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**The European Welfare States -  
the challenges of globalization to labour  
market skills provision**

**Industrial profiles transformation, changes in skill  
structure and social policy responses**

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## Abstract

Developing highly skilled workforce to enhance the national competitiveness in today's globalized world is an international concern regarding VET policy. This paper provides a brief description of the current skill profiles of the UK and Germany as well as the challenges posed to them by internationalization of capital and the consequent gaps between supply and demand of skills. It demonstrates the way these two different types of economies react to the adaptation problems through the reforms they undertake in their VET systems. In both countries, a trend towards the development of supply side policies is developed but for different reasons and with varying goals and success. The paper concludes that the current initiatives to develop highly skilled workforce are unlikely to lead to substantial changes in the current institutional frameworks which are the basis for differences in national VET systems and skill profiles.

# LIST OF ABBREVIATIONS

BA	Federal Agency for Employment
BIBB	Federal Institute for Vocational Training
CBI	Confederation of British Industry
CEE	Central and Eastern Europe
CIA	Central Intelligence Agency
CME	Coordinated Market Economy
CoVE	Centre of Vocational Excellence
DfEE	Department for Education and Employment
DfES	Department of Education and Skills
DIUS	Department of Innovation, Universities and Skills
DQP	Diversified Quality Production
DTS	Dual Training System
EMU	European Monetary Fund
ET	Education and Training
FDI	Foreign Direct Investment
FE	Further Education
GATT	General Agreement of Tariffs and Trade
GDP	Gross Domestic Product
HNC	Higher National Certificate
HND	Higher National Diploma
IMF	International Monetary Fund
ITB	Industrial Training Board
KMK	Conference for Ministers of Education and Culture
LEA	Local Education Authorities
LME	Liberal Market Economy
LSC	Learning and Skills Council
MNC	Multi National Company
NACETT	National Advisory Council for Education and Training Targets
NCVQ	National Council for Vocational Qualifications
NIESR	National Institute for Economic and Social Research
NSA	National Skill Academies
NTO	National Training Organization
NVQ	National Vocational Qualifications
OECD	Organization for Economic Cooperation and Development
QCA	Qualifications and Curriculum Authority
QCF	Qualifications and Credit Framework
SEE	South Eastern Europe
SME	Small and Medium Enterprise
SSC	Sector Skill Council
SSDA	Sector Skill Development Agency
TEC	Training and Enterprise Council
TFP	Total Factor Productivity
VET	Vocational Education and Training
VOC	Varieties of Capitalism
WB	World Bank
WEF	World Economic Forum
WTO	World Trade Organization

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# **Chapter One**

## **Introduction**

### **1.1. Purpose of the Study**

The goal of this study is to examine the effects that globalization in the 21<sup>st</sup> century has on different types of European welfare states in order to see if they respond in adequate ways to the challenges imposed by a more global environment. The aim of this paper is to show the effects of different responses to economic globalization challenges by states in terms of social policies on the flexibility and knowledge intensity of the labor force. The study attempts to investigate the relationship between nations' industrial profile and the prevalent skill profile among the workforce. A major factor to be taken into consideration is the possible transformation of the industrial profiles due to the pressure of international economic factors and competition in today's globalized world. The author makes the assumption that such a change in the industry profile of a nation would change the skills mix as demand for new competencies and decline for old ones will appear. The answers of different European welfare states will be examined presented through their social policy and more specifically, the structure and emphasis of their vocational training institutions.

There are two main types of welfare states discussed in the study: the liberal market economy and the coordinated market economy. This is the main theory used in this research – it is developed by Peter Hall and David Soskice and claims that the degree of coordination in industrial relations is a determining factor for the types of skills and labour relations developed in an economy, thus explaining the supply side of the labour equilibrium, namely the labour force skills provided in the state. Liberal market economies are associated with the formation of general skills among the majority of the workforce and flexible labour markets while in coordinated market economies specific skills and long term employment are prevalent. This distinction between types of institutional frameworks will be used in order to explain differences between economies in the area of skill formation, helping the reader to understand why German labor market is more coordinated and focused on specific skills why the UK is characterized by flexible labor market and general skills among the majority of the workforce. The issue of skill formation and the gaps between new demands and existing supply of skills will be discussed in chapter four.

