

# Institutional Moral Hazard in Multi-Tiered Regulation of Unemployment

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# Introduction

- Concept of ‘institutional moral hazard’ (IMH)
  - Caveats
  - Factors that contribute to its salience
- (Concern for) IMH in the 8 cases
  - General & country specific
- Conclusions
  - Minimum requirements
- The broader picture: fiscal decentralisation

## IMH: definition

- *A situation in which an insured person can affect the insured company's liability without its knowledge* (Barr, 2004)
- Two levels of government (A & B)
- 'A' covers a risk that 'B' could cover as well
- Policies by 'B' influence incidence of the risk
- Asymmetric information
- Examples
  - Dumping, parking, creaming

# IMH: caveats & nuances

- Our scope is limited
  - Other factors influence the risk of unemployment
  - There is a broader fiscal context
- IMH is inevitable in insurance
  - Danger of over-stressing and over-simplifying
  - Perceptions matter

# IMH: factors that contribute to its salience

- Design of schemes
  - Generosity for individuals, design of re-insurance, other fiscal mechanisms
- Interaction with other parts of the regulation of unemployment
  - Activation policies, SA
- Local or regional differences
  - Heterogeneity in employment rates, differences w.r.t. policy goals

## IMH in 8 cases: general findings

- Concern for IMH plays/played a role in every case
  - However, the extent of (concern for) IMH differs
- IMH takes different forms
  - Perverse interactions with other benefits
  - Growing heterogeneity between constituent parts of countries
  - Different views on policy goals
- Reforms differed as well: centralisation vs decentralisation
  - Federal/central take-over, more federal/central control or less re-insurance

# IMH in 8 cases: country specific findings (1)

## ■ US

- UI: federal-state cooperation, FUTA, extended benefits
- SA: move away from open-ended funding (AFDC) to block-grant (TANF)

## ■ GER, CHE, AUT

- Common issue: problematic dichotomy SA and UI (also: dumping)
- Different solutions: federal take-over, federal requirements, closing off UI

## ■ DNK

- Reimbursement model

## IMH in 8 cases: country specific findings (2)

### ■ CAN, BEL

- 'Classic' IMH: federal benefits, regional activation
- Difference in salience of IMH in UI, different solutions

### ■ AUS

- ALMPs privatised (no intergovernmental dimension)
- Increasingly strict governmental control



# Conclusions

- Most common forms of IMH
  - Poor activation (incentive structure, different views on policy goals)
  - Perverse interactions (dumping of caseloads, prioritising other benefits)
- IMH is inevitable
  - But it can be mitigated to a certain extent
  - Cost-benefit analysis is required
- Complexity of national systems will be a challenge to EUBS

# Conclusions: minimum requirements

- Most likely candidate to mitigate IMH in EUBS: minimum requirements
  - EUBS presupposes minimum requirements
    - Two purposes: optimising stabilisation & mitigating IMH
  - Minimum requirements best suited for heterogeneous constituent units
    - Less intensive than performance measurement
    - Stronger centralisation of regulation of unemployment is not an option
    - Can build on a precedent in the EU: OMC
    - Allows diversity

## The broader picture: why re-insurance?

- 1) Stabilisation, risk-pooling, promoting positive externalities
  - 2) Solidarity & unity
  - 3) Lack of fiscal capacity at lower government level
- Motivations 1 and 2 are likely to lead to less re-insurance than motivation 3
    - Leading to less costly IMH
    - Perception of IMH is viewed as a cost of explicit policy goals

