POLICY PAPER SERIES

IZA Policy Paper No. 82

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May 2014

Forschungsinstitut
zur Zukunft der Arbeit
Institute for the Study
of Labor

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Policy Paper No. 82
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ABSTRACT

Inclusive Growth: What Future for the European Social Model?[1]

This essay starts, after a short introduction on the importance and dimensions of “inclusive growth”, with a brief empirical sketch on to what extent Europe has already succeeded with respect to this ambitious goal. The result is quite sobering and gives rise to the question: why is it so? The main part of this paper is devoted to answering this question by presenting a model based on the trade-off between comparable productive capacity (CPC) and flexibility. After the introduction of the monetary union, this trade-off sharpened for many EU member states whose CPC now falls below the fair level playing field. To compensate for the lack of comparable productive capacities, flexibility measures would be necessary (e.g. downward wage flexibility, regional mobility and cuts in social expenditures) to an extent which is unrealistic or would erode social cohesion and democracy. As alternative, the possible future role of the European Social Model could consist of the implementation of four strategies: First, *investive social transfers*, in particular by establishing a European Fund for Employment and Income Security (EIS) to strengthen the inclusive function and stabilisation impact of national unemployment insurance systems; second, *protected flexibility*, in particular the promotion of an internal functional flexibility through work sharing; third, *investing in people*, in particular by strengthening dual learning systems and by inducing mobility chains (making transitions pay); and fourth, *efficient labour market regulation* for better utilising existing capacities and restraining inefficient forms of flexibility. Examples for each strategy are presented to illustrate and stimulate the debate.

JEL Classification: E24, I31, J65, J83, O43, P16

Keywords: Europe, social policy, labour market policy, growth, inclusion, unemployment insurance

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[1] This essay results from a contribution to the EEOP thematic seminar on modernization of the EU Social Model in Brussels on March 13, 2014. Many thanks go to the participants of this seminar, in particular to Miriam Hartlapp, Martin Kronauer, Wolfgang Schroeder and Wayne Vroman for helpful comments on previous versions.

Inclusive Growth:
What Future for the European Social Model?

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Introduction

What future for the European social model? Nobody knows. There are even good arguments against this question. *Empirically*, for instance, the existence of a "European Social Model" is hard to prove; at most some common guidelines can be asserted (Kaelble & Schmid 2004). Since the publication of "The three worlds of welfare capitalism" (Esping-Andersen 1990) at the latest, the deep lenses of academic research detected different fundaments of 'Social Europe': a liberal (market oriented), a social-democratic (Nordic) and a conservative (continental) Europe; but already the Mediterranean and the Eastern European worlds hardly fit into these categories (Saraceno 2004, Tomka 2004). In recent studies, however, at least one convergence is coming more and more under the spotlight, albeit in a negative sense: the emergence of a dual welfare regime with social protection for the core workforce at the cost of a growing number of atypical or precarious workers (e.g. Palier 2010, Schmid 2011b).

In contrast to this view, the wide and open lenses – in particular from the transatlantic side – tend to detect a unified "Social Europe", however, in a quite different 'Gestalt', either as a positive or negative caricature. The positive view conjures "The United States of Europe" pictured as a model able to reconcile freedom, social justice (equity) and economic efficiency all at the same time (e.g. Reid 2004). The American trend researcher Jeremy Rifkin, always a decade ahead of the media's buzz (e.g. "The end of work" in the Nineties) described 10 years ago the "European Dream" and how Europe's vision of the future is quietly eclipsing the "American Dream": "In many respects, the European Dream is the mirror opposite of the American Dream […] The American Dream puts an emphasis on economic growth, personal wealth, and independence. The new European Dream focuses more on sustainable development, quality of life, and interdependence" (Rifkin 2004, 13–14).

More widespread, however, is the negative view, namely the caricature of "Old Europe" as a 'sclerotic' society with excessive taxes, over-generous social benefits and high employment protection. "The 'social model'," writes the Nobel prize laureate James M. Buchanan, "that many Europeans hold up as superior to the somewhat more limited welfare states elsewhere is not economically viable for the 21st century." And he goes on to say that "an extensive universal or general welfare state is incompatible with democracy for two reasons: First, the 'natural logic' of majority rule implies differential or discriminatory treatment of those persons and groups that are in the minority. Second, fiscal transfer entitlements exceed the period of the majority rule they are usually not reversible, thus: a ratchet effect is occurring – the fiscal crisis is implanted" (Buchanan 1998, 14–5). Even most recent studies, e.g. researchers of the World Bank, find the key impediments of full employment in Europe in "unprecedented job security, generous benefits for the unemployed and easy pension eligibility" (Gill et al. 2013).

Even from a *normative* point of view serious reservations are expressed against striving for a "European Social Model", independent of its nature. Every aspiration or intention towards a political unity of Europe, wrote the eminent German sociologist Ralf Dahrendorf, has the consequence of excluding other nations or regimes. This would contradict Immanuel Kant's idea of a universal world citizenship. One should not strive for a Europe as a peaceful welfare paradise, but for a Europe as model for a political order that might generally hold for the whole world. The "European Categorical Imperative", therefore, should read: "Act as if the maxim of all your activities were to become a maxim of the universal order" (Dahrendorf 2005, 14).

It is, however, difficult to see why a European Social Model should contradict this imperative if – as the main title of this essay suggests – inclusive growth were linked to this idea. Inclusion has a high value. Although the term has no precise meaning in everyday life, its ethical canon comes near the categorical imperative of Kant. In the current German debate, the term is closely connected with the objective of including disabled people in a way that they can participate in all aspects of daily life, in particular the inclusion of disabled children into the regular school system instead of putting them into separate special schools.

In modern social sciences, especially in sociology, the term "inclusion" is more broadly conceptualised and always defined with its opposite twin "exclusion". Most definitions refer to Niklas Luhmann's functional system theory: *"Inclusion is to be understood as a form whose inner side (inclusion) is marked as the opportunity for the social consideration of persons and whose outer side is unmarked. There is therefore inclusion only if exclusion is possible. It is only the existence of nonintegrable persons or groups that renders social cohesion visible and makes it possible to specify conditions for it."* This outer side is to be understood as the lack of opportunity to participate in the key subsystems of society such as the economic, political, education, legal system and family with their communication media of money, power, knowledge, justice and love. *"It means […] that the societal system provides for persons and assigns them to positions in the framework of which they can act in keeping expectations; to put it somewhat romantically, where they can feel at home as individuals."* With universal functional differentiation, *"society no longer offered people any social status that also defined what the individual 'was' in terms of origin and quality. It made inclusion dependent on highly differentiated communication opportunities, which could no longer be coordinated reliably and, above all, permanently. In principle, everyone ought to have legal capacity and an adequate income in order to take part in economic life."*

The idealising postulate of full inclusion of all human beings in society potentially means a high degree of freedom; but it is also connected with high risks possibly leading to a negative integration of society: *"For factual exclusion from a functional system – no work, no income, no papers, no stable intimate relationships, no access to contracts and to the legal protection of the courts, no possibility of distinguishing between electoral campaigns and carnival events, illiteracy, inadequate medical care and food supplies – limits what can be achieved on other systems and defines larger or smaller sections of the population, who are often set apart residentially and hence kept out of sight."* Luhmann, recalling his shocking experiences of the Brazilian favela, even talks of the "totalitarian logic" of inclusion (Luhmann 2013).[2]

From this follows not only the maxim of inclusion for politics but also – and this is of the utmost importance – the maxim of social risk provision, which means to provide for institutional arrangements to prevent the challenging exclusion drift of increasing parts or populations, or at least to mitigate or to insure this risk.[3] To give one example: One cannot include disabled children at regular schools without enabling institutional, personal and financial provisions so they can equally participate in the gaining of knowledge. If these conditions are not fulfilled, then the worst case scenario might well be that the integrated class, which replaces the *inclusionary exclusion* of special schools (for disabled), becomes a place of *exclusionary inclusion*, which creates even larger gaps in accumulated knowledge than would have been the case in the segmented system prior to the United Nations convention on the rights of persons with disabilities (Stichweh 2013).[4]

Another example is more closely related to our topic: One cannot include adults with small children – traditionally related mainly to women – into the labour market without caring for institutional, personal and financial arrangements that compensate for their restricted income capacities. Otherwise, these people clearly face disadvantages in the competition for attractive jobs, or they will be excluded from certain jobs altogether. Comprehensive inclusion into the labour market, therefore, cannot only mean to make people fit for the market, but it must also mean to make the market fit for workers, for example, through re-entrance support or working time flexibility and transition opportunities between part-time and full-time, or – in the case of disabled people – workplace adjustment to their specific impairments (Gazier 2003; Auer & Gazier 2006, 183; Schmid 2011a, 152; Schmid 2013).

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[2] The quotations are from the electronic version. In the German original, the quoted passages can be found in Luhmann (1996, Vol. 2, pp. 620–1; 630–1).
[3] For strategies of social risk management, including supplementary literature, see Schmid (2008, 165–212, 281–328); Schmid (2013).
[4] Two evident examples (of many more) would be to endow regular schools with more guides and sign language interpreters as well as with computers and papers in Braille than they had (if any) before. The full text of this convention, adopted in 2008, can be downloaded at www.un.org/disabilities/.

In the following, the specific rationale for "inclusive growth" in a "European Society", if – as presupposed here – politically desired, can only briefly be sketched; the sobering empirical side as to what extent "Social Europe" comes near these principles can only be scraped, too; the emphasis lies in the presentation of a model that allows us to derive possible perspectives for a modernised EU Social Model and to illustrate them by some examples.

Fundamentals of 'Inclusive Growth'

From the *normative* point of view, the leading heads of social philosophy and justice theory – John Rawls (1971), Richard Dworkin (2000) and Amartya Sen (2009) – largely agree that economic inequality is only justified if it improves the lot of the poorest, in other words: if it enhances social inclusion. In their opinion, there is even a right to a comparable endowment of resource capacity in order to lead a self-determined, autonomous life.[5] In the recent debate, Jürgen Habermas (2013, 100ff) complemented these reflections with a stimulating case for a "European solidarity" that goes beyond moral or legal obligations. However, strictly speaking, this call no longer corresponds to Kant's categorical imperative with its deontological foundation. Solidarity as a universal ethical principle cannot be "European"; one can only appeal to the Europeans to apply this maxim in a political union of Europe whatever it looks like ('United States', 'Federal State', 'Federation', 'Union').[6]

Empirically, several relevant proofs have recently been presented – e.g. by the British social researchers Richard Wilkinson and Kate Pickett (2009) or the American economists Daron Acemoglu and James Robinson (2012) – that *inclusive institutions* enhance both equity and economic efficiency, in other words, there is not necessarily a "big trade-off" (Okun 1975) between both objectives as mainstream economists maintain. In their historically grounded and globally comprehensive study, Acemoglu and Robinson define the requirements for *inclusive economic institutions*: secure private property, an unbiased system of law, and a provision of public services and (added by myself) collective interest representation that provide a level playing field in which people can exchange and contract; they must also permit the entry of new businesses and allow people to freely choose their career. The two most important requirements for *inclusive political institutions* are plurality in opinion formation and allocating people to political offices plus sufficiently centralised and powerful states, i.e. according to Max Weber 'monopoly of legitimate violence'. They refer to *extractive economic* or

[5] See for an extensive discussion, with supplementary references, Schmid (2008, 224–231), and Kronauer & Schmid (2011).
[6] Even John Rawls, despite his Kantian-sounding rhetoric, regards justice as an abstract moral social ideal whose requirements must sometimes be compromised for the sake of other conditionally equal or occasionally mitigating moral and social ideals, and argues in fact for pure procedural justice as Dale Jacquette persuasively proves (Jacquette 2004, 481f).

extractive political institutions when either of these conditions fails, and they clearly demonstrate positive synergies between inclusive economic and political institutions (virtuous circles) and negative synergies between extractive economic and political institutions (vicious circles).

