

Analysis on Impact of Unemployment Insurance System Reform in Northern Europe on Employment Level¹

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Abstract

In 1990s, Northern European countries made reform on unemployment insurance system. They declined the unemployment insurance treatment, released more strict rules for obtaining treatment, and intensified the supporting force on active labor market policy. Under the effect of all these reform measures, the unemployment rate in Northern countries was decreased to different extent after the mid 1990s and kept at low level after 2000. The paper analyzes the influence degree of social security system reform on employment in five Northern European countries by applying the measurement model. At the end, it comes up with the conclusion that social security expenditure level forms negative correlation relation with employment rate. Unemployment insurance system reform decreases the social security expenditure level, and enhances the employment rate.

Key Words: *Unemployment Rate, Flexible and Safe, Active Labor Market Policy.*

Introduction

Northern European countries mainly include five countries, i.e. Denmark, Sweden, Norway, Finland and Iceland. After World War II, five Nordic countries built up social security system (hereinafter referred to as "social security") "from cradle to grave" successively. The social security system in Northern European countries is highly consistent while differing from other countries or regions, so it is called as "Nordic mode", or "Scandinavian mode". Due to the influence of oil crisis, economic globalization and collapse of Soviet Union, the unemployment rate in Northern European countries rose greatly and the economic recession occurred from the late 1980s to the early 1990s. Under this background, five Nordic countries reformed on unemployment insurance system to different degrees so as to decrease the unemployment rate

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and facilitate the economic growth. Through the reform for more than ten years, in 2013, the unemployment rates in Denmark, Finland, Sweden, Iceland and Norway were 6.5%, 8.8%, 8.0%, 5.1% and 3.2% respectively, with the actual GDP growth rate of 0.4%, -1.4%, 1.6%, 3.3%, and 0.6% respectively. Compared with 10.2% of unemployment rate and 0.1% of actual GDP growth rate in 28 countries of European Union, Nordic countries kept at low unemployment rate while maintaining relatively high economic growth. To some extent, the reform of unemployment insurance system in five Nordic countries played an important role in the employment level development and economic growth.

Content of Unemployment Insurance System Reform in Northern Europe

Through the research on Nordic countries, Bernt Schiller points out that the labor market mode in Northern Europe has four common features Bernt (1995), i.e. high density of Trade Union, collective bargaining and agreement, tripartite cooperation, and wide country participation. Based on above, Christer Thornqvist adds the features of high female employment rate and “double income family” Thornqvist (2010). These features form the unemployment insurance mode in Northern Europe. In the face of the severe economic recession and rise in unemployment, each Nordic country made reform on the unemployment insurance system to varying degrees in 1990s. The employment policy started to emphasize on work obligations. Denmark and Sweden were the typical countries for the unemployment insurance reform in Northern European countries. Their reform measures mainly focused on reducing the unemployment insurance treatment, making strict conditions for obtaining unemployment insurance benefits, and increasing the active labor market policy investment, etc. Most of the reform measures were based on the adjustment of the original system. Thus, there was no fundamental change in the unemployment insurance system in Northern Europe. Through reform, the unemployment rate in Northern European countries was reduced substantially, and kept at a relatively low level after 2000. The paper analyzes the main content of the unemployment insurance system reform in Northern European countries as below.

