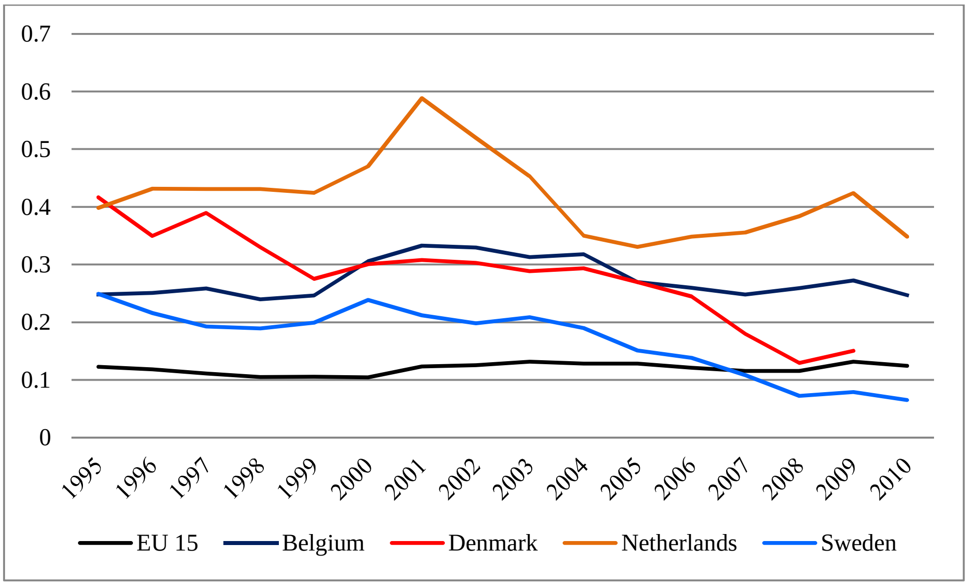
Although there is a range of different unemployment benefit systems throughout the EU, which is reflected in the various levels of protection granted (Graph 1-3)[3], most Member States responded to the common guidelines in a similar way, by introducing restrictions on the right to unemployment benefit (through the limitation of eligibility conditions, reductions to the benefit amount and entitlement period, the redefinition of the concept of suitable employment and strengthening of public control over beneficiaries' obligations); by reinforcing the principle of activation (which translates into the use of the benefit, wholly or in part, as pay for work); and by strengthening of the individual's approach to unemployment, which comes in part from the previous changes.

The question that can now be asked is: what has been the effect of these changes on the level of unemployment protection granted by the national systems? Given the aforementioned heterogeneity and the vast array of cases, it is hard to give a detailed answer to this question. Instead, we can use an indicator that gives the average of effort intensity of the national systems — the ratio between public expenditure on

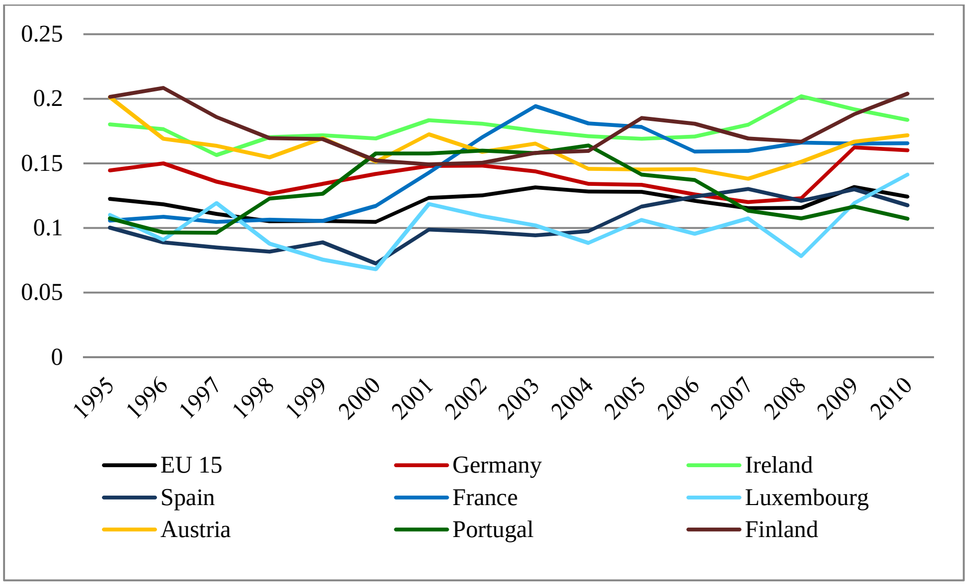
[3] It is not logical to include the new Member States, since they have not been involved in the process under analysis.