Politically, in March 2010 the European Council declared the new European Employment Strategy (EU-2020) with three overriding objectives: smart, sustainable and *inclusive growth* for the promotion of social and territorial cohesion. All EU-member states shall, among others, strive for an the employment rate of 75 percent for people aged 20 to 64 by 2020; for a school drop-out rate of less than 10 percent; for a rate of at least 40 percent with a (tertiary) academic degree (or equivalent) related to the 30 to 34 age cohort. Last, but not least – and this goes clearly to the heart of the inclusion goal – 20 million people shall not be any more under the risk of poverty (European Commission 2010). The reduction of poverty risk – and this is often neglected in the public debate – is targeted in three dimensions: First, to the *income poverty risk*, i.e. the risk of earning less than 60 percent of the median; second, the *risk of severe material deprivation*, i.e. the inability to afford some items necessary to lead an adequate life; third the '*autonomy risk*' (my formulation), i.e. the risk of people aged 0 to 54 living in a household of low employment intensity (Frazer et al. 2010; for the respective operative definitions see European Commission 2012b, 469).

These are ambitious goals. In practice, however, the development went in another direction as shall be shown in the next section.

Inclusive Growth: Where do we stand?

Tables 1 and 2 display some indicators of inclusive growth that bring high expectations down to earth. In the collection of data I restricted myself to comparing the 17 Eurozone countries with the total of 28 (sometimes 27) EU-member states (MS), and to confronting the strong and weak cases of Germany and Greece at two points of time: 2005/06 and 2012.[7]

GDP per capita shows a solid growth, yet a quite unequal development. Measured in purchasing power parity, the increase was higher in the Non-Euro areas indicated by the higher delta of the whole EU (here EU27) compared to the Eurozone (EU17). Within the Eurozone, the inequality in the economic dynamics could not be more drastic than between Germany (plus 14.2) and Greece (minus 12.5).

Related to the inclusion concept, however, one should keep in mind that GDP per capita is not a true measure of the standard of living in an economy. It is a meas-

[7] Unfortunately, I was not able to get recent comparative information on indicators for the inclusion of persons with a disability into the labour market. Eurostat or the European Commission doesn't provide any systematic data on this issue, for example, employment or unemployment rates for people with disabilities – a gap which needs to be filled.

ure of total national economic activity, and as such is not ideally suited to describing developments in the material welfare situation of households. The long-term trend of declining labour shares of income and therefore workers' reduced share from benefits of growth, for instance, has not been reversed recently. Changes in GDP and in household disposable income can even move in opposite directions and vary in magnitude from year to year. The Commission therefore followed in particular the advice given by Tony Atkinson (2013) to look at the *equivalised median disposable household income* which better captures *inclusive* growth by taking into account distributional issues, particularly for the poorest parts of society (European Commission 2014).

Table 1: Indicators of 'inclusive growth'

Indicator	Country	2005/06	2012	Delta % or % Points
GDP / Capita (Euro, PPP)	EU17	25,787	27,548	6.8 %
	EU27	23,691	25,578	8.0
	Germany	27,314	31,195	14.2
	Greece	21,793	19,058	- 12.5
Employment Rate (20-64)	EU17	67.9	68.0	0.1 % Points
	EU28	67.9	68.4	0.5
	Germany	69.4	76.7	7.3
	Greece	64.6	55.3	- 9.3
Unemployment Rate (15-64)	EU17	9.2	11.4	2.2 % Points
	EU28	9.1	10.5	1.4
	Germany	11.3	5.5	- 5.8
	Greece	≈ 9.9	≈ 24.2	14.3
Youth Unemployment Rate (15-24)	EU17	18.3	23.1	4.8 % Points
	EU28	18.9	23.0	4.1
	Germany	15.6	8.1	- 7.5
	Greece	≈ 15.0	≈ 55.0	≈ 40.0

Sources and definitions:
- Gross Domestic Product per capita 2006 and 2012 in purchasing power parity (PPP) according to Austrian National Bank, http://www.oenb.at/isaweb/report.do?lang=DE&report=10.9; download 7 October 2013
- Employment rates (20-64) according to European Commission (2014), Appendix "Labour Market Indicators"
- Unemployment Rates (15+) according to European Commission (2014), Appendix "Labour Market Indicators"; estimation for Greece
- Youth unemployment rates (15–24) according to European Commission (2014), Appendix "Labour Market Indicators"; estimation for Greece

From this inclusionary perspective, two important consequences immediately follow: One, the disposable income indicator shows to what extent member states have built up stabilisers that are able to buffer economic up and downs in terms of disposable income for households; two, this indicator reveals the emphasis countries put on welfare development favouring either economic dynamics (GDP growth) or social dynamics (social inclusion). Related to the first aspect, the European Commission's figures corroborate the strength of Germany – with some other countries like Denmark, Finland and Sweden – compared, for instance, to Greece and many other EU-MS: in these countries, the median disposable income even went up further during and after the great recession in 2008/09. However, related to the second aspect, Germany reflects – alongside Poland and the Czech Republic – greater emphasis on economic than on social dynamics: growth rates in the GDP have been consistently greater than growth rates in (equivalised) disposable median income since the beginning of 2000.[8] The following review of other inclusive growth indicators confirms this impression.

The *employment rate* (measured according to the new Employment Strategy) almost stagnated, in particular in the Eurozone, and is with 68.4 percent far behind the goal of 75 percent in 2020. The figures for Germany seem to confirm the German "Jobwunder" because the job increase of (+) 7.5 percent seems to be impressive, especially compared to the Greek employment collapse of (-) 9.3 percent; in addition, Germany has already passed the EU benchmark. However, as we know from many studies, this job miracle has serious flaws related to insecure or even precarious jobs (Eichhorst and Tobsch 2013, Schmid 2011b).

The mirror of this picture are the rocketing *unemployment rates*, especially at the European periphery and in particular related to *youth unemployment* with which we are all already too familiar to have to have repeated here in detail (e.g. European Commission 2013a).

The *poverty risk* (Table 2) again increased in the Eurozone more than in the total EU (de facto in the Non-Euro countries), and Germany shows one of the strongest increases (a plus of 3.9 percentage points) albeit from a still relatively low level, compared, for instance, to Greece where 23.1 percent of the population are below the at-risk-of-poverty threshold of 60 percent of the national median equivalised disposable income.

Severe material deprivation, too, increased in the Eurozone compared to an even slight decrease in the whole EU. In Germany, 4.9 percent of the population cannot

[8] See the Charts No 7 in the recent European Employment and Social Report. In other countries, including Denmark, France, Portugal, Romania, Finland and Sweden, household incomes grew at a faster rate than GDP over the period from 2000 to 2011, and in some cases (Denmark, Finland, France and Sweden) did not appear to be affected by the crisis and continued to rise. In contrast, a clear impact on household incomes can be observed in the Baltic States, Greece, Hungary, Italy, Portugal, Romania and Spain. The divergence in the trends between the unadjusted and adjusted income figures highlights those countries where increased effort has been put into social transfers in kind, most notably in Belgium, Denmark, the UK and above all the Netherlands (European Commission 2014, 386–8).

afford some items (at least four on a list of nine) considered by most people to be desirable or even necessary to lead an adequate life; the figure for Greece dramatically increased and is – in the meantime – four times higher than in Germany.

Table 2: Indicators of 'inclusive growth'

Indicator	Country	2005	2012	Delta (%Points)
At-risk-of-poverty	EU17	15.2	17.0	1.8 % Points
(Percent of	EU27	16.4	16.9	0.5
Population	Germany	12.2	16.1	3.9
<60% median)	Greece	19.6	23.1	3.5
Severe material	EU17	5.6	7.5	2.1 % Points
deprivation	EU27	10.7	9.9	- 0.8
(Percent of	Germany	4.6	4.9	0.3
Population)	Greece	12,8	19.5	6.7
Income	EU17	4.6	5.0	0.4
Inequality	EU27	5.0	5.1	0.1
(Quintile Share	Germany	3.8	4.3	0.5
S80/S20)	Greece	5.8	6.6	0.8
Wage Gap				
(Difference women's	EU17	n.a.	n.a.	n.a.
wages from men's	EU27	n.a.	n.a.	n.a.
wages in full-time	Germany	≈22.0	20.8	- 1.2 % Points
median in %)	Greece	≈16.7	9.5	- 7.2

Sources and definitions:

- At-risk-of-poverty (=Share of people with an equivalised disposable income (after social transfer) below the at-risk-of-poverty threshold, which is set at 60 percent of the national median equivalised disposable income after social transfer, according to European Commission 2012 and 2014, Appendix "Social Inclusion Indicators"; for information: The at-risk-of-poverty for children (0-17) is usually higher; in year 2011 for EU-27=20.6% but not for Germany =15.6 %.
- Severe material deprivation (=Inability to afford some items (at least 4 on a list of 9) considered by most people to be desirable or even necessary to lead an adequate life, according to European Commission (2012, 2014), Appendix "Social Inclusion Indicators"
- Income inequality (=Ratio of total income received by the 20% of the population with the highest income (the top quintile) to that received by the 20% of the population with the lowest income (the bottom quintile), according to European Commission (2012, 2014), Appendix "Social Inclusion Indicators"
- Wage gap (=the gender wage gap is unadjusted and is calculated as the difference between median earnings of men and women relative to median earnings of men. Estimates of earnings used in the calculations refer to gross earnings of full-time wage and salary workers; e.g. full-time women's median pay in Germany was about 20.8 percent less than that of men), according to OECD Family Database and Chart LMF1.5D (last updated 29/07/2013), www.oecd.org/social/family/database

Income inequality also slightly increased, however, it is again stronger in the Eurozone than in Non-Euro countries. In Germany, the increase is one of the strongest, and the ratio of total income received by the 20 percent of the population with the highest income (the top quintile) to that received by the 20 percent of the population with the lowest income (the bottom quintile) rose from 3.8 to 4.3 compared to the current level of 6.6 in Greece.

Finally, the German gender *wage gap*, i.e. the unadjusted wage gap between the median full-time earnings of men and women relative to the median full-time earnings of men is with over 20 percent one of the highest in Europe. Even in Greece this gap is much lower leading to the impression that exclusion on the labour market seems to make men and women more equal – no reason for consolation, indeed.

European Hangover: What follows from this?

So, there is no question that the aspired "inclusive growth" has not been a success story until now. Real disparities in the economic and social capacities of EU member states increased rather than decreased, in particular in the Eurozone. This is also confirmed by a synoptic study on the eve of the Lisbon strategy EU-2010 and the European Year for Combating Poverty and Social Exclusion during the Belgian Presidency presenting the harsh diagnosis, "that a decade of coordinated social inclusion policies has failed to reduce poverty and social exclusion in any substantial way" (Frazer et al. 2010, 187). This situation has also led to an increasing disparity in the attitude of people towards the EU, in particular among intellectuals, with which we are all familiar. In Germany, for instance, we were confronted with the wake-up call by the eminent political scientist Fritz Scharpf (2012): "Save Europe from the Euro", complemented by a sharp critical analysis of the sociologist Wolfgang Streeck (2013) calling for a renaissance of the nation state as the true guarantor of democracy and social justice on the one side; on the other side we find reputed social philosophers like Jürgen Habermas (2011, 2013) and Oskar Negt (2012) who enthusiastically embrace the idea of deepening the European political dimension and the supranational welfare society as a true guarantor for democracy.

Does it make sense to conjure the European Social Model in such a situation? Would it not be more important to do the housework and solve the Euro crisis and the financial crisis, and to take measures to create the conditions for equal opportunities in economic growth in Europe? Or to concentrate on the most urgent problem, which means to fight youth unemployment?

I think it does indeed make sense to tackle the big question of the European social dimension for putting the immediately arising problems into the right perspective (European Commission 2013b). It is also the gist of a strategy not to lose sight of the main objective even if adverse circumstances might divert from it. The EU Social Model evoked in the concept of "inclusive growth" is still a desirable vision not least for the reason of democratic "output legitimation" (Scharpf 1999, 16–46): Europe's citizen are not just asking *"if"* Europe is still holding together in 2020, they also are asking *"why?"* and *"for what?";* in other words, they are also judging Europe by its ability to solve their political, economic *and* social problems.

Why have we got so far and what can possibly be done to chase away the increasing fatalism with respect to the EU? In the following, I will not enter into another exercise on what the European Social Model could mean but instead I take up the advice by the Norwegian political scientist Johan P. Olsen (2002), who remarked that the research challenge is one of model building, not one of inventing definitions. Europeanisation may be less useful as an explanatory concept than as an attention directing device and a starting point for further exploration.