Another theory used as explanatory background of the research is a study on globalization challenges posed to nation states and their different responses in the area of social policy conducted by Fritz Scharpf and Vivien Schmidt. It presents the demand side on the skills equilibrium – the contemporary requirements on the workforce qualifications due to internationalization of capital. This theory explains why a knowledge economy creation is necessary in advanced economies and how economic globalization affect nations' production profiles and thus the skills required for their proper functioning. The main challenges stemming from the high mobility of capital and competition for foreign investment for nations are to raise their productivity and value added (UK) in order to avoid price based competition with developing countries or to lower social costs (Germany) in order to attract more investment and to decrease unemployment. These challenges and the possible responses to them are presented in chapter four.

The changes in the demand for skills in the present institutional environments provoked by the challenges discussed above are examined in the area of vocational training systems through the current national policy reforms. The paper is attempting to evaluate whether current policies in the area are aimed at bridging the skills gap and in what way. Human capital theory is employed to help explaining the underlying conditions and individual

motivation and benefits stemming from skills development. Investment in VET and creation of high skill economy is seen by the theory as an inevitable path of technological and wealth evolution which is universal for all states and depends on rational individual choice which coincides with the policy of non market intervention typical for LMEs which are more individualistic. On the other hand, the social capital approach claims that skills development is socially constructed and depends heavily on the existent institutional framework. Thus, high skills are based on networks and trust which are present in CMEs which are more coordinated. These two contradictory views will be employed to examine the changes in national VET systems in chapter five.

On the basis of the chosen theoretical framework, the former communist countries in the Balkans are expected to adopt one of these two kinds of welfare states and thus develop the associated paths of skills formation – flexibility (LME) or knowledge intensity (CME). The changes in industrial relations and secotral mix will be examined in a CEE transition country, comparing the previous environment of a centrally planed economy to the current market one. Deacon's theory on “political globalization” will be used in the attempt to explain the current path of development of CEE transformation. It is based on the view that international economic actors like IMF and WB influence the direction of change in transition countries towards liberal market economies thought their funding programs' requirements. This issue will be discussed in the additional chapter seven of the present paper.

It is important to attain knowledge about the ways European welfare states react to changing industrial demands in a time of increasing competition and globalisation on the European continent. Four main research questions have been developed which cover the above-mentioned purpose of the study. Answering the last question would shed some light on the direction that SEE economies are heading towards regarding levels of coordination of industrial relations which in turn influence the skill formation of the labour force. Nowadays, some welfare states develop knowledge intensive sectors as a response to globalization while others rely on flexibility of the labor market as a factor for achieving higher competitiveness. Welfare states in transition may benefit from a study of the changes taking place in the advanced welfare states in the area of skills formation in the process of choosing a path of social policy to follow in the sphere.

## 1.2. Research Questions

1. In a more competitive international market resulting from globalization, what adaptation challenges are posed to the Western European welfare states in terms of economic performance and competitiveness in relation to the skills of their workforce?
2. Is there a gap between the skills provided by the labour market in the economies examined and the contemporary demand present in the states?
3. How are the states responding to changing needs of the labour market in the area of skills formation through their vocational training policies – are there transformations in the vocational education structures and if so, in what direction?
4. What type of capitalism are the Balkan welfare states in transition heading towards – CME or LME (including their approach to skills formation - flexibility or knowledge intensity)?

The structural line which is the backbone of the present paper is going the following way: The goal of the research is to show how – in which field - national skill profiles (which are a result of the type of economy and its level of coordination – LME or CME) lead to the current gaps between supply of skills (influenced by national production patterns) and demand for skills (influenced by globalization). Globalization challenges on welfare states may vary in

impact and focus due to different national goals and priorities. After challenges and gaps have been identified, the paper will examine the reforms in VET systems that the two states under investigation have undertaken in order to answer the challenges and bridge the gaps. Then an evaluation of the direction of the changes will be made – whether they are aimed at the creation of more general or more specific skills.

