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Centre for Labour Market Research

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**Sharing Transition Risks:  
Towards a System of Employment Insurance<sup>1</sup>**

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## Table of contents

Abstract .....	4
Introduction.....	4
1. The Concept of Transitional Labour Markets.....	5
2. Social Risks on Current and Future European Labour Markets .....	9
3. Risk sharing capacities of social versus private insurance .....	15
4. Sharing risks of working time transitions through short-time work allowance.....	18
5. Sharing risks related to skill transitions .....	21
Concluding Remarks.....	23
Literature.....	24

## Abstract

*The concept of flexicurity recommends a paradigm shift from job security towards employment security. This reorientation, however, has not yet found sufficient reflection in respective changes of social security institutions, in particular unemployment insurance. Increasing flexibility in employment relationships seems to be a necessary condition of adjustment to volatile demand and technological changes as well as to changing preferences and individual work capacities over the life course. As a consequence, the balancing need of security to take respective risks of income volatility is rising. As income volatility is not only connected with transitions between employment and unemployment but also related to transitions between various employment statuses, the need of extending unemployment insurance towards a system of employment insurance becomes evident. This argument will be developed in five steps: First, by briefly summarising the concept of transitional labour markets; second by indicating the main social risks that challenge current and future European labour markets; third by laying the theoretical ground for an extension of social insurance principles against private savings; fourth and fifth by the application of these principles to the new emerging risks, in particular those related to working time and skill transitions.*

*Keywords: risk, risk sharing, education, training, flexicurity, transitional labour markets, unemployment insurance, employment insurance, social insurance*

## Introduction

“Good by Flexicurity?” This was the provocative question posed by Peter Auer a few years ago.<sup>3</sup> Is such a quick farewell justified? I don’t think so. But there are good reasons for such a provocation. The flexicurity consensus the European Commission was conjuring in 2006 breaks down.<sup>4</sup>

The flagship of the *European Employment Strategy* did not deliver enough “good jobs”. In its recent report on *Employment and Social Development 2011*, the European Commission (2012: 12) had to acknowledge an “intensified wage polarisation” as the key to understand rising income inequalities and risk of poverty in work.

In addition, the blatant neglect of a proper macro-economic framework led to mass unemployment in some countries which many thought a past relic of history. In March 2012, for instance, the youth unemployment rate in Spain climbed to 50.5 percent. One in two without a job! How long can a democracy stand such a situation?

Finally, the sexy slogan we learned from the Danes: “Protect people, not jobs!” turned out to be a too simple dichotomy. Right, we need a paradigm change “from job security to employment

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<sup>3</sup> IIRA European Congress 2010 in Copenhagen, June 28-30, Track 4 on Employment Relations (‘*Goodbye Flexicurity – Welcome (again) Transitional Labour Markets?*’), convener Peter Auer (ILO).

<sup>4</sup> “A consensus is [...] emerging [...] that countries should adopt institutional configurations in the labour market that better combine the requirements of flexibility and security – in other words ‘flexicurity’. This implies that, in an environment where workers experience more frequent transitions between employment and non-employment, and between different kinds of employment, policies need to put in place the right conditions for individuals to successfully manage these transitions, thereby ensuring sustainable integration and progress of individuals in the labour market” (European Commission 2006: 111).

security”. But this dichotomy tempts many people to neglect the difference between occasional jobs and systemic jobs. Occasional jobs don’t need protection because they don’t contain any investment. But systemic jobs need protection because they contain a lot of mutual investments between employers and workers.

Yet before we overdraw the critic, at least one cheer has to be given to two corners of the Danish “Golden Triangle”: Generous unemployment benefits and active labour market policies do not only provide individual income security and enhanced chances of reemployment. They also serve as important built-in stabilisers for the whole economy (Dolls et al. 2011). During the last recession, however, Germany has shown that this stabilisation function needs not necessarily to be implemented through the insurance of risks related to external flexibility; it can also be realised through the insurance of risks related to internal flexibility. My argument is that in both countries, in Denmark and in Germany, unemployment insurance and active labour market policy already function in parts as a kind of employment insurance, but with different emphasis in their approaches.

During the last years, however, flexibility and security got out of balance for more and more workers, at least in Germany. Many life course risks are not at all or at least not fully covered by the current system of employment insurance. Yet, a fully developed system of employment insurance has to mind all transition risks. In the following, this argument shall be developed in four steps: First, by briefly presenting the concept of transitional labour markets; second, by throwing some light on the changing employment relationships; third, by reflecting on the methodology of risk sharing and applying this, fourth and fifth, to the risks of income volatility in working time and skill transitions.

## **1. The Concept of Transitional Labour Markets**

The concept of Transitional Labour Markets (TLM) aims at a consistent framework to give the flexicurity-strategy a clear normative and analytical direction. The core idea is to empower individuals to take over more risk over the life course: First, through making not only work pay but also through making transitions pay by extending the social insurance principle beyond unemployment and including volatile income risks connected with other critical events over the life course; second, through making not only workers fit for the market but also through making the market fit for workers by enhancing employers’ and employees’ capacity to adjust to uncertainties by investing in individual competences as well as in the workplace environment.<sup>5</sup>

In a way, the TLM concept reflects a new stage of ALMP through its emphasis on active securities giving people ‘hands-in’ instead of only ‘hands-out’. Active means: first, investing in people versus passive charity as in pure “market” economies; and, second, protecting people’s investments versus protecting jobs as in pure “socialist” economies; under this perspective generous income replacement for searching a new job is an investment, in other words, an active security! It is utterly wrong to talk of unemployment benefits (if properly designed) as “passive” labour market policy.

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<sup>5</sup> For a full elaboration see Schmid (2008); the slogans have been coined by Gazier (2003) and Gazier/ Lechevalier (2008); see also various contributions in Jørgensen/ Madsen (2007).

The second emphasis of TLM is life course orientation. The concept of “careers” acknowledges individuals a right to a development perspective versus workfare in pure market economies; and a voice in choosing jobs versus directing people into jobs as in pure socialist economies. Labour market services, therefore, have to support transition securities beyond the employment-unemployment transition.

This leads to a third emphasis, namely to empower individuals to change from one work-situation to another according to changes in the economy as well as according to individuals’ changing preferences or work capacities over the life course. Citizens should have therefore the right to transitions. “*Work*”, thereby, includes all activities of an obligatory character, independent whether they are paid or not. Even participation in collective decision making should be considered as work because exercising voice in work-related decisions is an essential part of economic democracy. Historically, in fact, the first example for a work related right to exercise voice was granting time-off to representatives of works councils. Other examples are the right to negotiated exits like training leaves and sabbaticals, and the right to family related exits like parental leave or other care leave (Supiot 2001).

The TLM concept relies on a basic assumption of social action: Most people accept changes more easily if risks are shared in a just way. That’s why the theory of justice plays an important role in TLM. I can only briefly mention the four principles of justice as the normative pillars of risk sharing: First, justice as fairness, which basically means equal access to jobs and inequality only justified if the lot of the most disadvantaged improves; second, justice as solidarity, which means sharing responsibilities according to the type of risks and individual capacities; third, justice as agency, which means developing individual and institutional capabilities to enhance individual and regional autonomy, in other words freedom to act; fourth, justice as inclusion, which means enlarging risk sharing communities according to the interdependencies of economic and social life; in a globalised world this means de facto risk sharing communities beyond the nation state.<sup>6</sup>

The concept of the TLM has enormous consequences for studying labour markets. First, employment and unemployment have to be considered as a product of stocks and flows. An unemployment rate of 10 percent per year can mean quite different things. It can mean that 60 in 100 persons become unemployed but stay on average only 2 month unemployed. But a 10 percent unemployment rate can also mean that only 10 in 100 persons become unemployed and stay on average 12 months unemployed.

For employment services, these two possibilities represented by the same figure reflect two quite different problems to solve. If most people are only short-term unemployed, you have to concentrate on placement services; however, if a substantial minority is long-term unemployed, employment services have to concentrate on training, subsidised employment, protected work or work-place adjustment or even on public job creation.

