

On the Design of a European Unemployment Insurance Mechanism

by A. Abraham, J. Brogueira de Sousa, R. Marimon and L. Mayr

Discussion – Etienne Lalé (Bristol and IZA)

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What is it about?

- ▶ EUIM: provides insurance against country-level fluctuations in unemployment / avoids using public debt in the context of tight deficit requirements
- ▶ Take a quantitative approach to design an EUIM and evaluate its implications
- ▶ Replicate cross-country differences in labor market performance and run several policy experiments – Impressive quantitative part (still in progress)

Roadmap of the discussion

- ▶ Brief overview of the paper and main results
- ▶ Comments on the quantitative parts:
 - ▶ A good model to address your question?
 - ▶ The right experiments to answer it?
- ▶ Main take aways and some additional comments

The model

- ▶ Krusell, Mukoyama, Rogerson, Şahin (QE '10; JET '11; NBER '16)
- ▶ Mixture of (i) standard dynamic model of labor supply with idiosyncratic shocks and incomplete markets, and (ii) reduced form version of search-matching model
- ▶ Labor reallocation between a 'production island' and a 'leisure island'
- ▶ UI benefits in the model: tax τ , replacement ratio b , duration d for eligibility:

$$\begin{bmatrix} d & 1-d \\ 0 & 1 \end{bmatrix}$$

Calibration

- ▶ ‘Structural’ parameters are calibrated to gross flow data:
 - ▶ A : total factor productivity
 - ▶ σ_γ : st. dev. of search costs
 - ▶ σ : job separation rate (production island)
 - ▶ λ_u, λ_n : offer arrival rate (leisure island)

- ▶ The duration of unemployment benefits, d , is set exogenously

- ▶ b is calibrated to match government expenditures on UI benefits

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Some first results:

- ▶ TFP does not seem to play an important role
- ▶ Structural parameters, and not UI parameters, are key for explaining cross-country differences in labor market performance

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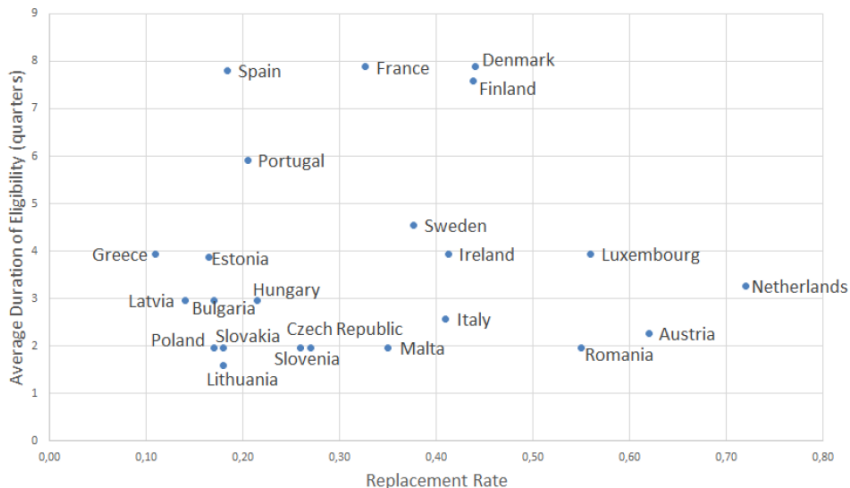


Figure 1: Generosity and duration of UI benefits (from the paper)

Remarks on the model fit

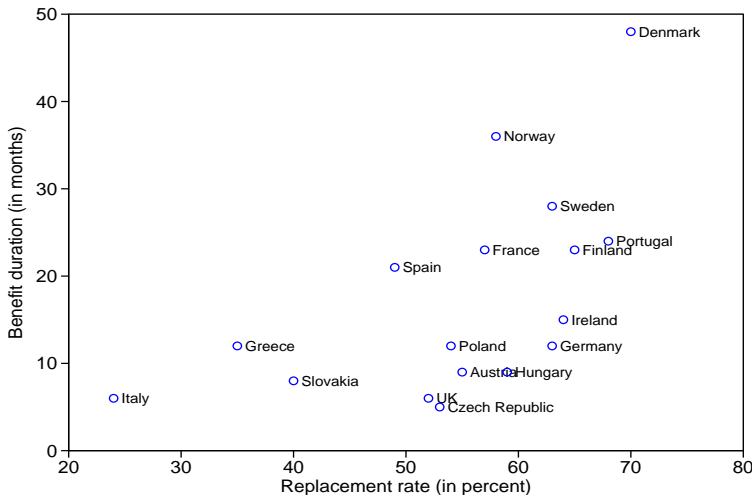


Figure 2: Generosity and duration of UI benefits (taken from OECD data)

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- ▶ b could be taken from the data (to reinforce your results on structural parameters)
- ▶ Improve the fit of the model with respect to stocks and flows w.r.t. inactivity

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Test of the ‘over-identifying’ restrictions of the model

- ▶ Consumption smoothing? Drop in consumption on moving from employment to insured and to uninsured unemployment
- ▶ Moral hazard? As measured by the elasticity of unemployment duration with respect to the generosity of UI benefits