unemployment benefit as a percentage of GDP and the rate of unemployment (Freyssinet 2002). Observing these figures, there are some aspects which stand out and deserve to be mentioned. The indicator has clearly decreased in the countries which are generally characterized by having “generous” systems and which have always presented levels above the EU15 average (Graph 1), such as Denmark, the Netherlands and Belgium. It is worth mentioning the case of Sweden, which is no longer a part of this group of countries, since its indicator is now relatively low compared to the EU15 average. At the beginning of the first decade of the millennium, and then again in 2005-2006, significant changes were implemented, such as the reinforcement of the principle of activation, reductions to the maximum entitlement period and maximum benefit amount, reductions to the possibility to reject jobs and restrictions on eligibility conditions. Of the countries with intermediate level indicators (Graph 2), the most emblematic case is that of Germany with its application in 2005 of the Hartz IV laws. These include a significant reduction in the entitlement period and redefinition of the concept of suitable employment, restrictions on eligibility conditions, and a reinforcement of sanctions for failure to comply. With regard to the countries which have indicator levels below the EU15 average (Graph 3), two cases can be clearly highlighted: the United Kingdom, which is the country offering the least protection to the unemployed (especially since 1996 when many benefit claims became means-tested); and Greece and Italy (and possibly Spain), which had higher indicator levels, essentially due to increased coverage, benefit amount and entitlement period. The case of Portugal is also worthy of mention. Since 2004, indicator levels have been falling and today it is below the EU15 average, despite the fact that it is considered to have a “generous” unemployment benefit system, given the income replacement rate and entitlement period (European Commission 2010). This development is explained by changes to the Portuguese unemployment benefit system, which include reducing the possibility to reject jobs, strengthening of the public control over beneficiaries’ obligations and intensification of the principle of activation. As will be seen below, with the financial assistance programme initiated in 2011, which includes measures designed to reduce the “generosity” of the system, this tendency has intensified.

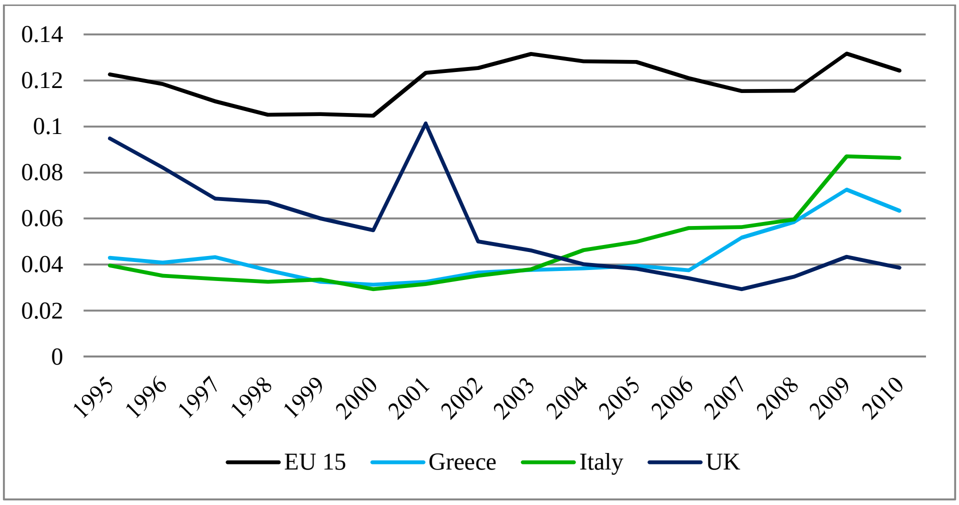
Graph 1: Average of effort intensity of national systems, countries with levels above the EU15 average