# The broader picture: understanding responses to IMH

## ■ Motivations 1&2

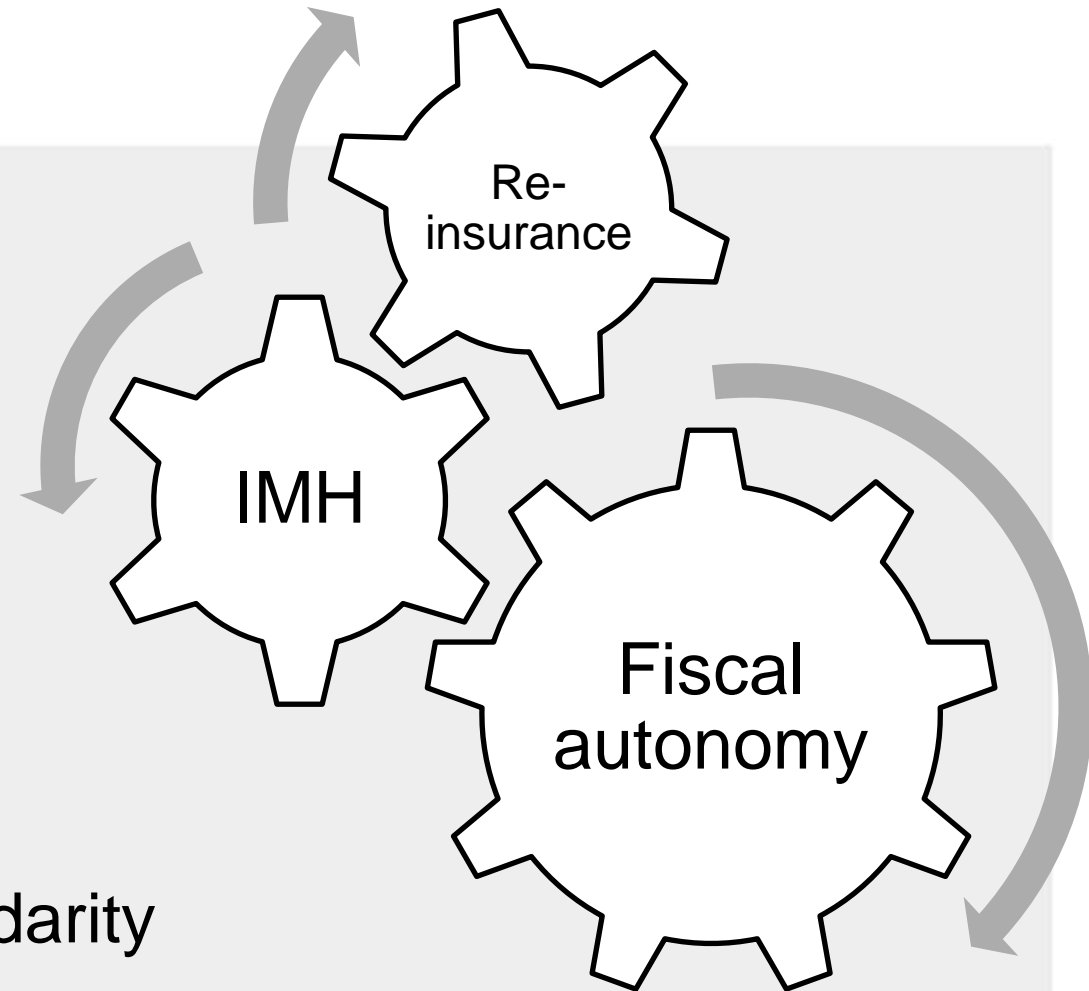
- Cost-benefit analysis, if IMH is too costly: scaling back/ending re-insurance

## ■ Motivation 3

- Scaling back/ending re-insurance not possible
- More central control
  - Incentives, performance measurement, minimum requirements
  - Federal/central take-over

## Broader picture: a nexus

- Nexus:
  - Re-insurance of subcentral governments
  - IMH
  - Fiscal autonomy
- Underlying variable: the nature of solidarity
  - National solidarity vs regional solidarity
  - Interpersonal vs interregional
  - Re-distribution vs autonomy



# Publications

- Via CEPS
  - <https://www.ceps.eu/publications/institutional-moral-hazard-multi-tiered-regulation-unemployment-and-social-assistance>
- Via European Commission
  - <http://ec.europa.eu/social/main.jsp?catId=738&langId=en&pubId=7887&furtherPubs=yes>

## Sources

- Barr, N. (2004), *Economics of the Welfare State*, New York: Oxford University Press.