A model: the Trade-off between Capacity and Flexibility

Figure 1 portrays a model inspired by a recent paper of Frank Vandenbroucke (2012). The vertical axis represents a measurement for overall economic inclusion, which I call *'comparable productive capacity'* (CPC), thereby modifying the concept of 'symmetry' used by Vandenbroucke. The members of a monetary union must have a minimal amount of comparable productive capacity to engage in market exchanges on equal terms. The horizontal axis is a measurement for economic flexibility, in other words, the ability to cope with external shocks through the flexible adjustment of key economic parameters. The country examples are just to illustrate where some EU member states stay related to the two dimensions.

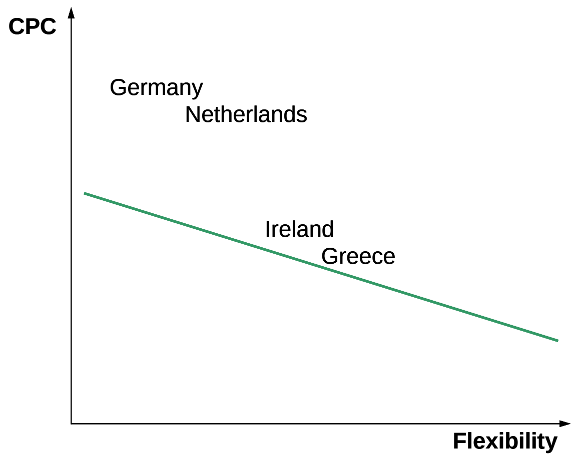

Fig. 1: The Trade-off between Comparable Productive Capacity (CPC) and Flexibility

Comparable productive capacity (CPC) is composed of various dimensions: natural, financial, human, infrastructural and institutional resources. Natural resources are raw materials such as oil, coal, minerals, fertile land or landscapes attractive for tourism and recreation. Financial resources consist of productive capital (especially related to manufacturing), private and public assets and the ability to make debts and absorb external shocks by inbuilt stabilisers.[9] Human resources are, above all, accumulated human and social capital, including their demographic structure and dynamic. Infrastructural resources comprise traffic and transport networks, energy nets, information- and communication technology, among others the regionally more or less inclusive provision with broadband cables.

Institutional resources are of special importance for inclusive growth, as mentioned at the beginning. Related to democracy, for instance, they consist of the right to free elections, free choice of occupations, to go on strike (collective action) and to workers' codetermination (voice) at the firm level; they also include legal resources in the form of inclusive labour law and social law, and – last but not least – the existence of an efficient administration free of corruption.

Three exemplary illustrations related to inclusive labour law and efficient administration have to suffice in this essay. In Italy, for instance, only few core workers in the manufacturing industry are properly insured against unemployment; there is no question of the failing inclusive character of the Italian unemployment insurance system.[10] Furthermore, Italy lacks capacities in efficient employment services for implementing active labour market policies (see Figure 4 below). Romania is another example for lack of institutional capacity: so far the country has been able to take up only a small share of the 3.4 billion Euros granted through the channel of the European Social Fund. A study of the University of Chicago estimated a lower bound of 28 billion Euros of unreported income for Greece; primary tax-evading occupations are doctors, engineers, private tutors, accountants, financial service agents and lawyers. The foregone government revenues of 11.2 billion Euros correspond roughly to the volume of public expenditure cuts that the Troika was demanding from the Greek government for the years 2013 and 2014 in exchange for the EU rescue measures (Artavanis et al. 2012).

Flexibility is also composed of several dimensions: price flexibility, i.e. flexibility in setting the prices of economic resources such as currency, capital and labour. Revaluation or devaluation, interest rates or taxes enlarge or limit the flexibility of capital; the same holds true for labour and, in particular, wages. Contractual flexibility refers to the flexibility of time resources such as the possibility to change contracts or even quit the contracts, and to the duration of property or user rights,

[9] In the Federal State of Germany, e.g. only few people are aware that the anticyclical capacity of the national unemployment insurance system (maintaining to some extent the purchasing power of regions with high unemployment during the recession) reaches with about 6 billion Euro per year almost the same level as the legally institutionalized financial balance mechanism between the 16 German regional states called *Länderfinanzausgleich* (Blos & Schwengler 2007).

[10] Among the self-reported unemployed, UI-coverage in Italy is somehow between 0.07 (according to LFS) and 0.36 (according to SILC); the corresponding figures in Germany are 0.75 and 0.85 (European Commission 2013c, Table 7, p. 28).

and – lastly – to the possibility to change working times. Mobility, i.e. the spatial flexibility of the most important production factors such as capital and labour, may be enlarged or restricted though trade law; possibilities of in- or outsourcing play a central role related to the deepening internationalisation of trade. Labour mobility is promoted or restricted through regulations of immigration and emigration; extensive commuting, made possible, for instance, through fast-speed trains or airplanes, might possibly be an increasing alternative to migration with all the possessions.

Once again, a few illustrations must suffice. The loss of the possibility to revaluate or to devaluate the national currency is indeed a severe restriction of flexibility. The severity of this loss of currency sovereignty, however, seems to be exaggerated in the current debate. There are functional equivalents. Denmark, for instance, is not a member of the Eurozone. The Danish government, however, has closely tied the Danish Kronor to the Euro and still managed the last economic crisis well. Admittedly, the Danish central bank had to fight against the pressure of revaluating the Danish Kronor through currency interventions (like Switzerland), however the Danish government also applied anticyclical fiscal policy and flexible working time measures to overcome the crisis; furthermore, it profited from the inbuilt stabilisers of its strong social security system. Latvia, to mention another EU member, did not – against the advice of many mainstream economists – devaluate its currency four years ago (2009) but bound it to the Euro; now, the country has the highest growth rates in the EU and has become a member of the Eurozone; admittedly, the real internal devaluation measures (drastic wage cuts, among others) were highly contested among a majority of the population.

Sure, there are cases where the opposite is true, like Poland which depreciated its Zloty by 50 percent in 2009 and today shows a strong economic standing. Nevertheless, the Polish government still envisages entering the Eurozone in 2015 for the simple reason that a common currency also has many advantages: protection against speculative up and downs of currencies und lower transaction costs in trading. Moreover, it is not at all sure whether the instrument of devaluation should be more ‘democracy-friendly’ or even more effective than the just mentioned functional equivalents.[11] The resulting increase of import prices hits not only the high-income population buying luxury goods from other countries, but also the low-and median income people if one thinks of vital goods such as energy, medicine or machines for the private household (including computers); it also hits the small and medium-sized firms depending on the intermediate products being imported. Moreover, the price advantage for export goods presupposes the existence of productive capacities in manufacturing or exportable services for utilising the resulting advantage in competitiveness as well as the inflow of foreign capital for investment into such capacities. It is quite uncertain if these pre-

[11] For the German debate see Deutschmann (2013).

conditions can be met in countries such as Greece with a debt level of about 170 percent of GDP; some kind of European-wide debt management seems to be necessary in this case, in particular to win time for extended investments into innovative capacities.[12]

But let us come back to our model (still Figure 1) which represents a trade-off between the two dimensions: A lack of comparable productive capacity has to be balanced out by increased flexibility, otherwise state debt or unemployment will rise and investments in new products, new technologies and education will dry out. To illustrate this, the figure displays the potential situation of a few countries: Germany and the Netherlands are above the line; Ireland and Greece are on the line, each presenting different trade-off constellations.

The introduction of the Euro has caused this line to move upwards, as Figure 2 shows. The demand for comparable productive capacity has grown due to increased competition and the loss of currency sovereignty. Although Germany and the Netherlands might now find themselves directly on the line, they have already moved downwards when it comes to more flexibility. This is – for instance – reflected in the huge increase of flexible employment relations, in particular part-time work in the Netherlands; or wage-flexibility, in particular the extension of the low-wage sector in Germany.

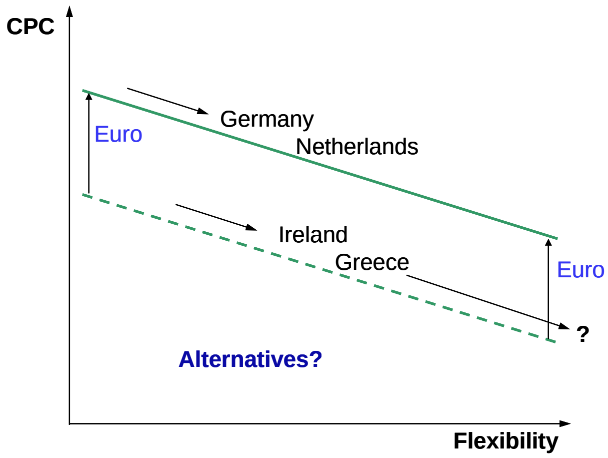

Fig. 2: The Impact of the Monetary Union on the CPC-Flexibility Trade-off

Just for the sake of illustration, Ireland and Greece are now both clearly below the line. Although measures for flexibilisation have already been introduced there, they would have to go much further than in Germany or the Netherlands as their productive capacity has not much improved in the meantime. For a long time, this

[12] Kritikos (2014) draws attention to the fact that in the last decade Greece used to spend only 0.7 percent of GDP on Research & Development in contrast to about 3 percent of strong EU member states.

deficit has been veiled by a real estate bubble and rocketing private (Ireland) and public debts (Greece). Only the bank crisis and then the fiscal crisis have brutally pulled away the veil, forcing these countries to adopt drastic flexibility measures: The Irish government imposed a drastic decline in nominal unit wage costs of 6.4 percent alone in 2010, compared to 0.7 percent in the whole Eurozone. In the following years, the proud Irish people did all they could to escape from the European Stability Mechanism (ESM). Eventually they succeeded in December 2013 but only at the price of a 64 billion Euros bank debt for which the Irish taxpayer is now liable.[13] In addition, more and more highly qualified young adults are leaving the country.[14] The Greek government has been forced to accept drastic cuts in public expenditure by the so-called Troika; between 2009 and 2013, state expenditure fell by 30 billion Euros, which means by about 25 percent since the outbreak of the Euro crisis.[15]

While Ireland seems to be standing on its own two feet, the flexibility measures in Greece would need to be even greater compared to its productive capacities. This would be unacceptable for a majority of people, in particular for workers and young adults. Democracy would become endangered and, with Greece leaving the Eurozone, this could be the first step towards Europe breaking apart.[16]

What are the alternatives? Macro-economic measures of course that have already partly been embraced, but not yet sufficiently implemented, for example: controlling the financial markets and banks; or a European-wide investment programme in material infrastructure such as energy, transport, sewage, and information and communication technology. In particular the control of the banking sector has not gone far enough, it has probably not yet even tackled the crucial reasons for the damaging speculative bubbles and the failure of the credit market (transforming savings into productive and sustainable investments) experienced in the last decade. Hellwig and Admati (2013) persuasively demonstrate that banks should dispose of at least 20 to 30 percent of its own capital (*'Eigenkapital'*) in order to control the risks. In the current praxis, however, the average own capital ratio is only 2 to 10 percent; 3 percent, even, in Europe. So far, the authors have seen no fundamental change in the situation and explain their frustration by the powerful lobby activities of the banking sector.

A coordinated fight against youth unemployment should have one of the greatest priorities, too. The six billion Euros provided for the European Youth Guarantee

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[13] Calculated for Germany, this would amount to the equivalent of 880 billion Euros!

[14] According to the Irish Central Statistics Office (CSO), in 2012 alone, 3,000 people per month left the country, a figure that has not been so high since the time of famine in the mid 19th century, although roughly half of these migrants have no Irish background, in others words, immigrated before they left the country; see also (http://www.m-media.or.at/welt/irland-und-zuruck-bleiben-die-alten/2012/12/29/).

[15] An incredible equivalent of 275 billion Euros in Germany!

