

A stress test of the welfare state

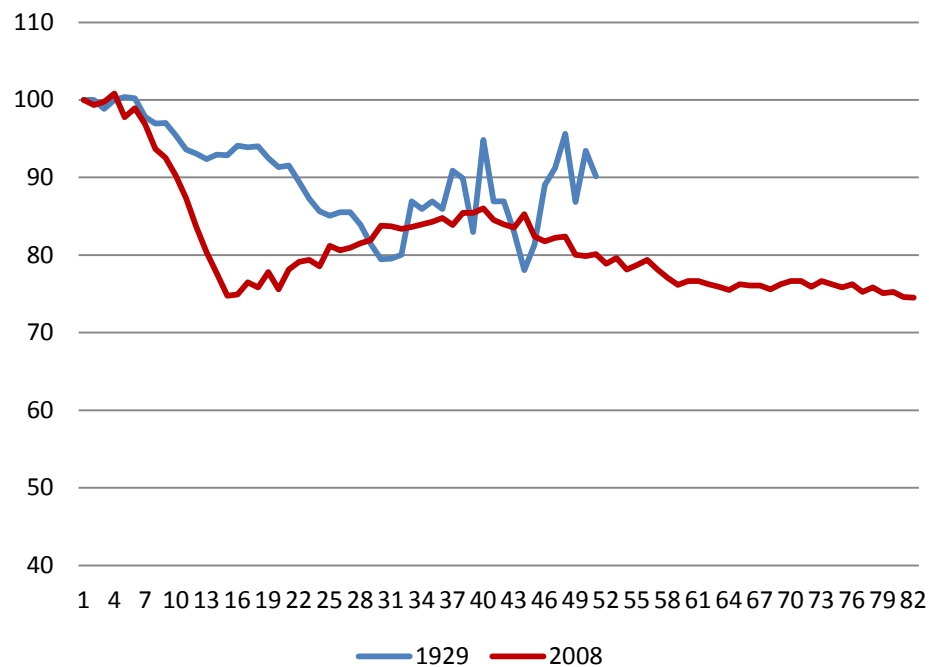
Public Lecture
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Tito Boeri

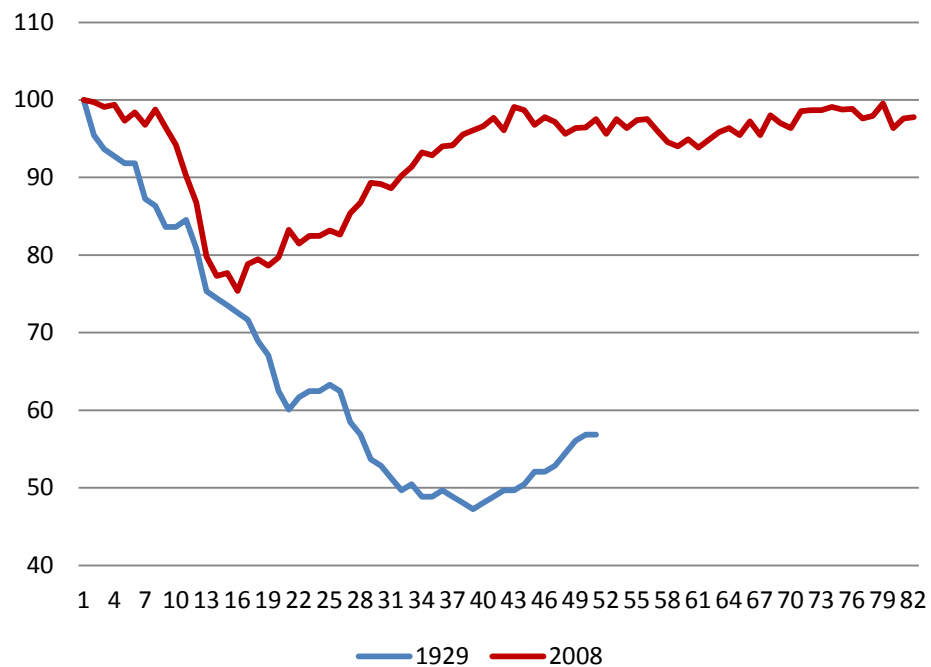
The stress test

Great Depression and Great Recession

Italy, IIP



Germany, IIP



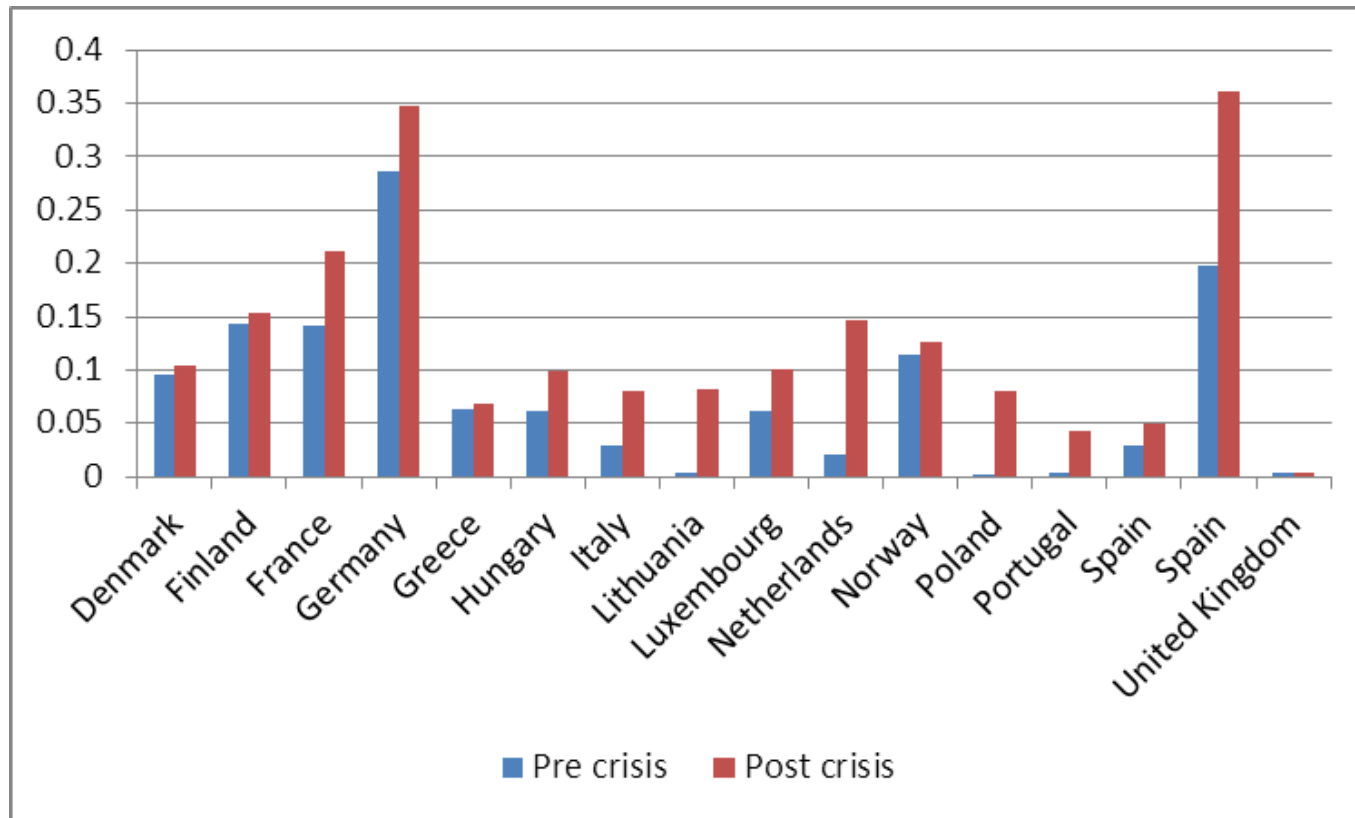


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Homelessness in the EU

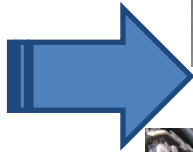
(% population)