Decline the Unemployment Insurance Treatment

In the early 1990s, due to rise in unemployment rate, the unemployment relief expenditure of Nordic countries was increased greatly. The countries had heavy pressure on unemployment insurance fund. From 1990 to 1993, the unemployment relief expenditure in Finland, Sweden and Denmark was increased by 3.6%, 1.8% and 1.1% as the proportion of GDP respectively. In the corresponding period, the countries of OECD increased by 0.5% averagely⁽³⁾. Under the pressure of the unemployment relief expenditure, Nordic countries successively declined the unemployment treatment. Taking Sweden as an example, the unemployment rate in Sweden has increased quickly since 1991. The open unemployment rate rose from below 1.7% to 8.2%. If we take the invisible unemployed population into consideration, the unemployment rate would reach 10% Anders(2001). The unemployment insurance expenditure of Sweden increased rapidly. The unemployment insurance fund could not make ends meet. It was changed from surplus SEK 19.6 billion in 1991 to deficit SEK 53 billion in 1994. The unemployment insurance fund lost the basis for stable operation Weijia(2011). In order to handle the severe situation of the unemployment insurance fund, Sweden lowered the unemployment insurance treatment in 1991. The substitution rate of the wage in unemployment insurance benefits reduced from 90% to 80%. Meanwhile, it set up Social Insurance Fund Administration for unified management of unemployment insurance fund. In 1994, after the social democrats ruled the country, the substitution rate of the wage in unemployment insurance benefits further reduced to 75%. However, it was strong protested by Labor Union Ereeman (1997). Through the negotiation between social democrats and Labor Union, the substitution rate of wage in Swedish unemployment insurance benefits in 1997 returned to 80%.

Since 2006, Sweden had made many substantive reform measures to decline unemployment insurance treatment. The unemployment fund policy which established in 2007 led to the rapid increase in unemployment insurance payment. As a result, it made 498,000 people left away from the unemployment insurance fund from 2006 to 2008, 40% of which were young people. Besides, Sweden also abandoned the

rights of obtaining the unemployment insurance benefits through study or previous work experience Andersen (2012). In 1997, the longest payment period of the unemployment insurance in Norway reduced from 160 weeks to 156 weeks. In 2003, the payment period for the people who earned more than EUR 13,300 annually reduced from 3 years to 2 years; while the payment period for the low income people reduced from 2 years to 1.5 years Reiertsen & Årethun (2007). In addition, Norway also adjusted the recommended benefit level for a few times after 2000.

More Strict Qualification of Obtaining the Unemployment Insurance Benefits

In order to reduce the unemployment insurance expenditure and maintain the stable operation of unemployment fund, Sweden set five days waiting period again in 1991. In addition, since 1997, the qualification of obtaining the unemployment insurance benefits by continuous 4 months payment was enhanced to 6 months. Meanwhile, a person was only able to obtain the unemployment insurance benefits for 3 years. If the person participates in active labor market policy or attends at least six months educational training in these three years, the person would extend the period for 4 years. In addition, it also stipulated that the people who resigned, or fired due to misconduct, or refused to accept the proper work assigned by the labor management department without sufficient reason, cannot enjoy the unemployment insurance benefit treatment Yao (2000). In 1993, the period of getting the unemployment insurance benefit in Denmark was divided into two stages, i.e. passive period, and activation period. The passive period was 4 years (it is shortened to 2 years in 1996, and shortened to 1 year in 1999). The activation period was 3 years. It also stipulated that the unemployed must take activation activity for 12 months so as to get the qualification of obtaining the unemployment insurance benefits. The passive period and the activation period in Denmark did not have any difference after July 1, 2003 Andersen (2006), i.e. since the day of unemployment, the unemployed must participate in the compulsive full time activation plan, join in the active labor market, attend the occupational training, occupational education, internships, and job rotation etc., so as to improve employability of the unemployed Xinxuan, Yu Yanfang(2010). After the reform in the early 1990s, in Finland, only the people who had been working continuously for 6 months before unemployment could have the qualification of obtaining the related unemployment insurance benefits. In 1997, it increased to 10 months, while setting the waiting period for 7 days Hng (2010). After 2000, the RWEA Department (Rehabilitative Work Experience Act) in Finland reformed the unemployment relief policy to different extent in 1997, 2005 and 2011 respectively. It had more strict rules on economic investigation, work test and sanction Nordic (2012). Norway had intensified the force of inspecting early retirement qualification continually since 1988. It emphasized more on the relation between right and obligation after 1995, i.e. each citizen has the rights to enjoy the unemployment insurance, but also has the obligation to work.

