

## Public policies targeting labour market rigidities

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**Abstract.** *Labour market rigidity becomes an issue of increasing importance under conditions of shocks associated with the economic crisis due to the need to increase the adaptability and responsiveness to them. Thus, labour market policies must be directed towards mitigating rigidities caused by institutional or demographic factors or certain mismatch between demand and supply of education qualifications. This paper highlights the major role of the active labour market policies targeting the increase of labour flexibility, stressing the importance and impact on the ability to adapt quickly and effectively to macroeconomic shocks. Located on a declining trend in the years preceding the crisis, spending on labour market policies increased in 2009 in all the Member States of the European Union. Spending differences are significant between countries, Romania being at the lowest end of the European Union. This requires special attention because the increased adaptability of workers through training, as active measure, is of major importance considering the increased speed of changes in the labour market.*

**Keywords:** active labour market policies; labour market flexibility; public employment services; training; labour market activation.

**JEL Codes:** J21, J62, J48.

**REL Code:** 12E.

## 1. Introduction

EU labour markets have witnessed changes in the last decade, with differences from country to country. The main elements that may be mentioned on these developments are large variations between countries in terms of unemployment, increasing employment rates, higher unemployment rates for women, high levels of youth unemployment (under 25 years) and long-term unemployment, low rates of labour force participation of people over 50 years.

In a dynamic and flexible labour market, employees are able to change jobs relatively quickly, thereby stimulating creation of more productive jobs and the disappearance of the least productive ones. Labour market dynamics contribute to increasing employment rates, while barriers to formal employment move employees to less productive informal sectors or to inactivity (Kuddo, 2009).

In analysing the unemployment rate as the main indicator of the labour market, we distinguish between cyclical unemployment, caused by temporary reduction of aggregate demand and structural unemployment caused by the labour market malfunctioning. Making the distinction between the two is not an easy problem, but it is estimated that there is a cyclical component and, since unemployment rates were high during long periods, there is a quite marked structural component (Calmfors, 2004, Ailenei, Mosora 2011).

The necessity to reallocate workers, from time to time, across alternative productive (Mortensen, Pissarides, 1999) manifests especially when the labour market must adapt quickly to the new conditions imposed by the economic crisis. Fast and efficient reallocation of workers is, under these circumstances, the cornerstone of the success of labour market response to the demand shock associated with the current crisis. Labour market flexibility is thus the most important element of the effective strategy to combat the effects of the financial crisis that has affected all the EU countries.

These elements have to be considered having as background the aging population, the differences between the supply and demand of skilled on labour market and the still low rates of employment at national and EU level compared to the objectives of Lisbon and Europe 2020 Strategies. The age and the scarcity of skills or the low educational level of the unemployed people put additional pressure on labour market flexibility strategies. Labour market rigidities prevent rapid adjustment of the volume and structure of employment in accordance with the changes after 2008. However, the solution is not to maintain the population employed in inefficient activities, mainly in the state sector, as was the case with industrial restructuring after 1989 (Cace, 2006). Now, it requires public policies to support the unemployed people on the short run and, at the same time, to prepare them, on the long term, to meet the new

requirements imposed by the global economic changes, including the crisis economy. The complementarity between the two is not only necessary, but also very important to limit the undesirable effects on the social inclusion. The key element remains the share of each of the two elements.

## **2. Activating labour market policies**

Promoting public policies regarding labour market should cover both the unemployed and the employed population but should also cover the labour reactivation through policies that stimulate the re-entry into the workforce of the inactive population.

These policies need to follow the effects on the short term as well as the effect on the medium and long term. Long-term policies aim to improve the labour flexibility that faces profound and repeated changes. Promoting active measure and especially extending their applicability could contribute to maintain acceptable levels of unemployment and increasing flexibility (Cace, 2006).

Labour market policies aim to achieve the efficient functioning and correction of the imbalances in the labour market and also to support certain categories considered of interest for the good functioning of the labour market, categories facing difficulties: unemployed people, persons at risk of involuntary job loss, people considered inactive but that would like to enter the labour market (NIS, Statistical Yearbook 2010). Recommendations of the European Commission refer to the provision of active labour market policies including labour market measures and labour market services (public employment services) and an adequate system of social protection that includes financial support, or passive labour market policies. Reform programs, on the one hand, must ensure investment in successful transition to the labour market, developing appropriate skills through education and training system in order to effectively fight poverty and social exclusion, reducing structural unemployment, youth unemployment and inactivity but, on the other hand, they should ensure sustainable and adequate social protection, favourable to social inclusion (European Commission, 2010).