[16] For this assessment see, for instance, Mak (2012) and Scharpf (2012).

programme for the next seven years, even with some topping up in the short term, is no more than a drop in the ocean. The International Labour Organisation (ILO) estimated an effective youth guarantee in the Eurozone to cost a minimum of 21 billion Euros. The Dublin Foundation for the Improvement of Work and Living Conditions (Eurofound) guessed the foregone economic costs (social transfers plus lost output) by the currently 7.5 million unemployed youth in the EU at 150 billion Euros, psychic and other intangible costs not included (European Commission 2013a). There seems to be little doubt that more investment into the fight against youth unemployment coordinated at the European level would be a win-win-game.

Once again, I have to leave that aside and to ask instead: What role could the European Social Model actually play in solving the EU crisis in general and the Euro crisis in particular? I can see four strategies which must be partly intertwined (Figure 3).

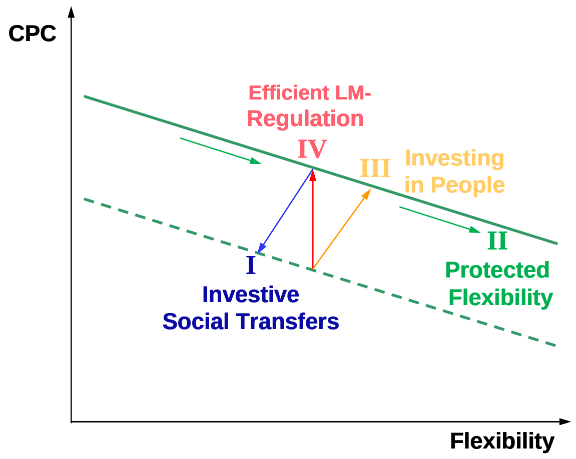

Fig. 3: Possible Strategies of the European Social Model to mitigate or to cope with the sharpened CPC-Flexibility trade-off

First, *investive social transfers* could push the trade-off line downwards, hence relieving member states below the line from taking recourse to further flexibility measures (I).

Second, the demands for greater competitive productive capacities could be compensated for or supplemented by *protected flexibility* (II).

Third, the competitive productive capacities could be improved by *investing in people*; this would also simultaneously raise the capacity of protected flexibility (III).

Fourth, productive capacities could be raised by establishing a real European labour market through *efficient labour market regulation* which better utilises existing capacities and reduces inefficient flexibility at the same time (IV).

Strategies for Inclusive Growth in a Modernised European Social Model

I. Investive Social Transfers

Transfers between the EU member states are nothing new. The European Social Fund, the ESF, is one example. This fund annually invests around 10 billion Euros in employment-oriented social policy. To illustrate the scale, this corresponds to about 500 Euro per unemployed in the EU flowing into European regions with severe employment problems. Doubts about the effectiveness of this fund are widespread, and unfortunately the European Commission has so far provided little robust information to dispel this impression. In the context of our current debate, it would be – for instance – most interesting to learn to what extent this fund has been able to build up sustainable capacities for effective national employment services.

We have to talk about *investive* social transfers from strong to weak member states with low productive capacities because the legitimacy of permanent social transfers is always problematic, and the subsidiarity principle anchored in the European Treaties definitely forbids permanent consumptive transfers between member states. With this in mind, it is of the utmost importance to nurture the effective implementation of the ESF resources. Furthermore, the role of this fund could be extended on two accounts, in particular in *institution building* related to (un-) employment insurance and to effective employment services. In the following, I present some information and reasons to buttress this argument.

Many of the EU member states have, if any, only small developed systems of unemployment insurance (Clasen & Clegg 2011, Lefresne 2010). One reason, among many, is that mainstream economists tend to underestimate or even reject the investive function of this institution. It is, however, a great mistake in politics and academia to see in unemployment benefits only a "passive" transfer. Properly designed wage replacements are not only a fair compensation for people who become unemployed through no fault of their own but are also an "active" investment in their productive job search. Recent studies – even from the OECD – demonstrate that the unemployed with generous wage replacements in the first six to nine months find more productive jobs (higher wages) than the unemployed not covered by unemployment insurance or covered only by means tested benefits. Even more important: These jobs are more sustainable, which means that decent wage replacements mitigate revolving door effects, i.e. leaving the benefits system and returning soon or entering another benefit system (such as health or disability insurance).[17]

It goes without saying that inclusive unemployment insurance (UI) has to be complemented by an effective system of employment services in order to manage information asymmetries in job matching, if necessary supported by training or recruitment subsidies, and – last not least – to control moral hazard. It seems that many new member states or members from the southern sphere in Europe have deficits related to this institutional capacity.

Inclusive unemployment insurance and effective employment services also play an increasingly important role in the restructuring of enterprises, helping to maintain and extend their competitiveness by supporting the respective human resource management. Cooperative approaches can often prevent mass dismissals as, for instance the Austrian Work Foundations demonstrate (Borghouts-van de Pas 2011; Gazier & Bruggeman 2008). Policy measures targeted at hard-to-place people can effectively contribute to preventing long-term unemployment. It is therefore no wonder that most of the member states, having invested in instruments of proactive work promotion, show significantly lower long-term unemployment rates, as the following Figure 4 demonstrates.

Well-balanced systems of unemployment insurance also increase the capacity of inbuilt stabilisers and of redistribution among regions to ensure comparable living conditions, thereby also lowering the pressure of migration. Finally, and last but not least, well-established capacities of national unemployment insurance systems are also a precondition for a potential European Employment Insurance system, to which I will turn in the following paragraphs.

I argue that the US might be taken as a model for building a rudimentary system of employment insurance in Europe in the medium or long-term. The reason for this suggestion mainly relates to the US feature of federalism. Following this model would mean creating a transnational (European) institutional insurance capacity but leaving the national member states the discretion to decide on most of the rules and the implementation of their own systems. The European employment insurance, therefore, would *not* establish (at least not in the short and medium-term) a uniform core system of European unemployment insurance as is currently being debated.[18] It would instead concentrate on strengthening the rather

[17] For more evidence and references see Schmid (2012a, 2013).

[18] For tentative considerations in this direction in the Employment and Social Commission see Andor (2013); European Commission (2012a, 62); European Commission (2013b, 11). German economist Sebastian Dullien (2007, 2013) is an active promoter of this idea, emphasising in particular the stabilising function of a uniform European UI: a payroll tax of 1.7 percent shall provide a modest income protection (50 percent) for unemployed in the months 3 to 12 and a stabilisation capacity of 0.5 percent EU-GDP; national insurance systems would be responsible for short-term benefits (the first three months) and, if they wish, would take care of more generous or extended benefits. The British economist Tony Atkinson (2013, 30–3), on the other hand, seems to accentu-

diverse national unemployment insurance systems by setting minimum standards for coverage, size and duration of benefits, and by complementing these systems through establishing a European Fund for Employment and Income Security targeted to the infrastructural support of national unemployment insurance systems. Furthermore, this new fiscal capacity would also allow a discretionary support of national systems through (repayable) credits, co-financing extended benefits and stimulating activation measures. For better understanding this proposal, a brief sketch of the US unemployment insurance system may be helpful.

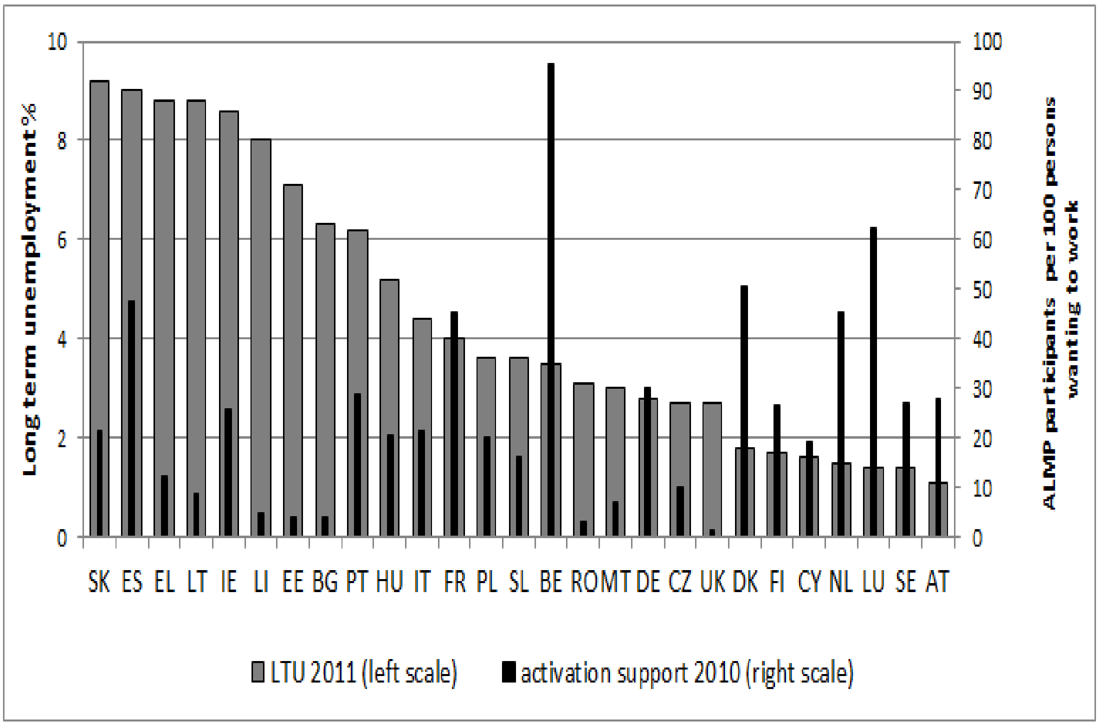

Fig. 4: Participants in 'Active' Labour Market Policies (ALMP) 2010 and Long-term Unemployment Rate 2011

Source: Draft Joint Employment Report to the EU-Commission's Annual Growth Survey 2013, Figure 14, p. 14. Admittedly, attentive readers will immediately discover the contradicting examples Belgium (middle level of long-term unemployment and high 'activity' rate) and UK (middle level of long-term unemployment and very low 'activity' rate). I have no explanation for this, but it could well reflect the fact that Anglo-Saxon countries in particular take recourse to tax credits (Earned Income Tax Credits in the US, Work Tax Credits in UK) that are not subsumed under 'ALMP' but applied to a large extent to support and incentivise low-income earners. Furthermore, the usual disclaimer for causal interpretations of correlations holds true in this case, too.

ate the social insurance function of the US system coming close to my own proposal. Others, for instance Enderlein (2013), argue for establishing only cyclical shock insurance based on the so-called "output gap" as a trigger. For a discussion of these proposals see European Commission (2013c).

Excursion: The Unemployment Insurance System of the US

Up until the world economic crisis of the 1930s, only few American employees were insured against unemployment. Only under the impact of mass unemployment were there serious efforts beginning in 1933 under President Franklin D. Roosevelt to find a legal basis for establishing a public unemployment insurance system, despite the constitutional problems and opposition of individual states. As part of the Social Security Act of 1935, a national 3 percent payroll tax applicable to employers with more than seven employees was finally introduced. The act provided that the payroll tax could be reduced by 90 percent (that is, 0.3 percent of the payroll) if employers paid wage-related contributions to the state unemployment insurance programs that satisfied certain minimum requirements. This legislation thus provided individual states with a financial incentive to create their own unemployment insurance programs and removed the most important argument against individual state programs, that is, that there would be an unfair financial burden on employers in states with insurance systems, because employers in states that failed to establish an unemployment insurance programmes would now be subject to the higher federal tax. As a consequence, all states passed their own unemployment insurance laws between 1935 and 1937, establishing individual state unemployment insurance systems. The federal payroll tax thus came to have the character of an additional contribution and was paid, as a consequence, everywhere at the reduced rate; subsequently it was earmarked for three activities: extended insurance benefits, the employment service (possibly including special employment promotion programmes), and the administrative cost of unemployment insurance (Schmid et al. 1992, 78–9).