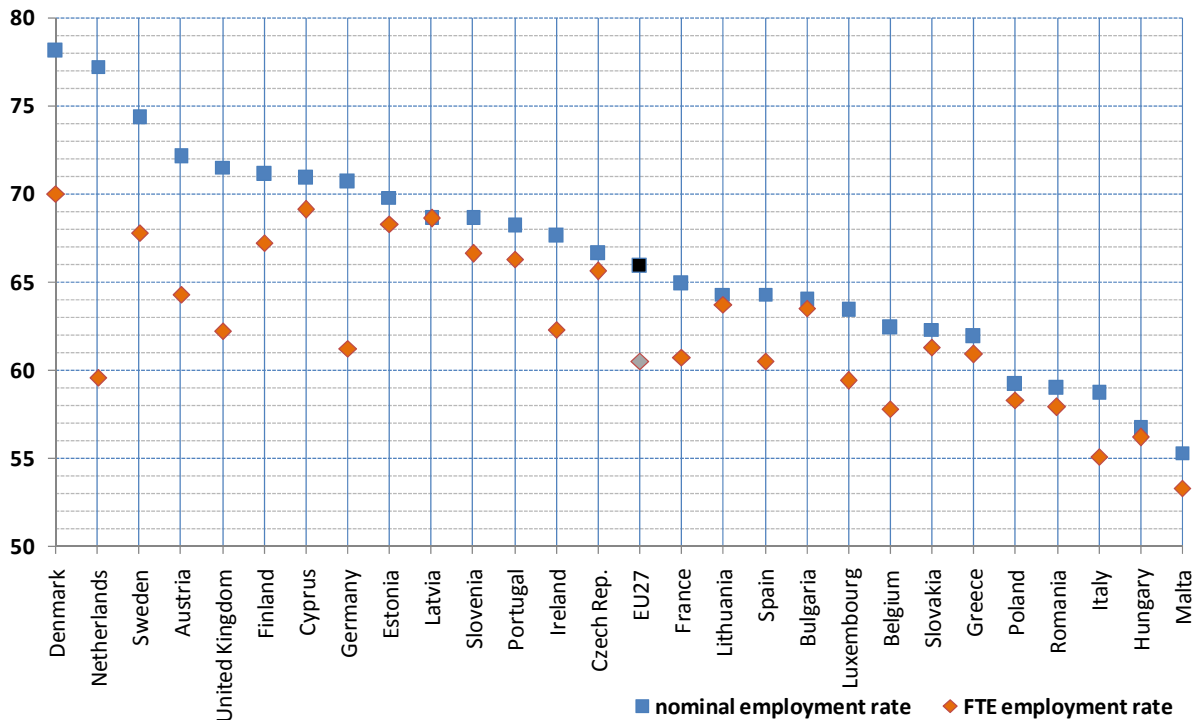
Working time also varies over the life course. People move from part-time to full-time and vice versa. Measuring employment by simple head counting does not take account of such transitions. In Lisbon 2000, the European Commission, for instance, defined full employment as 70 percent employment rate by 2010. Apart from Denmark at the top, the Dutch total employment rate of about

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<sup>6</sup> For a full exposition see Schmid (2006) and Schmid (2008, pp. 224-231).

77 percent far exceeds the official benchmark. But if one measures the Dutch employment rate in full-time equivalents, it falls to 59 percent, which is far below the Lisbon benchmark (Figure 1).

Figure 1: Nominal employment rates (employed as a percent of working age population 15-64) and employment rates in full-time equivalent (FTE) in the EU 2008



Source: Employment in Europe, ([http://ec.europa.eu/employment\\_social/eie/statistical\\_annex\\_key\\_employment\\_indicators\\_en.html](http://ec.europa.eu/employment_social/eie/statistical_annex_key_employment_indicators_en.html))

Now, one can interpret this discrepancy in different ways: Some might say, look, the Dutch part-time economy is far below its full capacity. Others might say, look, the Dutch part-time economy is a model for solidaric risk sharing in form of work sharing (Visser 2002). The TLM-concept favours more the work-sharing point of view, however, only under three conditions: First, a developed economy can afford work-sharing as long as productivity is not affected; second, people working in part-time must do this voluntarily, and they must have the opportunity to transit between part-time and fulltime as they wish; third, part-time workers must be equally treated in terms of wages, access to social security and employment services.

The transition perspective, however, goes beyond work sharing or working time flexibility. It includes transitions between different statuses of work, be they paid or unpaid. People undertake transitions from activity to inactivity, often without changing the formal employment status. In other words: one has to make distinction between nominal and effective employment. The nominal employment rate, for example in Sweden, is about 76 percent, but Sweden's effective employment rate is only about 65 percent, which means, only 65 percent actually are on their job in a given week.

Where are the remaining 11 percent? In a positive sense, this could mean that about 11 percent of the active workforce are on education, training, parental or care leave, or even on a sabbatical free

of any work obligations. However, in a negative sense this could also mean that about 11 percent of the active workforce are ill or absent from the workplace by cheating, making for instance “Einen blauen Montag” as we call it in Germany.

As a matter of fact the absence rates seem to increase with the employment level, as I will show later. Important, however, is here the conclusion that the concept of TLM can also be understood as a concept of managing the differences between nominal and effective employment rates in an equitable and efficient way by enhancing an economy’s transition capacity (Korver/ Schmid 2012).

The TLM perspective also forces researchers and policy makers to concentrate on risky events over the life course and to look if job-to-job transitions lead to social integration, career development or social exclusion. This requires analytical and empirical instruments to study transitions and multi-year transition-sequences, to utilize descriptive transition matrices and to control individual transitions sequences through proper statistical methodologies. Let me give you an example from Germany, which also contains a clear policy message (Table 1).

*Table 1: Yearly Transitions of West-German Women in Age of 20 to 55 (2000-2006)*

		t+1			
	<b>High Wages</b>	<b>Low Wages</b>	<b>Unemployed</b>	<b>Inactive</b>	<b>Total</b>
T (Year)					
<b>High Wages</b>	87.4	6.8	1.3	4.6	100
<b>Low Wages</b>	27.3	61.8	3.0	8.0	100
<b>Unemployed</b>	16.4	20.1	33.4	30.0	100
<b>Inactive</b>	5.9	4.9	4.6	84.7	100
<b>Total</b>	51.1	14.4	3.5	30.9	100

Source: GSOEP and Mosthaf/ Schank/ Schnabel (2009)

This transition matrix shows the yearly transitions of West-German women between different statuses of employment or inactivity. The most important result is that women in low wage jobs have a higher probability to move into high wage jobs than unemployed women: 27.3 against 16.4 percent. In contrast, unemployed women have a much higher probability to move into inactivity than women in low wage jobs: 30 against 8 percent.

These figures suggest that the strategy of work first seems to make sense, however with an important caveat: The chance to get stuck in low wage jobs is still very high: 61.8 percent. Too high! The strategic conclusion for employment services, therefore, can only be: “Work first plus Training”. Work first is a meaningful orientation; especially for the low skilled for whom training on the job is more effective than training off the job. Efficiency oriented employment services have to care not only for a quick placement but also for sustainable placements with a high productivity potential.

Finally, one also has to note the importance of transitions within stable employment relationships, for instance the transition from full-time work to short-time work or the combination of part-time work with part-time education or training. In other words: internal flexibility can be a functional