Graph 2: Average of effort intensity of national systems, countries with levels close to the EU15 average



Graph 3: Average of effort intensity of national systems, countries with levels below the EU15 average



Source: Eurostat-ESSPROS, Unemployment function, Full unemployment benefits and partial unemployment, which include means-tested; own calculations.

This attitude to unemployment benefit should also be analysed in connection with fiscal policy. If unemployment benefit is viewed as essentially a search subsidy, another of its main functions (its very *raison d'être*) is put in jeopardy, namely the fact that it constitutes a replacement income for those who lose their job, as has already been mentioned. Thus, unemployment benefit's role as a macroeconomic stabilizer with anti-cyclical properties is undermined, and the action of fiscal policy via automatic stabilizers is also limited. This issue has always raised questions regarding the framework of national fiscal policies within the Stability and Growth Pact (Resolution of the European Council, 17 June 1997), which stipulates that Member States must "respect the medium-term budgetary objective of positions close to balance or in surplus". This, along with the 3% limit on the public deficit-to-GDP ratio, seems to leave a 3% margin of GDP in public deficit for the functioning of automatic fiscal stabilizers in periods of economic slowdown, or at least this is how it is currently understood. However, the more pressure there is to reduce unemployment benefit or its duration because of its disincentive effects, the less will be the public expenditure on unemployment benefit for the same level of unemployment and the smaller will be the increase in this spending in times of greater unemployment. Therefore, the capacity of unemployment benefit to function as an automatic stabilizer is reduced. However, even if it has worked or does work, it will also have been conditioned by the pressure to reduce public expenditure which results from compliance with budgetary rules. There are studies (Noord 2000; Dullien 2007) which show that, in some Eurozone countries, discretionary fiscal policies designed to comply with the fiscal convergence criteria of the 1990s and the Eurozone's budgetary rules have wholly or partially neutralized automatic fiscal stabilizers, to the extent that the total effect has been a-cyclical or even pro-cyclical. With regards to this issue, Solow (2004: 38) says:

> Suppose my guess is right, and automatic stabilization has become less effective. It would not matter much, if we could count on discretionary fiscal policy to supplement monetary policy in the pursuit of such social goals as high employment, low inflation and an appropriate balance among private and public consumption and private and public investment. If, however, discretionary fiscal policy is delayed or even paralysed because of its inevitable entanglement with distributional and allocational controversy, the weakening of automatic stabilizers is a real loss.

There are various empirical studies which suggest the importance of automatic fiscal stabilizers for the reduction of GDP volatility or for macroeconomic stabilization when shocks occur in EU Member States (OECD 1999; Noord 2000; Brunila *et al.* 2002; Debrun *et al.* 2008; Debrun and Kapoor 2010; Dolls *et al.* 2010). However, these results have been relativized by empirical studies (some of the previous ones) which value supply-side incentives for the economy or labour market. According to these, stabilizers are only important in the case of demand-side shock. When dealing with supply-side shock, stabilizers — such us direct and indirect taxes — may delay the adjustment by creating disincentive at the moment of economic recovery (Brunila *et al.* 2002), especially if they are associated to public expenditure, which tends to reduce the labour market's flexibility and job search incentives (Noord 2000). Another set of studies claim that government-induced stabilization is no longer very necessary given the reduction in GDP volatility since the mid-1990s. This deprecation of macroeconomic stabilization mechanisms is justified by the credibility of independent central banks in dealing with economic demand shock, and by financial liberalization, which allows consumers to create their own "self-insure" system against economic fluctuations, smoothing consumption, and enables firms to better plan their investments (Debrun *et al.* 2008; Debrun and Kapoor 2010). However, this substitution in stabilization mechanisms seems to be felt more keenly in countries where the weight of the state is lower (Debrun *et al.* 2008). There are also authors (Brunila *et al.* 2002) who downplay the role of automatic fiscal stabilizers because they consider that Europe's economy has acquired a capacity for self-stabilization through the flexibilization of the labour market and other markets. Finally, there are those who continue to give importance to automatic fiscal stabilizers in reducing GDP volatility, but argue that they become counterproductive after a certain threshold given the disincentives created (Debrun *et al.* 2008) or because they cause public finance problems (OECD 1999).

