Bertelsmann Stiftung (ed.)

A European Unemployment Benefit Scheme

How to Provide for More Stability in the Euro Zone

Verlag BertelsmannStiftung

A European Unemployment Benefit Scheme

Bertelsmann Stiftung (ed.)

A European Unemployment Benefit Scheme

How to Provide for More Stability in the Euro Zone

Sebastian Dullien

Verlag Bertelsmann**Stiftung**

Bibliographic information published by the Deutsche Nationalbibliothek

The Deutsche Nationalbibliothek lists this publication in the Deutsche Nationalbibliografie; detailed bibliographic data is available on the Internet at http://dnb.d-nb.de.

© 2014 Verlag Bertelsmann Stiftung, Gütersloh
Responsible: Thomas Fischer
Copy editor: Aimee Male, Berlin
Production editor: Christiane Raffel
Cover design: Elisabeth Menke
Cover illustration: panthermedia.net/Sony Sivanandan
Typesetting and Printing: Hans Kock Buch- und Offsetdruck GmbH, Bielefeld
ISBN 978-3-86793-549-4

www.bertelsmann-stiftung.org/publications

Content

Foreword

The idea of complementing the European Economic and Monetary Union (EMU) by automatic stabilizers is not new at all. Already in 1977, the European Commission published the so-called "MacDougall Report," which advocated the introduction of counter-cyclical fiscal stabilizers at the European level in order to tackle regional asymmetric shocks. Sixteen years later, in 1993, Commission experts wrote about the possible creation of a shock-absorption mechanism based on changes in national unemployment rates. This suggestion came already quite close to the idea of introducing a European Unemployment Benefit Scheme, as proposed in this book by Sebastian Dullien.

Since the completion of the EMU in 1999, however, the question of how to improve the capacities of its member states to cope with excessive cyclical fluctuations and country-specific shocks has gained considerable economic and political momentum – due to the profound changes of the macroeconomic policy framework we have gone through since then. In the euro zone, monetary policymaking is centralized and delegated to the European Central Bank (ECB). Due to the introduction of a single monetary policy, the risk of cyclical divergences between euro-zone member states has even grown.

The nominal interest rate fixed by the ECB has different impacts on countries in different stages of the economic cycle: For countries in recession and with low inflation, the given nominal interest rate is prone to be too restrictive and to further weaken output growth. In booming countries with high inflation, the same interest rate is too low to counter the risk of an overheating economy. Even if this aberration may be corrected by adaptations of the real exchange rate in the longer run (which depends on the flexibility of prices and wages), this means that, at least in the short term, the single monetary policy may contribute to amplifying booms and recessions in its member states.

At the same time, the sole responsibility of the ECB for monetary policy implies that euro-zone members have to rely on non-monetary counter-cyclical adjustment mechanisms if they are hit individually by idiosyncratic shocks. Taking into account that (unlike in federal systems such as that of the United States) there are still extremely low levels of cross-border labor mobility and rather strong impediments to wage and price flexibility in the euro zone, it is mainly by means of fiscal policy that member-state governments can stabilize their economies if they are hit by asymmetric country-specific shocks. This also applies to exogenous shocks affecting the euro zone as a whole since the impact of that kind of shock is different in individual member states depending, for example, on the extent of labor market flexibility they have implemented and the specific features of their national fiscal system.

It is against this backdrop that interest in the role of automatic stabilizers as mechanisms of shock-absorption has considerably grown in the past few years. As regards discretionary fiscal policies, there seems to be a growing consensus that there is a high risk of procyclical government action. Tax and expenditure changes have to go through lengthy parliamentary decision-making processes and are politically difficult to reverse if circumstances change due to an economic shock.

However, beyond that (and perhaps even more important) are the constraints resulting from the EMU itself for any kind of shock-absorbing discretionary fiscal policy solutions. In the euro zone, fiscal policy is to be carried out within the boundaries of the "Maastricht criteria" and the Stability and Growth Pact (SGP). In a nutshell, the SGP requires member-state governments to avoid excessive deficits and to achieve a medium-term objective that ensures the long-term stability of public finances. The new "Fiscal Pact" goes even further and sets a legally binding maximum structural deficit of 0.5 percent of GDP, while the maximum actual deficit must not exceed 3 percent of GDP. This leaves little room for counter-cyclical discretionary fiscal policy at the member-state level.