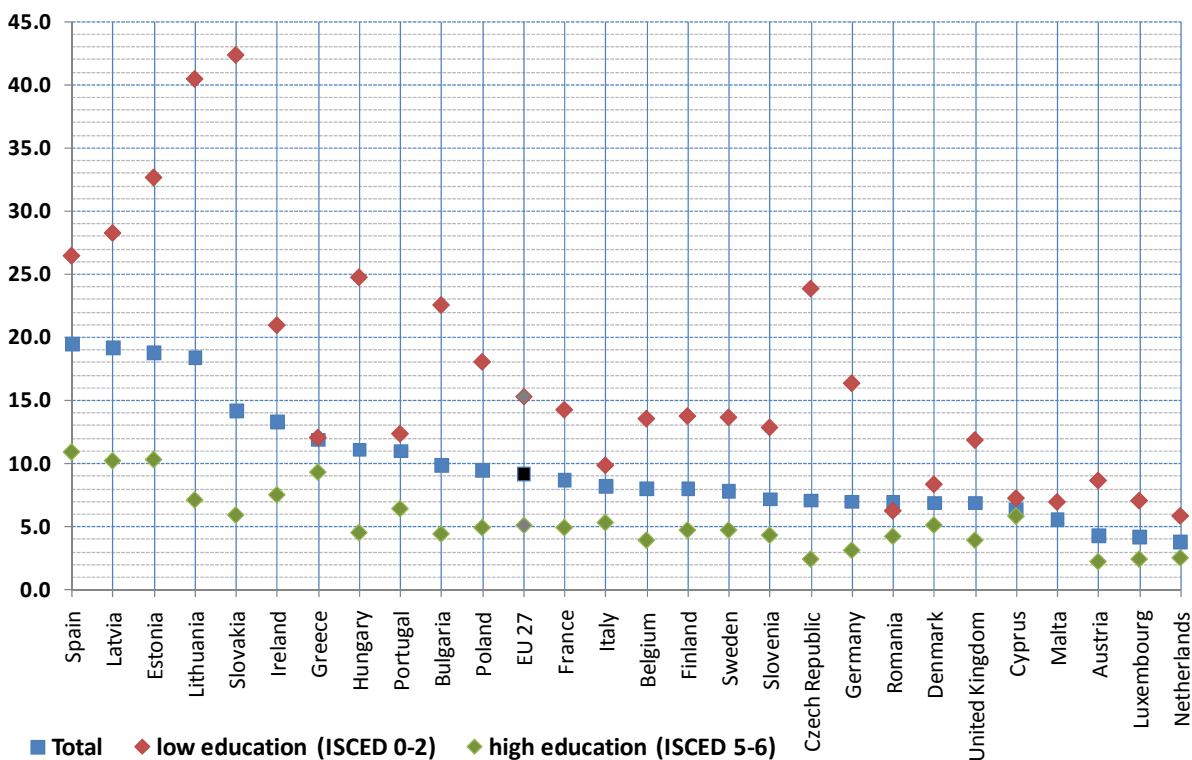
equivalent to external flexibility. An example for such protected internal flexibility is short time work, to which I will come back later. At this moment it is enough to stress the concluding point: Studies, for instance by Peter Auer and Sandrine Cazes (2003), that provide evidence for stable if not increasing job tenures are not in contradiction with TLM, provided that stable employment contracts allow numerical and functional internal flexibility.

Summing up: The normative as well as the analytical view of TLM is the perspective of managing social risks over the life course in an equitable and efficient way. The next step, obviously, is to look at the current and likely future of European labour markets to identify the most important old and new risks.

## 2. Social Risks on Current and Future European Labour Markets

The first and most evident risk is to become a loser in the competitive market game due to low or obsolete skills. The current labour market clearly reflects the tremendous unequal impact of the unemployment risk by qualification and the huge differences of employment participation by education. In many EU member states, the difference in unemployment rates between low and high educated people is three to fourfold. People with high qualification often face unemployment risks that correspond to the common full employment definition, i.e. around three to four percent; this gap, however, differs quite distinctively between EU member states (Figure 2). Skills in terms of educational credentials seem still to be the best insurance against unemployment.

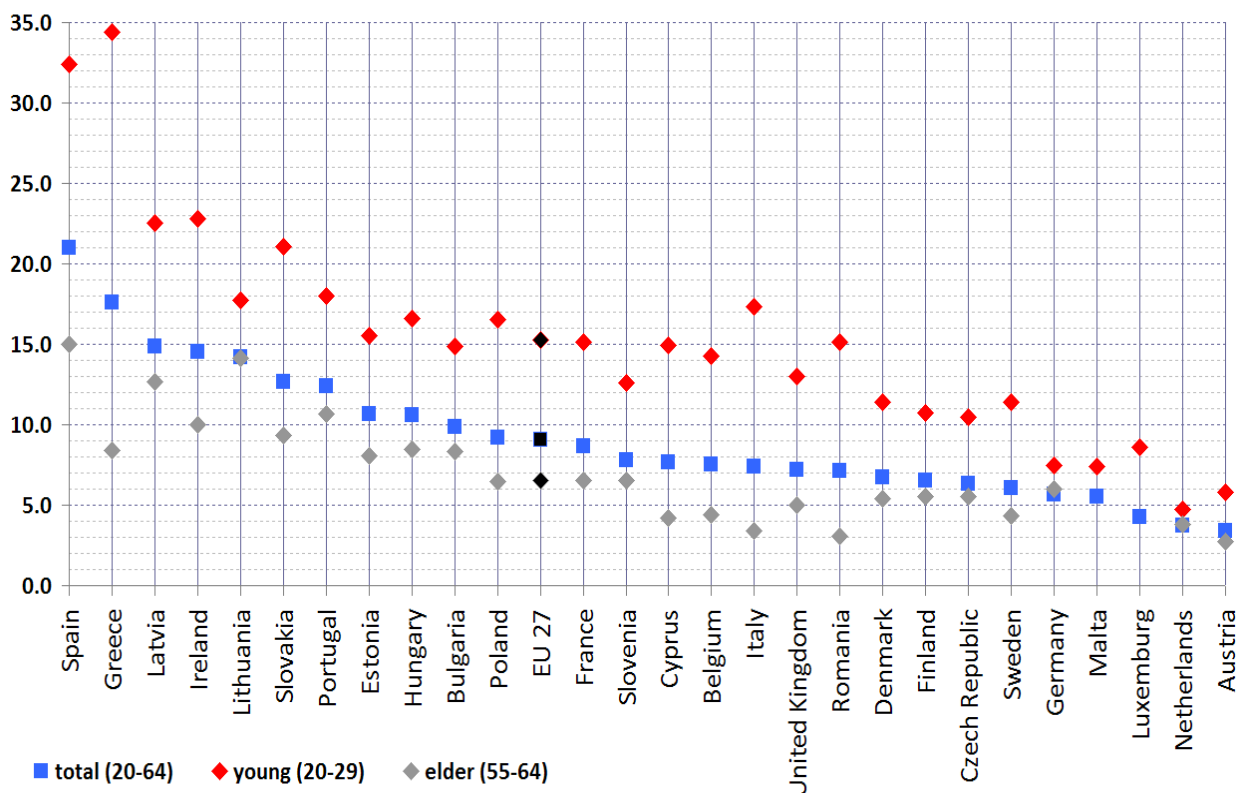
Figure 2: Unemployment rates of EU Member States by education level, 2010 and ranked according to 'Total' (age 20-64)



Data for second quarter 2010; Source: European Labour Force Survey Database lfsq\_urgaed, download 12.03.2011

The risk of skill deficits is often aggravated by age. With the exception of a few countries (Austria, Germany, the Netherlands), youth unemployment (here related to young adults in the age 20 to 29 according to the new EU-2020 strategy) is at least twice the size of average unemployment; in some countries (Greece and Spain), the adult youth unemployment rate even surpasses 30 per cent. Obviously, the lack of any experience knowledge and of work related social networks puts young adults at a disadvantage. On the other hand, outdated skills and short prospects of firm specific investments in skills lowers the re-employment chances of mature aged workers considerably, although their unemployment rates usually remain below average due to the lower risk of dismissal compared to young workers (Figure 3).

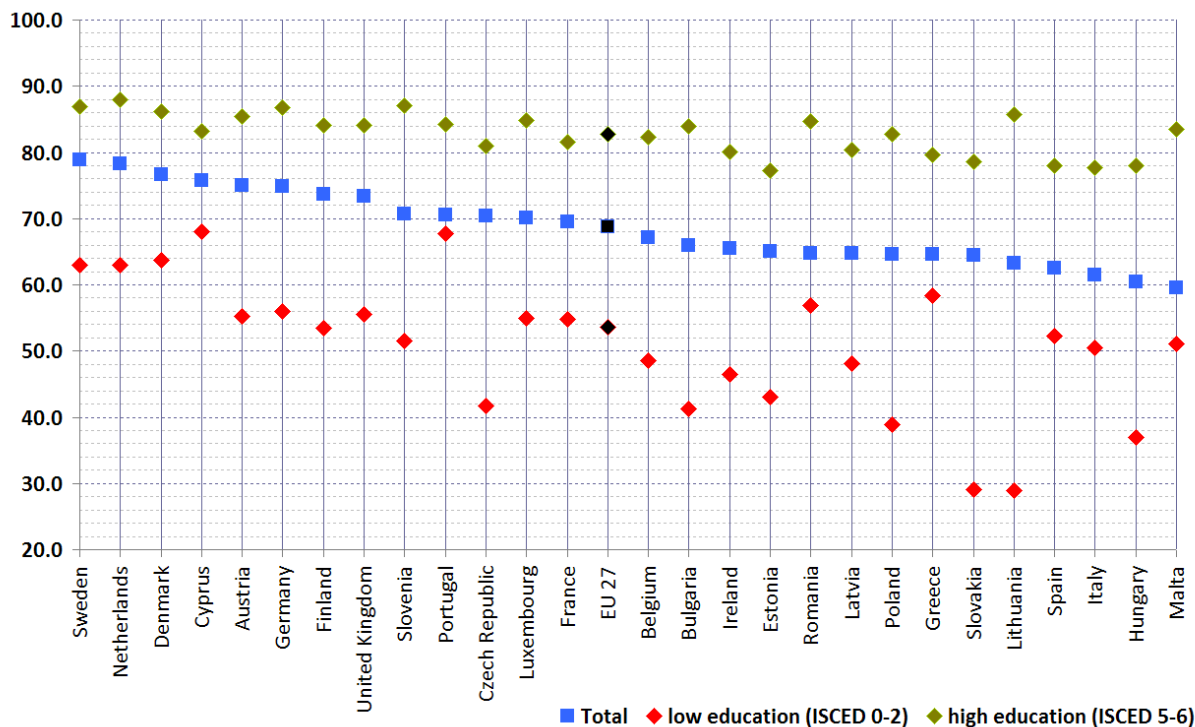
Figure 3: Unemployment rates of EU Member States by age, 2011 and ranked by 'Total' (20-64)