However, the economic and financial crisis of 2008 challenged these studies and the capacity of the financial markets and of monetary policy to stabilize the economy. It was the functioning of the financial markets which triggered the crisis, and the subprime crisis showed the exact opposite of what was being claimed (that is to say, it showed that access to financial markets does not enable consumption and investment stabilization mechanisms after all, and that consumers did not have a "self-insure" system at their disposal via the market). The crisis also revealed that price stability expectations were not sufficient to stabilize levels of consumption and investment, and that the monetary policy of the central banks, including the European Central Bank (ECB), was not able to counter the negative effects caused by the fiscal consolidation policy on the product and on employment. This is increasingly evident in the case of the Eurozone, despite the ECB's effort to maintain the current low rates of marginal lending. Furthermore, European market flexibilization and liberalization policies, launched with the Single Market programme, did not guarantee the self-stabilizing mechanisms claimed. Instead, the crisis showed the importance of automatic fiscal stabilizers in the EU, as will be seen next.

3. Unemployment benefits during the crises

In mid-2008, the true dimension of the economic and financial crisis started to become clear, and by the end of the year, the European Commission had presented the European economic recovery plan, appealing for anti-cyclical economic policies to be implemented in the various Member States. Many countries (especially those with less "generous" benefit systems *a priori* [see Graph 1-3]) chose to raise the amount, coverage and entitlement period of unemployment benefit, which reinforced the functioning of the automatic fiscal stabilizers and effectively mitigated the destabilization of disposable income in the European economy, particularly in the

Eurozone (Dolls *et al.* 2012; OECD 2011). Hence, the effectiveness of this type of response to the 2008 crisis demonstrated the value of unemployment benefit as a replacement income with anti-cyclical properties, aspects which had been neglected in the EU since the mid-1990s, when priority was given to labour market flexibilization, in accordance with the logic mentioned above, and when there was belief in the new stabilization mechanisms. This was recognized by the European Commission (2010: 131): “In the last two decades preceding the crisis this issue [‘automatic stabilization function of the Unemployment Insurance systems in the EU’] received somewhat little attention due to a decline of business volatility, the rapid rise in household wealth and fast development of the financial markets, which possibly facilitated a self-insurance against labour market risks”.

This should have led to questions about the way unemployment benefit is currently conceived in the EU, but it did not. In 2010, with the identification of the public debt crisis in the Eurozone, the anti-cyclical measures that had been deemed so necessary just a few months before were promptly reversed, preventing the automatic fiscal stabilizers from working. Moreover, the economic policy decisions taken by European institutions in order to solve the crisis strengthened the already existing macroeconomic framework, generating the notion that unemployment benefit is also a public expenditure that has to be reduced. Thus, the solutions put forward in 2010 were based on two main principles: a) fiscal consolidation, primarily through a reduction in public spending and which included, in accordance with broad economic policy guidelines, the idea that “tax and benefits systems should provide better incentives to make work pay”; b) greater flexibilization of the labour market so as to improve its future capacity to respond to economic shocks and to promote wage flexibility, which was considered to be a decisive factor for the competitiveness of Member States, especially in countries with trade deficits. Within the framework of the correction and reduction of macroeconomic imbalances within the Eurozone, the broad guidelines recommended that Member States with current account deficits should guarantee wage development in line with price stability and the development of productivity, and that “institutional barriers to flexible adjustments of prices and wages to market conditions should be removed” (Council of the European Union 2010).