In recent years, this dilemma has even been aggravated by the woes of the sovereign debt crisis. The fear of insolvency has further limited national governments' room for counter-cyclical fiscal maneuver. Instead of being able to use national budgets as stabilizing instruments, many countries have seen themselves forced to further cut expenditures or increase taxes in the downturn – i.e., to act pro-cyclically – to restore market confidence in their ability to service public debt.

It is for all these reasons that a growing number of experts consider the lack of automatic fiscal shock absorbers at the euro-zone level to be one of the main construction flaws of the EMU – although the issue remains a highly controversial one. Opponents of EMU-wide shock absorbers continue to argue that fiscal stabilization should remain the responsibility of national governments, and that the introduction of such mechanisms at the euro-zone level might result in permanent transfers to so-called periphery countries.

As the Bertelsmann Stiftung, we agree that this risk of permanent transfers has to be minimized. At the same time, however, we support the idea of complementing the EMU by the introduction of automatic shock-absorption mechanisms. Our foundation welcomes the analysis of the European Commission's "Blueprint for a Deep and Genuine EMU" and the "Four Presidents' Report" from 2012, which found that there are strong arguments in favor of transnational automatic stabilizers for the euro zone – and that, at least in the longer run, exclusively national solutions will prove insufficient to provide for a more resilient and robust EMU. Accordingly, from our perspective, avoiding permanent transfers is crucial for overcoming pertinent political opposition against the introduction of such European mechanisms.

Hence, from our point of view, the debate about automatic stabilizers for the euro zone should primarily focus on the "how," not on the "if": What kind of European shock-absorption mechanisms do we need, and how should they be designed to mitigate the risks of permanent transfers and moral hazard?

Over the last year, we have closely collaborated with the European Commission and several research institutes to answer this question, and we have identified three particularly intriguing responses on how to best stabilize the euro zone:

Some researchers favor the instrument of a European "Cyclical Shock Insurance" that would be automatically triggered by deviations of national output gaps to counter excessive cyclical fluctuations.

Another proposal follows the logic of mitigating only particularly severe economic slumps by establishing a "European Re-insurance Fund" for national unemployment benefit schemes.

The third – and, in our view, most promising – approach is Sebastian Dullien's proposal for a European Unemployment Benefit Scheme, which is outlined in this book.

In two conferences and several workshops jointly organized with Commissioner László Andor and the Directorate-General for Employment, Social Affairs and Inclusion of the European Commission between October 2013 and June 2014, we will be taking a more in-depth look at the pros and cons of these different approaches.

There is, however, one specific feature of the European Unemployment Benefit Scheme proposed by Dullien for which we have chosen his model as key reference point of our discussions. Beyond its economic rationale, this solution could also help restore citizens' trust in the EU and mobilize public support for a fiscal union.

Europe is currently not only experiencing a financial and economic crisis. Perhaps even worse, it is facing a severe democratic crisis characterized by a sharp decline in public confidence in the EU and its institutions. The rise of anti-European and Euroskeptic parties clearly illustrates the explosive political power of this alarming development. In order to counter this trend and to prove the added value of Europe for its people, we think that we have to enhance the EU's capacities to address the everyday concerns of its citizens. In this context, the introduction of a European Unemployment Benefit Scheme might also be an important step toward a more "caring Europe" that really lives up to the expectations of its citizens.

It is for both reasons – the possible contribution of a European Unemployment Insurance Scheme to more stability in the euro zone and its potential to mitigate the EU's democratic crisis – that we have asked Sebastian Dullien to prepare this book. In this way, we also hope to inspire more open-mindedness in a political and public debate that is dominated, so far, by massive doubts about whether there is a need for EMU-wide automatic stabilizers at all and whether their introduction is politically feasible.

Aart De Geus
Chairman and Chief Executive Officer
of the Bertelsmann Stiftung

Foreword

In the last six years, Europe has been tormented by an unprecedented financial and economic crisis. It has caused record high unemployment and a social emergency in the more peripheral countries and regions of the euro zone, and raised existential dilemmas for the European Union as a whole.

It was a malfunctioning, risk-blind international financial system that brought us into this quagmire in the first place. However, it is the imperfect architecture of the Economic and Monetary Union (EMU) that made this crisis persist so long in Europe, causing a second recession and creating dangerous imbalances.

The fragility of the Maastricht model was not recognized early enough. As the crisis deepened, careless politicians made the situation worse by creating uncertainty about some countries' membership in the euro zone, thereby themselves contributing to additional instability and endangering the future of the euro itself. If we have to choose between preserving the inherited model of the EMU and safeguarding the current composition of the euro zone, we have to opt for the second and build an EMU 2.0.