Intensify the Supporting Force on Active Labor Market Policy

Northern European countries reduced the unemployment relief expenditure; at the same time, they also intensified the supporting force on the active labor market policy. On the one hand, they made more complete policy system of active labor market. For example, Sweden further completed its policy system of active labor market, and set up the career development program with the service ranging from educational support to community work in 1990s. The beneficiary could get a training allowance equal to the unemployment insurance benefits. Denmark started to implement the active labor market policy in 1993. This policy, flexible labor market and generous social welfare system formed the flexible and safe employment policy of Denmark, or it was also called as “golden triangle” employment mode. Denmark government called the improved unemployment security system as “obligations and rights Ploug (2008)”.

According to this system, the unemployed not only had the right to enjoy the unemployment insurance benefits, but also had to perform obligations for active labor market policy. For the unemployment problems of the people without work experience, Finland introduced the labor market allowance on the basis of economic investigation in 1994 Timonen (2003). It changed the unemployment insurance of

Finland to three main systems (unemployment insurance benefits related to income, basic unemployment insurance, and labor market allowance). The policy coverage increased rapidly. Up to the end of 2008, the coverage rate for the unemployed at 25 years old or above was about 50%, while the coverage rate for the unemployed below 25 years old was above 80% Lorentzen, Angelin, Dahl, Kauppinen, Moisio & Salonen (2014).

Labor market allowance has become the most important unemployment policy in Finland. In addition, the labor market policy reform in Finland also included expanding the region of accepting the work obligations, and intensifying the punishment on the people who refuse to accept work, etc. If the unemployed refuses to accept the work, their basic unemployment insurance benefits would be reduced by 20%-40% Grubb & Singh (2009). In order to handle the uncertainty of international economy, the Northern European countries have expanded the educational and training plan for the young people under 25 years old since 2008 so as to adjust the professional skills of the young and meet the demand of the employer. For instance, Finland, Norway and Sweden have carried out "the youth guarantee" plan, mainly focusing on the education and training for the young people around 16-24 years old. At the same time, Denmark has also implemented a few "youth packets" projects Halvorsen and Hvinden (2014). The young people with disabilities in Norway were regarded as special target group Norwegian Ministry of Labour (2013).

On the other hand, the countries increased the investment on the public active labor market policy. Compared with 1990, the expenditure of the public active labor market policy in Sweden, Denmark, Finland and Norway to the proportion of GDP had been increased by 1.2%, 1.0%, 0.7%, and 0.4% respectively, while the countries of OECD had average increase by 0.1% in the corresponding period. At the end of 2009, the unemployment insurance expenditure of Sweden, Denmark, Finland and Norway were 1.8%, 3.9%, 2.9% and 0.9% respectively, while the average of OECD countries reached 1.6%. From 1990 to 2009, the unemployment insurance expenditure of Sweden, Denmark, Finland, and Norway reached 1.8%, 1.6%, 1.1%, and 0.8% respectively, while the average level in OECD countries was only 0.6% OECD. The expenditure of the active labor market policy in Northern European countries increased along with the rise in unemployment rate. Its expenditure level was much higher than other countries of OECD.

Theory Analysis of Unemployment Insurance System and Employment

Unemployment insurance system is an important system arrangement for assuring basic living rights of the unemployed, and facilitating the employment and reproduction of labor. It has significant impact on the labor employment. The welfare mode in Northern European countries is famous with their target of full employment and high employment.

Analysis of Unemployment Insurance System and Social Employment

In the market economy, the social insurance system, especially the unemployment insurance system is closely related to the employment. The most important capital source for the modern social insurance system is the payment from employer and worker. However, this payment mode is built on the basis of employment of the worker. The higher the employment rate is, the more the social insurance fund would be collected.