According to Nuti (2013), this combination of policies (“structural reforms” and fiscal consolidation policy) is the recognition that the fiscal adjustment will slow growth. It is believe that these reforms are a way to offset this, since they improve the economic efficiency and increase the potential growth.

In the specific case of Portugal, after the start of the public debt crisis in May 2010, the government, pressured by European institutions, decided to anticipate the elimination of the economic stimulus measures (which included changes to unemployment benefit and assistance unemployment benefit), even though it had already been announced that they would continue until the end of the year, and introduced changes into the unemployment benefit system in order to reduce the possibility to reject jobs and the maximum benefit amount. Some months later, before the request for financial assistance, a Eurogroup statement (30 September 2010) continued to insist on the need for more flexibilization of the Portuguese labour market, alongside policies for reducing the public deficit and debt:

> The Eurogroup, the European Commission and the ECB welcome the ambitious additional consolidation measures adopted by the Portuguese government yesterday, which cover both 2010 and 2011… We urge the Portuguese authorities to back the budgetary measures by reforming the budgetary framework and by adopting further comprehensive and ambitious structural reforms that would enhance potential growth, focusing on removing rigidities in the labour market and in wage formation and improving productivity. This would allow Portugal to improve competitiveness.

When financial assistance was requested in April 2011, the Eurogroup and ECOFIN announced that, alongside fiscal sustainability and solvency of the financial sector, the “removing of rigidities” in the product and labour markets would be one of the pillars of the programme and provided for changes to the unemployment benefit system in the “Memorandum of Understanding”. These changes (which include reductions to the maximum benefit amount, entitlement period and benefit amount after half a year of support) have now been implemented, considerably affecting the level of unemployment protection, precisely at a time when unemployment rates are reaching around 18% (18,2%, in 2013, according to the Seventh Review of Economic Adjustment Programme). The view that unemployment benefit is a mere public expenditure became even more marked when, in the 2013 budget, the Portuguese government proposed a 6% cut to unemployment benefit (understood as a social security contribution), as well as other cuts to public expenditure (wages and pensions). However, this measure was later rejected by the Constitutional Court[4].

In the EU, this latest reconfiguration of unemployment benefit is in keeping with the original European view on the matter. Their reduction, according to the EU, boosts the labour supply and permits downward wage flexibility. This idea is clearly present in an ECB publication (2013: 97-98) on the Eurozone adjustment process, which regards as a positive development the reduction in the amount and duration of unemployment benefit in some countries in the context of fiscal consolidation. Concerning the employment-enhancing reforms, it states:

> Relatively limited wage adjustment was initially observed in several countries, despite the severity of the recession; this was consistent with the presence of downward wage rigidity in the euro area. More recently, labour market reforms to deliver greater wage and employment flexibility have begun to be implemented. The ongoing labour market reforms in countries such as Greece, Ireland, Portugal, Spain and Italy include some important measures to increase the flexibility of wage bargaining structures and working time arrangements, and reduce excessive employment protection; they constitute first steps towards improving labour market performance and competitiveness in these countries, and in the euro area as a whole. There are also signs that downward wage flexibility has been increasing, particularly in the programme countries.

Therefore, with the European response to the public debt crisis, unemployment benefit is now subject to a double conditionality: one derived from the reaffirmation of the need to improve labour market flexibility as a way of increasing employment and the capacity to respond to economic shocks, and the other associated to fiscal consolidation policies based on public expenditure reduction, which have become more noticeable since 2010. These two conditionalities not only influence unemployment benefit by making it less “generous”, they also work together, reinforcing each other. The idea that it is a replacement income and an automatic stabilizer falls outside the new framework of the national unemployment benefit systems. Apparently to remedy the failure of these systems on this matter, the creation of a common insurance system, which is supposed to function as a macroeconomic stabilization mechanism for economic shocks, is currently being discussed by European institutions.