Source: Eurostat, own calculations, 3<sup>rd</sup> quarter

Differences in employment rates between low and high educated people are not less striking (Figure 4). Whereas the *employment rates* of high educated people are in a range between 78% and 88%, those of low educated people vary between 29% (Lithuania, Slovakia) and 68% (Cyprus, Portugal). The difference in employment rates between low (53%) and high educated (83%) people in EU-27 is 30 percentage points. And there is more alarming: these gaps seem to grow.

Figure 4: Employment rates of EU Member States by education level, 2010 and ranked according to 'Total' (age 20-64)



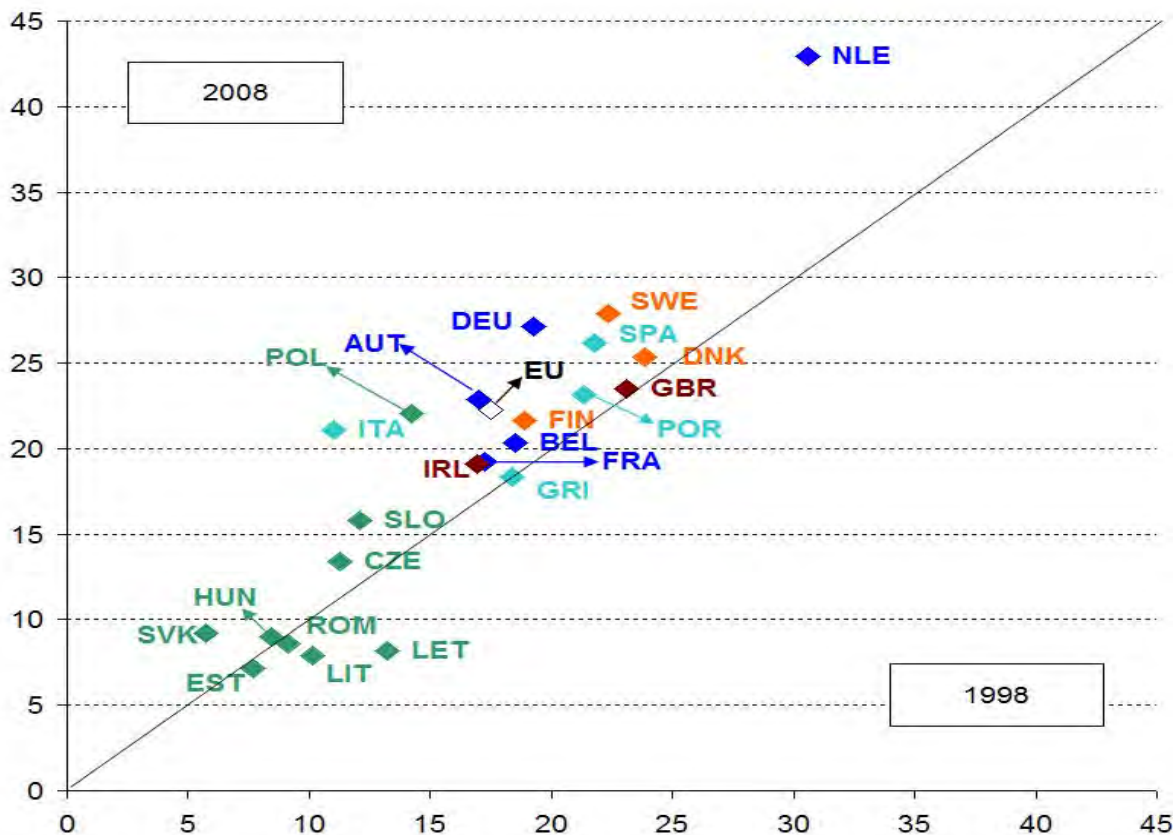
Data for second quarter 2010 Source: European Labour Force Survey Database lfsq\_ergaed, download 17.03.2011

The second main and increasing risk over the life-course is job insecurity reflected in particular by increasing levels of non-standard employment. The current dynamics of transitions tends to lead to new forms of labour market segmentation. Many people get stuck in exclusionary transitions, especially in low skilled jobs or in – often precarious – non-standard employment relationships. The following graph of non-standard employment in the EU member states gives only a rough impression of this challenge. The figure represents aggregate non-standard employment rates which comprise all jobs in part-time work, temporary work or own self-employment, controlled for overlaps (e.g. temporary part-time work) (Figure 5).

Comparing EU-member states reveals three messages: First, non-standard employment rates vary enormously between the 24 EU member states represented in Figure 5, ranging from about 7 percent in Estonia and 43 percent in the Netherlands in 2008. Through differentiation by gender, the picture – not shown here – becomes more telling. Both the level (EU-average of about 15 percent for men, 21 percent for women in 2008) as well as the dynamics (EU-average of about 2 percentage point increase from 1998 to 2008 for men, about 4.5 percentage point increase for women) hint to the fact that non-standard employment mainly affects women.<sup>7</sup>

<sup>7</sup> For a more detailed analysis of non-standard employment see Schmid (2010a) and Schmid (2010b).

Figure 5: Aggregate non-standard employment rates in Europe, 1998 and 2008



Source: Schmid in Berkhout et al. (2010: 121); Eurostat, Labour Force Survey; own calculations. ‘Non-standard employment’ includes part-time work, fixed-term employment (including temp-agency work) and self-employment (only own account work) controlling for overlaps (e.g. part-time self-employed or temporary part-time workers). The ‘aggregate’ non-standard employment rate is the number of people in non-standard employment as percent of working-age population (15-64). For example, the aggregate non-standard employment rate of the Netherlands increased from 31% (1998) to 43% (2008); the EU-average (about 22% in 2008) excludes Bulgaria, Malta and Cyprus; the new MS display very low and even declining levels. The inclusion of all part-time work as “non-standard” may be, rightly, contested, especially related to open-ended “long-part-time” (20 to 34 hours) which could (or even should) be counted as an important element of a new “standard employment relationships” defined over the life course.

As the clustering (through colours) according to employment systems shows, the so-called social democratic systems (the champion Netherlands, as a hybrid system, included) as well as the ‘liberal’ systems are on the top; the family centred continental-conservative systems as well as the Mediterranean systems are in the middle; and all of the transition countries (the new member states) – with the exception of Poland – are at the bottom. The aggregate non-standard employment rate correlates positively (not shown here) both with labour force participation and with economic prosperity in terms of GDP per capita. This pattern allows the conclusion that high contractual variety of employment relationships seems to be a prerequisite for higher prosperity in economic terms.

Whereas self-employment and part-time work show no particular relationship with age, the risk of temporary work is strongly related to youth. On the average (EU-27), 40 percent of all temporary

workers are in the age of 15 to 24, but only 10 percent in the age of 25 to 64.<sup>8</sup> Part-time is particularly (familiar to everybody) related to women. Denmark and the Netherlands are the only countries where the part-time rate for men comes near to one third of the female part-time rate, being on average (EU-27) 31 percent against only 8 percent for men.<sup>9</sup>

As the clustering above the steady-state diagonal (the implicit time axis) in Figure 5 demonstrates, non-standard employment increased in almost all EU-member states, especially in the Netherlands, Germany, and Italy. On the other hand, it is remarkable that most of the new MS not only cluster together in the left corner of the figure, but some of these countries, especially Latvia, Lithuania, and Romania experienced even a decline in the aggregate non-standard employment rate. The most likely explanation for this feature is, first, that work in the informal economy (still widespread in these countries) is a functional equivalent of formal non-standard employment; and, second, that part-time work (the most important component of formal non-standard employment) does not provide enough earnings for women engaged in formal labour market work in the MS with low income per capita.