Passive labour market policies refer to direct or indirect financial assistance for the disadvantaged people in the labour market, the main passive measure referring to unemployment benefits.

There are two effects of unemployment benefits. The first concerns the impact on search intensity, judged in terms of coordination between unemployment and vacancies. The second effect is the fact that benefits make unemployment less painful and tend to increase negotiated wages. Both effects increase the duration of unemployment and the natural rate (Blanchard, 2006).

Generous unemployment benefits are a cause of labour market rigidities and high unemployment rates. Unemployment benefits should be assessed both in terms of income levels compared to the previous work income (replacement rate) and in terms of the *grant* periods.

Under the current conditions, due to the expansion of atypical employment and to the growth of leaving labour market rate, it becomes more difficult to meet the basic conditions for receiving the unemployment benefit in case of a future period of lack of job. Besides, unemployment benefits do not address the problem of long-term unemployment, a phenomenon that is considerably longer than a few decades, especially among those who lack or have low qualifications (Clasen, Cregg, 2006).

Passive benefits lost ground since 1990 in many countries. In the most developed welfare states of Europe, it fell by 10-20% compared to the minimum wages. Decrease did not occur only in the countries where the level was high such as Sweden and the Netherlands, but also in the countries with low levels, Germany and Belgium (Cantillon, 2010). The reduction of generosity was determined, in addition, by the expansion of the test methods on eligibility and tightening of the compliance.

Given that the protection using passive measures in the labour market remains the main method of allocating costs for labour market policies in most EU countries, the primary objective of labour market policies is to fight unemployment by complementarity between passive measures and labour market activation, respectively professional reintegration (Hemerijck, 2011).

The stimulating character of the financial support should be understood in order to determine an active behaviour of labour force to find (keep) a job. If the passive measures refer to providing a replacement income during the unemployment periods, the active measures stress the (re)integration into the labour market through training, creating new jobs, employment subsidies, support for start up businesses by the unemployed people etc. (Meager, 2008).

Based on the recommendations of the international organizations each country devises its own country policy on employment. In this regard, there is the standard recommendation of international organizations to reallocate resources from unemployment allowance as passive benefits to the active labour market measures (Calmfors, 2004). The transition from passive to active measures was an important pillar of the European Employment Strategy, at least from Lisbon (European Commission, 2010). Active policies are more effective than passive, on the one hand because of the lower costs but also because they support improving the skills and competitiveness at the individual, national, regional level.

The concept of activation policies involving tighter links (even conditional) between passive and active policies implies labour market entry

and participation and gradual abolition of exit from the labour market for people of working age (early retirement, disability and long-term sickness benefits) (Clasen, Clegg, 2006). Activation helps those seeking employment to be more active by improving their employability by investing in their skills (Kuddo, 2012), but makes the passive benefits depend on the obligation to participate in various programmes, changing the balance between the rights and obligations of the unemployed people (WB).

Active labour market policies as part of activation labour market concept are a way of coping with high levels of unemployment in many countries. It should be noted that in some countries unemployment is not very high, despite some major imbalances in the labour market in terms of youth unemployment and long-term unemployment, employment in rural areas and employment those over 50 years. A cause of hiding unemployment is the rigidity and lack of efforts for its flexibility. Under these circumstances, it cannot respond optimally to the needs of the (re)allocation of labour.

One of the reasons that underline the necessity of the active policies refers to the market failure (Greve, 2006), due to the lack of transparency and insufficient investment in training. In some sectors, there is a rigid wage structure and possible discrimination of certain groups. In addition, there is a self-supporting risk of unemployment (already become unemployed is becoming increasingly difficult to find a job). Market failure refers to the fact that labour markets are not empty and do not provide full employment, resulting in a mismatch between labour supply and demand. Active labour market policies act to enable all who can actively participate in the labour market.

Active employment policy is one of the four pillars of flexicurity policies promoted by the European Union (European Commission, 2007). These policies have two main objectives (World Bank):

- An economic one: to increase the probability that the unemployed find work, increasing productivity and income;
- A social one: to improve social inclusion and participation associated with the employment.