## **Chapter Two**

### **Methodology**

The methodology chosen to serve the purpose of the current problem investigation will rely on qualitative research analysis. The concept suggests methods for examining social research data, without converting them to a numerical format. More specifically, qualitative analysis refers to: “the nonnumeric examination and interpretation of observations, for the purpose of discovering underlying meanings and patterns of relationship” (Babbie, 2007). The particular type of analysis was selected due to its greater relevance to the research topic of skills formation which suggests evaluation in non-quantitative terms. In delivering the analysis, the case study method was selected as a small unit example that will be assessed. The design of the research is a case study as it allows the author to examine issues at a great depth, to reveal causal relationships and to draw conclusions. There will be two main parts of the investigation process.

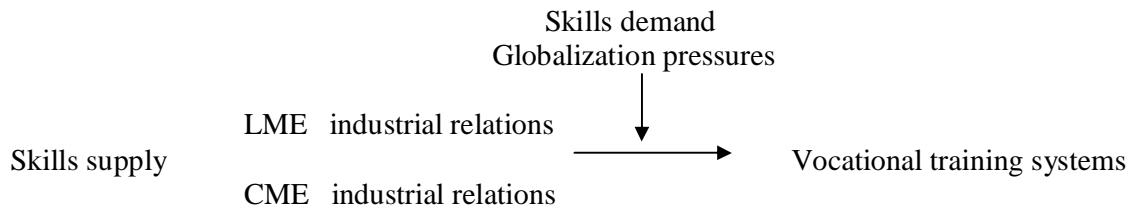
In the first part the focus of the analysis is on the institutional frameworks of two types of market economies identified by Hall and Soskice. It will be executed in the form of a focused comparison of labor market skill profile structure in the liberal and coordinated market economies. The sampling approach which seems most appropriate for this propose is the stratified purposeful sample because it illustrates subgroups and facilitates comparisons. This is the major goal of the study – to compare social policy development directions in the area of skills formation of the two profiles of national economies and industrial relations. The nations which will be examined in the stratified sample are United Kingdom as an example of the LME group and Germany as an example of the CME group. These two cases will be used in order to see how they vary in their responses to common challenges such as globalization pressure for economic competitiveness on national industries and the consequent demands on the workforce and its skills mix. The cases are selected on basis of the “most different” design approach for focused comparative case study as the aim of the research is to show how dissimilar systems react to the same problem. Germany and the United Kingdom have different historical, cultural and political backgrounds and thus vary greatly in their institutional frameworks.

As globalization is the constant factor that affects both types of economies, it will be the standardized independent variable. It will be applied here from its economic perspective including the international mobility of capital, free trade, foreign direct investment and spread of technology and production. Globalization leads to competitive pressures on advanced welfare states and demands for certain types of skills. The explanatory independent variable is the level of coordination which determines the type of institutional framework in the country – whether it is a liberal or coordinated market economy. More specifically, this can be seen in the industrial relations and the prevalent type of skills they supply which varies among the two systems and has great influence on the VET development.

The dependant variable of the study is the human capital of the two states and namely, the level of presence of vocational training systems. Thus, estimation can be made about the skills formation in the labour market on the basis of vocational training institutions – if the state is developing general skills (at low levels of vocational training) or specific skills (at

high levels of vocational training). The attempt to measure such a change will be based on investigation of the current policy reforms undertaken in the last decade.

The following scheme will be used in the analysis:



Thus, there are two independent variables – industrial relations and globalization pressures which affect the development of the dependant variable – vocational training systems. The industrial relations typical for CMEs and LMEs, discussed in the theoretical part (networks, unions, corporate governance, financial markets etc.) influence the supply of skills in the workforce according to the needs of prevalent sectors of production. Globalization pressures have an effect on the demand for skills due to increased competition and technological development leading to new requirements in the existing sectors of production and the emergence of new ones causing the need for improvement of skills or creation of new ones.