The extraordinary ECB interventions since 2012 have resulted in a period of relative tranquillity in European financial markets. However, ongoing socioeconomic divergence in a context of low or negative growth might yet call into question the sustainability of this heterogeneous monetary union.

This book by Sebastian Dullien is therefore a very timely and highly valuable contribution to a much-needed debate. Experience since 2010 has clearly shown, among other things, that Europe's EMU needs a transnational fiscal capacity alongside the already strengthened framework for coordinating national fiscal and structural policies. What we should discuss is the right design of such fiscal capacity.

Fiscal risk-sharing and capacity to dampen asymmetric shocks would clearly strengthen confidence in the euro's future. Even more importantly, EMU-wide automatic fiscal stabilizers would help to prevent losses of output and the related social hardship during future downturns. They would help to optimize the EMU's functioning so that it actually delivers on the objectives of full employment and social progress set out in the EU's treaties, as expected by Europe's citizens.

The European Commission's Blueprint for a Deep and Genuine EMU and the Four Presidents' Report of 2012 clearly foresee transnational fiscal shock absorbers for the EMU in the long term. To get there, preparatory work has to start now. This is why I strongly appreciate the intellectual and educational effort of Sebastian Dullien and others who have invested their time and efforts to explore possible designs of EMU-level automatic stabilizers long before this issue appeared on the political agenda.

For a long time, such work has also had to counter the skepticism of those who considered that the EMU *should not* involve transnational fiscal transfers or *cannot* possibly ever achieve sufficient political unity to establish them. Progress in designing and implementing the Banking Union, however slow, offers encouragement and inspiration. It also should be understood that the Banking Union will most likely not complete the process of EMU reconstruction.

Despite the complexity of the debate, and inevitably difficult political dynamics among and within EU member states, the European Commission has been explicitly looking into the merits of, and options for, EMU-level automatic stabilizers since 2012, building on its much earlier expert work in the 1970s and early 1990s.

From the various options proposed in the recent debates, an EMU-wide scheme of basic unemployment insurance appears to have several obvious advantages. Unemployment is an easily observed and understood indicator of cyclical developments. Data is available and reliable, and maintaining unemployment compensation spending in a downturn has a high macroeconomic stabilization potential, as learned from national experience (that of federal states, in particular).

Unemployment insurance cannot replace an investment stimulus, but it mitigates the otherwise inevitable fall in demand among households with jobless people, who happen to spend most of their income. Partial pooling of unemployment insurance systems could therefore help reduce the severity of downturns and give EMU governments greater fiscal space to implement structural reforms and invest where needed for the affected economies to durably recover.

In a nutshell, partial pooling of unemployment insurance systems in the EU would provide a much safer, more predictable and more legitimate support mechanism for adjustment processes in the EMU than sequential bailouts of troubled countries. The U.S. has a credible rule in place on non-bailout of individual states, also because it has a large federal budget.

The currently debated EMU-wide scheme of basic unemployment insurance would have a much more modest volume of around 1 percent GDP. Nevertheless, it could already significantly improve the economic and political dynamics of adjustment processes within the EMU. From a longer-term perspective, this would also help to prevent asymmetrically distributed short-term downturns from developing, through hysteresis, into long-lasting loss of productivity and structural disparities between core and periphery.

While the urgency of EMU reconstruction is widely felt, further analysis and debate are needed around the subject. The sourcing options can be contentious even among supporters. How to take into account cyclical and structural aspects of unemployment is not just a theoretical, but also a very practical issue. Where does the legitimacy of automatic, i.e., unconditional, support come from? Is the loss of autonomous fiscal and monetary policy sufficient basis for the creation of automatic stabilizers in order to function alongside other, more conditional transfers? What is the minimum level of solidarity in the EMU, and where are its justified limits?

I would like to congratulate and thank the Bertelsmann Stiftung for helping us move toward the answers by publishing this book. I am also grateful for their ongoing cooperation with the Commission in exploring this important topic of the EU policy agenda.

László Andor
EU Commissioner for Employment,
Social Affairs and Inclusion

1 Introduction

According to a Chinese proverb, a crisis brings opportunity and change. How true this is has been vividly demonstrated in Europe since the outbreak of the euro crisis in 2010. One can easily argue that the recent crisis has brought more change to the European integration project than would have been imaginable over several decades of further integration attempts by national policymakers in calmer times.