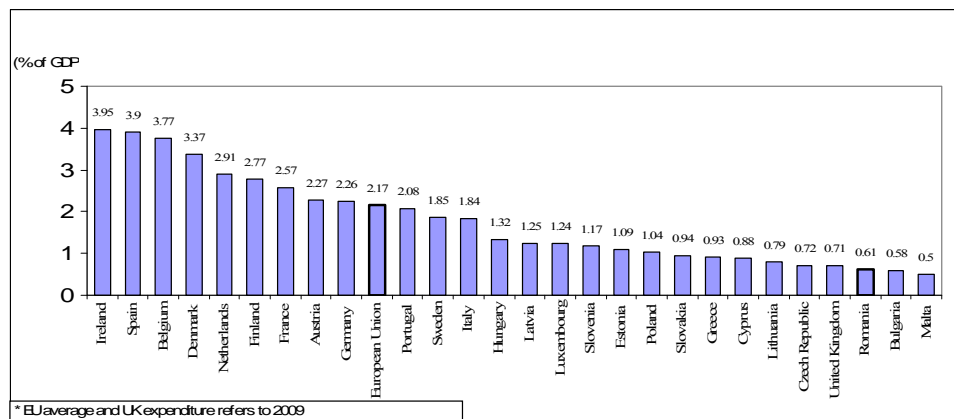
Active labour market policies include a range of activities to stimulate employment and productivity such as increasing labour quality (training to update and improve skills), increased demand for labour (job creation in the public sector and private sector subsidies) and a better match between supply and demand for labour (through counselling and search assistance, but also by training and retraining the unemployed or those at risk of unemployment) (OECD, 1994). Active labour market policies help the unemployed to return to work through placement and counselling services, but also through training programs and job creation (Kuddo, 2009). There is a strong heterogeneity in the

effects of active measures, estimating that some groups are more effective than others are. It is also considered that the assessment of long-term effects is more favourable than short-term assessment, long-term unemployment being a key indicator of the evaluation of the active employment measures (Boone, Jan van Ours, 2004).

### 3. The orientation of labour market policies

In all countries, special attention is paid to measures directly affecting the unemployed, countries promoting active and passive measures, observing a greater concentration of financial resources on the passive measures in Eastern Europe, and therefore in Romania.

Public labour market policies are various in the European Union. An important indicator to assess this is expenditures on labour market policies as percentage of GDP. It is noted that while the expenditures were on a downward trend in most of the European Union since 2005, they increased in all countries in 2009 and continued to increase in 2010 in most Member States. In Romania, public expenditure policy was below 1% of GDP in 2005-2010. In 2008-2009, Romania had the lowest level of spending on labour market policies as percentage of GDP in the EU. In 2010, it exceeded Malta and Bulgaria, with a level of expenditure of 0.61% of GDP. This level is about 30% of the European average. The data on public expenditures on labour market are shown in Figure 1.



Source: Eurostat Statistics (lmp\_ind\_exp).

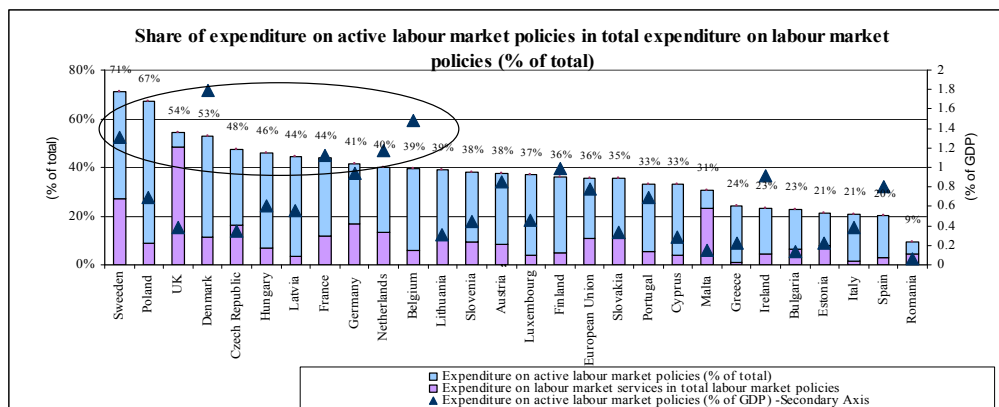
Figure 1. Public expenditure on the EU labour market policies (5% of GDP), 2010

In 2009 (the latest year for which data are available at EU level) the European Union spent 255 billion euro on labour market policies (2.17% of GDP). These are grouped in three categories (financial support, measures and

labour market services). About 63 billion euro (25%) was allocated to labour market measures aimed at activating the unemployed and other disadvantaged groups in the labour market. Labour market services held 11% of the total. These two groups, about 35% of the total, represent, according to the methodology of the European Union, expenditures on active labour market policies. Passive support represents the rest of 64% of the total labour market spending.