The unemployment insurance system has the function of protecting worker and facilitating employment. It can reduce the unemployment risk of the worker and help the worker for re-employment. At the same time, there is mutual restriction relation between unemployment insurance and employment. When the unemployment security level is extreme high, the sense of urgency for the unemployed to get a job would decrease, and the employment stability would get worse too. Many studies have found that high unemployment security level had great impact on the low income people for employment situation. It influenced the working enthusiasm of the worker and led to the phenomenon of maintaining the lazy. By analyzing from macro-perspective, as showed in Fig. 1, S represents unemployment security level, while L

represents social labor supply. The relation between unemployment security level and labor supply is a curve which bends to the right side. As an institutional arrangement of labor protection and re-production, the unemployment insurance system could reduce the unemployment risk of the worker and resolve the workers' worries about future. When the unemployment security level is below S_0 , the social labor supply would increase along with the rise in unemployment security level. However, when the unemployment security level exceeds S_0 , there is little income difference from joining in work and without a job. It even has the situation that the work income would be lower than unemployment insurance benefits. Thus, it would influence the enthusiasm of the worker for work, or even cultivate sluggishness of the people in the country Lihua(2011) and influence employment. It would lead to the phenomenon of "maintaining the lazy". As a result, social labor supply would decrease along with the improvement in unemployment security level.

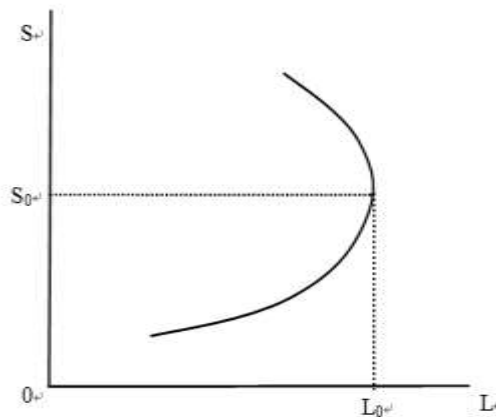


Fig. 1 Relation between unemployment security level and social labor supply

Analysis of Unemployment Insurance System and Individual Employment

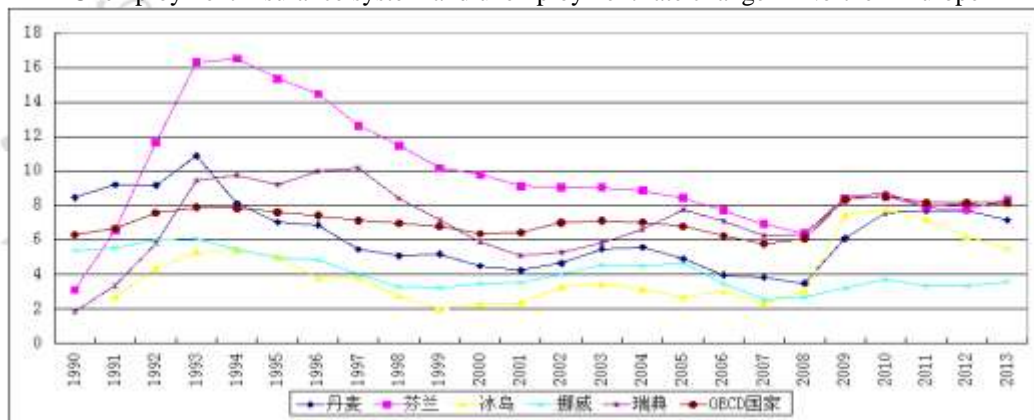
Unemployment insurance system has negative effect and positive effect on individual employment at the same time. Firstly, negative effect. Search theory is the important theory for studying the impact of unemployment insurance system on individual employment. Feldstein and Topel held that the unemployed could estimate the cost and income of searching a job according to the information from labor market. Then, they could decide the psychological bottom price or acceptable minimum wage, i.e. retained wage. The search behavior of the unemployed would continue till the marginal income equals to marginal cost. At this time, the wage level just equals to retained wage, and the unemployed would accept to work. When the unemployed is able to get the unemployment insurance benefits, their expected income and retained wage for searching job would rise. Therefore, the unemployed would be "picky" for jobs, while their enthusiasm for searching job would decrease. Finally, it extends unemployment period Feldstein (1976).