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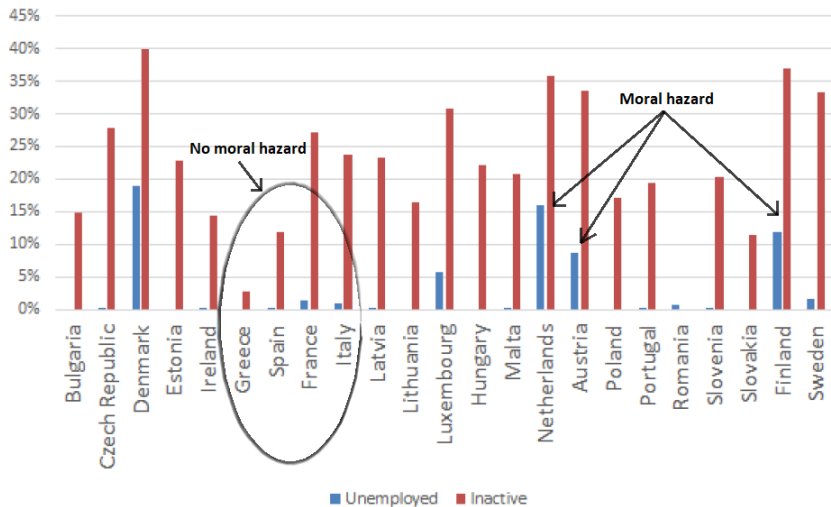


Figure 3: Probability to reject a job offer (from the paper)

Exp. 1: Insurance against country-level fluctuations

- ▶ One-off shock (allowing agents to have perfect foresight over the dynamics of the economy), which is either positive or negative with probability 1/2 each
- ▶ In financial autarky, the tax rate τ adjusts along the transition path
- ▶ τ is constant under the EUIM (financing through an actuarially fair system)
- ▶ Main result here: Very small gains from risk-sharing via the EUIM

Exp. 2 and 3: Financing benefits at the EU level

- ▶ In Exp. 2, solve for a tax rate τ set at the EU level
 - ▶ One-to-one mapping between gaining/losing from the reform and being among the net financial beneficiaries/contributors
 - ▶ However, no one-to-one relationship between a generous system and being a net contributor
- ▶ In Exp. 3, use a common bundle (τ, b, d) after setting b and d at the EU average
 - ▶ More complex relationship between the welfare gains/losses and net beneficiaries/contributors
 - ▶ Countries with a generous system and low unemployment suffer the most

The 'right' model?

Pros:

- ▶ General formulation, yet sufficiently detailed to capture country-specific \neq in labor market dynamics (as measured by labor market flows)
- ▶ Consumption-savings decisions and an operative labor supply choice along the extensive margin
- ▶ Potentially important effects at the macro level: endogenous response of the capital-labor ratio to changes in UI benefits

The 'right' model?

Cons:

- ▶ Some relevant dimensions of labor market heterogeneity are omitted:
 - ▶ Life-cycle dimension of \neq in employment performance
 - ▶ 4 state model for France and the countries of southern Europe (i.e. with fixed-term vs. temporary employment)?
 - ▶ Richer structure of policies: housing benefits, social assistance benefits, etc.
- ▶ Is there a strong reason for preventing workers from dropping from U to N?
- ▶ λ_u , λ_n and σ remain exogenous (more on this below)

The 'right' experiments?

In Exp. 1 (risk-sharing), very small effects. This seems to be driven by the symmetry of positive and negative shocks

- ▶ Lack of non-linearity suggests that few agents reside close to the borrowing constraint
- ▶ More importantly, the asymmetric behavior of labor market variables is missing (jump in σ and prolonged negative response of λ during downturns)
- ▶ Suggestion: Construct an empirically plausible version of asymmetric 'tranquil times' and recessions (for instance with respective probabilities 9/10 and 1/10)

The 'right' experiments?

Some remarks on Exp. 2 and 3 (financing at the EU level):

- ▶ With a common tax τ , big incentives to change b and d to free ride the system
- ▶ Report more statistics on the welfare effects (e.g. dispersion, average welfare loss at the bottom 10 percent, etc.) to discuss the political support of these reforms
... after accounting for the transition dynamics
- ▶ In these experiments, the interest rate at the EU level should adjust

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Suggestion (more important?): Allowing λ_u , λ_n , σ to respond to policy changes

- ▶ Think of $\lambda_u = p(\theta)$, $\lambda_n = sp(\theta)$ (with $s = \frac{N \rightarrow E}{U \rightarrow E}$) and $\sigma = F(R)$
- ▶ Compute the response of θ and R using an auxiliary DMP model for each country

Concluding remarks

- ▶ Very interesting questions, thorough quantitative work with potentially important implications for policy debates in Europe
- ▶ Looking forward to seeing the future versions of the ‘risk-sharing’ experiment
- ▶ Provisional conclusion from the other two experiments: UI reforms must be accompanied by reforms that change the structural parameters of the labor market