The existing discrepancy between supply and demand of skill types (if there is any), following from the changing demands of industrial production and sectoral ratios in national economies is expected to lead to transformation of the vocational training systems in an attempt to bridge the gap. The independent variable serves to show us if there is such a transformation in vocational training systems of LMEs and CMEs and what its direction is for each of the two groups – whether, for example, both of them are trying to achieve a more mixed and balanced skills profile which is not predominantly based merely on either flexible or specific skills.

The second part of the investigation is relatively independent of the findings of the first part but is strongly related to the characteristics of the general institutional framework of the two types of economies examined previously. It will consist of a case study of a Balkan state which represents a former centrally planned economy. The country chosen as an example is Bulgaria due to the interest of the author in its development. The case study will describe briefly the institutional framework of the country after the transition period from the 1990s taking into account the communist legacy when evaluating its structures (including employee representative organizations, business associations, financial markets, corporate governance and ownership, industrial sectors structure, trade unions and general social policy approach) comparing them with the ones present in the CMEs and LMEs.

The goal of the this part of the study is to place Bulgaria on a continuum where LME and CME are the two extremes in order to see to which type the country is more similar based on resemblance in the indicators mentioned above. Thus, also an assumption for the direction of skill formation in the country can be made – whether it is towards the creation of general skills (flexibility of the labor market) or specific skills (knowledge intensity) based on its proximity to either a LME or CME.

The particular method of gathering data for producing the evaluation relies exclusively on documentary analysis, which provides documentary evidences in different forms, ranging from official and private documents to personal letters and memos. (Grix, 2004) In addition the analysis will be delivered through secondary document sources evaluation, which refers to “interpretations of events by others” (Bell 1993:68, as quoted in Grix, 2004). The document

analysis will be based on statistics on state industry profiles, product demand, employment and vocational training participation from national and international databases (Eurostat, OECD) as well as articles, academic publications on the topic.

Though delivering an explanation about how the research approach will be applied in elaborating the specific case evaluation, the author recognizes that the particular analysis method suggests certain limitations of the findings. This is due to the fact that their validity is constrained first by the small sample evaluation of the case study technique selection. This can be identified as a weakness, since the limited number of examples in the documents and the lack of comparison with other countries from the same type of economy suggest ambiguity about the credibility of the evaluation outcomes. In addition, the analysis is non-random, non-representative and findings are narrow and not generalisable. Furthermore, qualitative analysis operates with soft data evaluation, which compared to the hard nature of the quantitative approach, suggests no numeric verification of the assessment. (Grix, 2004) However, the scope of the research poses constraints by volume and time limitations that do not allow going deeper into the various theories, concepts and ideas included in the paper. In addition, due to the same arguments, though being restricted by some of its characteristics, the particular qualitative approach was selected as relevant to the focus of the problem evaluation that is of interest of the author.

## **Chapter Three**

### **Theoretical Framework**

The theoretical framework used as a backbone for understanding the issues investigated in the current paper consists of three relatively complementary theories. They are chosen on basis of their capacity to help answering the research questions through explanation of the background factors behind the issues under investigation. Globalization is posing challenges to national economies requiring higher competitiveness in the global race for mobile capital present in the contemporary integrated financial markets. The nature and impact of these challenges is presented by the Globalization theory of Scharpf in this chapter. They affect labor markets in a way that creates gaps between the new skills demanded (by expanding sectors or productivity requirements) and the supply provided by the existing structures. However, the gap dimensions vary among countries in accordance with their competitive strategies and welfare goals and this leads us to the Varieties of Capitalism theory which explains why. It is due to the different institutional frameworks and thus the structures influencing the labor market and skills formation. One of the most significant institutions regarding the latter is the system of VET. Countries respond to adaptation challenges regarding national skill profiles through reforms on VET with different focus and direction. This view is in accordance with the VoC theory – investment in VET is seen as creating human capital in liberal individualistic economies while in the coordinated collectivist economies it is perceived as generating social capital. The causes for this are explained in the respective theories which are linked to the degree of trust and coordination in the economy – a view supported also by VoC as basis of its typology.