[4] For further developments on the Portuguese case, see Mota *et al.* (2012).

4. The common insurance system project

European institutions have been discussing the idea of moving towards "deep and genuine economic and monetary union" since June 2012. It is within this framework that the creation of a common insurance system is proposed. This idea seems to be the result of yet another self-reflection exercise by European institutions on the fundamental aspects of the crises (the 2008 economic and financial crisis and the public debt crisis) and the various reactions to them by the economies of different Member States. Once again they consider that the main problems stem from insufficient surveillance of national economic policies at the EU level, lack of economic coordination within the Eurozone, and a sluggish takeoff of "structural reform". This, it is argued, has not only allowed some Member States to adopt lax fiscal policies, it has also given rise to external imbalances in the Eurozone, widened the gap between national competitiveness levels, and conditioned the market's capacity to respond (in other words, it has not allowed the markets to work as automatic stabilizers). As stated by the European Commission (2012: 20), "slow or absent implementation of important structural reforms over long periods of time aggravated competitiveness problems and hampered Member States' adjustment capacity, in some cases significantly". As had happened previously at other moments of crises management by European institutions, the economic and institutional model of the Eurozone was not questioned; instead, it was considered that there were flaws in the way the model had been implemented or that the model was incomplete (meaning that measures should be taken to conclude it). The solutions put forward include the "improvement" of economic governance in the Eurozone, which means *ex-ante* coordination of national economic policies and greater surveillance at the EU level, not only of the "structural reforms" introduced to liberalize the markets and make them more flexible (see below), but also of national fiscal policies (reducing their capacity to intervene in the economy and thus the actuation of the national governments).

Within the framework of labour market policy, there has been a reaffirmation of the need to continue the "structural reforms" implemented to date on the grounds that they are insufficient, though this would take place in a different context. There are two aspects to this: the first is the creation of a system to financially support the execution of these reforms in the Member States, which implies a specific new European fund. In this context, in short term, it is proposed a Convergence and Competitiveness Instrument, responsible for the celebration of contractual agreements between the European Commission and Member States, which would establish the conditions for financial support. The second involves, in short term, the implementation of *ex-ante* coordination of "structural reforms" at the EU level (i.e. before they are decided at national level) in the context of the European Semester (to complement those that already exist on the level of fiscal and economic policy). These new measures will be mandatory for Eurozone countries, with the exception of those undergoing macroeconomic adjustment programmes, which will receive specific treatment. They will be outlined in the context of Macroeconomic Imbalance Procedures, a framework that will also produce recommendations for national contractual agreements.

This project also provides for the creation in the medium term of a new macroeconomic stabilization instrument for the Eurozone, meant to facilitate adjustments in the case of economic shocks which may or not be asymmetrical. In this context, the creation of a common insurance system managed at the EU central level is proposed, designed to complement or partially substitute the national unemployment benefit systems. This instrument is meant to interact with the implementation of "structural reform", firstly, because it is believed again that, with liberalization, the markets will function better, becoming better capable to absorb economic shocks, thereby reducing the need for macroeconomic stabilization mechanisms. Secondly, it is hoped that the establishment of a common insurance system with the objective of economic stabilization will encourage Member States to pursue "sound fiscal and structural policies in accordance with their contractual obligations" (Van Rompuy 2012: 5). This means that any leeway governments had to justify "generous" national unemployment benefit systems will be removed, and the conditions are created for further restrictions on the amount, duration and coverage of the benefit, and on the possibility to reject jobs. In other words, unemployment benefit is set to become, once and for all, a search subsidy. According to the neoclassic view of the labour market, it is possible to make wages more flexible (the goal of the "structural reform" of the labour market) by reducing the "reservation wage" and increasing labour supply.