As the Social Security Act did not prescribe any minimum benefit standards, the eligibility requirements, level and duration of benefits, and contribution rate differ from state to state. Only a few basic features are similar in all states: a minimum earnings or period of employment during the preceding year is a prerequisite for eligibility; the level of benefits is related to previous earning, and the maximum duration of benefits is as a rule (that can be overcome) 26 weeks. In contrast to most European unemployment insurance systems, however, only employers have to pay contributions according to their unemployment experience (*experience rating*), that is, the contribution rate is higher for firms that have laid-off or dismissed more workers in the past. The financial streams flow through a federal trust fund which redistributes the contributions according to the need of individual states. In case – and this is an interesting point from a European and stabilisation point of view – an individual state runs into a deficit, the state government can apply for a federal credit repayable in two years with interest. So, there is no intention of permanent redistributive transfers between individual states or from the federal state to the individual states. However, because states are diverse in generosity (mainly in access to benefits) the more generous states do get systematically larger transfers in emergency unemployment benefit programmes financed by the Federal State (see below).

Table 3: The Unemployment Insurance System of the United States*

	Regular UB	**Emergency UB**	**Extended UB (EB)**
Administration	States	Federal State	Federal and States
Financing	Federal (0.6%)[1] and States (variable)[7]	General Federal means	Federal 50% States 50%
Entitlement	Unemployed (U)[2] variable coverage	U in States with defined higher U	U in States with high or increasing IUR[3]
Duration	mostly 26 weeks	Up to 53 add. weeks	mostly 20 weeks
Size	relative to wage,[6] stark variations[4]	like regular UB	like regular UB
Conditions	active job search	ditto	ditto
Automatic	yes	no[5]	partial (see above)

*) Actualised Table 2 from European Commission (2013c) plus own and extended comments.

1) Only employers contributions on the first earned $7,000 US; these uniform federal contributions finance only the administration of the US-States' unemployment insurances plus, sometimes, (experimental) activation programmes, *not* the regular unemployment benefits (UB)!
2) Note the difference between "laid-off" and "fired": only employees of the first category are entitled to regular UB! The coverage varies according to Dullien (2013) between 18 percent (South Dakota) and 69 percent (Idaho) in 2011; the average coverage rate was 34 percent in 2007 according to Sauviat (2010).
3) IUR = Insured Unemployment Rate (usually much lower than the general unemployment rate); IUR must be 5 percentage points higher than the average, and it must have increased by 20 percent within the last two years; States may also choose 6 percentage higher IUR-rate to circumvent the 20 percent change criteria; entitled are unemployed (U) whose regular UB or whose Emergency UB ran out. After February 2009, EB was financed 100 percent federally (as a carrot to induce states to offer EB) with triggers that were more easily activated than the permanent triggers in existing state laws (personal communication by Wayne Vroman).
4) According to Dullien (2013), in 2011 the maximum benefit varied between $133 per week in Puerto Rico and $1,101 per week in Massachusetts; the wage replacement rates varied between 24.8 percent in Alaska and 56.3 percent in Hawaii; the average wage replacement rate was 35 percent, and it is taxable, in absolute values, according to Sauviat (2010), $300 per week.
5) Must be authorised by law (currently – April 2014 – hotly debated and denied).
6) May be complemented by FAC (*Federal Additional Compensation*), e.g. in 2009/2010 $25 per week for all UB-receivers! See also Table 4.
7) The average contribution rate is, according to Vroman (2012), less than 1 percent of the corresponding taxable payroll. The greatest difference of these contributions seems to result from the highest taxable payroll (which has been freezed by the Federal State at $ 7,000 in 1983); some States are indexing this amount (the current value of $ 7,000 would be $ 21,000); Hawaii has, according to Vroman & Woodbury (2014), the highest taxable payroll of $38,800. The payroll tax of the States also varies according to the size of their reserves; the highest tax rate in the "experience rating" procedure shall not be lower than 5.4 percent (6%–0.6% Federal contribution); thus, the actual payroll tax for employers may vary between 0 percent and 5.4 percent or more. Most States seem to raise the maximum payroll tax only a little above the 5.4 threshold. According to Vroman & Woodbury (2014), the highest payroll tax found was 8.9 percent, however, only in case of high deficits in the States UI fund.

The US unemployment insurance system (Table 3) thus established has retained its basic features to the present day. In the meantime, however, the federal payroll tax has been increased to a level of 0.6 percent, and the minimum tax-base to the first earned $7,000. In 1971, *extended benefits* (EB) were established that nowadays usually add another 20 weeks of benefits after the 26-week regular benefits have run out, and their cost is shared equally by the federal state and the individual state (50:50). Since 1958, the federal state also fully finances *emergency unemployment compensation* (EUC) from its own resources. So, the maximum duration during 2010-2012 was up to 99 weeks in the majority of states (26 regular UB, 53 EUC, and 20 EB).

At the low point of the recession (2010) the US spent $144 billion US for 14.8 million unemployed, i.e. numerically speaking $9,730 per unemployed and year (Table 4). However, only $58.6 billion (≈40 percent) originated from the States' unemployment insurance funds; the bulk of the modest payments for wage replacements ($66 billion, i.e. 46 percent of total expenditure) came from emergency benefits financed by the Federal State whilst expenditure for the co-financed 'regular' extended benefits were marginal ($9.2 billion), exceeded even by the $10.3 billion discretionary Federal Additional Compensation (FAC) aimed at strengthening the stabilisation impact. However, the States' share of expenditure increased to 56 percent after the economic recovery.

Table 4: Unemployment (in million) and Annual Expenditure (in billion US-$) for Unemployment Benefits in the US

	Unemployed	Regular UB	Emergency UB	Extended UB	FAC	Total
2007	7.1	32.4	none	none	none	32.4
2008	8.9	43.1	7.8	none	none	51.0
2009	14.3	78.8	42.3	6.0	9.5	136.6
2010	14.8	58.6	66.0	9.2	10.3	144.0
2011	13.7	47.2	47.2	10.0	none	104.4
2012	12.5	43.1	35.7	2.9	none	76.5

Source: Vroman & Woodbury (2014); UB = Unemployment Benefits; FAC = Federal Additional Compensation

Thus, through its benefits and financing mechanisms, the US unemployment system serves as an automatic stabiliser for the economy. In recessions spending is injected through benefits, and benefit disbursements decline in recoveries. Through the forward funding principle, states accumulate reserves during economic expansions and draw them down during recessions. The federal state can endorse this stabilisation function through credits to individual state insurance systems. Studies of the US Congress Budget Office estimate the unemployment insurance job creation strength to be between two to five times that of infrastructure spending. Furthermore, a study estimated the poverty rate at 14.3 percent in 2009; without unemployment benefits it would have been 15.4 percent (O'Leary 2013, 1). Other studies point to the fact that an extension of unemployment benefits is not as expensive as most mainstream economists maintain: an extension of benefits for 13 weeks prolongs a job search only for another week. Furthermore, positive external effects have to be regarded. Some studies argue that an extension of benefits in the recession diminishes the competition for scarce jobs and thereby the unemployment duration for people not receiving benefits (in particular youth without any job experiences). This effect has been confirmed by a most recent study for Austria (Lalive et al. 2013). Currently, however, this stabilisation function is weakening and the US system of unemployment insurance has come under pressure since the rules and regulations have not properly adjusted to the changing situation.[19]

Towards a European Employment Insurance System

To be sure, the US unemployment insurance system cannot be transferred 1:1 to Europe. But it seems plausible that some basic elements fit the insurance logic as well as the virtual federal character of the EU. The most important question for establishing income security during involuntary unemployment is the decision between the principles of means tested flat rate payments and insurance-related replacements of wage income. Five considerations clearly speak for the latter:[20]

- First, individual and wage-related benefits can be calculated much easier and fairer than means tested flat rate benefits for which all household-related income streams have to be assessed and taken into account. The German Hartz-IV system (means tested flat rate) can be taken as an example of how complicated *and* awesome such a procedure is even at the national level; at a supranational level the hurdles appear almost impossible to overcome.
- Second, due to the property right established through wage-related and targeted contributions at the national level, social insurance benefits are better protected

[19] The payroll tax-base (the first earned $7,000), for instance, has not been changed since 1983 and has now reached the level of only 6.2 percent of the maximum taxable payroll for social security ($113,700). Since most individual states kept this minimum level, the available fund for unemployment insurance dropped dramatically. This led, first of all, to a decline of the average coverage rate, and second, to an increasing use of extended benefits and, above all, of emergency unemployment compensation, amounting in 2011 to 55.7 percent of total compensation for unemployment benefits (O'Leary 2013, 2). Only a few states have increased the payroll tax base to $25,000 or have indexed this tax base. Nevertheless, it is expected that the accumulated deficits of the insurance funds will not disappear for a long time and will not enable most individual state to accumulate reserves. Experts, therefore, call for a fundamental overhaul of the US unemployment insurance system looking (paradoxically) to European systems as possible models (Vroman 2012).
[20] See, more extensively for this point, Atkinson (2013) and Schmid (2013).

against discretionary (and sometimes opportunistic) political decisions than benefits relying on general and, by definition, not targeted taxes; this would be an argument following the practice of the majority of European countries which have wage-related contributions both from employees and employers.

- Third, the incentive of social insurance benefits to work is stronger than for means tested and (usually) flat rate benefits, not least due to the entitlement effect because only formal and regular employment relationships ensure this re-entitlement.
- Fourth, the macro-economic stabilisation impact of wage-related replacements is higher than of means tested and usually lower benefits.
- Fifth, research even shows that jobless people covered by unemployment insurance remain healthier and more self-confident than jobless people without unemployment insurance or only means tested benefits.[21]

The next question is whether a uniform European Unemployment Insurance (EUI) should be established with national (member states') systems complementing the EUI for idiosyncratic social policy reasons, or whether the member states' UI systems should be strengthened and complemented by a European Fund for Employment and Income Security (EIS) focussing on capacity building and on social inclusion by preventing unprotected or too-low protected long-term unemployment as one of the main reasons for poverty and social exclusion, thereby also enhancing the economic stabilisation function. This essay clearly prefers the second alternative for two reasons: First, the current diversities of national unemployment insurance systems plus their underlying different philosophies are too big to realistically expect a political majority for a uniform EUI in the foreseeable future; second, a uniform EUI would currently probably induce a (further) convergence process of income security for involuntary unemployment to the bottom[22] or even substitute evident deficiencies of current national UI systems.[23]

The first step, therefore, must be to create a process of upward convergence to ensure minimum standards of national unemployment insurance systems, which would also be a logical step in view of our model on comparative productive capacities. In view of the inclusion principle, one of these standards could be a minimum share of workers covered by unemployment insurance (e.g. about two-thirds of the active labour force), another would be a minimum income guarantee of insured workers referred, for instance, as a percentage (e.g. 60 percent) of the equivalised median household income. Certainly, such minimum standards would promote some minimum level of institutional congruence but would not at all

[21] For the consequences of unemployment for health see Schmid (2008, 140–3).

[22] Which happened already to some extent, see Clasen & Clegg (2011), Paetzold & van Vliet (2014).

[23] This does not exclude in the (very) long-term a strive for a uniform EUI system, which obviously also has advantages but would require – in my view – a really functioning European labour market.

forcefully bring about institutional harmonization regarding size, duration or even financing unemployment benefits. On the contrary, the application of OMC principles (*open method of coordination*)[24] could set in motion some kind of institutional competition.

The EU, however, should create an own fiscal capacity to support and complement the EU member states' national UI in two directions following the US model: First, infrastructural support for administering employment services which will increasingly be oriented across national borders; second, regulated or discretionary support for ensuring income security and new employment prospects for involuntary unemployed in emergencies due to structural changes or deep recessions. The financing of such a European Fund for Employment and Income Security (EIS), however, should not copy the "experience rated" payroll tax system of the US model. Apart from highly bureaucratic costs, such a system nowadays would induce false incentives for companies to avoid long-term employment relationships creating entitlements to unemployment benefits; it would also create barriers for firms standing before necessary restructuring measures that might involve reducing the staff level. On the other hand, fixed payroll taxes would have the advantage that employers and employees develop a stake in the system thereby increasing its legitimacy. However, these advantages have to be weighed against possible disadvantages, such as the increase of labour costs which small and medium-sized firms, in particular, might not be able to shift forward to the prices of consumption or investment goods, thereby reducing their job-creating capacities. Wages also have the disadvantage of small and decreasing fiscal capacity. Therefore it seems advisable to finance the EIS through a fixed share of national GDP, all the more since the function of this EU fiscal capacity focuses on enhancing the infrastructural capacities of national insurance systems and discretionary stabilisation functions in emergencies. Nevertheless, the financing of EIS should allow reserves to be built up in good economic times to enhance countercyclical automatic stabilisers in bad economic times.[25] A system of employment insurance in the EU could possibly look like this (Table 5).