#### **3.1. Human capital theory**

The basis for the economic evaluation of vocational training is established by Gary Becker and his theory of human capital. It describes human capital as resources people

possess which allow them to generate income. Comparing them with physical capital, these human resources can also be increased through investment. One type of such investment is vocational training system development and participation in it by the workforce. The benefits of vocational training and education have economic value as they consist of the generation of productive skills which can be traded in labour markets. Thus, the concept of human capital is often applied in empirical and theoretical studies of vocational training.

Nowadays, nations depend more heavily on human capital due to globalization and technological innovation which lead to an increased demand for knowledge workers and the creation of a knowledge economy and people are the major factor for its successful establishment. Human capital theory claims that skills are inherent in individuals, they are measurable and the motivation to increase one's human capital is based on the rational calculation of individual rates of return. This notion coincides with the findings of the study conducted by Estevez-Abe on skills formation that there is a relation between the levels of social protection a country and the motivation in the workforce to invest in specific skills.

The human capital theory assumes that the more technologically advanced societies become, the greater demand for technological, managerial and professional workers becomes and there are fewer jobs for the employees with little formal education and training (Kerr, 1973). The creation of a high skill economy is thus seen as a matter of evolutionary process of technical progression (Brown, 2001). The concept of skills is difficult to define and measure and is generally presented as the ability or competence to perform specific activities usually obtained through education or work experience (Brown, 2001).

Before the emergence of the human capital theory, any direct relation between labor force skills and productivity was rejected within mainstream economics (Becker, 1964). Human capital theory did not support the idea that the workforce is homogenous and was searching for a broader concept of capital which covered areas like skills, knowledge and know how of the labor market. According to that theory, systematic investment was needed to achieve the level of skills which may increase the capital yields of human labor (Becker, 1964). Thus, education was seen as a form of investment rather than consumption. Unexplained increases in productivity and economic growth were perceived as a consequence of higher investment in human capital even though it is difficult to measure such an alleged contribution. Some theorists suggest that human capital has become as important in the contemporary globalized world as was the financial capital during industrialization. The technological upgrading of employment has transformed the relation between capital and labor and wealth creating activities are now based on "productivity and innovation achieved through the application of knowledge to work" (Drucker, 1993). According to Schultz (1971), the individual employability determines the value of personal human capital and provides economic opportunity, choice and occupational status. Human capital theory sees the creation of a highly skilled labor force as a natural consequence of technology progress thus requiring governmental and individual investment due to the decrease in demand for low skills caused by necessity of technical, managerial and professional knowledge (Clark, 1962). Equality and distribution are not seen as a focal point of discussion among human capital theorist because of their conviction that investments in human capital will create prosperity and social inclusion.

According to Becker, there is universal implementation of human capital theory in all nations regardless of history and culture because it complies with the economic development laws. In the contemporary global environment such views have gained support as national economies are no more protected by limits on international trade through tight currency control and tariffs. In the post-war period of Keynesian settlements among shareholder, mass production and consumption provided relatively high income and the inception of consumer culture. Large scales of production and demand for it allowed corporate profitability despite

the high wages paid to low skilled workers. With the growing complexity of the technology employed in production of more sophisticated goods and services, the need for investment in education and training of the workforce was recognized.

