The European Unemployment Insurance 2.0: the Reinsurance Mechanism

Miroslav Beblavý
(with Daniel Gros and Ilaria Maselli)

CEPS
Why Reinsurance?

• Appropriateness of the solution always depends on problem definition

• Reinsurance is the best solution to the following problem - how can EU have:
  – Significant value added in helping member states absorb large shocks and stabilize their economy
  – At the smallest possible cost
  – And with minimum intervention into how national welfare states function?
The ingredients of reinsurance

- Considerable upgrade / intellectual development compared to the EP study conducted by CEPS 2013/2014
- The trigger = what starts the mechanism
- The claim = materialised utility of insurance
- The deductible = amount paid before the EUI pays
- The actual payout = claim – deductible
- The contribution = the annual premium charged per country
Reinsurance simulation

• How reinsurance would have worked in Europe between 2000-2012
• EU27 as if they had been in the EU at the time
• Principal data used: GDP, unemployment and short term unemployment, passive labour market expenditure, nominal compensation per employee, duration of unemployment benefits
• Using time series starting in 1990
  – 10-year average for benchmarks in several variables
  – where data unavailable, simulation used
Trigger

- Large unemployment shocks, however trigger can be made as sensitive as desired:
- Short term unemployment > 10 yrs average + x st dev
- X = 0.1-1-2-3

“Brussels rain, storms and tornado shelter”
- Why short-term unemployment?

NB: Small triggers (0.1 of SD = “Brussels rain”) can be done, but the mechanism is not really suitable for that (sharp borders), mechanisms à la Dullien are more suited for such policy preferences

Thinking ahead for Europe
Number of EUI cases, had it been in place since 2000 (EU27)
Trigger

Number of interventions of EUI increases with

- Short-term unemployment rate
- Divergence around it

Thinking ahead for Europe
Claim

• Notional formula for calculating the amount – actual use is up to national governments
• Claim = 0.8 UST x 0.4 MonthlyNCE x 12 Months
• 80% of short-term unemployment = < 12 months
• 40% of national compensation of employee
• 12 months of benefits
Claim, euros

Euros


0 20 000 000 000 40 000 000 000 60 000 000 000 80 000 000 000 100 000 000 000 120 000 000 000 140 000 000 000 160 000 000 000

stdev = 3  stdev = 2  stdev = 1  stdev = 0.1

Thinking ahead for Europe
Claim, % of EU27 GDP

% of EU27 GDP

stdev = 1
stdev = 2
stdev = 3
stdev = 0.1

Thinking ahead for Europe
Deductible

- **Why a deductible?**
  - “if we stay within the class of contracts with the same expected loss, EU [expected utility] maximizers prefer a contract with full (100%) insurance above a fixed deductible.”

- **Which deductible:**
  - Based on additionality principle
  - Equal to passive labour market expenditure for short term unemployed
  - Since we do not have data for what is the share of STU in PLMP, just overall PLMP data, we simulate by adjusting PLMP data to duration of UB in the country
  - the longer the duration of UB, smaller % of PLMP is counted as larger portions of the expenditure go to non short-term unemployed
  - Range used – from 0.5 for Belgium and Netherlands to 1.0 for most countries

Thinking ahead for Europe
Max duration of UB by country

Thinking ahead for Europe
Payout

Cumulative payout - 2008/12

% of GDP

Spain
Estonia
Greece
Slovenia
Romania
Czech Republic
Ireland
Sweden
Finland
Poland
Netherlands
Italy
Germany
Belgium

stdev = 3
stdev = 2
stdev = 1
stdev = 0.1

Thinking ahead for Europe
Contribution

- Basic contribution: 0.1% of GDP if the overall fund holds less than 0.5% of GDP
- Experience rating: basic contribution is multiplied by a coefficient that reflects country balance with the fund over the last ten years
- Technically:
  - Coefficient = sum of 10 annual coefficients
  - Annual coefficient
    - 0.1 if the country balance in a given year is positive or negative, but less than 0.1% of GDP
    - Country balance in a given year expressed as a % of GDP if it is negative and equal or higher than 0.1% of GDP
Contribution, average 2000/12

Thinking ahead for Europe
Balance 2000-2012

Thinking ahead for Europe
Pay out at the EU level

Thinking ahead for Europe
Contributions at the EU level

Thinking ahead for Europe
Overall balance of the fund, EU level

Thinking ahead for Europe
Conclusions

• Because of data availability issues, we could only simulate how the mechanism would have worked.

• Simulation showed that:
  – For a small average contribution, it delivers large shock absorption capacities.
  – Due to threshold issue, it is not suitable for EU-level absorption of small national shocks.
  – Optimal trigger is between 1 and 2 S.D. of short-term unemployment.
  – Large symmetric crisis can exhaust the fund so the following is needed:
    • Either a larger annual payment should be envisioned.
    • Or a backstopping / one-time contribution.
    • Or scaling down the mechanism.