The fact that ‘social democratic’ as well as ‘liberal’ systems rank high in terms of non-standard employment can be taken as circumstantial evidence that non-standard jobs are related with very different regulatory frameworks. Whereas the Dutch or Danish non-standard employees are well covered by employment and income security arrangements, this cannot be said, for instance, for their counterparts in Britain or Germany.<sup>10</sup> Further, not all of these jobs are precarious or exclusionary. They can serve as stepping stones or as intermediary jobs within a meaningful work life career. Nevertheless, even in countries with high security standards, non-standard jobs often involve higher risk of exclusion than standard jobs.

The third increasing risk of the life course is related to decreasing earning capacities due to health problems related to ageing, work related accidents or demanding work intensity. In 2009, only 11 of the 27 MS reached the ‘full-employment’ target for senior people (age 55-64), underlining that this full-employment target was set at only 50% under the Lisbon strategy. However, it has to be acknowledged that many countries succeeded in raising the employment rates in the last decade (2000-2009), even sometimes to a considerable extent.<sup>11</sup> The EU-2020 ‘full-employment’ target of 75 percent does not differentiate by age, yet the Barcelona target of increasing the average retirement age from 60 to 65 still holds, and the ‘New skills and jobs’ flagship is quite outspoken that a further increase of the retirement age should be envisaged as response to the demographic challenge. ‘Active ageing’, therefore, has become an accepted strategy (Hartlapp/ Schmid 2008), reflected for instance by the fact that between 2000 and the latest available figures, retirement ages have been increasing by about 1.5 years on average (Eichhorst 2011).

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<sup>8</sup> Berkhout et al. (2010), Figure 40, p. 104.

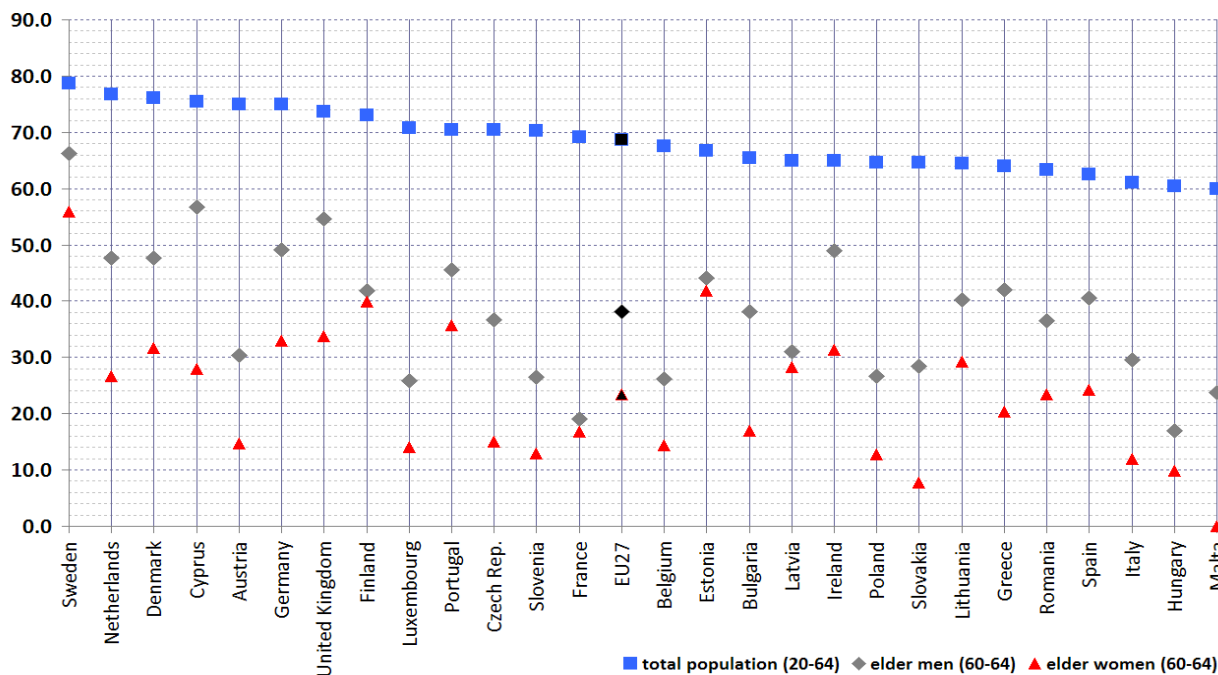
<sup>9</sup> Berkhout et al. (2010), Figure 32, p. 96.

<sup>10</sup> The best available comparison of security arrangement related to non-standard employment, at the time being, is Schulze Buschoff/ Protsch (2008).

<sup>11</sup> For instance Germany by about 18 % points, the Netherlands by 17 % points, Finland by about 14 % points, and last but not least some of the new MS (e.g. Bulgaria by about 25% points, Slovakia by about 18% points, and Latvia by about 17 % points).

Comparing the employment rates of people in age 60 to 64 with the new full-employment target reveals large differences between MS. Women in this age scale, in particular, are far away from this target, even in the Nordic countries and in the Netherlands, with noticeable exceptions in Finland, Estonia and France where elderly women and men are on equal terms. Sweden is the only country that comes near this target; Denmark and Germany (slightly better) are almost at an equal level in employment participation of elderly men and women (Figure 6).

Figure 6: Employment rates in Europe, 2010 total population (20-64), elder men (60-64) and elder women (60-64)



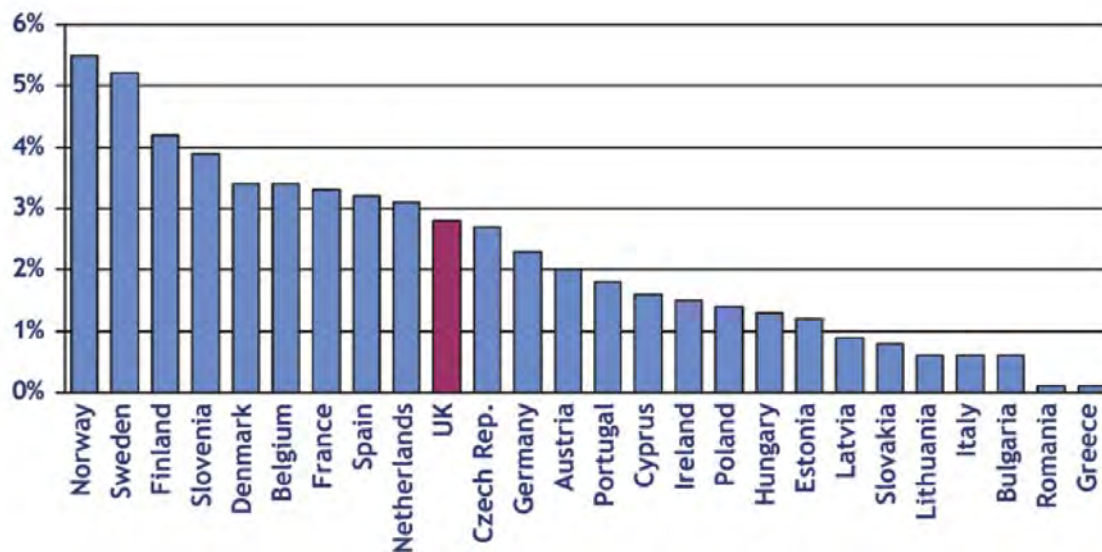
Annual averages 2010; Source: European Labour Force Survey Database lfsa\_ergan, download 20.04.2011

It is evident that varieties in pension schemes and in labour markets situations account for these large scale country differences. Both factors have been subject of extensive research, summarised among others by the OECD (2006). Little attention, however, has been given to the spreading risk of reduced work capacities that often comes with ageing. The absence rate due to sickness can be taken as indicator of this risk, and as Figure 7 shows, this indicator seems to correlate somehow with labour force participation, the Nordic countries having the highest incidence.