In the 1980s, at the dawn of globalization, neo classical ideas about economic competitiveness emerged. They were based on the view that political coordination between capital and labor leads to unjustified increases in wages not covered by enhanced productivity. This was believed to cause economic inefficiencies becoming obvious under the conditions of global markets like high unemployment, inflation and low rates of economic growth. Human capital theorists claim that income should reflect the market value of labor otherwise MNCs would move their activities to more profitable locations offering adequate wage levels and lower social costs. According to Woods, globalization leads to the transfer of low skilled jobs to newly industrialized countries which has caused a 20% decrease in the demand for low skilled workforce in the developed countries. Another study, conducted by Reich in 1991, shows that there is an international market for workers from all countries based on competition supporting the ones possessing human capital of global attraction. Thus, national educational and training policy will be effective only if it creates world-class workforce in order to compete in the “global knowledge wars” through the attraction of foreign capital in high value added sectors (Brown, 1996). However, there are some limitations on workers’ participation in the global market. Nationality can be such a restriction which gets loosened in cases of skill shortages in an economy for particular occupations and the need for imported labor force. Thus, capital is much more mobile than labor.

The declining importance of national borders in a global environment reinforces neo-liberal ideas as a necessity. According to Wade (1990), governments should not interfere in economic matters and as industrial policies lead to market rigidities, flexible and deregulated labor markets are required which reflect the real value of human capital and will provide higher employment. Also, employers-driven vocational training is needed. Human capital theory presents a “win-win scenario” in which investments in education in training are expected to cause higher levels of productivity and income stemming from the enhanced demand for skilled work. However, according to Brown (2001), some economies can achieve high economic competitiveness without reliance on highly skilled majority among the workforce using different strategies than those pursuing high skills formation. Moreover, investments in human capital may not lead to beneficial outcomes for all parties if elite groups limit access to prestigious education to representatives of lower social classes. “Positional competition” is present in most skill formation systems and its outcomes depend on the way it is structured by the state – as meritocratic or market one.

Thus, the following section will discuss some of the drawbacks in human capital theory which perceives individuals as instruments for technical skills provision. It does not acknowledge the social construction of skills and examines motivation only from rationally economic perspective. The theory uses limited evaluation of human nature, seeing individuals as driven by self interest with individual optimization not being influenced by social or cultural conditions. One important feature of skills formation in the globalization era is the short life cycle of knowledge which requires constant upgrading of qualifications especially with the emergence of new jobs – the average American changes their workplace at least ten times. Thus, “learning is the new form of labor” (Zuboff, 1988). According to Brown, individuals are motivated to develop new skills by changes in the social world in areas like technology, organizational structure and political priorities.

Human capital theory is based on the assumption that evolution from low skilled to high skilled production is inevitable consequence of technological progress ignoring the current industrial relations and skill content of occupations. According to a study conducted in

1999 by Finegold, the effect of technology on skills varies. ILO data shows a significant increase in employment in the service sector in the period 1980-1998 in both Germany and the UK, complemented by a decrease in the employment levels in the agricultural and manufacturing sectors. This can be attributed to technological progress which increases productivity in manufacturing with the labor base held constant. Esping-Andersen claims that the shift to the provision of services does not necessarily mean higher skills levels as most of the newly created occupations in the sector are low-skilled and low-paid ones showing a trade off between unemployment and mass inferior jobs. According to Brown, the linear model of technological change affecting education and training system so that they produce higher skills which lead to higher incomes is not an adequate and universal way to establish a high skills economy.

Some human capital theories suggest that a universal best practice exists for the achievement of optimal skill formation strategies not taking into account that powerful social conditions also influence outcomes in the field. The practice of adoption of outside approaches in national economic policy is exemplified by the spread of Fordism in the early twentieth century and Japanese lean production techniques popularity as well as UK privatization. However, they show that national adaptations are required when importing strategies (Brown, 2001). There is a view that national educational and labor market systems would converge towards a best practice which delivers efficient skills transfer based on technological rationality. According to Brown (2001), the development of a highly skilled society is not merely a trait of knowledge driven economies but is more of a social priority which requires broad participation.