At the fiscal policy level, the main intention is that governments continue to implement public expenditure reduction policies and that they comply with the targets established by the Treaty on Stability, Coordination and Governance (TSCG) with regards to the public deficit and debt. This implies that those public expenditures that have stabilizing characteristics over the economic cycle (as is the case of unemployment benefit) will have to be managed. It is argued that these measures will inhibit excessive increases in these expenditures in periods of economic slowdown and prevent them from becoming an obstacle to economic recovery because of their disincentive effects on job search. “The reason is that the distortion created by more generous benefits is pro-cyclical, while the insurance motive counter-cyclical” (European Commission 2010: 136). Thus, it is now proposed that the stabilizing capacity of unemployment benefit should be managed at the EU level by the creation of the common insurance system. With this idea, the European institutions seem to be managing the economic dilemmas associated to unemployment benefit. Member States are allowed some leeway to treat unemployment benefit as a search subsidy (as something to be reduced), thereby diminishing the public expenditure, and unemployment benefit starts to be managed like a macroeconomic stabilizer at the central level. Therefore, in the field of fiscal policies, stabilization functions may be divided up, also centrally managed by the EU, while allocation and distribution functions will remain the responsibility of national governments, although conditioned by the budgetary rules centrally defined by the European institutions.

Thus, the main idea underlying this common insurance system seems to be the stabilization of income over the economic cycle in the Member States, though without undermining the view that unemployment benefit has disincentive effects on job search (or in other words, that there is always moral hazard associated to it). In periods of recession, the main objective is to stabilize the income of those affected by the economic conjuncture, considering that in these phases the moral hazard is lower, given that unemployed workers tend to accept jobs more easily at times of low job offer, irrespective of their conditions (European Commission 2011; OECD 2011). In periods of expansion, the main objective is not to disincentivize jobseeking, but to prevent unemployment from becoming long-term unemployment by removing the unemployment benefits awarded during periods of recession.

According to the European Commission (2012) and Van Rompuy (2012), this insurance system is designed mainly for normal times when there may be country-specific economic shocks affecting one or two countries in isolation, rather than situations like the present one. As the system is symmetrical throughout the economic cycle, it is expected that each country will alternate between situations when it is a net beneficiary and times when it is a net contributor. What is more, this system cannot result in constant unidirectional and permanent transfers between countries (Van Rompuy 2012); that is to say, it should not be seen as a system of fund redistribution among Eurozone Member States. As for the necessary financial resources, there is still no definite proposal, though there are indications that it will come from national contributions or from the EU's own resources.

The question now is of knowing under what circumstances and for how long this common insurance system should intervene in each case. As the EU is still debating the issue, the design of the system is not yet known. However, Van Rompuy (2012) seems to indicate that trigger variables (i.e. criteria that enable the system to come into action) will be chosen to represent the labour market situation and job conditions in different Member States. In papers prepared for the European Commission, Dullien (2012; 2013) has proposed a "E(M)U-wide unemployment insurance". This project is already relatively structured and according to it, each unemployed in the Member States would receive individual benefits from the European system for a limited time (12 months) whose amount would be linked to wage received before. This system could be financed by a contribution from employees and/or employers on gross wages (up to a certain threshold). Following the case of American unemployment insurance, Dullien also proposes a triggering mechanism in times of economic slowdown[5]. Another question, related to the last one, concerns the choice of these trigger variables. The Eurozone's experience, particularly in defining quantitative convergence criteria and in establishing limits for public deficit and debt in the ambit of budgetary rules, shows how arbitrary the treatment of these kinds of issues can be. Doubts also exist concerning situations in which economic shocks affect a significant group of countries, irrespective of whether this involves an economic crisis like the current one. This is something that should not be underestimated given the strong degree of integration of the different economies. In this case, the future common insurance system may not have the capacity to stabilize the economies of the affected countries. If the Member States have already configured their unemployment benefit systems in accordance with this project, this may signify a "real loss" of economic policy instruments, particularly automatic fiscal stabilizers.