First of all, EIS would provide for each MS a fixed contribution to build up and administer the MS' employment service system (integrating income replacement and employment service functions). The main reason for this financing function is to ensure the capacity building of modern employment services, which in many member states is underdeveloped, in particular with regard to cross-border ser-

[24] Maria J. Rodrigues (2013), "mother of the Lisbon Strategy," clearly states that OMC should be considered a method for deepening European integration rather than just a method of intergovernmental cooperation.

[25] A conservatively assumed 0.2 percent of national GDP contribution would create a fiscal capacity of €26 billion per year, compared – for instance – to the total yearly EU budget of €146.2 billion; following the EUI-proposal by Dullien would imply contributions of about 0.5 percent GDP (substituting, however, to some extent, national contributions); an effective but nevertheless realistic contribution might lie somewhere between.

vices (especially EURES) and the implementation of projects co-financed, e.g. by the ESF. MS having already developed such capacities might opt for lower EIS-contributions. In general, however, MS would carry the main responsibility for administering and financing regular unemployment benefits.

Table 5: A Possible Employment Insurance System of the EU

	Regular UB[1]	**Emergency UB[1]**	**Extended UB[1]**
Administration	EU-Member States	EU +MS	EU + MS
Financing	EIS (0.2%)[2] + MS (variable)	EIS[3]	EIS 50% MS 50%
Entitlement	Unemployed (U) variable coverage[4]	U in MS with defined higher U[5]	U in MS with high or increasing IUR[6]
Duration	Minmax = 52 weeks	Up to 52 ad. weeks[7]	Up to 26 weeks
Size	relative to wage, MS variations[8]	like regular UB	like regular UB
Conditions	active job search	active search and activation[9]	active search and activation[9]
Automatic	yes	no	partial

1) A re-labelling of this term into "Employability Benefits" (or, alternatively, "Transition Benefits") would be timely in order to stress the investive function of income replacement during involuntary unemployment, or temporarily limited wage income due to other (legitimate) reasons, e.g. short-time work, involuntary part-time and training or 'activated' UI-benefits for subsidised employment to bridge periods of productivity below the required level.
2) Contribution from the European Fund for Employment and Income Security (EIS) for capacity building and administration (at least 0.2% MS-contributions into this fund), whereas regular EBs are financed by MS' own insurance systems. MS-systems running into deficit could apply for EIS-credits which would have to be repaid within two to four years, e.g. through increased contributions to EIS.
3) From EIS reserves or, if necessary, other EU-funds.
4) Minimum level about two-thirds of active labour force.
5) Only for insured unemployed, ensuring thereby national insurance systems' compliance to EU standards.
6) Insured Unemployment Rate (IUR), ditto.
7) In stages, comparable to the US procedure, and after discretionary decisions of EU Council and EU Parliament.
8) However minimum wage replacement, e.g. 50% of wages before unemployment.
9) Explicit priority on placement with support, training and education, temporarily subsidised employment.

Second, EIS would provide credits to national insurance systems that run into deficits under the condition of repayment plus, possibly, priority to utilise these credits for proactive labour market measures such as training, subsidised employment or short-time work. This fund would also have the potential for emergency benefits for EU regions with extremely high unemployment, possibly made conditional on job-creating measures or training and education, as well as additional compensation like the US-FAC to enhance the automatic stabilisers. A further possibility would be to provide for extended benefits at shared costs (50 percent from the EIS-budget, and 50 percent from the national insurance budget, like in the US) which would require, of course, a minimum-maximum duration of national insurance – according to European standards – of at least 12 months to prevent member states from setting their own standards as low as possible to profit from the EIS-support.

All these opportunities – credits, emergency or extended benefits, and possibly additional compensations – would enhance the stabilisation as well as regional redistribution capacity of national insurance systems. Emphasis on social inclusion would not only reduce the disastrous impact of mass unemployment on long-term unemployment, but also mitigate the pressure of people (especially those with families) to leave their homes. More regional mobility is certainly required, and it is also acceptable or even desired among young people; however, this flexibility potential is restricted for various reasons (see below) and even not desirable at any costs (brain drain may reduce the internal adjustment capacities), in particular not for adult workers with families. So, to some extent it makes sense, indeed, to bring “jobs to the people” instead of only demanding to bring “people to the jobs”.

Such a targeted but independent EU-fiscal capacity would certainly require a change in the European treaties, which may take a long time. Due to its urgency, an experimental special fund could be created to start the process. Extending the *European Globalisation Adjustment Fund* (EGF) would be another justifiable possibility.[26] Even though such investive transfers would have to be quite small at the beginning, the symbolic value of a genuine transnational social investment institution should not be underestimated. Social Europe must become visible for European citizens. Studies on institutional Europeanisation (Egeberg 2012) also show that persons employed in transnational institutions start to develop cross-national identities which might be considered not so bad for mitigating narrow national interests and developing a European solidarity.

The priority of such investive social transfers, however, should be set on capacity building and proactive labour market policies. A first candidate, of course, would be the modernisation of the European placement service, including the European

[26] Established in March 2006, this fund of currently €150 million annually supports job search and training of unemployed workers in EU member states who have been made redundant due to globalisation, e.g. when a large company shuts down or production is moved outside the EU, or as a result of the global economic and financial crisis. Apart from the small fiscal capacity, the conditions to utilise this fund are quite restrictive; for more information see: http://ec.europa.eu/social/main.jsp?catId=326&.

Job Mobility Portal (EURES), financial incentives and additional support (language courses, assistance in housing) for those unemployed willing to cross the borders. Further transfers should be made conditional, for instance, linked to training measures or youth guarantee programmes in European regions with special employment problems. One could also think of bold temporary wage cost subsidies for employers who increase the employment from the pool of unemployed or who – like the short-time working scheme (see below) – maintain employment for restructuring reasons or keeping their skilled workforce. It was the intellectual contemporary of John M. Keynes, Nikolas Kaldor (1936), who already hinted to the instrument of wage-cost subsidies as a functional equivalent to devaluation.

II. Protected Flexibility

A paradigmatic example for protected flexibility is short-time work allowance to maintain employment in recessions through temporarily reducing working hours and compensating the temporary loss of income by unemployment insurance. This labour market adjustment measure is a true paradigm for the concept of transitional labour market (TLM) developed by a network of European social scientists[27] and coordinated by the Social Science Research Centre in Berlin (WZB).[28] Economically, this instrument allows workers to accept some wage flexibility in exchange for employment security, and employers to accept some fixed wage-costs in exchange for workers' loyalties and skills. In terms of social risk management, this instrument provides fair risk-sharing between capital, labour and the state. The European Employment Strategy running under the flag of "flexicurity" has so far emphasised external flexibility, i.e. contractual flexibility inducing high labour turnover (job-to-job transitions, transitions from employment to unemployment and back to new employment, regional mobility) buffered by some income security (the Danish model). TLM argues, among others, for a more extensive use of internal flexibility which should be better acknowledged in future EU directives, guidelines and respective employment promotion programmes. Both features – adjustment through internal or functional flexibility by maintaining the employment relationship and fair risk-sharing by ex ante redistribution through social insurance covering to some extent not only external but also internal or 'manufactured' risks (Giddens 1996) – justify speaking of employment insurance which of course still includes unemployment insurance. That's why we shall take a closer look at this instrument, starting from German experiences where short-time working played an important role in managing the last recession.[29]

German *Kurzarbeit* goes back more than 100 years. In fact – and interestingly for the current debate in Europe – it was established (1908) before the national unem-

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[27] Visit the network, which was supported by the EU Fifth Framework Research Programme (running from about 2000 to 2007), at www.siswo.uva.nl/tlm.
[28] Among others: Auer & Gazier (2006); Schmid (2002, 2008, 2011, 2013); Schmid & Gazier (2002); various contributions in Jørgensen & Madsen (2007); Muffels (2008); Rogowski (2008).
[29] The following relies on Schmid (2013).

ployment insurance system in the Weimar Republic (1927). Most importantly, it was – in contrast to the highly contested unemployment insurance – broadly accepted and legitimised because it covered a risk caused by a national legislation that increased tobacco taxes which immediately would have led to some sectoral and regional-specific unemployment if *Kurzarbeit* were not established.

Today, there are three different types: *cyclical short-time work* to maintain employment in cyclical troughs; *seasonal short-time work* helps construction workers in particular to overcome income risks during bad weather and cold winters; *structural short-time work* helps companies to restructure and prepare redundant workers to find a new job. Workers – and this is an important ingredient for institutional capacity – are entitled to short-time work. Even works councils have the right to apply for short-time work at the public employment service (PES). Reduced wages are compensated like unemployment benefit, which is by 60 or 67 percent replacement of net income.

In 2009 about 1.4 million workers went on short-time work and reduced their working time on average by about one-third by maintaining their full-employment relationship. However, *other instruments of internal flexibility* were also used, for instance, the reduction of overtime, the melting down of accumulated working-time accounts, and the reduction of working time by utilising time *and* 'wage corridors' provided by collective agreements. These corridors allow firms to deviate from standard collective agreements, for example, by reducing under certain conditions working time *with* respective cuts of wages; so, 'wage corridors' are an instrument of both: working-time *and* wage flexibility. Most agreements provide for 10, some for 20 percent deviation from the standard weekly working time (e.g. a corridor of 32 to 40 hours); but wages are not allowed to fall below this level. Although, for instance, the volume of working time fell in the machine-tool industry by about one-fifth, the employment level was practically maintained; at the end of 2010, only a few short-time workers remained, and the working volume reached the level before the crisis. The use of these internal flexibility instruments combined with various elements of income security is one of the main reasons why Germany coped with the crises without substantial increase of unemployment (Eurofound 2010, Möller 2010).

Yet, before praising this as the 'German job miracle', the balance of this kind of risk-sharing has to be carefully assessed (Table 6). *For the workers* the advantages are quite clear: Their wages are insured in a double form: by inclusion into the UI system, and by collective agreements that top the regular wage replacement up to 90 percent. In addition, short-time workers maintain their jobs, their qualifications and their social networks. The low incentives for activation and mobility, however, are problematic, and current regulations do not legally entitle short-time workers to qualification measures.

Table 6: Fair Risk-Sharing through the instrument of "Short-time Work"

	Strengths	(Current) Weaknesses
Workers	- job security - labour market security (in particular maintenance of skills) - income security (80–90%) - social network security	- little activation incentive - little mobility incentive - no entitlement to training or education
Employers	- maintaining workers' skills (opportunity costs up to 32,000€) - high flexibility in form of: > fast reaction, strategic waiting, reversible > task specific adjustment of staff	- high fix costs (24%–46%, depending on size of discretionary subsidies) - little activation incentive - no right to issue instructions to short-time workers
Society (State)	- diminished unemployment > 1.4 million (Germany 2009) - stabilising purchasing power and psyche - high flexibility in form of: > discretionary regulation	- disadvantaging ‚outsiders' - slowing down structural change - debt financing of > payroll taxes, qualification > 5 billion for wreck-bonus

Source: G. Schmid, own presentation

For employers the most immediate advantage is the maintenance not only of skilled workers, but also of workers who are loyal and cooperative; the transaction costs of recruiting, for instance, high-skilled craft workers or engineers are estimated to amount up to 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 also offers employers the opportunity of *strategic waiting* in the 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 an opportunity to adjust the organisation of work precisely according to the specific tasks to be reduced or expanded. The government increased this flexibility by relaxing the 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. The remaining fix-costs per short-time worker of between 24 to 46 percent depending on the size of government subsidies can be problematic; for the society, however, these remaining fixed-costs are an effective incentive to not misuse the system. The low incentives for employers to improve the long-term employability of their workers are also problematic; they do not even have the right to instruct workers in the short-time work phase.