This leads us to the concept of social capital which is based on the existence of social networks supporting the achievement of mutual goals (Baron, 2000). A more specific definition is given by Boudieu: "social capital is the aggregate of the potential resources which are linked to possession of a durable network of more or less institutionalized relationships of mutual acquaintance and recognition which provides each of its members with the backing of collectively-owned capital" (1997). The ability of stakeholders to collaborate is claimed to depend on the degree and shape of networks, norms and trust in society. According to Putnam, there is a relationship between the achievement of socially desirable outcomes like higher levels of economic prosperity and successful educational outcomes on one side and the presence of social capital on the other. Among some of the reasons for the raising interest in the social capital is the increasing concern with the excess of individualism in western developed states as well as the raising sensitivity to perceived globalization and the difficulties of establishing a civil society in some post communist countries. In the economic sphere, social capital concept questions the assumptions concerning human behavior and challenges the notion that it is based solely on individual perceptions of maximization of self interest. Thus, it is contradictory to the idea of bounded rationality which may look very attractive in times of complex labor markets and abundant career paths (Fevre, 2000).

According to Streeck, there is a connection between identity, self transformation and economic development which may explain the spectacular effect on skills level among German manufacturing workers exerted by norms and networks determining the behavior of labor market entrants. The author claims that the "heritage of community bonds" in Germany which is absent in the UK facilitates the creation of highly skilled workforce. The basis for this is not the rational behavior of optimizing individuals but a sense of obligation which together with community bonds leads to more positive attitudes to training. Thus, the social identities created by the German occupational community motivate participants in the labor market to take part in education and training. However, the post industrial society is characterized by individuation, risk and return on uncertainty which makes social capital

irrelevant and in the 1980s identity in Britain was acquired simply from employment, placing less emphasis on learning (Beck, 1992). Brown claims that evidence suggests that motivation and commitment are tied to social and cultural issues of economic involvement and emotional intelligence and thus are socially constructed. The creation of networks and trust which are the basic source of social capital depends on cooperation rather than individualism. Thus, societies which praise competition, self interest and acquisitiveness rather than collaboration, common interest and the quality of life are less expected to maximize human potential which leads to inequalities and waste of talent due to market individualism influence.

The impact of this theory in the present study is significant as it is used as basis for the examination of the shape of the reforms in VET systems in Germany and the UK presented in chapter five as they are evaluated taking into consideration the presence of human and social capital. The direction of the reforms is investigated in terms of development of general or specific skills which are related to the type of economy presented in the next subsection of this chapter – LME or CME – and the level of coordination. This concept can be connected to the human and social capital theories as low coordination and individualism are emphasized in by the first one and high collaboration and collectivism are essential for the second one.

### **3.2. Varieties of Capitalism**

The theoretical framework chosen for basis of the analysis in this study is the concept of Varieties of Capitalism (VoC) developed by Peter Hall and David Soskice. This is an actor centred approach which includes firm behaviour in political economy research presenting micro economic notions to macroeconomic problems. The theory suggests there are two types of economies – liberal market economies (LME) and coordinated market economies (CME) - based on the degree of coordination among their structures. These two economic profiles show significant variation in the areas of industrial relationship, corporate governance, training and education, inter firm relationships and employee representation and financial system. According to the authors, these institutional differences are interrelated and are based on historical arrangements and industrial specialization, and as a consequence lead to the establishment of specific production regimes which in turn create comparative institutional advantages for the nation states.

The concept of comparative institutional advantage claims that the institutional structures of a political economy provide support for engaging in specific types of activities and advantages in different business areas which are not likely to be evened out by the international movement of capital and globalization. According to the authors, free trade will not affect nations negatively but will encourage them to specialize further in the goods produced most effectively. The welfare production regimes are reinforced by institutions like collective bargaining systems, business organizations, unions and financial systems which facilitate commitments to particular strategies leading to cross national patterns of specialization. The Varieties of Capitalism approach states that the current trend under the pressure of international capital markets is greater specialization in national industrial profiles with incremental reforms in some areas rather than convergence towards a specific pattern like deregulation. Structural changes are different to implement and would be greatly opposed by interest groups and nation states are unwilling to jeopardize their comparative institutional advantages. This can be seen also in the profound differences in the positions of EU member states during negotiations for the design of common institutions which may threaten national interest. The underlying determinant of national preferences over the structure of multilateralism is the composition of its market economy (Fioretos).