[5] For further developments on the American unemployment insurance, see Dullien (2007).

Conclusions

The main point of this text has been to analyse unemployment benefit within the framework of the economic policies within the Eurozone. Frequently understood only from the point of view of social protection, unemployment benefit has not been analysed according to its economic dimension and, consequently, has been undervalued as a relevant variable for the Eurozone's economic model. Considered to be an "imperfection" which limits European labour market flexibility and a public expenditure which must be reduced, it has been subject to a double conditionality which remove its very *raison d'être*. Unemployment benefit is also a replacement income for those who lose their jobs, and, on the macroeconomic level, operates as an automatic stabilizer. However, this function has been devaluated, and with it, the stabilization capacity of national fiscal policies, as discretionary fiscal policies are already being conditioned by the rules laid out in the TSCG.

With the European project to create a common insurance system, together with the *ex-ante* coordination and surveillance of "structural reforms", we can expect a weakening of national unemployment benefit systems, without there being any strengthening from the EU level. The texts are not yet very explicit, and the conditions in which the system will function are not yet defined. However, we are left in no doubt about it by the Eurozone's recent functioning, the constant doubts regarding quantitative limits to the budgetary indicators, the discussions that have taken place concerning the next Multiannual Financial Framework and the basic conception of unemployment benefit. This weakening of national unemployment benefit systems is part of the broader political objective of reducing national governments' leeway for decision-making and acting, so that the markets will do the decision-making and acting instead.

In considering the alternatives to current conception of unemployment benefit, it is necessary to bear in mind, first of all, about what we intend the labour market to be and what functions it should have within the economic system. The last two decades have shown that, irrespective of the issues posed regarding the neoclassical principles of the labour market, this cannot be the reference for an economic policy which aims to guarantee low unemployment rates and high economic growth. In the Eurozone, where this concept of the labour market has been the theoretical reference, wage is essentially considered a production cost and an instrumental variable for economic policy. This has been reflected by a decrease in the wage share in most Member States, which has conditioned domestic demand in the Eurozone and, therefore, GDP growth. In the Eurozone between 2000 and 2008, the GDP annual growth rate was generally low (less than 2% on average) and unemployment rates were quite high (close to 8% on average).

Thus, we need to conceive another kind of labour market, one in which employment is not simply the outcome of a confrontation between demand and supply that ensures full employment and, when this does not happen, the blame is no placed on subjective causes such as worker behaviour or other exogenous "imperfections" caused by state intervention. We need to conceive another kind of labour market, where unemployment is also understood as an involuntary phenomenon caused by insufficient aggregate demand, and where wage is also valued as a component of income and, as such, an element which directly contributes to economic growth through consumption and more importantly, by stimulating productive investment. Some authors (Stockhammer *et al.* 2009; Onaran and Galanis 2012) have identified a wage-led demand regime in the Eurozone as a whole and in its main Member States, where an increase in the wage share leads to an increase in aggregate demand and GDP.

This reconfiguration of the variable "wage" will necessarily produce a change in the way unemployment benefit is perceived — more as a replacement income and less as a search subsidy.

Rethinking the labour market in this way also means acknowledging that it is necessary to reconsider the architecture of economic policies and the institutional framework of the Eurozone. In thinking up alternatives that are always based upon this monetary union, we run the risk of making changes without changing anything. Palley (2013: 2) calls this "Gattopardo Economics":

> Gattopardo economics takes on board ideas developed by critics of mainstream economics, but it does so in a way that ignores the thrust of the original critique and leaves mainstream analysis unchanged. Gattopardo economics makes change more difficult because it deceives people into thinking change has taken place. By masquerading as change, it crowds-out space for real change.

The author got his inspiration from the book *The Leopard* by Lampedusa, which served as the screenplay for a film of the same name by Visconti, in which one of the characters, while trying to maintain the existing social order, utters the famous phrase: "If we want things to stay as they are, things will have to change".

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