In Romania, in 2010, 3.155 million lei was spent on labour market policies, of which only 4.64% on active measures (0.03% of GDP) and the same percentage (4.64%) on labour market services. Overall, the active labour market policies amounted 9.28% of the total spending on labour market policies and 0.057% of GDP in 2010.

Figure 2 presents the share of expenditures on active labour market policies as percentage of total expenditure in the EU. It is noted that the state with the largest spending is Sweden. Labour market policies in Sweden have a long tradition in making agreements between associations and unions, and in active labour market policies. Employment policies are based, particularly, on active measures. The passive measures, mainly unemployment benefits were introduced relatively late and were not very generous at first (Aceleanu, 2012). Outlined and introduced since 1950, active labour market policies adopted in Sweden were the starting point of the north distinctive pattern of the active policies for the other Nordic countries. Poland is the second country regarding the expenditures on active policies. This state doubled its spending in 2005-2010.



Source: Eurostat Statistics.

Figure 2. Expenditure on active labour market policies

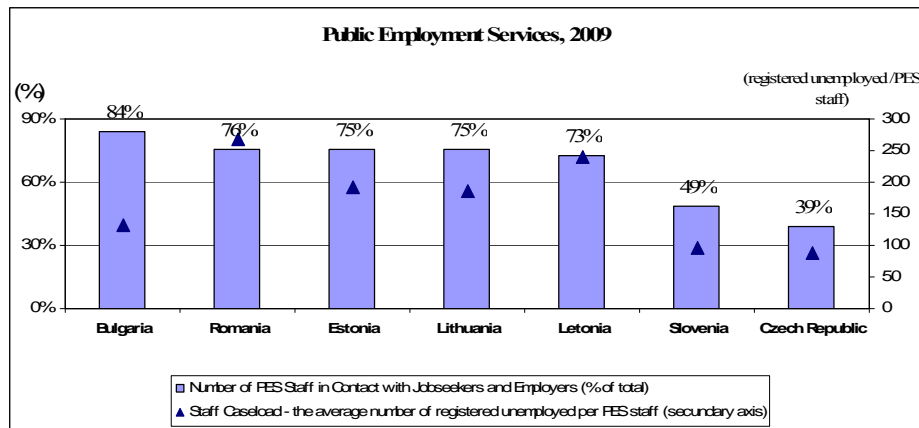
Some countries (Denmark, Belgium, Sweden, the Netherlands, France) allocate more than 1% of GDP to active labour market policies, most countries allocating between 0.3 and 1 % of GDP. The great diversity can be explained partly by tradition and partly by the different priorities of the states. Other factors that may influence the spending levels are unemployment rates, total public spending, changes in unemployment rates and GDP (Greve, 2006).

Regarding the share of the two components of active policies as they were defined in the guidelines of the European Union, the measures and services of the labour market differ considerably in the total active measures. Great Britain is the country where labour market services have the highest percentage of active policies. Romania is above the EU average (which is 31%) in the share of services in total expenditures, ranking 3<sup>rd</sup>, with 50% of funds allocated to active labour market policies after the United Kingdom (90%) and Malta (75%). This high percentage of labour market services is not due to a minimal fixed cost for labour market services. This conclusion is supported by the evolution of the labour market spending in 2003-2010, where there is a relatively constant share of labour market services in the total expenditures.

PES (Public Employment Services) are responsible for the issues related to the labour market interventions for people seeking employment without changing their status in the labour market, helping only the unemployed ones to find a job. They refer to registering the unemployed people, paying unemployment benefits to those who are entitled, giving advice, guidance and counselling to jobseekers, and delivery of active labour market programs. It is estimated (Kuddo, A. 2009) that the public employment services in the Eastern European countries face difficulties: they lack funds; they are understaffed and heavily constrained by a fragmented network of employment offices; there is an old-fashioned system of employment services of limited menu and scope; and does not have access to labour market information and the wide range of potential modern labour market measures and techniques. These aspects make them ineffective in reconcile labour market problems.

The data on the efficiency and workload for PES employees shows that, compared to the other Eastern European countries, Romania has the largest deficit of workers in this sector, the situation expressed by the number of registered unemployed people per public employment services employee (Figure 3). In addition, the large share of workers directly linked to unemployed and front office employees should not reveal a negative situation if it did not represent mainly administrative services (registration, ordering, checking eligibility and disqualification). Unfortunately, this is difficult to assess, lacking available information on services orientation towards training, counselling and guidance etc.