Through empirical research, Meyer found out that, when unemployment insurance benefits level rose by 10%, the average unemployment time of the unemployed would increase by about 7 days. Compared with the wage before unemployment, the wage of the unemployed would rise by 1.2% after obtaining employment. Secondly, positive effect. Mortensen pointed out that unemployment insurance had "entitlement effect" Mortensen (1977). For stimulating and facilitating people to search job actively. During unemployment insurance period, higher unemployment insurance benefits would lengthen the unemployment time of the people. However, at the end of unemployment insurance period, there is high probability of the unemployed to terminate the unemployment situation. By analyzing the data from Sweden, Carling and other people discovered that, when it got close to the end of unemployment insurance period, there was no obvious probability that the unemployed got away from unemployment situation Carling and Holmlund (1996). In summary, the unemployment insurance system extends the unemployment period of the unemployed.

Impact of Unemployment Insurance System Reform on Employment Level

The aging trend of Northern Europe influences the labor supply greatly. In addition, unemployment insurance system also affects the employment level directly or indirectly. When unemployment security level is lower than a certain level, it would form positive correlation to labor supply. When it is higher than a certain level, it would form negative correlation to labor supply. In the aspect of individual labor supply, the unemployment insurance system mainly has the function for increasing income effect of labor supply and reducing the substitution effect of labor supply. Income effect and substitution effect decide whether increasing the labor supply or not. In order to face severe economic and aging trend, and solve the problem of “maintaining the lazy”, Northern European countries adjusted their unemployment insurance system in 1990s. Employment security could be divided into negative employment security and positive employment security. For negative employment security, it mainly assures the basic living of the unemployed by providing unemployment insurance allowance to the unemployed. The purpose of positive employment security is to improve the employment ability of the people for joining in labor market again by training, education and employment allowance, and other measures Dewei(2007), rather than maintaining the basic living of the unemployed. In this paper, it is mainly referred to as active labor market policy. Northern European countries decrease the expenditure of negative employment security, but increase the investment on positive employment security. It exerts impact on employment level to some extent.

Unemployment insurance system and unemployment rate change in Northern Europe



Denmark, Finland, Iceland, Norway, Sweden, OECD countries

Fig. 2 Chart of unemployment rate change for 15-64 years old labors in Northern European countries (Unit: %) Data source: OECD official website.

The social security system in Northern European countries uses full employment as target, and meanwhile, it regards full employment as operation condition. In 1990s, Northern European countries had serious economy recession. Except for Norway, the unemployment rate of Northern European countries increased generally. As showed in Fig. 2, the unemployment rate of Northern European countries reached to the peak around 1994.

Among these countries, Finland had the highest unemployment rate, up to 16.67%. The unemployment rate of Denmark and Sweden were 10.87% and 8.25% respectively. In order to face the severe unemployment situation, Nordic countries carried out reform on unemployment insurance system. Negative employment security policy started to shrink, while the positive employment security policy expanded substantially. The shrinkage of negative employment security was mainly reflected on the reduction of wage substitution rate of unemployment insurance benefits and more strict qualification for obtaining benefits. The wage substitution rate of unemployment insurance benefits in Sweden was reduced from 90% to 80%. Meanwhile, it set 5- day waiting period, etc.