For the society or the state, the first evident advantage is the avoidance of open unemployment. The German short-time working scheme together with other working-time adjustments prevented the open unemployment of 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', meaning the panic reactions of workers, for example, an unreasonable saving that might reduce effective demand leading to a vicious circle. For the *government* and the PES as social 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 employers a comfortable planning horizon; and the PES gave employers a great deal of freedom in implementing the scheme. It could do so because both the managers of private companies and public employment agencies had over a period of time gained not only experience with this instrument but also mutual trust relationships.

The problematic features, however, are not just minor. Each job protection scheme weakens the situation for '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 on 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 by offering a large stimulus package through a so-called wreck-bonus. People owning a nine-year-old car could deposit their car in a wrecker's yard and take home a new car subsidised by 2,500€. This cost the society another five billion Euros and contributed, of course, to high public debts.

Short-time work as an instrument of employment insurance, therefore, has clear disadvantages compared to external flexibility covered by UI. State subsidies may shift the costs to taxpayers or to marginal workers; job security may maintain non-competitive industrial structures and lead to jobless growth or new job creation only in a non-standard form, especially temp-agency work. In 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 are too low; and a corresponding capacity of flexible training infrastructure is still missing. All in all, however, the balance is positive. Yet there is a clear need to complement this instrument with other elements, especially with lifelong learning, which can also be seen as an opportunity to take a definitive step forward to a system of employment insurance.

Further examples for protected flexibility are hedging income risks during further training or retraining by providing education vouchers; or hedging income risks during leaves for parenting, taking care of sick family members or for sabbaticals. In the spirit of TLM, preventative upskilling or re-skilling (e.g. for the green economy) would be a particular challenge for enhancing the social dimension in Europe, especially directed towards low-skilled people and small and medium-sized firms. It goes without saying that the demographic challenge also calls for enhancing measures for preventing skill deficits.

Non-standard employment relationships have expanded in most EU member states. They certainly enhance flexibility both for employers and employees, but they also contribute to increasing social inequality (Reimann 2013; Schmid 2011b). It would therefore be a distinct task of the European Social Model to further develop *and* maintain mutual standards of social protection for life-course transitions that are of common value in Europe, such as the right to return from a part-time job to an equivalent full-time job. Often the legal framework for such protection is already available, but effective implementation is hampered by lack of procedural securities and control. Reloading the open method of coordination (OMC) could enhance efficient implementation by encouraging member states to establish binding procedures and control measures according to their administrative culture, for instance, work inspectors, legally endorsed collective agreements or administrative agreements like the covenants in the Netherlands or regional employment pacts in many member states (Falkner et al. 2005; Bekker 2013; Hartlapp 2014; Korver & Schmid 2012). To give the OMC sharper teeth, a combination of 'hard' European Framework Directives with 'soft' OMC guidelines (recommendations, 'naming and shaming') should be considered (Scharpf 2010).

Final examples are wage insurance for workers who have to change to lower paid jobs as a result of diminished individual productive capacities, and targeted in-work-subsidies for workers whose income capacity is temporarily restricted through unpaid care obligations, in particular single parents. Wage insurance might be included into the national or European employment insurance systems or financed and implemented in separate funds (like in the German case of parental leave allowances) or even in joint ventures by the state and social partners (collective framework agreements).

Yet, external flexibility in the form of labour mobility (migration, long-distance commuting) should not be neglected. The labour demand side requires increasing flexibility to meet new challenges from lengthening value chains and work organisations governed by permanently changing projects (i.e. deepening labour division); the labour supply side, too, requires increasing flexibility to meet challenges from unstable family structures or changing preferences during the life course and ageing of the workforce shifting the pressure of structural change from intergenerational to intra-generational adjustment. Freedom of movement for EU citizens, i.e. the freedom to settle and work in any EU member state, has only created the necessary condition for a *European labour market*. The sufficient conditions – like enhancing language skills, developing a welcome culture of indigenous people for foreigners, transferability of security entitlements from national health, unemployment or pension insurances, transnational acknowledgment of skills and many more – are, to put it mildly, not yet realised to their full potential. This is, however, not the place to discuss this complex field extensively.[30]

Only one often neglected fact shall be emphasised in the following: the capacity of long-distance mobility for labour market adjustment (in particular across the border migration) is quite restricted and will remain so. But even this restricted capacity might be better exploited through a European-wide coordination of housing and transport policy. Recent empirical research corroborates this fact (Table 7). A comparison of mobility experiences in six EU-countries, first, confirms that about half of the active labour force aged 25 to 54 is currently mobile or had mobility experiences looking backwards. However, two-thirds up to three-quarters of these mobile people move in a circular manner, which means they daily commute long distances and do not give up their residence. Of those who gave up their residence, only 2 percent moved across national borders. In Germany, for instance, only 22 percent of 49 percent of mobile people changed their residence. In other words, only 10 percent of the core active labour force changed their residence over a longer period of observation.

Table 7: Extent and Patterns of Spatial Mobility in Six Selected EU-Member States, in percent

	FR	DE	ES	PL	CH	BE	Ø
Total mobility = Σ	51	49	52	37	51	42	48
currently	15	19	14	15	13	17	16
earlier	36	30	38	21	38	25	32
Structure of Σ-mobility	100	100	100	100	100	100	100
circular	65	69	83	76	73	87	70
residential	27	22	12	12	18	11	22
both	8	9	6	12	9	2	8

Source: Ruppenthal and Lück (2009), according to their table 1; the percentage figures refer to the active labour force aged 25 to 54; basis of these figures was a representative survey; "currently" refers to mobility experiences in the last three years; "circular" = long distance commuting (at least two hours daily); "residential" = new residence at least 50km distant from original, inclusive transnational (which, however, makes up only 2 percent of all mobile people)

[30] Some references must suffice here: Cedefop (2011), Dhéret et al. (2013), Kahanec (2012), McLoughlin & Münz (2011), OECD (2013), Schneider & Meil (2008), Schneider & Collet (2009), Thränhardt & Hunger (2003), Zimmermann (2009).

The low acceptance of residential mobility (in particular across national borders) and the obviously high acceptance of long-distance circular mobility can only lead to the conclusion that there is still a potential to promote this mobility in a limited way through an improvement of transport infrastructure. A European-wide coordinated investment programme, therefore, could synchronically support jobs in the transport sector as well as the adjustment capacity of labour mobility. Moreover, the great barriers for residential mobility could at least partially be reduced through a mobility-friendly housing market, for instance, through the price regulation of rented flats or real estate insurances.

Summing up this section, it should be emphasised once again: External flexibility in the form of regional mobility can be considered – in its pure economic function – as an important element of employment insurance, but its actual potential is fairly limited, apart from the social costs which every migration brings with it (loss of friends, neighbourhoods, etc.). Ettore Recci (2008), for instance, calculated on his new empirical basis of mobility experiences that it would take at least 10 years to equalise the regional differences of European unemployment through regional labour mobility.[31] There is therefore no way out, as has been emphasised several times already, of reorienting the EU-2020 concept of 'flexicurity' more towards exploiting the potentials of numerical and functional internal flexibility. This leads me to the next strategy, which is particularly related to functional flexibility.

III. Investing in People

Investing in people is central if Europe wants to remain competitive. The issue is not just about preventing skill shortage due to our ageing society, for example; the issue is above all about combating a central cause of rising inequality. Across the whole union, the employment rate for highly qualified people is on average about 83 percent; the employment rate for low-qualified workers is on average only around 53 percent. This makes a difference of 30 percentage points. It should become an objective of the European Social Model to narrow this gap, e.g. by including into its EU-2020 objectives the benchmark of at least 65 percent employment rate for low-skilled people.[32]

The costs of not investing in individual skill capacities are enormous: It hampers not only the creation of new jobs but also innovation and thereby competitiveness. One of the many studies on growth and skills finds that 50 additional points on the PISA scale induce 0.6 percentage points more growth. This makes 30 percent more income measured after 40 years (Piopiunik & Wößmann 2011). Further-

[31] Even in the US a clear trend towards decreasing labour market transitions (in particular job-to-job transitions) and geographic mobility (intraregional as well as interregional) has been observed (Molloy et al. 2014).

[32] For Germany, this would mean an increase of the employment rates of low-skilled by 10 percentage points; the benchmark might be weighted by the share of low-skilled related to total employment.

more, OECD's new comparative survey on the state of education for adults (*Programme for the International Assessment of Adult Competencies*, PIAAC) hints at the important fact that the usual measurement of returns to education on the basis of earned income in the early phases of working life underestimates the total life-course income by about one quarter (Hanushek et al. 2013). For Germany, in particular, it is remarkable that the institutional capacities for continuous training and education were not able to compensate for or even to reverse the disadvantages related to the social and economic background in the formal (primary, secondary and tertiary) school system. PIAAC shows drastic deficits in key competences like reading, calculating and managing computers especially for the long-term unemployed, which are probably further aggravated the longer the unemployment spells are (Rammstedt et al. 2013). So, the battle against long-term unemployment still has to be fought, and this challenge could be a further task for European co-ordination and mutual learning from each other (OMC).

But it is not just about enhancing social inclusion by targeting investments into formal education or continuous education and training for disadvantaged people. As the current unemployment situation among highly educated young adults in some countries (in particular Mediterranean member states) shows, it is also about encouraging a good balance of simple, professional and high qualifications. Europe needs not only academics but also engineers, skilled craft workers and competent labourers. From this perspective the current EU-2020 emphasis on at least 40 percent with a (tertiary) academic education for young adults (aged 30 to 34) is not justified. The emphasis should be shifted more to opportunities of upward mobility for low and middle-level skills through enhancing dual systems of learning (combining work and education) and to breaking the glass ceilings for disadvantaged children in the early stages of education.

As we cannot wait until the education system has produced the new skills for new growth, it would be an essential component of the future European Social Model to strengthen the links between the education system and the labour market over the whole life course. Easy transitions between education and work or the combination of both should not only be possible after secondary or tertiary education, but also for the rest of one's whole adult working life. This would not only improve the horizontal and vertical mobility, but also *induce mobility chains* that would altogether raise the capacity of flexibility. Why is it still exceptional if not impossible that a nurse step-by-step becomes a professional doctor?

Education or training should not stop at a certain age. Recent research shows a clear positive correlation between training participation and labour force participation of elderly people, even after controlling for other factors.[33] Furthermore,

[33] In a well-designed study, Picchio & van Ours (2011) investigate – in the spirit of TLM – whether on-the-job training has an effect on the employability of workers. Using data from the Netherlands, they disentangle the true effect of training incidence from the spurious one determined by unobserved individual heterogeneity and controlling for other factors. They find that training pro-

the widespread belief (and respective policy advice) of mainstream economists that investment in education and training in old age doesn't make sense for the simple fact that substantial returns of these investments cannot allegedly be reaped anymore due to soon-to-be-expected retirement (e.g. Heckman 2000), should be reconsidered at least under two perspectives: First, retaining older workers in employment through life-long-learning enables these older workers to pass over their tacit knowledge to the young generation, which enhances the productivity of the firm. Second, the (economic) link between labour market and the education system exists even beyond retirement: knowledge goods need knowledgeable people to buy and to consume.

IV. Efficient Labour Market Regulation

Productive capacities and flexibility could be enhanced by establishing a real European labour market through *efficient labour market regulation*. The basic orientation must be to diminish inefficient flexibility by better utilising existing capacities. This may sound like squaring the circle, but plausible arguments and illustrative examples can be put forward.

An example immediately at hand is the EU-wide recognition of qualifications which would improve mobility, especially in areas threatened by skill deficits. A directive for a European Professional Card is already in the making. However, this should not lead to an erosion of quality standards in order to guarantee a sustainable rise in productive capacities. We may not, just to name an example, praise dual vocational training and education as a successful tool against youth unemployment and jeopardise the merits of this qualification at the same time through lowering standards. Furthermore, there is a contradiction between national vocational education and training systems and the European labour market. The case of qualifications for bricklayers shows, that there are at least three different models in education and training in this occupation calling for *sectoral qualification frameworks* if differences in qualification are to be recognised and if the European Qualification Framework (EQF) passed by the European Parliament in 2008 is to function as a meaningful translational device (Clarke et al. 2014).