All these (partly new) life course risks (skill deficits and income volatility for various reasons) must be considered against the background of eroding internal labour markets. From the perspective of risk management, the backbone of internal labour markets has been an implicit insurance contract: Employers were offering the male breadwinner a family wage, job security and earnings stability over the life course in exchange for the acceptance of wages below the productivity level at the peak of the work career. This implicit insurance contract is breaking down without a clear alternative in sight.



Figure 7: *Sickness absence rates in the EU*



Source: Baumberg (2011: 3), [www.employment-studies.co.uk](http://www.employment-studies.co.uk); <http://www.employment-studies.co.uk/news/empstudies13.pdf>

Two alternatives are in the debate or practiced: Either extending private insurance elements like individual savings accounts and privately funded retirements schemes, or including the new risks into universal social insurance, in particular by extending already existing or establishing new employment insurance elements.

In the next section, I will argue for the second alternative, yet with some qualification allowing greater individual autonomy. Employment cannot anymore be treated as binary phenomenon, which means that somebody is full-time employed or unemployed, employed or retired. The employment relationship becomes fluid so that “people need to be able to carry their welfare state on their back like a snail shell” (Barr 2001, 149).

### 3. Risk sharing capacities of social versus private insurance

Let me start with a strong statement by Nicholas Barr as well: “Unemployment compensation is publicly organized in all advanced industrial countries, because unemployment is a risk which the private market is unable to provide systematic protection. Foreseeable twenty-first century developments do nothing to change this conclusion” (Barr 2001, 49). The immediate objection can easily be refuted: Even the Danish system – often labelled as private unemployment insurance according to the Ghent system – is publicly organized in essential points, especially in terms of financing (Andersen 2011). Why is this so? The following briefly reminds of the differences between private and social insurance.<sup>12</sup>

<sup>12</sup> Apart from Barr (2001), I also recommend for this part Atkinson (1991), Diamond (1999), and Sinn (1996). As the reader will notice, the implementation aspect of private versus social insurance is not discussed in this section. For an informative conceptual as well as empirical background see Sol/ Westerveld (2005), Schmid (2008, chapter 7 “New forms of governance in labour market policy: Are there any limits to privatisation?”, 242-280); particularly related to Denmark see Bredgaard/ Larsen (2008) and Bredgaard 2011.

First, unemployment cannot be insured privately because this risk is correlated, even infectious like a flu. Because of uncertainty, the risk of unemployment has no reliable probability distribution over the life course; no private insurance can guarantee liquidity high enough to compensate for the losses of mass unemployment due to fiscal crashes. Second, unemployment risks are unequally distributed, and this inequality cannot be treated in actuarial terms for reasons of justice as solidarity. A social market economy cannot allow that good risks opt out of insurance and that bad risks (often related to low income and low education) have to pay deterrent high premiums. Finally, unemployment is not a single item risk but a risk affecting individual life existence: Being able to earn one's own living (under normal and healthy circumstances) is an essential element of human dignity.

To sum up: Private insurance is based on private law and individual property rights and can therefore only insure uncorrelated single item risks governed by actuarial principles. Social insurance is based on collective law and human rights and has therefore to ensure equality (freedom from want) and equal opportunity (freedom to act) independent from the individual ability to insure against the risk.

Whereas these arguments in favour of social insurance are widely acknowledged, some behavioural traits speaking for social insurance are less well known. But the new behavioural economics has rediscovered the "animal spirit" governing our behaviour which was already self-evident for instance in Adam Smith "Moral Sentiments" as well as in John Maynard Keynes "General Theory of Employment".<sup>13</sup>

We often fall into cognitive traps by misleading heuristics or by overestimating the most recent information or experience. We are not always as self-disciplined as rational choice assumes. We often are inclined to procrastination and to postpone important decisions or actions to the next morning *ad ultimum*.

In interaction we do not always behave strategically rational as game theory recommends us to do, but we are often guided by emotional rationality, for instance by feelings of reciprocal fairness. If we feel treated unfair, we may not remain cool but burst out into anger. There is the anecdote about two game theorists who learned the lesson of reciprocal fairness when attending a conference in Jerusalem:

*Arriving at the airport in Tel Aviv, they took a taxi. But they did not ask for the price because they knew, they are strategically in a better position after the taxi driver had already provided his service. As they arrived at the conference location, they started to bargain but made two mistakes: They bargained in the car, not outside, and they shamelessly made low offers. This made the taxi driver so angry that he returned and drove them back to the airport.*

We also perceive risks asymmetrically. Our loss aversion is greater than our risk taking for chances because we value one bird in the hand more than two pigeons on the roof. We are myopic related to high risks with low probability, but we are far-sighted related to low risks with high probability. In

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<sup>13</sup> For a comprehensive exposition of the psychological foundations of new behavioural economics see the most recent book by Nobel laureate in economics Daniel Kahneman (2011).



other words, we are more inclined to buy a travel insurance than to buy an insurance against work disability.

Finally, and most important, we do not always maximize economic utility, for instance through opportunistically exploiting or even cheating the insurance agency, the so-called “moral hazard”. We rather tend to maximize social reward and see, for instance, insurance as an opportunity to take new risks since we know that we will not fall into misery when we fail but are covered by the insurance; this is what I call “innovative hazard” to which I will come back later.

The conclusion is clear: For behavioural reasons, we would tend to overinsurance of low risks but to underinsurance of high risks if we would solely rely on private insurance. What is the solution?

My suggestion is: Mind Bernoulli's Beggar! What is the story of this beggar? It is a widely neglected side remark in Bernoulli's St. Petersburg Paradox published in 1738.<sup>14</sup> As St. Petersburg must have been boring at that time, Bernoulli frequented the casino and observed that people do not bet much money even on games that theoretically promise unlimited gains. In his solution, he anticipated the theory of marginal utility: Reasonable people have no interest in unlimited gains if at the losing end of the game life essentials are at stake. Bernoulli gave a telling example:

*“For the great majority the most valuable portion of their possessions [...] will consist in their productive capacity, this term being taken to include even the beggar's talent [...] The proposition is all the more valid for the majority of men who possess no fortune apart from their working capacity which is their only source of livelihood ” (Bernoulli 1954).*

So, a beggar will not give up begging for a workfare job since he would lose his “productive capacity” to beg. He has to be offered something more. What is this “more”? It is (to make it short), first, the capacity of decent work, which means the confidence in one's own ability to earn one's own livelihood; second, the reliance on non-degrading solidarity, which means unconditional help in case of need!

Unemployment insurance and active labour market policy are venerable institutions to provide both. However, in behavioural terms insurance is always related to moral hazard. People might exploit solidarity or even become addicted to solidaric help. The ordinary and mean solution to solve this kind of moral hazard is nicely reflected in the Swabian version of how to treat beggars:

*One day, a beggar knocked at the door of a preacher's wife. As she opened the door, he said: “I am hungry. I could not eat for three days.” After a sharp look at him, the Swabian wife responded: “You can eat if only you force yourself!”, and shut the door.*

Yet there is another side of behavioural risk, and this side has been largely neglected. As a safety net, the function of insurance is also to provide incentives to take reasonable and calculated risks, for instance the risk of making voluntarily a transition from one job to another, from one occupation to another or to invest in training and education for which the returns are uncertain. This incentive function of insurance is a core element of TLM-theory, and the reason to talk of “innovative hazard” as the counterpart to the negatively loaded “moral hazard”.

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<sup>14</sup> Even Daniel Kahneman seems to have overlooked this remark as his (otherwise correct) critic of Bernoulli's utility theory shows (Kahneman 2011: 275-7).

So, the slogan “Mind Bernoulli’s Beggar” and the reminder of the Swabian beggar means that both sides of behavioural risks have to be balanced: By discouraging the exploitation *of* insurance or the dependency *on* transfers through ‘tough love’, and by encouraging risk taking through capacity building. Tough love means making transfers conditional on accepting reasonable job offers; capacity building means increasing employability through making workers fit for the market and the market fit for the workers.

The question now is: How can employment policy support such a strategy? Let me summarize the answer in the following way. As a general strategy, the TLM-concept suggests extending the expectation horizon both for workers and employers. This idea goes back to the political theory of Niklas Luhmann (1990) who assigns to the political system the function of ‘*binding decisions*’.

The central element of binding decisions is not to impose a specific behaviour on its citizens. The thrust of binding decisions is to set in motion a cognitive process, in other words learning through commonly agreed objectives and values, which still have to be specified and operationalised through communication and negotiation, in other words, through a constant process of trial and error.