European institutions have transformed with breathtaking speed. Prior to the euro crisis, the coordination of national economic and fiscal policies was almost non-existent. The Stability and Growth Pact was designed only to limit the largest excesses in public borrowing, and even for this purpose, it was widely ignored. Macroeconomic policy guidelines, designed to look beyond fiscal imbalances at potential macroeconomic problems, were little more than a discussion exercise. At the time, the European treaties clearly stated that a country with fiscal problems must not be bailed out by its partners, and this was widely interpreted as also excluding emergency loans. While not legally codified, the European Central Bank (ECB) was not expected to buy government bonds and certainly not only those of selected countries.

1.1 The new European economic governance structure

At the time of writing, European policymakers have agreed on several rescue mechanisms for illiquid national governments, starting from the first ad hoc and temporary European Financial Stability Facility (EFSF) to the European Stability Mechanism (ESM). The ESM actually has been introduced into the Treaty on the Functioning of the European Union (TEFU), to bridge the gap between the no-bail-out clause and real-world emergency funds.

Known under the terms “six pack,” “two pack” and “fiscal compact,” a number of new rules on deficits and debt reduction as well as the coordination, reporting and surveillance of budget plans and budget implementation to and by the European Commission has tied the hands of national parliaments and governments in budgetary matters much more thoroughly.

With the decision in the summer of 2012 to form a “banking union,” with the ECB in a Europe-wide supervisory role and a common resolution regime, national governments will surrender a significant part of their remaining control over national financial institutions to the European Union. However, there continued to be bickering over specific details even at the time of writing, and it is far from clear whether integration in this area will be as encompassing in the end as originally promised.

Even more sovereignty has been signed away by crisis countries. Rescue packages assembled by European partners and the newly installed emergency funds of the EFSF and ESM come paired with harsh conditions, imposed by the so-called troika, a joint operation of the European Commission, the International Monetary Fund (IMF) and the European Central Bank. While one can argue that handing over sovereignty to the IMF has been common practice in financial crises over past decades, the imposition of harsh conditionality involving the European Commission and the ECB is clearly new.

Finally, the ECB has taken a much more active role in its monetary policymaking and has assumed new powers. In the past, the ECB was seen as a passive institution, setting interest rates and interacting with private financial institutions with the single goal of influencing a single macroeconomic price, the short-term interest rate. At the latest, with the announcement of the program of Outright Monetary Transactions (OMT), the ECB has assumed the ability to influence relative prices between government bonds of different euro-zone countries.

It is safe to say that such an immense transfer of sovereignty from the national level to the European level would have been all but impossible in non-crisis times. Some of this change is clearly for the better and will make the European Economic and Monetary Union a more viable entity. The lack of emergency facilities to lend to illiquid governments clearly made Europe vulnerable to a self-fulfilling fiscal crisis in which expectations of market participants alone could drive governments into insolvency, a shortcoming which has been fixed with the establishment of the ESM in combination with the ECB's announcement of its OMT program. Applied correctly, the "six pack," including procedures for the detection and correction of macroeconomic imbalances, might well help to prevent macroeconomic divergences, real-estate price bubbles and boom-and-bust cycles, as witnessed prior to the euro crisis.

Moreover, there are ample indications that the crisis has brought an opportunity for even more fundamental change and further integration in the future. Many economists believe that much more institutional reform is still necessary to guarantee the long-term viability of the European integration project, and that the changes to European economic governance structures that were passed in a hurry show that there is now a window of opportunity for far-reaching reforms. Especially in the crisis countries, the experience of the past years has shown that in times of severe distress, nation-states might not be able to provide their citizens with an adequate level of social protection anymore.

Economically, the important question is how Europe can deal with asymmetric macroeconomic developments at the national level, be it through an outright asymmetric external shock or through an asymmetric reaction of different national economies to a common shock. As it is widely accepted that the euro crisis is to a certain extent a consequence of real-estate bubbles in some of the periphery countries, which in turn had first led to excessive wage growth and loss of competitiveness and then to a dramatic contraction of economic activity, the central theme then becomes how to prevent or at least dampen such divergences and boom-and-bust cycles in the future.

Politically, the question is how the European monetary union can again be transformed in the eyes of the general population from something that has led to more instability and crisis to something that helps countries to weather difficult economic times and hence helps to preserve or even improve overall standards of living.

