A new automatic cyclical stabilization mechanism for the Eurozone?

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Economic disintegration: GDP

(2012 to 2007)

Unemployed: absolute numbers 2007-2012*

Correlation deficit – unemployment*


\[ y = 0.852x + 2.1557 \]

\[ R^2 = 0.7067 \]
Rational for an ACS

- lack of timely and automatic stabilization

- 2 of 3 most effective tools of economic policy (monetary, exchange rate and fiscal policy) are lost on the national level inside the EMU

- Furthermore, all three work in the wrong direction in the case of asymmetric negative shocks:
  - Monetary policy: too restrictive
  - Fiscal policy: limited by the SGP and decentralised financing
  - (exchange rate policy: overvalued due to monetary policy and current account imbalances)
ACS – two options

- Transfer mechanism based on a macroeconomic variable like output, employment or unemployment
- European unemployment insurance

Diagram of a European Unemployment Insurance System
As a percentage of previous income

Historical background

- Centred around the discussion about the „Optimum Currency Area“ since Mundell in 1969
- Delors’ Report (1989): collective insurance system
- Mainstream opinion succeeded: market forces sufficient
- Dullien (2007): unemployment insurance scheme for the euro area
- Padoa-Schioppa-Group (2012): cyclical adjustment insurance fund
- EC (2012), Van Rompuy (2012): fiscal capacity
Strategic considerations

- One of the potential positive elements of the commission’s/president’s current proposals
- Strategic focus on (un)employment
- Delors (1989): can be „both the product of, and the source of the sense of national solidarity which all relevant economic and monetary unions share“
- Direction of transfers a priori unclear – it is an insurance for all and not a structural transfer
- Plan B which is probably more realistic than abolishing SGP & introduction of Eurobonds
- Opportunity for progressive revenue measures
- No treaty change necessary
Arguments against an ACS

- Technical problems
- Moral hazard
- Eurobonds & softer SGP could be more efficient: enhance well-functioning existing national stabilizers
- Lack of willingness for additional financing/taxation
- Could enforce right-wing-populism
- In the current situation danger of excessive and counterproductive conditions (structural reforms, …)
- National unemployment policy could be harmed
- Transfer mechanism based on potential output politically more likely
Example

- Construction similar to the ESM
- Transfers triggered automatically by a function of the unemployment rate relative to national average over time and eur. average at the moment (caps possible)
- EUROSTAT unemployment rate
- Financed by a fraction of the corporate tax
- Up to 1 % of the Eurozone's GDP in crisis
- Must allow for deficit in times of crisis
- No additional conditions such as structural reforms
0,2 % of GDP for every pp. UR > 20J-Ø

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- Most beneficial for Finland, GR, ES and DE

Source: own calculations based on AMECO (EC, Nov. 2012).