f R
D B



Stereotypes

homeless = clochard



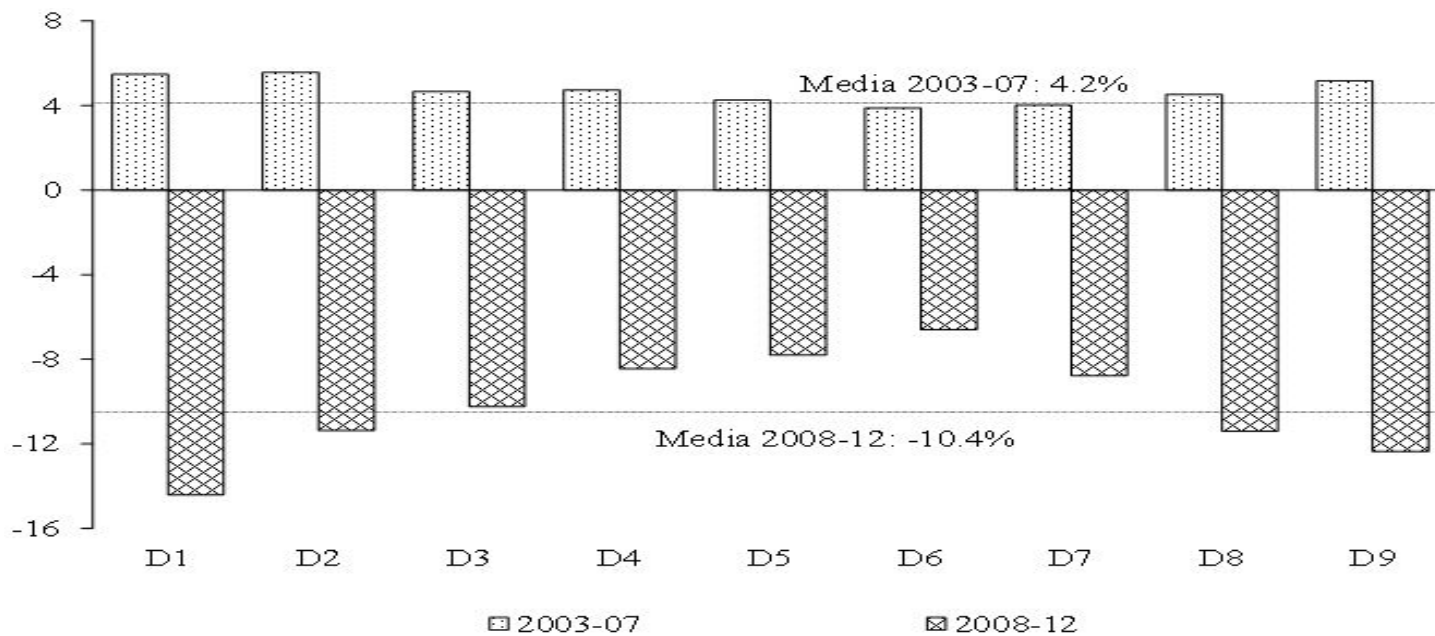
Are we sure?

Functions of the Welfare State

1. Reduce poverty (more than inequalities per se)
2. Protect against uninsurable market risk
3. Promote labour force participation

Inequality and poverty are not the same thing: Italy after 2007

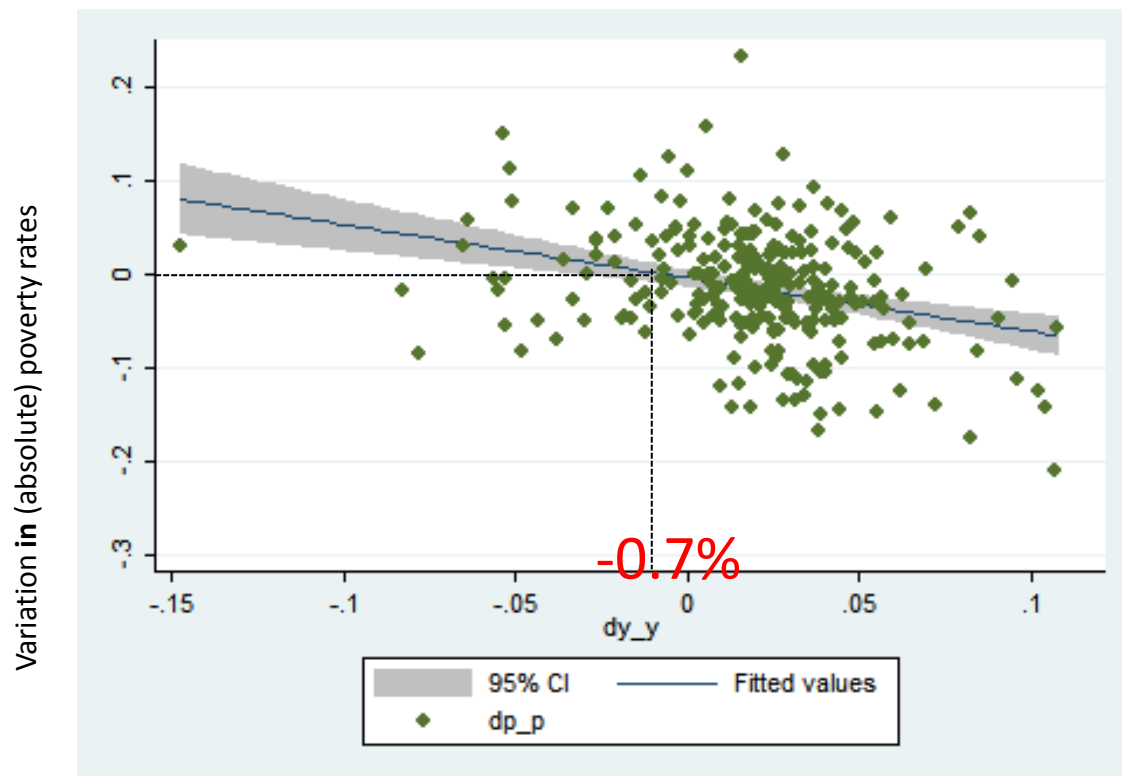
	Gini	Absolute Poverty rate (Anchored to 60% of median income in 2006)
2006	33.7%	19.9%
2012	34.0%	27.0%



Outline

- The critical threshold and Social Europe(s)
- The mechanism: job loss vs. job start, unemployment vs. inactivity
- The social policy response and the generational divide.
- What can be done to avert the loss of a generation?

By how much should GDP decline for poverty to increase?



Countries:

ES IT PT GR DK FI IS NO NL AT LU DE BE UK EE HU LV LT PL

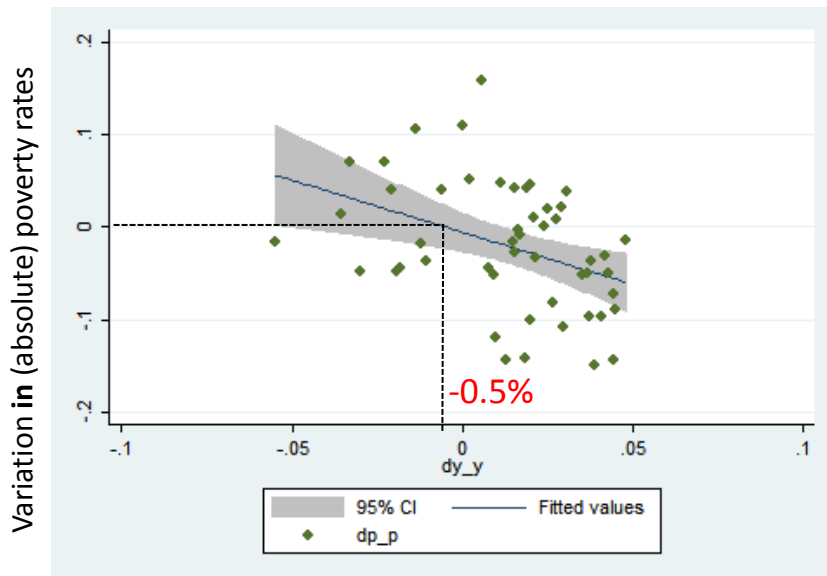
Vertical axis. Variations in absolute poverty rates obtained by fixing in real terms the poverty threshold at 60% of the median income in the initial year.