Related to the already mentioned lift in non-standard forms of employment relationships, recent research shows that the excessive use of fixed-term contracts, including temp-agency work, may hamper innovation and productivity if excessively used as an easy short-term adjustment mechanism to retain price competitiveness instead of investing in sustainable quality competitiveness.[34] So, some restriction of fixed-term contracts would enhance and not erode productive ca-

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vided by firms significantly increases future employment prospects. This finding also holds for older workers, suggesting that on-the-job training may be an important instrument to retain older workers at work.

[34] For recent corresponding research on this issue see the impressive overviews by Martin & Scarpetta (2011) and Kleinknecht et al. (2013).

pacities in the long-term. One way to do this would be to set the right economic incentives, for instance internalisation of risks, in other words risk-related contributions to social security and training funds. Fighting inefficient flexibility would also support the life-course planning of young adults who are most hit by non-standard and often precarious forms of employment.

A highly contested example is the suggestion to regulate a Europe-wide minimum wage. Of course, this target cannot be met by a unifying minimum wage, which would be an economic hara-kiri. It would however be sensible to establish common rules, for example to set the minimum wage on a national level and to monitor the impact through reloading the open method of coordination in close cooperation with corporate representatives and trade unions (social dialogue). One rule could be that the minimum wage should not be lower than a certain relation to national average or median wages respectively, e.g. 50 percent. Member states may then make annual adjustments according to their individual experiences. Another aspect in which European guidelines could be helpful is for exploring possibilities and impacts of national legal acknowledgements of collective agreements related to wage standards. Two recent studies clearly demonstrate that a joint European monitoring of minimum wages could help to coordinate European wage policies without affecting national or sectoral sovereignty. Whereas the Eurofound-Study (Fernández-Macías & Vacas-Soriano 2013) sets the emphasis on the impact of a hypothetical European minimum wage threshold, the ETUI-Study (Kampelmann et a. 2013) focuses on the different national processes of minimum wage formation.

The *Eurofound-Study* engaged in an accounting exercise to quantify the number of workers that are currently below the threshold established by a hypothetical common EU minimum wage policy (EUMW) of 60 percent of the median wage in each member state, and to identify the types of companies, jobs and individuals that would be most affected. It turned out that the country where the impact would be one of the highest is Germany: its share of workers currently below 60 percent of the median is around 25 percent. More interesting, however, are the estimated microeconomic and social effects. Most of the workers below the EUMW threshold work in small companies, mostly in personal service sectors such as in retail and health. Almost half of them would work in service and elementary occupations, and although the incidence of part-time and temporary employment is higher for this group, most of them have permanent and full-time contracts. Nearly two-thirds of the population potentially affected by a hypothetical EUMW policy are women; and they are predominantly young, too. Hopes, however, that a EUMW could substantially contribute to diminish poverty should be dampened because the main reason for the risk of poverty is related to households with low employment intensity. On the other hand, fears that a EUMW would negatively affect competitiveness should also be dampened because the raise of minimum wages would affect mainly the non-exporting sectors.

The *ETUI-Study* is highly informative in two respects: First, the authors demonstrate how difficult it is to come up with reliable measures of factual or virtual national minimum wages; so, the first step still has to be made in establishing a reliable comparable data base. Second, they clearly underline the importance of thinking about the European debate as a choice between different minimum-wage systems rather than as the choice of a certain rate to be harmonised across the Union. They show empirically that the combination of sectoral minimum rates and high levels of collective bargaining coverage can be regarded as constituting a functional equivalent to a binding statutory minimum wage at the national level. Their results notably suggest that both higher collective bargaining coverage and a national statutory minimum wage are significantly associated with lower levels of inequality among workers and between sectors.

But there are also trade-offs. Minimum wage systems with statutory rates at the national level are related to relatively lower wage floors. This is evidence in favour of an argument frequently put forward by trade unions from the Nordic countries claiming that sectoral-level bargaining allows workers to obtain higher relative minima. However, in systems without statutory minima, the higher rates enjoyed by insiders appear to come at a cost for outsiders. All other things being equal, the higher the level of the minimum wage relative to the median wage, the more workers earn wages that are actually below the prevailing minimum. Minimum-wage systems differ also with respect to the proportion of workers that are either uncovered or whose wages violate existing minimum rules. A system with a national statutory minimum fares better in this respect than a system with sectoral level minima, although higher levels of collective bargaining can offset this difference to some extent.

To sum up this point, starting with a joint European monitoring of minimum wages and then coming up with some common guidelines would contribute not only to avoiding cut-throat competition by wage dumping. It would also contribute stimulating investments in quality work and increase the domestic purchasing power of strong economies, thereby enhancing the export chances of weaker countries.[35]

Finally, regulation to ensure universal access to basic social services – provided free or at affordable prices for everybody – is of special importance for social in-

[35] By regarding unit wage cost trends of the last decade, it is understandable that many people gained the impression that Germany was playing some beggar-thy-neighbour policy by having insufficient minimum wages and rapidly expanding the low-wage sector. According to a compilation by the *Wirtschaftskammer Österreich* (WKO), in the period 2000–2005, nominal unit wage costs increased by 0.1 percent in Germany (yearly average) compared to 1.8 percent in the Eurozone; the respective figures between 2005 and 2010 were 0.8 percent in contrast to 1.9 percent in the Eurozone. It was only in 2011 that the German increase of nominal unit wage costs was higher than in the Eurozone; http://wko.at/statistik/eu/europa-lohnstueckkosten.pdf (download 15.10.2013).

clusion. The “Service Directive”[36] provided a general framework for the liberalisation of the service sectors and was implemented in revised form after heavy opposition (mainly from Western trade unions) in 2006. Although the revisions now respect some social considerations, a true European social model would have to provide more securities to ensure accessibility and a high quality of basic services such as energy, telecommunication, care, health, and waste disposal for all, in particular for low-income households with children. The main problem lies in the fact that the directive still reflects the presumption that the market is better able to provide these services than the state. Certainly, while the reverse is not true either (see the well-known possibilities of state failure), a generally accepted Social Union of Europe should leave more room for decision at the decentral level to take care of such services provided that commonly agreed accessibility and quality standards are ensured. It is problematic that democratically legitimised local or regional public authorities find themselves pushed into the defensive, for example, because they are obliged under certain circumstances to justify government aid to the European Commission, or where new players (foreign or otherwise) challenge imposed rules at the European court of Justice as being trade restrictions, arguing that they distort competition. It would be the task of the European Commission and the European Parliament to ensure minimum social standards for basic services through a revised EU Social Services Directive[37] and to ensure European social standards in the further globalisation process (e.g. in the bargaining over a transatlantic trade and investment partnership).

Summary and Outlook

This essay intended to make clear the rationale for a political deepening of Social Europe. Although *the* “European social model” proves to be an illusion when regarded as a uniform, integrated system, some kind of an overall common concept of the “social” can be defended. Sure, the Portuguese, the Hungarians, the Swedes, the English, the French, the Germans, the Polish – not to mention the Bavarians, the Basques, the Welsh, the northern Sami, and others – all understand and practice a different “social Europe”. Yet, in comparison to the United States or Japan, never mind India or China, Africa or Latin America – there are undeniable commonalities (see, for instance, Giddens 2007; Matzner 2002). My own version contains the following elements:

- The idea of the *social obligation* of individual property which acknowledges the role of sheer luck in market incomes from which follows the need for *periodic redistribution* to ensure comparable living standards for all

[36] See the Directive 2006/123/EC of 12 December 2006 on services in the internal market, which is also known as the Bolkestein-Directive.
[37] For a concrete proposal see Frazer et al. (2010, 191–5).

- The idea of *social inclusion* which acknowledges different physical, cognitive and emotional endowments of people from which follows the need for *ex ante redistribution* to ensure equal opportunities in participating in social and economic life

- The idea of *social partnership* which acknowledges the need of cooperative competition from which follows the need to restrict the market by social standards and *give workers a voice* in market decisions, among others through collective interest representation to ensure a fair level playing field in contracting employment relationships and working conditions.

Surveys and empirical studies also hint at the existence of a common canon of social policy values. The expectations to entitlements from the 'welfare state' are closer among Europeans than the realised entitlements in individual European member states (Kohl 2013). The idea of solidarity across and between European member states is widespread (Gerhards & Lengfeld 2013). The Eurobarometer indicates that trust in European institutions is often higher than the trust in national institutions. Although the generalised support for the EU went drastically down during the Euro crisis and Great Recession, a reversal to the positive side seems to be on the horizon, and the generalised positive attitude towards European institutions seems to not be fluctuating as much as the generalised support. Furthermore, policy makers and intellectuals from the outside world often see Europe as a model to push forward their own social reforms. John Buchanan (2004), for instance, points out that Australia's trade unions and women's movements historically always regarded Europe as a model. The European social dialogue is also often mentioned as a model in the public and intellectual debate in Latin America and Asia (Bizberg 2004; Tanaka 2004). A failure of the EU Social Model would thus come as a great disappointment to many observers outside Europe.

Even if it is true that the social dimension is not yet deeply anchored in the European treaties, it is more existent there than often maintained. Article 9 of the Treaty on the Functioning of the European (TFEU), in particular, deserves to be mentioned because it contains a 'horizontal social clause' imposing the EU to take into account *"requirements linked to the promotion of a high level of employment, the guarantee of adequate social protection, the fight against social exclusion, and a high level of education, training and protection of human health"* when defining or implementing its policies. Experts of European labour and social law point to additional clauses which endorse the nearly equal importance of the social dimension related to the objective of economic integration. Franscesco Costamagna (2012), for example, persuasively argues that some of the conditions attached to the ESM assistance packages raise doubts as to their compatibility with a number of basic social principles and objectives that represent the foundations of the EU social dimension. The financial assistance programmes devised to rescue some EU Member States required governments to adopt draconian austerity measures (e.g. Greece, Portugal) to an extent that their consequences were not compatible with the principles of social inclusion.

In Germany, it is above all the well-respected social philosopher Jürgen Habermas (2013, 82–111) who calls for fundamental reforms of the treaties, better today than tomorrow, because the rescue measures of the Euro and fiscal crisis have already gone to the limits of democratic legitimacy. He argues therefore for a deepening of the "Political Union" and a strengthening of the "Union Principle" ("Gemeinschaftsmethode") by extending, in particular, the rights of the European Parliament, for instance, the right of initiative in European laws and directives, and de facto the right to elect the European Commission's president. He persuasively reasons that the necessary generalisation of European interests crossing national interests can only take place in the European Parliament structured by political and not by national fractions. A European-wide "us-perspective" (*"Wir-Perspektive"*) of European citizens can only be transformed into institutionalised power through parliamentary procedures. Such a change in perspective is necessary to overcome the so far privileged intergovernmental coordination of only seemingly sovereign nations through a joint formation of political opinion by the European Parliament. The inevitable effects of short- and medium-term redistribution to solve the current economic crisis can only be legitimised if national interests get linked to and qualified by the common European interest (Habermas 2013, 148).[38]

So, the best part of a European Social Model could still be on the way. But this little glimmer of hope might soon become extinct if Europe does not succeed in controlling the financial markets (for instance, through a European Banking Union) and in getting its weak economies on a path to stronger inclusive growth (for instance, through a massive investment programme into the European infrastructure (energy, transport, ICT, education) and into a 'greening' economy. In turn, only an *institutional capacity building* striving for a *European* social model as suggested here and in other recent publications (e.g. Vandenbroucke 2012, Vandenbrouck & Vanhercke 2014) as well as more binding coordination of social policies (e.g. Scharpf 2010, Bekker 2013) would support and ensure the *sustainability* of this growth.

The main aim of this essay was to show that it is not only 'the economy, stupid', which necessitates and legitimises a deepening of the EU political union through strengthening supranational institutions like the European Parliament and the European Investment Bank. It is also 'the social dimension, stupid' which necessitates and legitimises a deepening of the EU political union through strengthening supranational institutions like the European Social Fund and possibly (in the long-term) building up an own European institutional capacity of employment insurance. By strongly directing these institutions towards the complementary support of national capacity building, in particular through – as suggested here – investive social transfers, protected flexibility, human and social capital investments, and an

[38] For further considerations on necessary reforms of European political institutions see, among others, Nida-Rümelin et al. (2013).

efficient European labour market regulation, such a deepening of the European political union could probably regain if not an enthusiastic then at least an optimistic support of European citizens.

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