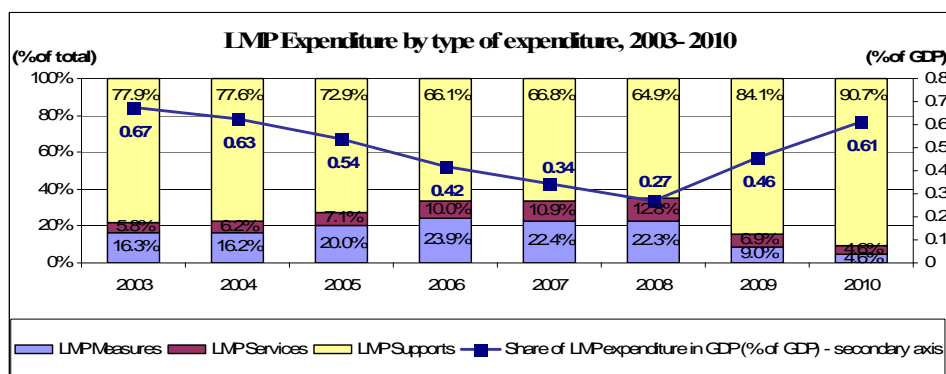




**Source:** PES Survey 2010 in Kuddo, A. 2012. "Public Employment Services, and Activation Policies." Washington DC: World Bank.

**Figure 3.** PES in European Union, 2009

The evolution of the total expenditure on labour market policies enrolled on the same trend as for most EU countries, respectively decreased until 2008 followed by progressive increases without exceeding the level of 2003 (Figure 4). In the period under review, the expenditure on the active measures registered favourable evolution until 2008, reaching to 35.1% of the total labour market policies. Having the economic crisis as background, the share of passive expenditures increased sharply from 64.9% in 2008 to 90.7% in 2010. This was due to the necessity to support the increased number of unemployed people. In 2009, the number of registered unemployed people increased by 76% compared to 2008 while the number of unemployed people receiving unemployment benefit has tripled. Basically, the increase of unemployment in 2009 was almost entirely included among the unemployed paid, unpaid unemployed increased by only 5%.



**Source:** Statistical Yearbook 2003-2010, Eurostat Statistics.

**Figure 4.** Share (% of GDP) and structure (% of total) of labour market expenditures in Romania, 2003-2010

More than the low expenditure on labour market policies in Romania, the share of labour market spending that goes to active measures is very low, the lowest in Europe. Furthermore, almost half of this spending goes to the public employment services. This indicates that the passive benefits are well above the average, Romania having a much more “passive” orientation than all the countries in the European Union.

#### **4. The importance of active measures for labour market flexibility**

The purpose of the active measures is to improve the correlation between labour demand and supply to overcome quickly without social implications the unemployment periods and to ensure balanced employment needed nationally. This implies a more rapid adaptation to the new requirements of the labour market through training and retraining. Improving or acquiring new skills are required both by unfavourable developments of the national or global economic environment as well as by the changing occupational structure required by the technical evolution and the progress towards the knowledge-based Economy. The active measures support the employed and the unemployed people as well as the employers, allowing the first to remain or re-enter the labour market and giving the last better-qualified workforce.

The active policies are an important part of the policies aimed at “*the new social risks*”. It is estimated that today's society is facing new social risks resulting from socio-economic changes caused by post-industrialization. The new social risks are concentrated on specific groups, mostly young, single parent families and women in the labour market. They refer to the reconciliation of work and family life, changes in family structure, single parent families and the growing participation of women in the labour market, the existence of low or obsolete skills, insufficient social protection, young people with low qualifications. People with low income and low skills experience additional difficulties due to the accumulation of disadvantages that affect their social position (Armingeon, Bonoli, 2006). In addition, the labour market changes have strengthened the relationship between education and employment (Taylor-Gooby, 2004). The role of the active labour market policies is to integrate or reintegrate, to help these groups to meet the new challenges through various measures adopted at national level.

The channels through which the active policies work are:

- increasing the intensity of job search through counselling and access to information;
- improving the skills of participants in programmes;
- adapting the skills to the labour market needs.

Therefore, the active policies can increase employment and reduce unemployment levels by a *better match between labour supply and demand*. Competitiveness increases because the participants in these measures put additional pressure on those who are already in the labour market (as employees) due to improved skill levels, certain authors (Hujer, Thomsen, Zeiss, 2004) highlighting the favourable effect on labour productivity and thus on overall economic performance. The aggregate demand is a factor that ensures the success of the active policies. In the absence of significant changes in demand, the active policies will work by replacing the workers who leave the labour market (retirement) or those that no longer meet the level of required qualifications.