Sources: EU-SILC, ECHP.

Is it the same threshold across Social Europe(s)?

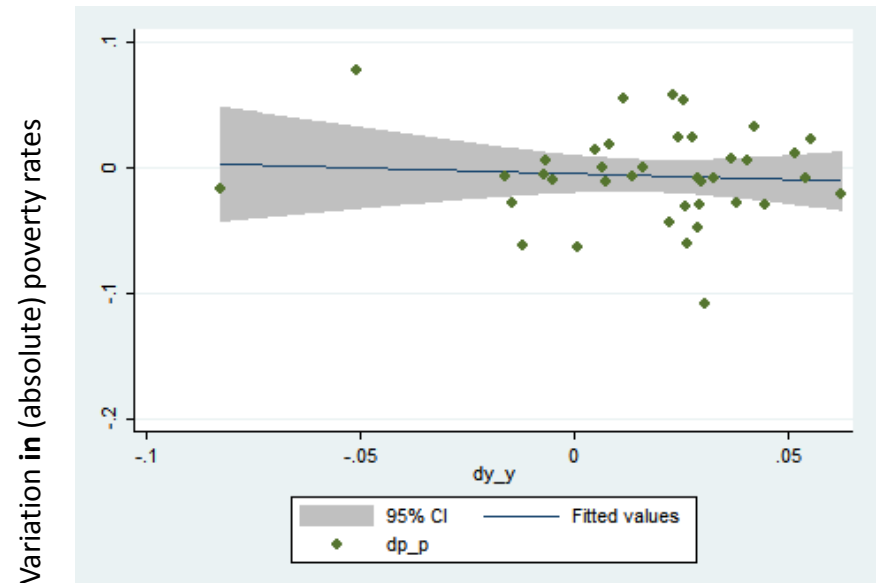
No higher in Eastern and Southern Europe, no significant correlation in the Nordics

Southern Europe



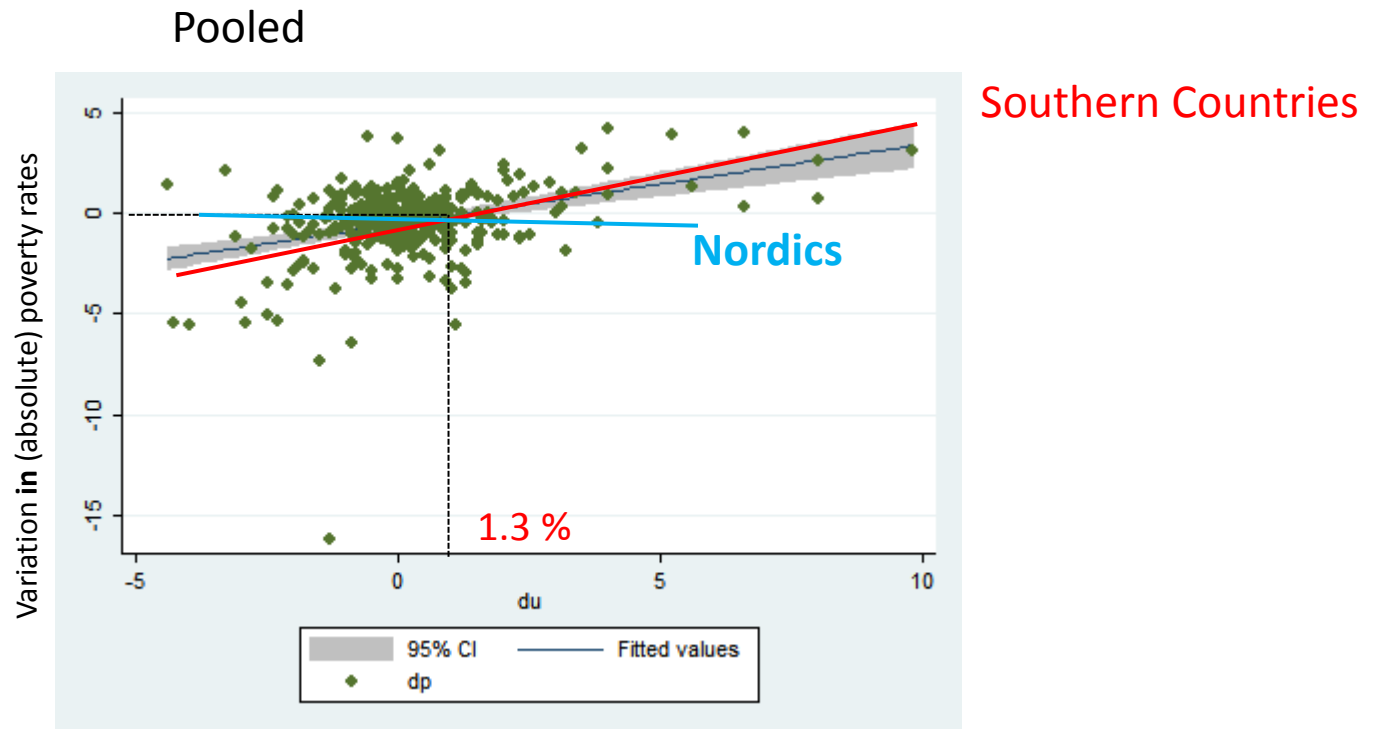
Countries: ES IT PT GR

Northern Europe



Countries DK FI IS NO

By how much should unemployment rise for poverty to increase?

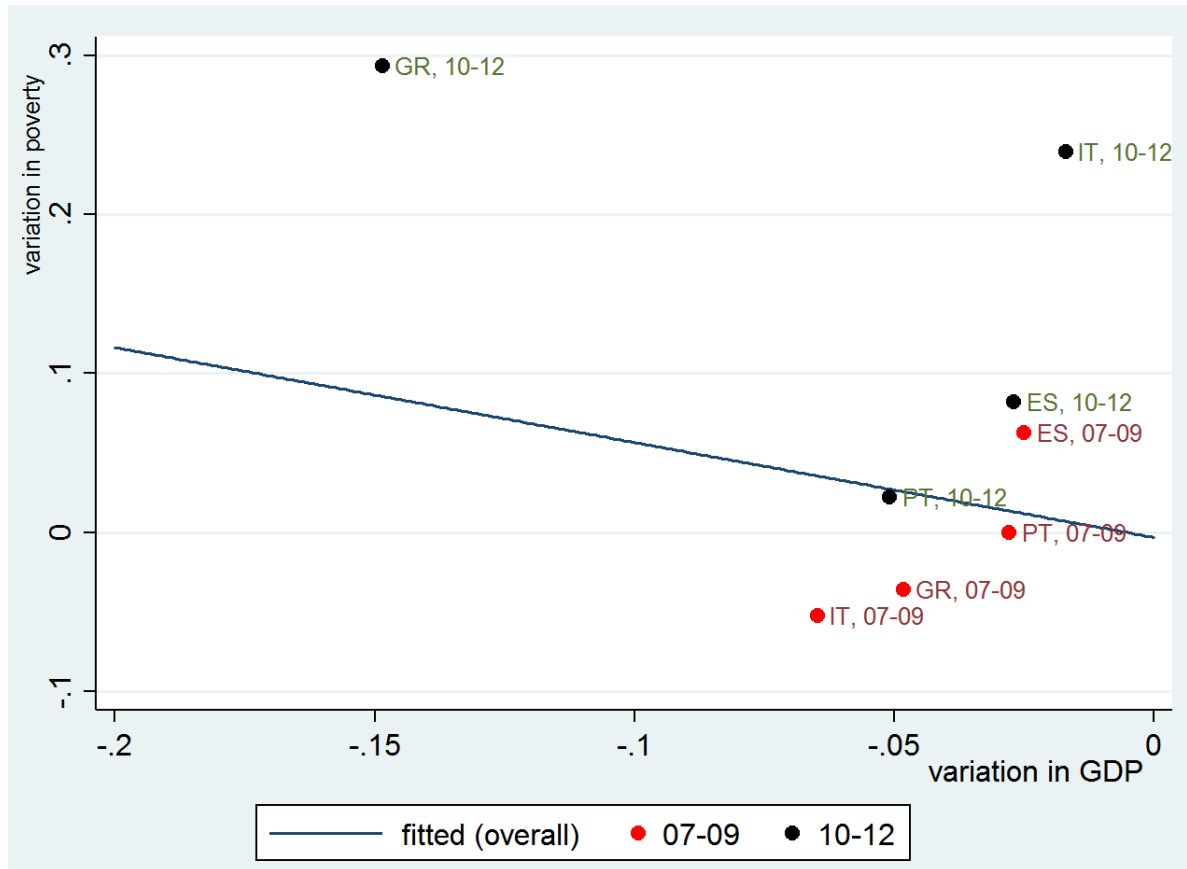


Countries:

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LU DE BE UK EE HU LV LT PL

The second dip was worse



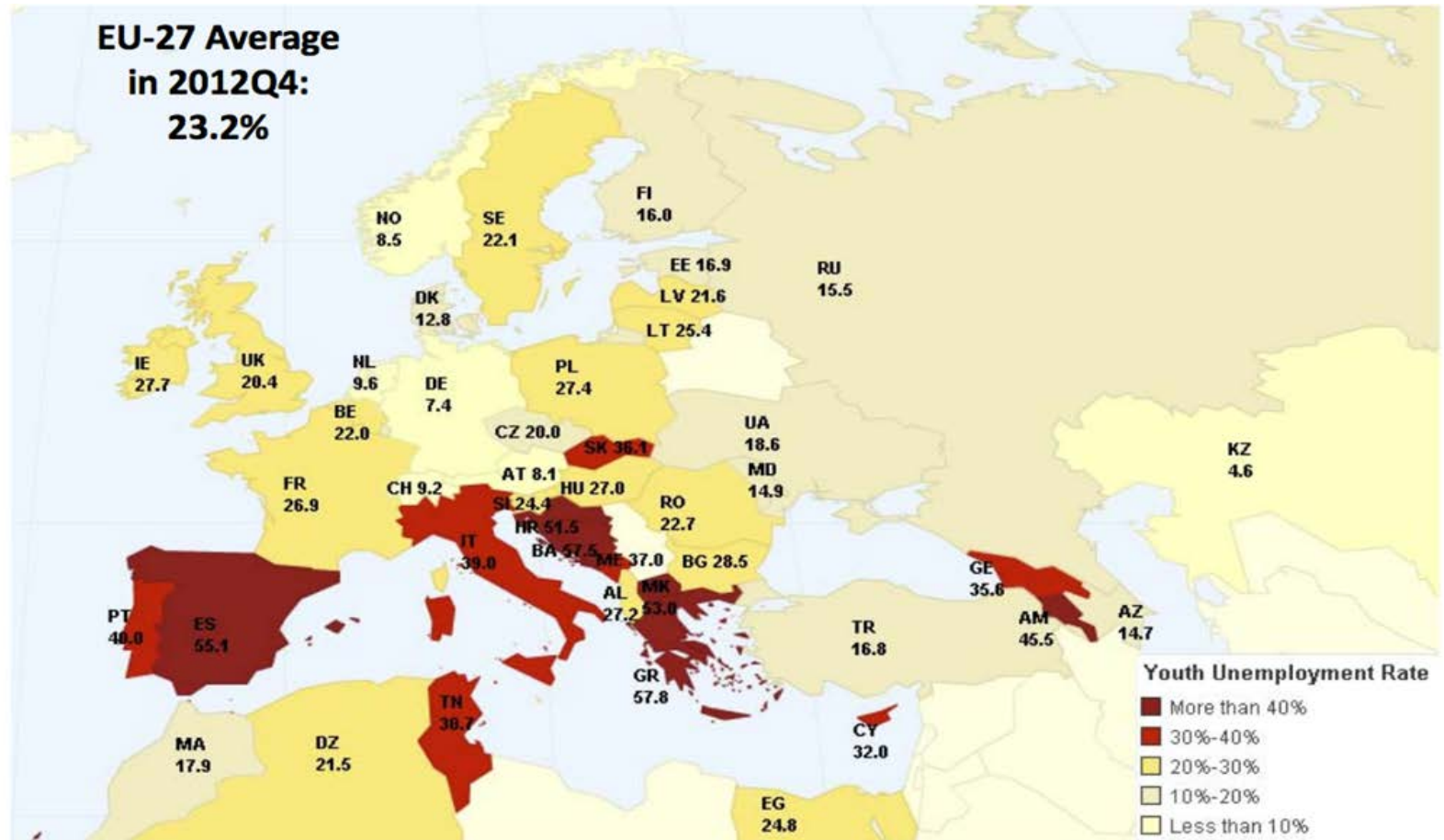
Summary

- Some countries, notably Southern (and Eastern) Europe are more vulnerable to shocks to GDP (and unemployment)
- These are precisely the countries hit by the Eurozone crisis
- Which was worse than the Great Recession in terms of its effects on poverty per given output fall

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The spatial and age divide

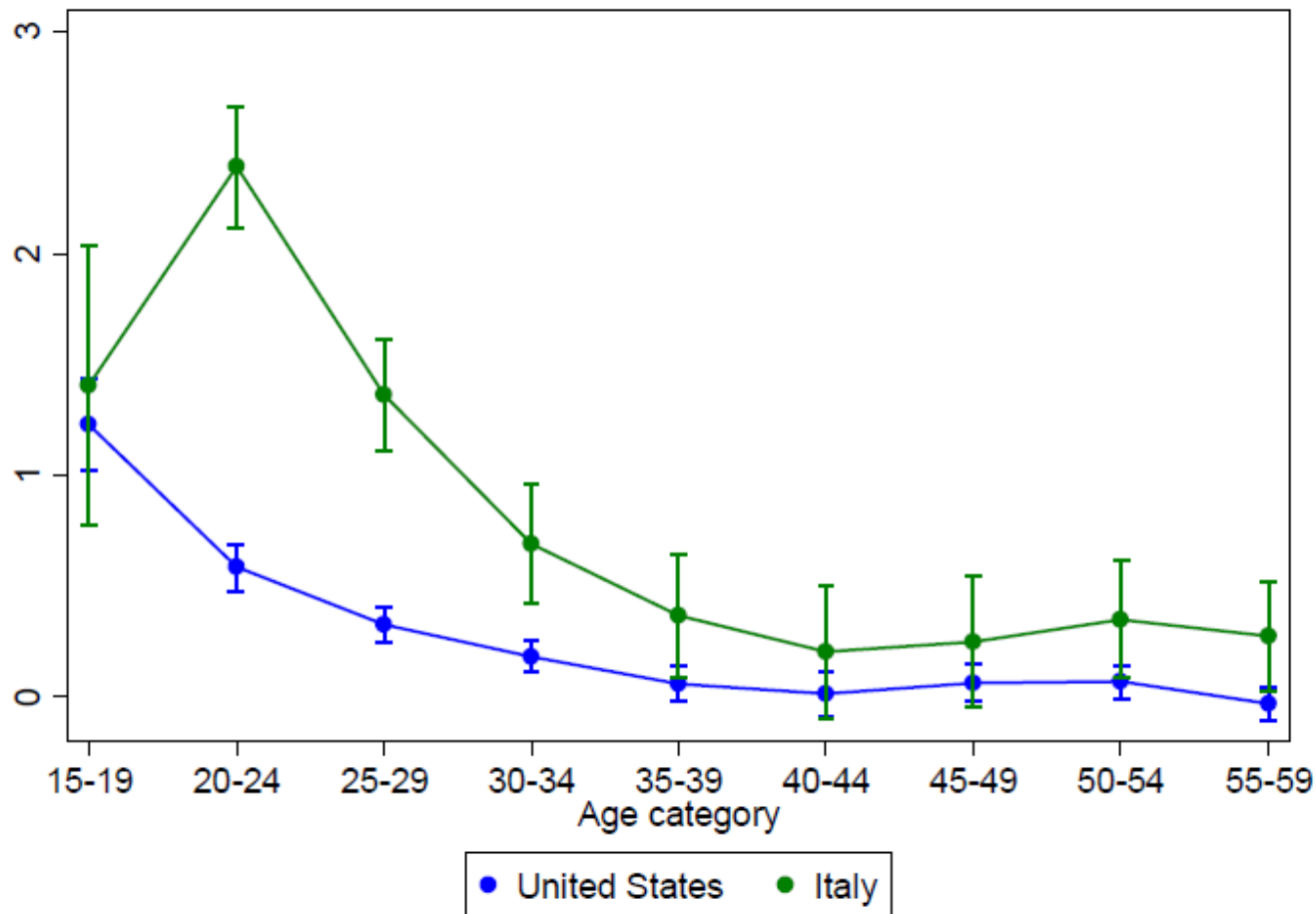


Source: Eurostat , IMF Unemployment, youth total (% of total labor force ages 15-24)

Why is unemployment so much concentrated among young people?