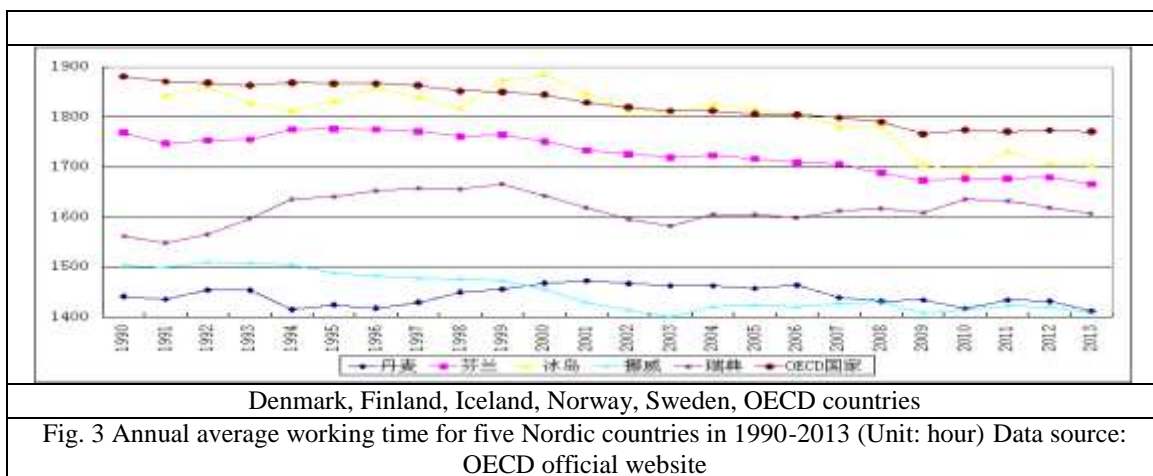
According to the above research of Meyer, the wage substitution rate of unemployment insurance benefits in Sweden was reduced by 10%. The unemployment period of the unemployed was reduced for 7 days. Denmark shortened the benefit period of unemployment insurance, while Denmark, Finland and Norway had more strict qualification for obtaining the benefits. To some extent, it reduced the expenditure of unemployment insurance benefits and was good for shortening the unemployment period. The expansion of positive employment security was mainly reflected on more complete active labor market policy and more public expenditures. Except for Iceland, all the other Northern European countries increased the expenditure for public active labor market policy.

Through the reform of unemployment insurance system, the unemployment rate of Northern European countries started to decrease with different degree after mid 1990s. From 1993 to 2001, the unemployment rate of Denmark, Finland, Iceland, Norway and Sweden was respectively reduced by 6.7%, 7.2%, 3.0%, 2.6% and 4.4%, while the unemployment rate of OECD countries was reduced by 1.5% in the corresponding period ①. According to the data from European Union Statistics Office, the youth unemployment rate in Denmark, Finland and Sweden was respectively reduced by 4.5%, 13.8%, and 7% from 1993 to 2001 (EUROSTAT).

It proved that unemployment insurance system reform in Northern European countries exerted great function on reducing unemployment rate. From 2001 to 2008, except for Iceland, the unemployment rate of Northern European countries was reduced continuously and slowly. After the global economic crisis in 2008, the unemployment rate of five Nordic countries increased slightly, and then showed the decreasing trend. From 2001 to 2013, the average unemployment rate of Denmark, Finland, Iceland, Norway, and Sweden was respectively 5.6%, 8.2%, 4.4%, 3.6%, and 7.0%, while the average level in OECD countries was 7.2% in the corresponding period. Except for Finland, the average unemployment rate of Northern European countries was lower than the average level in OECD countries. However, compared with the other EU countries, the unemployment rate of Northern European countries still stayed at relatively low level. The unemployment insurance system after reform still possessed certain advantages.

Social Security System Reform and Annual Average Labor Time Change in Northern European Countries

The annual average labor time in the world shows the decline trend generally. Its decline range relates to aging degree and social security level directly. As showed in Fig. 3, from long term perspective, the annual working time of the people in five Nordic countries is declined. However, the annual working time of Sweden in 1991-1999, and Denmark in 1994-2001 showed rising trend. The reason of showing different trend is mainly related to the different employment policy reforms in each country.