The concept of TLM recommends four elements of such a strategy: The first element is to establish a *general labour force membership status* through universal social rights and duties that include all kinds of work, paid and unpaid. The second element is to induce a *career orientation* over the life course through *making transitions pay* and insuring life course risks beyond the risk of unemployment. The consequence of such a perspective is to extend unemployment insurance to a system of employment insurance. The third element is to overcome inequalities and risk aversion through *capacity building*, for instance through stepping stones, reasonable adjustment of workplaces, and active securities like drawing rights for investing in human capital; in other words: making workers fit for the market, *and* making the market fit for workers. It is under this perspective that unemployment benefits are an active and not a passive security. The fourth element is to *transform danger into trust* through negotiated flexicurity, in particular through establishing learning communities.

These principles of sharing transitions risks shall now be demonstrated with two major risks over the life course: First (section 4), the risk of income volatility due to working time transitions; second (section 5) the risk of income volatility due to skill transitions.

#### **4. Sharing risks of working time transitions through short-time work allowance**

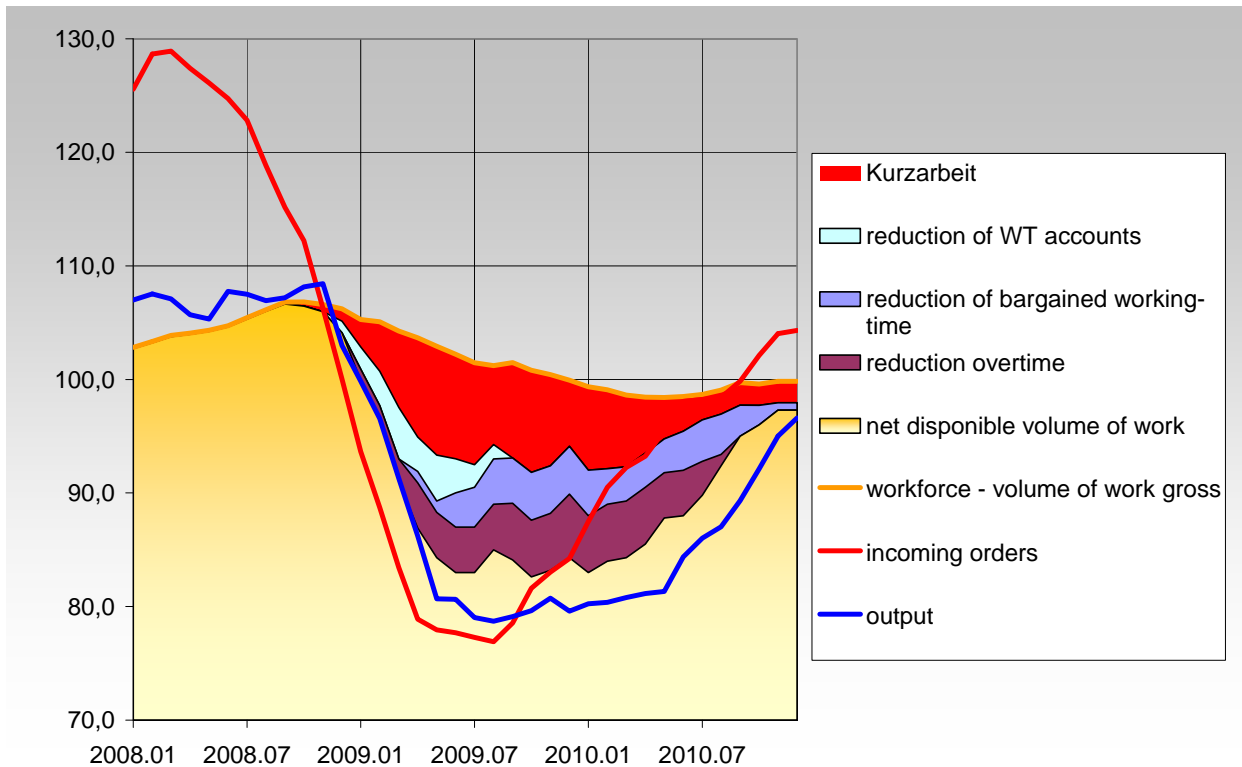
In Germany, short-time work (or ‘*Kurzarbeit*’) has a long tradition. It goes back to more than 100 years. Today, there are three different types of short-time work allowance: the major role plays *cyclical short-time work* to maintain employment in cyclical troughs; *seasonal short-time work* helps especially construction workers to overcome income risks during bad weather and cold winters; *structural short-time work* helps companies in restructuring to prepare redundant workers finding a new job.

It is important to note that workers have a right to short-time work. Even works councils are entitled to apply for short-time work at the public employment service. The cut of income due to the

reduced working time is compensated like unemployment benefits ('short-time work allowance') often topped up by collective agreements.

On average, 1.2 million workers went on short-time work in 2009 and reduced their working time by about one third, preventing thereby a drastic jump in unemployment. Yet other instruments of internal flexibility were also used as the following figure related to the German mechanical engineering industry demonstrates (Figure 8).<sup>15</sup>

Figure 8: Internal Flexibility in the German Mechanical Engineering



Source: Jörg Hofmann, IG-Metall Baden-Württemberg

Incoming orders in this sector (the red line starting left at the top) fell by almost 50 percent and output (the blue line) by about 30 percent within less than one year. Both recovered within one year but remained at a slightly lower level. The workforce however, the dark and almost horizontal yellow line, dropped only by about 3 percent. The bulk of adjustment was managed by working time flexibility. However, short-time was only one element; it reduced the overall working time volume by 8%. Other elements were the return to the regular 35 hours week (-1.4%), the reduction of overtime (-5.6%), the melting down of working time accounts (-5%), and the reduction of working time by utilising collectively bargained working-time corridors (-2.8%). Altogether, the volume of working time fell by 20.8 percent, and rose again to almost the pre-crisis level at the end of 2010 when only a few short-time workers were left.

<sup>15</sup> For a detailed analysis of the German response to the last fiscal and economic crisis see Möller (2010); for the application of short-time work in a European comparative perspective see Eurofound (2010).

Yet, before we praise this as a ‘German job miracle’, we have to be careful in assessing the balance of this kind of risk sharing. For the workers the advantages are quite clear: Their wages are insured by 80 to 90 percent, since collective agreements top up the regular wage replacement of 60 or 67 percent. In addition, of course, short-time workers maintain their jobs, their qualifications and their social networks. Problematic are the low incentives for activation and mobility, and current regulations do not entitle short-time workers to qualification. For employers the most immediate advantage is the maintenance not only of skilled workers, but also of workers who are loyal and cooperative; the opportunity costs of recruiting for instance high skilled craft workers or engineers are estimated up to Euro 32,000.

Short-time work allows a much quicker reaction to demand fluctuations than dismissals because dissolving employment contracts needs more time and implies higher transaction costs than just reducing working time by maintaining the employment contract. Short-time work offers employers also the opportunity of strategic waiting in face of uncertainty, which means ‘workforce liquidity’: Nobody knows at the beginning how big the drop in demand will be and how long this will take. Short-time work is a reversible instrument, dismissals are not.

Short-time work also provides for employers the opportunity to adjust work organisation precisely according to the specific tasks to be reduced or expanded. The government increased this flexibility by relaxing conditions which allowed especially small firms (for instance logistic enterprises and suppliers of large firms) to use the scheme to a larger extent than in former times.

Problematic for employers are the remaining fix-costs per short-time worker between 24 and 46 percent depending on the size of government subsidies; for the society, however, these remaining fixed-costs are an effective incentive not to misuse the system. Problematic are also the low incentives for employers to activation, which means to improve the long-term employability of their workers; they even do not have the right to instructions of workers in the phase of short-time work.

For the society or the state, the first evident advantage is avoidance of open unemployment. The German short-time working scheme together with other working time adjustments prevented open unemployment by about 1.4 million workers. This is not just manipulating statistics. This form of job security, first, maintains high purchasing power in times of otherwise falling demand, and second avoids ‘Angst’, which means panic reactions of workers, for example unreasonable saving that might reduce effective demand leading to a vicious circle.

For the government and the public employment service as insurance principals, short-time work offers a lot of discretion to fine tune the scheme as the situation develops. The government used this discretion by extending short-time work up to two years, giving the employers a comfortable planning horizon; and the public employment services gave employers much freedom in implementing the scheme. It could do so because both, the managers of private companies and public employment agencies, had developed not only experiences with this instrument over a long time but also mutual trust relationships.