- Search theory: labor market with frictions and job shopping; good description for youngsters
- They need to collect more information about jobs and experiment
- Employers are less informed about them
- More turnover among young people (higher hirings and separations)
- During a recession hiring freeze and increase in separations. Even if proportional across age groups would hit more the youngsters

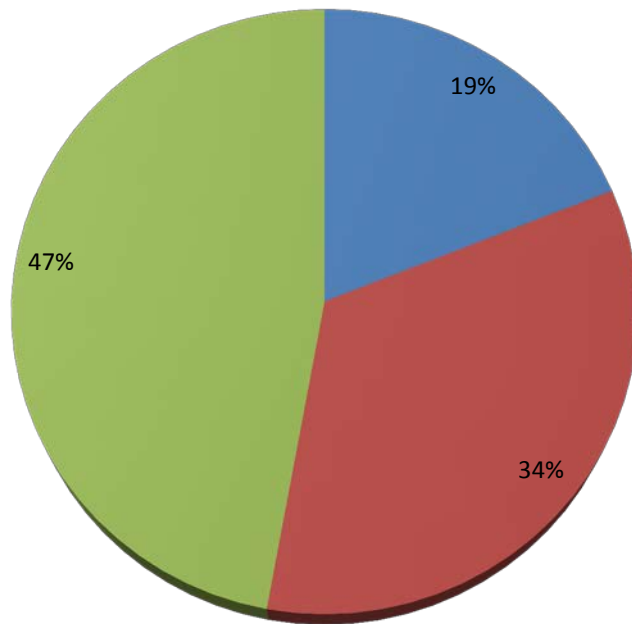
More than pure search effect?



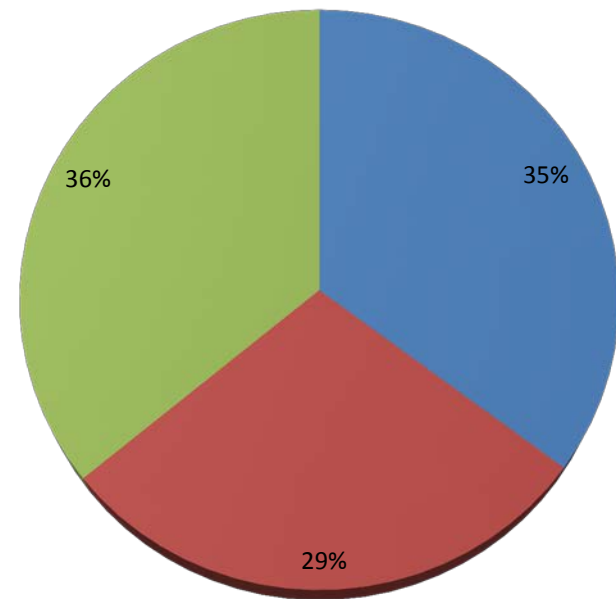
Dummy age in regressions of group specific unemployment against total unemployment as in Hoynes, 2011

Is it job loss or postponed entry? (flows into poverty unemployment)

Southern Europe, all ages.



Southern Europe, age<25.