Both observations lead to the same policy advice: Strengthen Europe's fiscal capacity to stabilize national economic cycles.

In this context, the idea of a European unemployment insurance has been repeatedly mentioned. The most prominent reference so far has been the report "Toward a Genuine Economic and Monetary Union," a roadmap also known as "the four presidents' report," as it was written by European Council President Herman Van Rompuy (who also presented the report), European Commission President José Manuel Barroso, former Eurogroup President Jean-Claude Juncker and European Central Bank President Mario Draghi. The document identifies a number of policy elements necessary for a complete economic and monetary union by establishing: 1) an integrated financial framework, including a single supervisory mechanism and a single resolution mechanism for banks in the euro area; 2) an integrated economic framework with a working ex-ante coordination of economic policy reform; and 3) an integrated budgetary framework, including not only the six pack, the two pack and the fiscal compact, but also a fiscal capacity that could help to absorb country-specific shocks. As one of the options for such a fiscal capacity, the roadmap suggests a system of common unemployment insurance for the euro area that could "work as a complement or partial substitute to national unemployment insurance systems."

This roadmap is only the tip of the iceberg. Since 2012, a number of workshops and conferences focusing on the potential benefits and problems of European unemployment insurance have been held in Brussels and other national capitals. Institutions from the European Commission to the European Parliament and national ministries have started to look into the effects and potential financing requirements of such a scheme.

1.2 Genesis of the book

Already prior to the euro crisis, I had written extensively on the topic of a potential European unemployment benefit scheme, even though only small parts of the work had been published as proper academic articles. Building on the observation that economic imbalances have continuously grown within the euro area and have resulted in dangerously diverging labor costs, diverging current account balances and real-estate bubbles in some countries (Dullien and Schwarzer 2005; Dullien and Fritsche 2007, 2008, 2008a, 2009), I worked on a number of proposals on how to improve macroeconomic governance in the euro area (Dullien and Schwarzer 2009, 2009a), including a detailed proposal for a European unemployment insurance system that would act as a fiscal stabilizer for asymmetric shocks and macroeconomic divergences between countries (Dullien 2007, 2008).[1] During most of this time, these proposals were mainly belittled, as there seemed little appetite for a thorough reform of Europe's economic governance structure and many economists actually believed that macroeconomic divergences in Europe were not a problem.[2]

The Bertelsmann Stiftung had played an important role early in this process. When the idea was still fresh (and not completely articu-

1 A couple years after publishing the initial two papers at the Stiftung Wissenschaft and Politik (Dullien 2007, 2008), I found out that Roland Deinzer, an economist at the Bundesagentur für Arbeit, had actually written his PhD thesis on this very topic and published the thesis as a book in 2004 (Deinzer 2004). In his work, he offered a proposal for a European unemployment insurance scheme in many aspects very similar to the one discussed in this book (even though some details are clearly different). While I really was not aware of Deinzer's ideas when writing the initial papers on European unemployment insurance, having missed his work was a little embarrassing for me since I had talked to Deinzer several times about other labor market issues, such as recent developments in unemployment and employment figures, when I was still working as a journalist for the *Financial Times Deutschland*. Deinzer clearly deserves at least as much credit as I do for spelling out the idea of a European unemployment insurance scheme.

2 A good example for this position is Ahearne, Schmitz and von Hagen (2007), in which the authors conclude that their results "suggest [...] that the observed current account imbalances are a sign of the proper functioning of the euro area rather than a sign of improper macroeconomic management."

lated) and still far away from mainstream debate, the foundation invited me to several workshops to present and discuss the idea with both its internal experts and outside scholars. Then, in the early summer of 2013, the head of the foundation's Brussels office, Thomas Fischer, asked me to use the expertise from my past work to put together a coherent and comprehensive study on a European unemployment benefit scheme that should serve as a key point of reference in the uture.

Following the request by the Bertelsmann Stiftung, I have prepared this book for publication mostly in the second half of 2013. While writing, the critical feedback I received from the foundation's economic policy experts was extremely helpful.