The problematic features, however, are not just minor. Each scheme of job protection, of course, weakens the situation of ‘outsiders’ and may slow down structural change that might be necessary in the long-term. Also the costs of such schemes are not minor. The risk sharing community of all workers, for example, spent about five billion Euros for the minority of short-time workers, and high social contributions are always hidden costs of production. Finally, the government

complemented this risk sharing community by subsidising social security contributions and a by large stimulus package through a so-called wreck-bonus. If you had a nine year old car, you could deposit your car in a wrecker's-yard and take home a new car subsidised by 2,500 Euro. This cost the society another five billion Euros and contributed, of course, to high public debts.

So, short-time work as an instrument of employment insurance has clear disadvantages compared to external flexibility covered by unemployment insurance. State subsidies may shift the costs to tax payers or to marginal workers; job security may maintain non-competitive industrial structures and lead to jobless growth or new job creation only in non-standard form, especially temp-agency work. Finally, it has to be mentioned that by implementing short-time work, Germany failed in at least two respects from a TLM point of view: the incentives for training during short-time work were too low; and a corresponding flexible training infrastructure is still missing.

All in all, however, the balance is positive. Yet there is a clear need of complementing this important element of employment insurance by a kind of life-long-learning insurance. Explaining the main reasons and the main features of such insurance will be the final task of this essay.

## 5. Sharing risks related to skill transitions

Why should the state, as the social insurance principal, get involved into the game of sharing skills related transition risks? The first reason is savings restrictions. Numerous studies have shown that workers with the greatest need for continuing education and training are especially the ones who will not be able to save enough for substantial investments. Yet only social insurance entitles you to cash in your insurance largely independent of how much you have already saved or contributed.<sup>16</sup>

Largely neglected are comparable restrictions at the demand side: Many enterprises, especially small and medium sized firms working at the profit margin will not save for investments into the employability of their workers or work organizations. Under competitive pressure, they will take rescue to cost-cutting measures, which means to price competition instead of quality competition needed in a globalising world.

The second reason is capital market restrictions, again on both sides of the labour market. The market does not loan to those who most need credit for continuing education and training. Unlike for instance to housing loans, education or training loans have no collateral for the bank to sell if the loan recipient defaults on repayment. The same holds true for enterprises with weak capital endowments. Studies show that non-participation of enterprises in life-long-learning of their employees is strongly related to the lack of targeted budgets for training and to the lack of professionals devoted to personal development.

A third reason is poaching or free-riding related to the well know theorem of prisoners' dilemma: It may be rational for both sides not to cooperate. Firms investing into their employees might not ripe their returns because other firms are poaching their skilled work force, and workers might opportunistically run away to the competing firm offering higher wages. Of course, clauses in the

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<sup>16</sup> This section draws in part on Acemoglu/ Pischke (1998), Chapman/ Ryan (2005), and Diamond (1999).

employment contract might control for poaching or free riding. However, such clauses might involve high transaction costs leading to an underinvestment into life-course employability.

Fourth, this tendency will be enforced by mobility restrictions related to internal labour markets. From institutional theory we know that internal labour markets provide for workers a kind of wage insurance, especially through seniority wages, and for employers a kind of loyalty insurance. In the future world of work characterised more and more by network labour markets, this rationale for implicit insurance, however, is weakening. Furthermore, firm specific and sector specific investments in life-long learning restrict unduly job-to-job transitions between firms and sectors. This does not mean that the rationale for internal labour markets disappears completely as my remarks to short-time work made clear, but it has to be enhanced by internal transition capacities through life-long-learning.

Yet there are further behavioural reasons that call for a universal life-long-learning insurance, however to be implemented in the form of negotiated flexicurity. The first reason is uncertainty of returns for workers. As mentioned above, our cognitive map values what we have already much higher than what we might expect from risky investments. This endowment effect is more relevant for low skilled and low income earners than for high skilled.

The resulting risk aversion can only be overcome by extending the expectation horizon through conditional job security or through employment security; legal rights to life-long-learning and possibly legally guaranteed minimum levels of education, would also provide for an extension of the expectation horizon; finally certification of acquired new skills belong to this solution which, ideally, would have to be put into the context of learning modules leading to a promising career perspective.

At the other side of the coin, employers having to make the decision to invest into their low skilled workers face the high risk that the returns of their investments might be zero or small due to low learning capacities. Only higher education levels signal them higher learning capacities (both in terms of cognitive abilities as well as in terms of learning motivation). This is the rationale for the consistent empirical findings that life-long-learning strongly correlates with education levels: The participation rate of high skilled is on average 40 percentage points higher than for low skilled across OECD countries.<sup>17</sup>

This risk aversion of employers can only be overcome by co-financing investments into low-educated workers by providing a corresponding training infrastructure that ensures positive returns for these target groups and by a universal obligation of employers to contribute into a training fund targeted to unemployed or low skilled people.

Finally, there are information uncertainties for both: labour supply and labour demand. Research shows consistently, that workers are often faced with complete intransparency of the training market, and that employers do not know in what kind of skills they should invest. More important: These uncertainties beget another uncertainty: The players of the life-long-learning game – workers, employers and the state as the representative of externalities – do not know beforehand where gains

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<sup>17</sup> See Chart A5.2 of the OECD report “Education at a Glance” (2011). The overall participation rate of high skilled varies between 20% in Hungary and 90% in Sweden; for low skilled between 2% in Hungary and 55% in Sweden.

are going to accrue and where losses must be incurred. This observation holds true at micro- and macro-levels alike. The veil of ignorance, the insurance situation, is a given.

The solution of these information uncertainties can only be in learning by monitoring through establishing learning communities at the local or regional level, in which all relevant actors – schools, training institutions, employers, and social partners – get involved. This involvement, however, needs to be organised in a form that makes actors committed and responsible.<sup>18</sup>

Covenants are an established form of negotiated flexicurity, well known under this term in the Netherlands. Best practice in continuing education and training is not common knowledge yet, but it probably already exists, de facto for instance in Denmark (Lassen et al. 2006), and it may be the secret of successful local or regional labour market pacts or local strategic partnerships (Burroni et al. 2010). It is also likely to evolve, for the urgency of this overarching common goal at all levels of governance is pressing, not least in relation to the Flagship initiative ‘*New skills and jobs*’ of the new European Employment Strategy in the frame of EU-2020 (European Commission 2010).

Covenants are written agreements between two or more partners to reach a common goal through procedural security considered as fair by all involved parties. In many cases, the state is involved as an initiating and co-signing partner. Unlike private or public contracts, covenants are voluntary and require no legal framework. Partners thus retain an exit option if the risk-taking appears excessive. On the other hand, such agreements must also contain voice options to solve problems step by step as they arise. Because the balance of costs and benefits might change at each step, the partners involved in the game must trust into the possibility that corrective measures are taken in pursuit of the common goal through a fair process of re-negotiations.

## Concluding Remarks

Summing up and setting these reflections into the TLM framework at the beginning, learning by monitoring means that security is in trust and flexibility is in learning, and both come together through negotiation under fair procedures ensured by law. Learning by monitoring, for example through covenants, is a strategy of policy sequencing. Instead of planning we get exploring, and uncertainty is managed stepwise through renegotiation as new information arises concerning the distribution of costs and benefits.

TLM do not emphasize risks we want to avoid but risks we want to take, for instance when moving from one job to the next, from one employer to the next, from one combination of activities in work, care and education to the next, and so forth. Here the counterpart of risk is not danger but trust. We do not want to insure only for accidents, ill-health, unavoidable old age or other undesired mishaps; we want to insure for moves we want to make during the life course.

And as we make such moves in the expectation that they conform to the common goal of more flexibility and security in employment, especially through life-long-learning, we want to be able to cash in on our insurance when these expectations are disappointed. A system of LLL-insurance would transform risks from external attribution, which means events that we undergo, to internal

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<sup>18</sup> For a theoretical development of “learning communities” see Korver/ Oeij (2008), Korver/ Schmid (2012), and Schmid (2011, pp. 105-112).

attributions, which means events we bring about (Korver/ Oeij 2008: 162). Its basic elements would be ex ante redistribution through establishing collective funds and high universal educational standard; and, last but not least, negotiated flexicurity that allows flexible implementation of such funds embedded into the security of fair procedures.

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