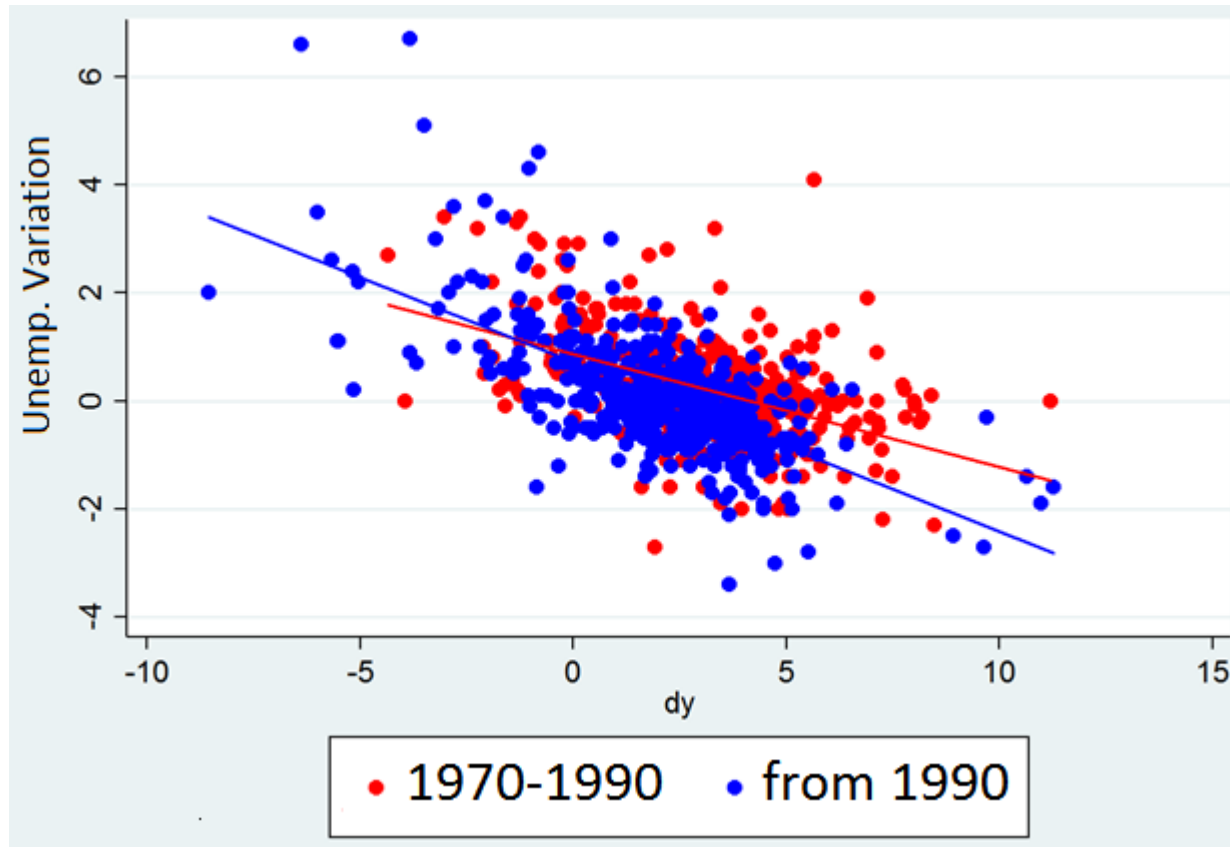


■ from inactivity

■ from employment

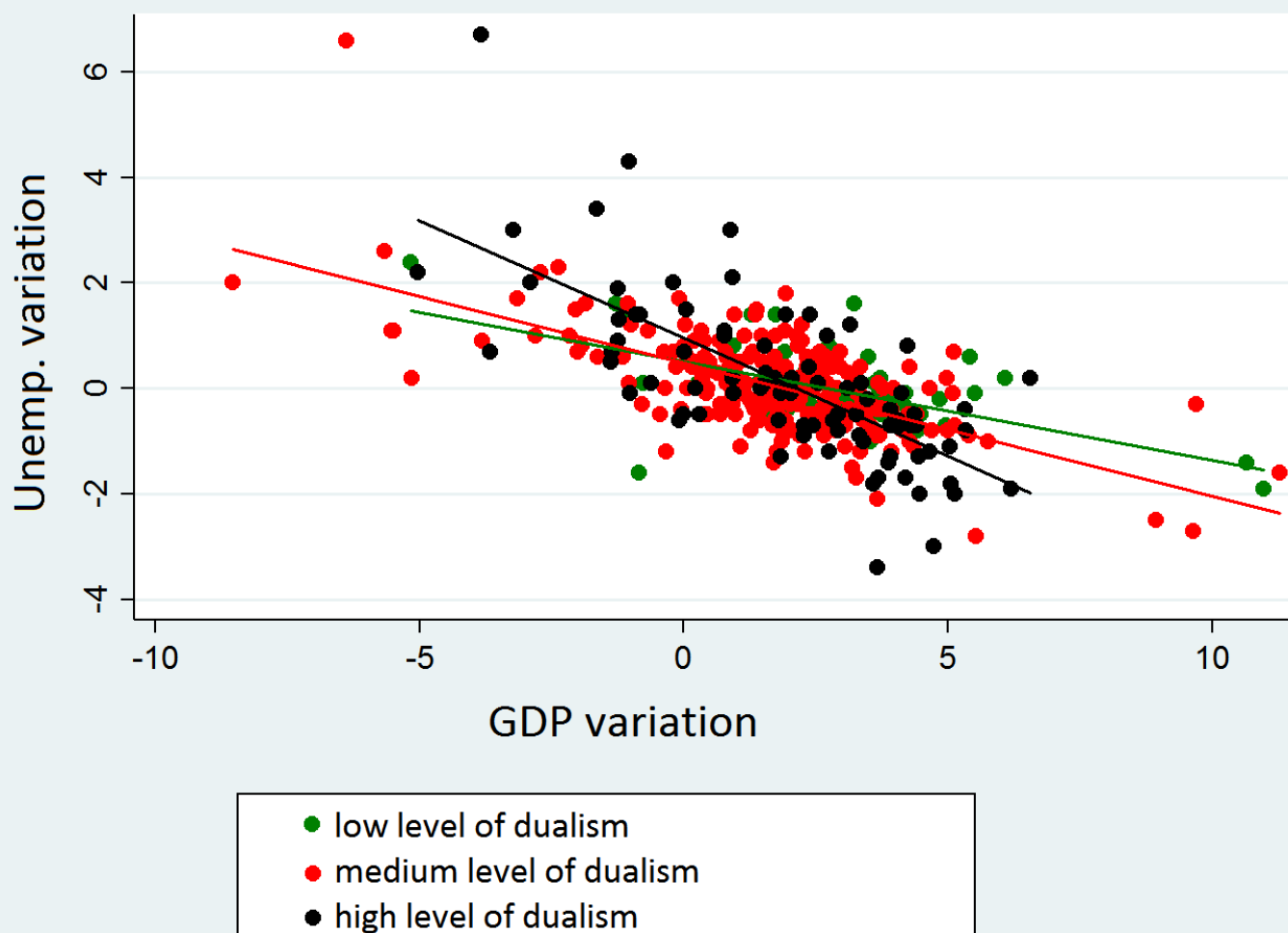
■ from unemployment

Responsiveness of youth unemployment to GDP variation



Estimates of Okun's law for youth (15-24) unemployment
Source: author's calculation on EUSILC

The role of temporary employment



Source: author's calculation on EUSILC



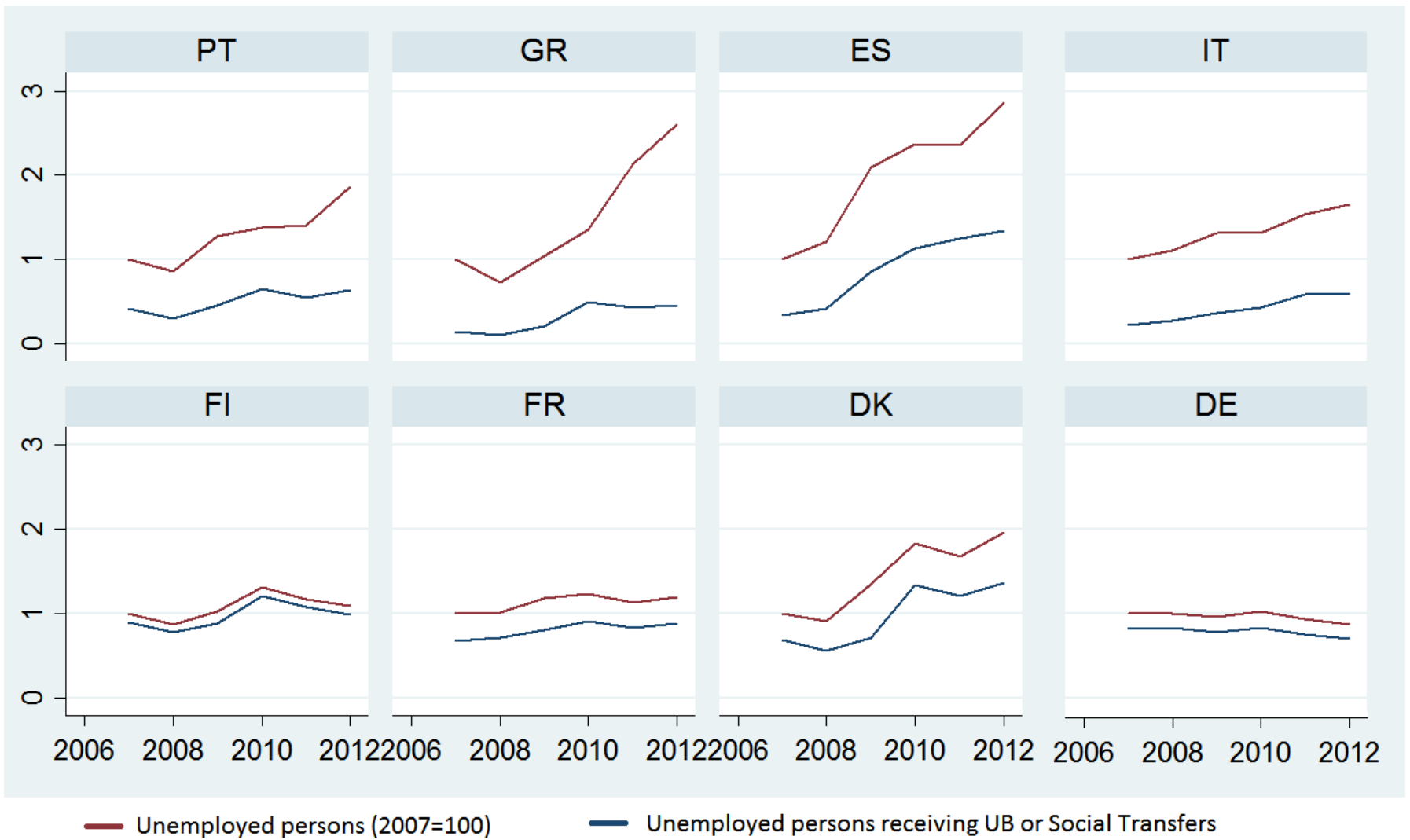
Summarizing

- Pathological increase in youth unemployment in the South
- Associated to job loss more than to postponed entry
- Contractual dualism increases the unemployment response to output falls