Beyond that, I have benefitted enormously from discussions with a large number of colleagues over the past years. Probably the most important role in the development of the concept of European unemployment insurance was played by Daniela Schwarzer, a long-time coauthor of mine on European issues. Daniela has served as a sparring partner on uncountable occasions and helped to include the idea in a broader proposal for EU budget reforms. Also important in the development of these ideas was my academic mentor, friend and long-term supporter of European monetary integration, Stefan Collignon, mostly because of his unfaltering belief in the European project. I have benefitted from the critical remarks of my university colleagues, especially Heike Joebges and Jan Priewe, my former colleagues in journalism, Mark Schieritz and Thomas Fricke, my contacts at the European Commission, especially Georg Fischer, Robert Strauss, Guy Lejeune, Olivier Bontout and Isabelle Maquet, my current colleagues at the European Council on Foreign Relations (ECFR), especially the "Reinvention of Europe" team, Piotr Buras, Silvia Francescon, Thomas Klau, Hans Kudnani, Mark Leonard, José Ignacio Torreblanca and Jan Zielonka, my former ECFR colleague Ulrike Guérot, as well as my coauthor, Ferdinand Fichtner, who works with the Deutsche Institut für Wirtschaftsforschung (DIW) in Berlin. In addition, I remember specific remarks from a number of economists from various institutions, including Henrik Enderlein, Kai Konrad, Jean Pisani-Ferry, Arthur Sode, Nicolas Véron and Jakob von Weizsäcker, as well as from a number of policymakers.

A number of institutions have supported my research on European unemployment insurance. I started with the U.S. unemployment system as a possible model for a European stabilization device in 2007 with a seven-week German Academic Exchange Service (DAAD) fellowship at the American Institute for Contemporary German Studies (AICGS) at the Johns Hopkins University campus in Washington, D.C. The AICGS's director, Jackson Janes, helped me enormously in getting in touch with the right people to talk about American unemployment insurance in Washington and provided me with a very stimulating work environment. Later that same year, I spent a few months at the Stiftung Wissenschaft and Politik in Berlin at the invitation of my colleague Daniela Schwarzer, where I could not only finish the first papers on European unemployment insurance, but also publish the first study on this topic (Dullien 2008). In 2012 and 2013, the European Commission asked me to write two short reports on European unemployment insurance, which were then discussed at events in Brussels (Dullien 2012, 2013). This book, prepared for the Bertelsmann Stiftung, builds on all my previous work, and it is for that reason that I would like to express my gratitude to all these supporting institutions.

1.3 Structure of the book

The following study is structured as follows: Chapter 2 reviews the debate on fiscal stabilizers in the euro area. It will especially summarize and discuss the recent arguments on why fiscal stabilizers in the euro area are necessary and why national fiscal policy is not enough to do the job.

As for some time the United States has been the main point of reference for a working monetary union and U.S. unemployment insurance is often referred to when trying to assess which kind of macroeconomic stabilization one could expect from such a scheme, Chapter 3 describes the basic setup and most important institutional features of the U.S. benefit scheme. In this chapter, some emphasis will be given to the different measures of stabilization effects, as the literature is far from homogenous both in its methodological approach and in its conclusions on the macroeconomic merits of the U.S. system.

Chapter 4 will present a blueprint for a possible European unemployment benefit scheme. The scheme presented would replace part of already-existing national unemployment insurance programs. The idea would be not to increase the effective level of social protection, but to use existing payment flows in a way that they stabilize national economies. This is to be achieved by constructing a basic European unemployment insurance system that tries to find a minimum common denominator of European unemployment benefits. This minimum common denominator might take the form of paying those who lose their jobs (and have previously been active in insured employment for a certain time) 50 percent of their last wage for up to 12 months. These benefits would be paid for by a European contribution to the unemployment scheme. Both the payments and the contributions would substitute for part of the existing national systems, and national governments would be able to top up this European system should they choose a higher level of protection.

The second part of Chapter 4 offers some evaluations of the potential stabilization impact of this proposed scheme. It also provides estimates based on historical data of which countries would have especially benefited from such a scheme.

Chapter 5 contrasts the proposal of a European unemployment insurance with other ideas for increasing Europe's fiscal capacity to stabilize national business cycles. Three alternative options are discussed: direct budget transfers linked to the output gap; direct budget transfers linked to the development of national unemployment; and a larger EU budget.

Chapter 6 draws on the numerous discussions I have had both with fellow economists and policymakers about a European unemployment insurance. On the one hand, this chapter aims to frankly list the open questions raised by this kind of stabilization scheme. On the other hand, the chapter is intended to address a number of objections with which I have been repeatedly confronted when conceiving and defending the idea of a European unemployment benefit scheme. As I will hopefully be able to convey, while some questions clearly remain open and deserve more scrutiny, others seem sound only at first glance, but can easily be refuted. Chapter 7 provides a conclusion.