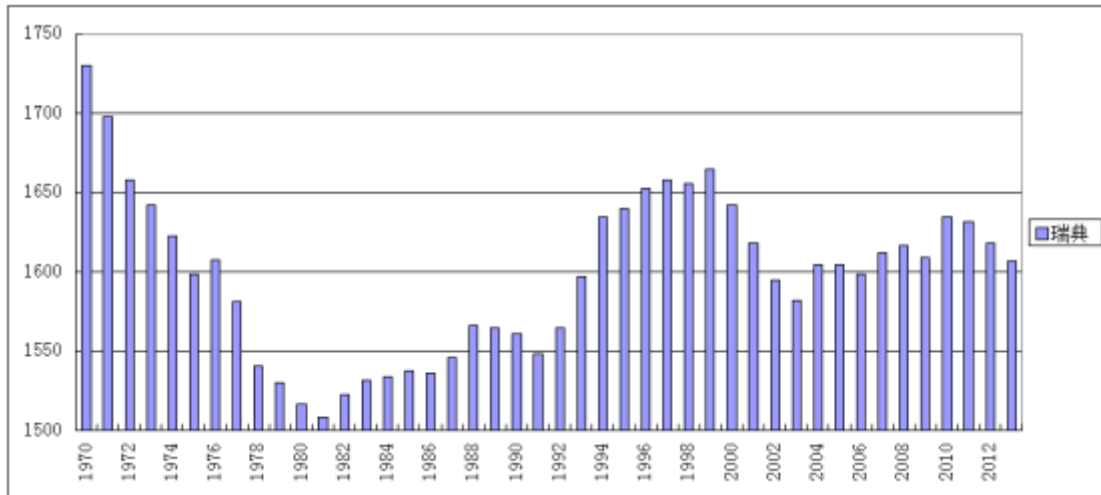


Fig. 4 Annual average working time change of Sweden in 1970-2013 (Unit: hour)

Data source: OECD official website

Take Sweden as an example, as showed in Fig. 4, along with the expansion and completeness of social security system in Sweden, and continuous improvement of social security level, the substitution effect of social security system was larger than income effect for the labor supply in 1970-1981. The annual average labor time decreased rapidly. It decreased 222 hours in 11 years. In the early 1990s, Sweden declined the unemployment insurance treatment substantially. The substitution rate of unemployment insurance income was reduced from 90% to 80%. In addition, it set the waiting period for 5 days. There was not much difference on the income of working or unemployment. The work enthusiasm of the worker was improved. At the same time, Sweden invested on active labor market policy continuously. The annual average labor time of Sweden in 1991-1999 increased about 100 hours, and maintained at about 1,600 hours after 2000. The annual average labor time of Denmark also showed the increasing trend in 1994-2001. It was directly related to the flexible and safe employment policy which carried out by Denmark in 1994. From 2003 to 2010, the annual average labor time showed the increasing trend again. After 2010, it showed the declining trend. This was directly related to the domestic economic situation change of Denmark at that time.

Conclusion

The paper analyzes the effect of unemployment insurance system reform on labor market in Northern Europe by adopting the research method of combining theory and empirical analysis and utilizing the data sample from 1990 to 2013. It comes up with the following conclusion. Firstly, when unemployment security level is lower than a certain level, it would form positive correlation to labor supply. When it is higher than a certain level, it would form negative correlation to labor supply. The social security reform in Northern Europe decreased some welfare expenditures. The security level of unemployment insurance was declined. It increased the income effect of labor supply and reduced substitution effect of labor supply at the same time. Income effect and substitution effect decide whether increasing the labor supply or not. Secondly, under the combined function of negative employment security and positive employment security, the unemployment rate of Northern European countries started to decrease after mid 1990s. Finland had the biggest falling range. The unemployment rate of these countries kept at low level after 2000. Thirdly, under the general trend of the falling annual average working time, the annual working time of Sweden in 1991-1999, and Denmark in 1994-2001 showed the rising trend. It was directly related to the continuous completeness and investment on active labor market policy, active implementation of employment policy, and forming “golden triangle” employment mode. It proved that social security system reform in Northern Europe played an important role in reducing the unemployment rate and improving the employment level.

It enlightens us to realize the balance between fair and efficiency, and facilitate the stable and sound development of labor market in China through social security system reform.

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