Even if the active policies can also work by creating jobs in the public sector or by subsidized private sector employment, measures directly related to training and assistance in finding jobs are the most effective ones for the integration or reintegration into the labour market of the unemployed people, the discouraged people, the young people and the long-term unemployed people, the disadvantaged groups. The training and retraining of the labour force support the long-term integration of labour market participants, making them adaptable by increasing the capacity to cope with a changing economic environment. Given the long-term effects of qualification, these are the most effective measures in terms of cost (Meager, 2009).

*Policies to increase labour market mobility* represent an effective active policy for Romania. The positive effects of encouraging internal migration are based on significant differences in unemployment rates in different areas or counties in Romania.

In terms of labour market rigidities, the most important element of the active policies is the better correlation between the structure of job vacancies and the unemployed occupational structure. Even if it is difficult to predict, the structural changes and trends in the labour market should be evaluated in order to anticipate as close as possible to reality the future need for qualifications.

In emphasizing the importance of training as a "classical" measure of active labour market policies, the aging population trend that characterizes the current period should also be mentioned. This often implies the existence of low or out-dated qualifications requiring urgent update because the population over 50 years old is at risk of leaving the labour market through early retirement programs, medical retirement, or simply due to discouragement. Even if the newly entered the labour market, the *young* graduates are also an important target group of the active policies. They are inexperienced and unskilled sometimes due to an education system less based on skills and more focused on acquiring theoretical knowledge. A period of extended unemployment/inactivity at the beginning of the labour market entry can sometimes irreversibly affect the chances of this category to integrate successfully.

The risk of degenerating due to labour market failure in unfavourable social effects caused by alcohol, drug abuse and so on is higher in this age group than in other. Therefore supporting the integration of young people, recent graduates, on the labour market is a long-term investment in social cohesion.

A category that requires special attention in Romania consists of underemployed persons. Although it does not yet have a high share in total employment, this category is important because more than half of those affected are in this situation involuntarily. Therefore, their chances of getting a job full time should be increased in order to eliminate the risk of marginalization and social exclusion.

Lifelong learning is important for all age groups, especially because there is always a continuous change in the demand for skills. Thus, training is a *preventive* measure that can offer people the opportunity to remain in the labour market. For this reason, the active measures from different countries have started to aim the employees as well, training representing the key to labour adaptability.

### Conclusions

In fact, Romania pays little attention to the measures aimed at the employed population in order to prevent rising unemployment through education, training and labour market flexibility. The participation in lifelong learning of people over 25 years old is the lowest in the European Union and the gap between the skills required and the ones existing on the labour market is highlighted. In addition, reducing unemployment by creating increased (additional) job opportunities is shy, investment in creating jobs is reduced, and the division of labour by reducing working time is not an optimal medium and long-term solution. In this respect, it is important to note that the in-work poverty risk is particularly high for part-time employees in Romania (over 50%), which makes this solution inapplicable for Romania, at least for the time being. At the same time, there are clauses in employment contracts that do not allow reduction of working time. Labour legislation amended in 2010 by the new Labour Code introduced provisions that support increased flexibility by increasing temporary employment or part-time employment. However, these measures require special attention so that they do not produce unfavourable effects on social inclusion.

The active policy success depends on many characteristics of that economy, not only in the labour market, that is why they should be examined together. Firstly, the passive policies should be evaluated, implicitly unemployment benefits as the main element, in terms of generosity as level of payments and duration of grant. If the active policies aim at labour market flexibility by increasing the opportunity to adapt to labour force under certain circumstances, the passive policies can have strong negative effects, stimulating

rigidity and the lack of *active* behaviour in the labour market. Therefore, the activation policies through increased mutuality between the active and passive measures have become of major importance for all the states and are placed among the recommendations of the international organizations. Secondly, the extremely restrictive measures regarding employment protection should be considered, especially those that prevent employers to act effectively for qualitative and quantitative adjustment of the labour force when conditions change. Finally yet importantly, various macroeconomic policies should be considered such as the policy on income tax.

If in the past the public policies on employment aimed primarily at countering the unfavourable effects on the labour market after their occurrence, the acceleration of technological changes in recent years call for increasing the adaptability of workers to the changing conditions in order to reduce the risk of becoming unemployed in the future.

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