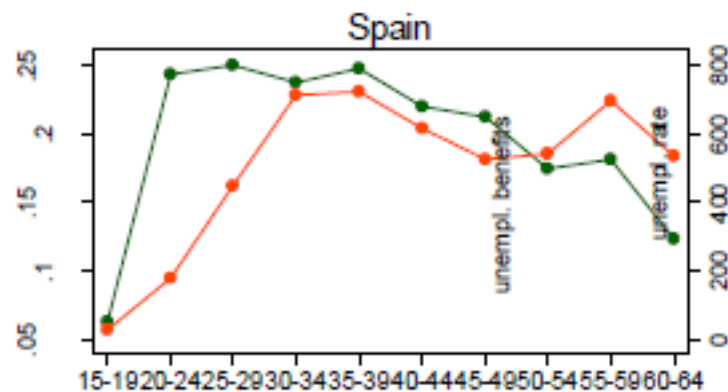
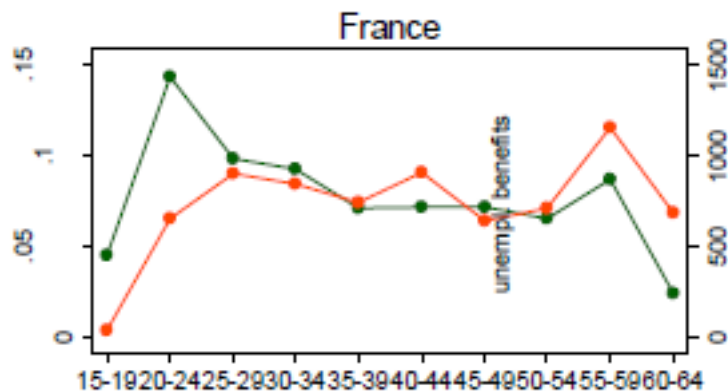
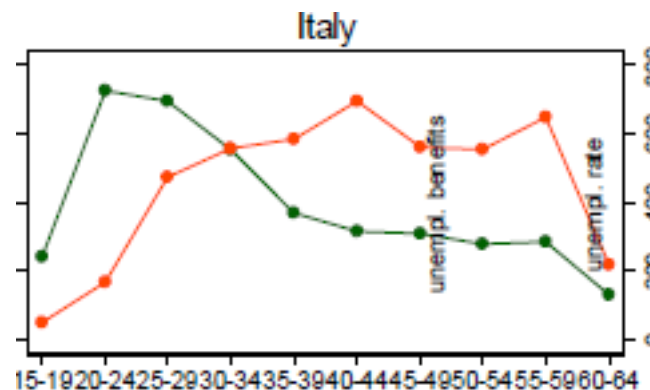
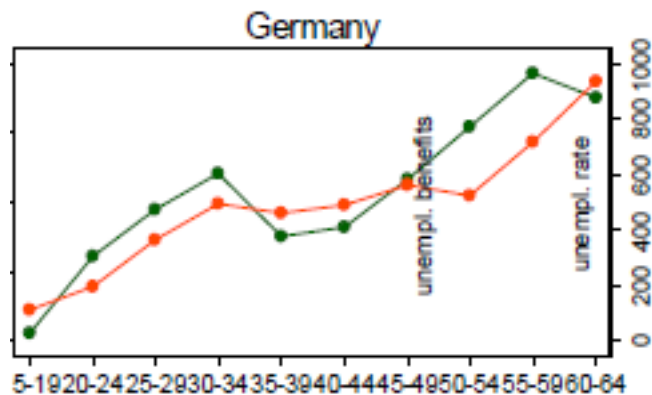
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Coverage of UB and SA

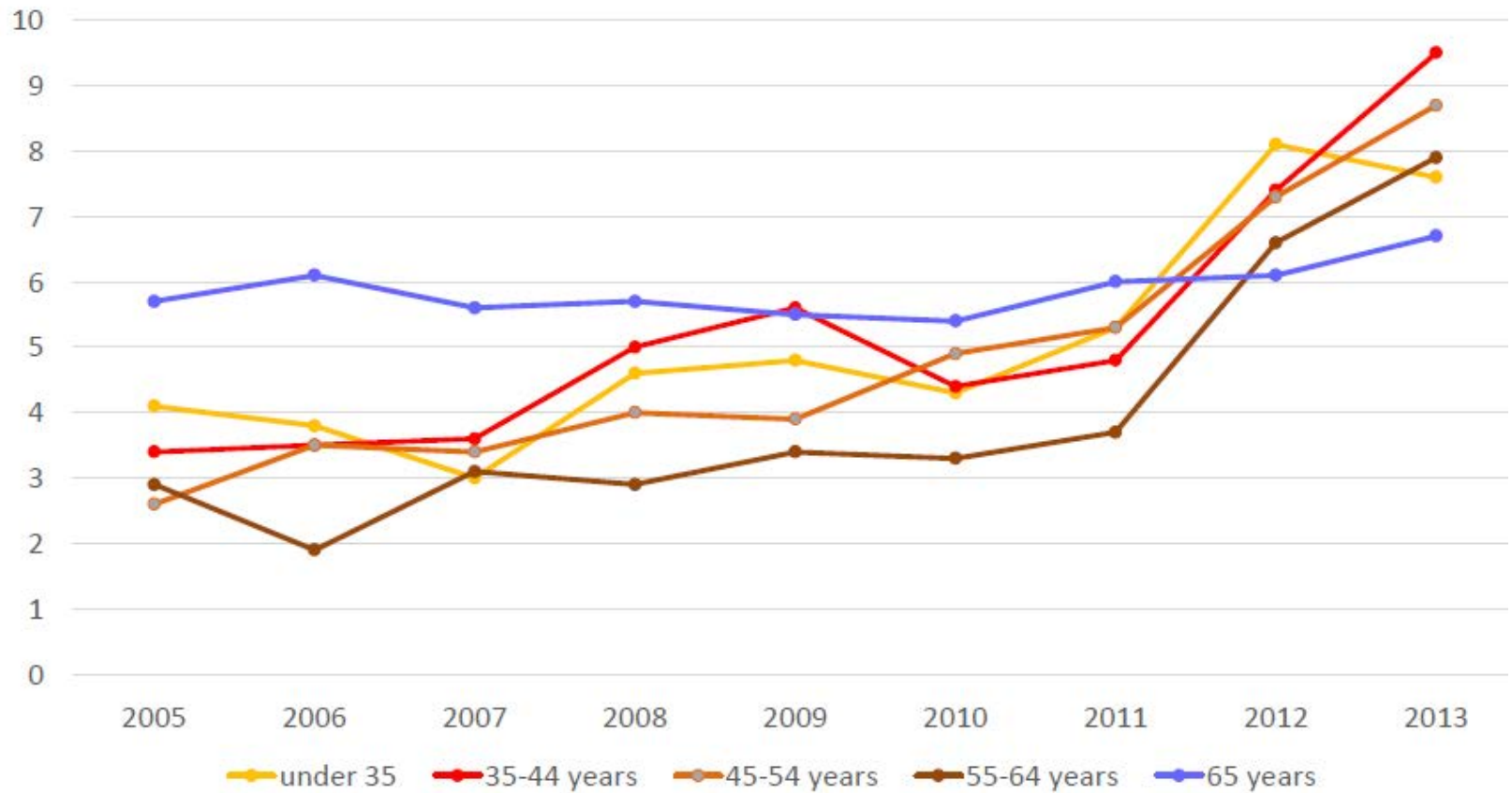


Coverage of UBs by age (2012)



Poverty by age

Absolute poverty in Italy, by age of the head of household



Should we worry about it?

- About 1/3 of youth unemployment is long-term
- Evidence from longitudinal studies that long duration unemployment can be very harmful.
- It carries implications for wages and unemployment incidence in later life (the scarring effects of unemployment). Also health problems
- It causes a lot of misery (from “happiness” studies)

Summary

- The welfare state does not sufficiently cover the young people notably in stress countries
- Problem related to the structure of social protection, but also to contractual dualism
- Serious issue. Risk of loss of an entire generation.

Outline

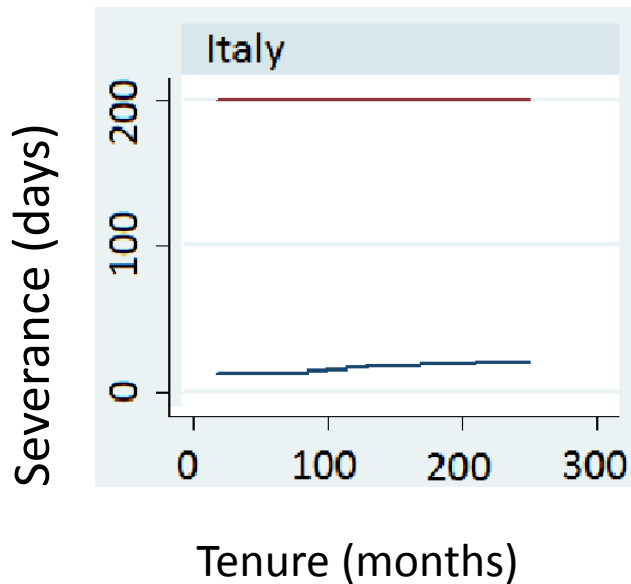
- Some facts about the shock: output fall, poverty and unemployment
- The social policy response. Did they cover the most needy?
- **What can be done to avert the loss of a generation?
National and supranational dimensions**

Tackling Contractual Dualism at the national level

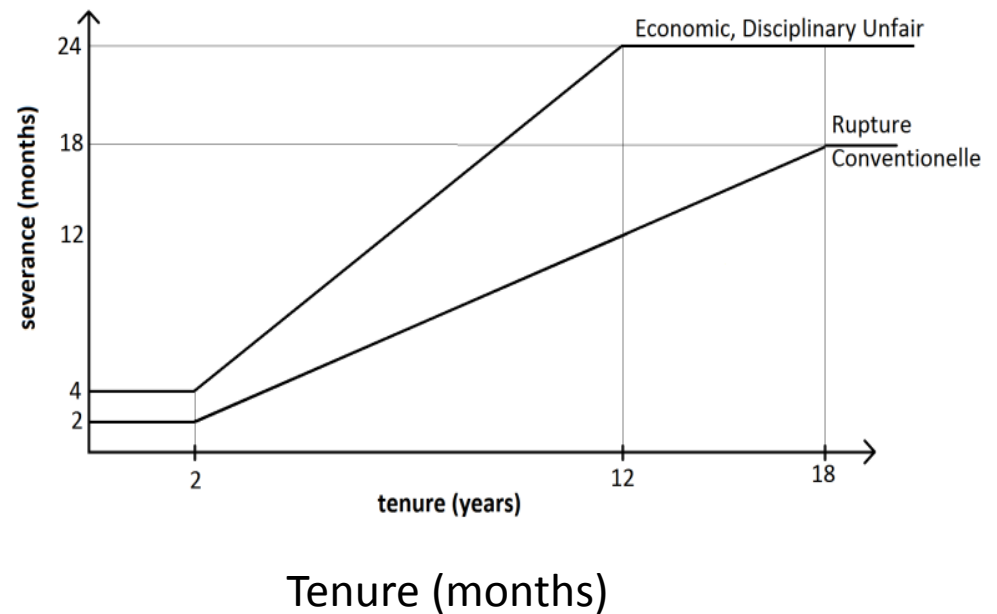
- The Italian Jobs Act
- Graded security contract for all **new hires in open-ended contracts**
- Extension of the coverage of unemployment benefits to workers with short contribution records and «self-employment» with only one employer

Severance and tenure

Status quo



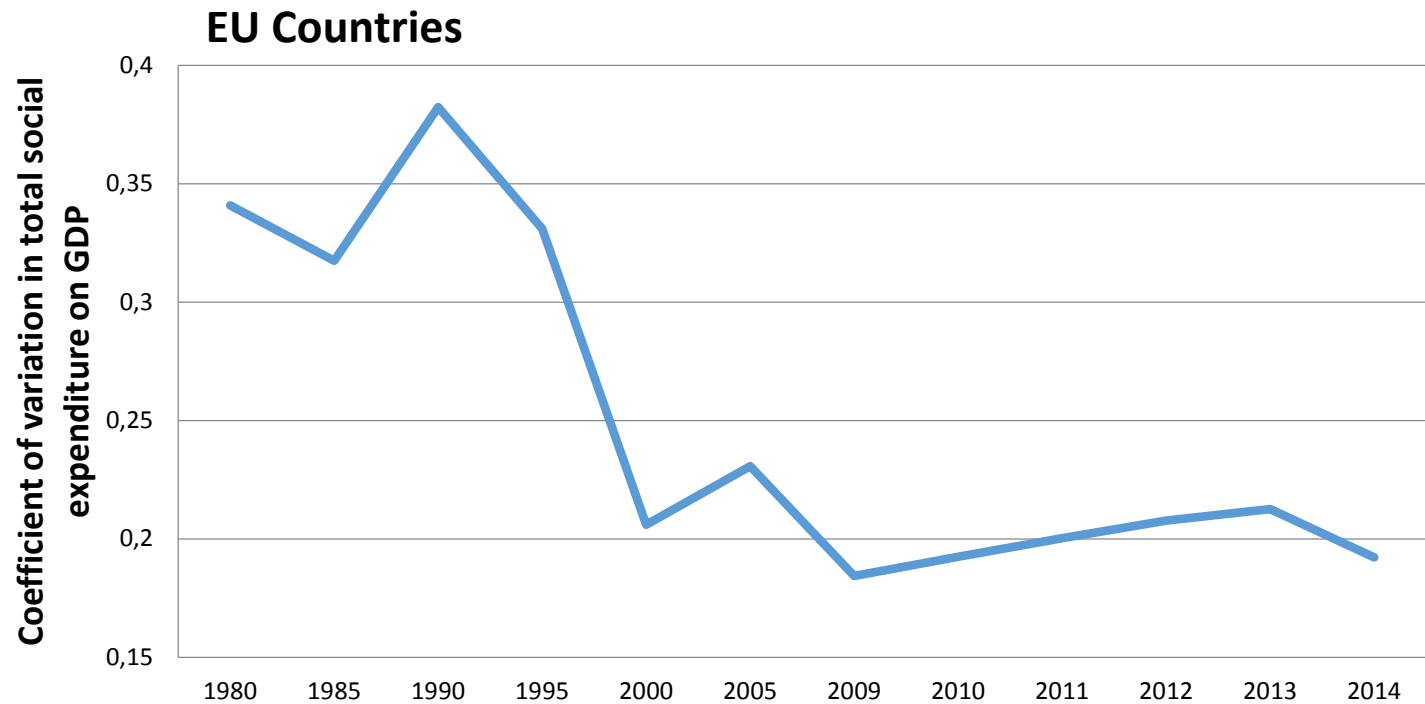
The new open-ended contract



Coverage unemployment benefits

- Entitlements also for short tenures (e.g., 3 months of contributions in the last 4 years)
- Not yet social assistance of the last resort for long-term unemployed
- Too costly for a country under a nasty recession under the EC fiscal rules

No longer convergence in social spending over GDP



Under asymmetric shocks divergence across (relevant) jurisdictions

Decomposition of differences in unemployment
rates: *between* and *within* countries

Theil Index	2008	2009	variation	2010	2013	variation
Overall	13.6%	11.7%	-14.0%	11.70%	18.80%	60.7%
Within	7.0%	4.9%	-30.0%	4.40%	4.40%	0.0%
Between	6.5%	6.8%	4.6%	7.30%	14.40%	97.3%

A EU-wide stabilizer?

- Vulnerability in banking is faced by promoting bank mergers
- Vulnerability in social policy requires more risk pooling
- A EU wide social safety net?
- A EU wide unemployment benefit?
- A European Equal Opportunity Contract creating individual accounts for all new hires of youngsters to be used to buy social security or training?

Lessons from the stress test

- There are many things that could be done within each country to fill the gaps of the « land of the welfare state » in fighting poverty and protecting from privately uninsurable risk, but..
- Can we continue to fight poverty in case of asymmetric shocks without some shock absorbing mechanism at the supranational level?
- Do we need a welfare **union** rather than simply a welfare **state**?