### **3.2.1. Two types of economies**

According to the VOC theory, firm strategy follows institutional infrastructure which causes variations of corporate structures on national level. The structure of the national institutional framework determine not only firm behaviour but also the patterns of the educational, financial, labour market systems and the skill mix of the workforce. These interrelations and the following national differences can be exemplified through examination of the characteristics typical of liberal and coordinated market economies.

#### Coordinated market economies

Coordinated market economies are based on strategic interaction between major actors and supportive institutional presence. There are implicit contacts between the government and business associations which possess strong structural influence to influence the state to keep its commitments due to decentralized policy making thus providing more security for investment in non switchable assets. CMEs can be presented as “coordinated business, constrained government” systems (Wood). An effective state policy is considered the one that supports the institutional networks of coordination. The participation of local governments and unions in business decision making determines one important characteristic in corporate structure and management – the real integration of the banking institutions with the industrial enterprises as balancing part. Not only a great share of savings are transformed into investment through the banking system, while the stock exchange plays a modest role in capital allocation, but the major commercial banks are major shareholders in industrial corporations and their members serve on the boards of directors of these corporations. The enterprises are given access to “patient” capital so they can pursue long term returns. Thus, the business system determines the emphasis on the long term goals. An essential part of the model is the financial system that allocates capital not in order to achieve a high short-run return on investment but to gain market share in strategic industries. Firms are not constrained by the need to please impatient shareholders. This relationship between firms and external providers of finance are determining the “stakeholder” model of corporate governance present in coordinated market economies. The majority of the companies’ ownership structure is in the form of large shareholdings by strategic investors (Vitols).

Dense networks of business associations are present which conduct joint research and product development contributing to a common knowledge base and diffusion of new technologies and companies keep close relationships with suppliers and clients through cross shareholdings or joint membership. Regarding the internal corporate governance structure, managers do not have the capacity for unilateral actions and decision making is based on consensus. The industrial relations in this type of economy are characterized with industry level bargaining on wages, business associations monitoring and sanctioning procedures which limit free riding, heavy investment in skilled workforce, and company level system of work councils. In coordinated market economies there is a high degree of cooperation between the private and public sector and the main economic goals are long term growth and employment, thus directing investment to specific and co specific assets formation. This can be seen also in the educational and training system which is designed in such a way to create skilled labour through more specialized programmes in given sectors and emphasis on vocational training as well as strong connections with the business providing for apprenticeships.

Kathleen Telen, one of the followers of the VOC approach, describes coordinated market economies as systems employing collectivist strategies in their labour politics. They are characterized by collective regulation of the labour markets, negotiations between

organized employer associations and unified labour movements which serve employers' interest in labour market stability through a decrease in the competition for labour, coordinated wage formation and shared costs of skill formation, monitoring and poaching punishment. This strategy pursues competitiveness through controlled decentralization, not deregulation. In Germany, codetermination applies to almost all industries. Codetermination means allowing worker representatives on the management boards of industry, the objective being to force management to take workers' interests into consideration when making policy. Moreover, in the situation of strong unions, financially beneficial coordination for the employers can arise – for example, in the area of skill formation. High value-added production depends on high degree of stability and cooperation with labor as the companies compete on basis of high quality and reliability. Thus, employers are reluctant to undertake full decentralization and are afraid of industrial conflict which deems lockout measures obsolete. However, employer associations are also very strong in the countries with a coordinated market economy and are a powerful instrument in industrial organization. They are members of the Chamber of Commerce and are required to participate in the vocational education and training of the young, along with the local governments and unions. Moreover, many students are able to acquire jobs at the companies, involved in the vocational training leading to smooth transition to work and high-skilled, high – wage equilibrium. It is not surprising then, that the rate of unemployment among the young is extremely low in the coordinated market economies compared to the liberal ones (Culpepper).

The VOC theory claims there is a correspondence between the type of political economies and the types of welfare states. As industry production requires skilled workforce with specific knowledge and social policy is usually also directed at providing incentives for the employees to invest in such skills. However, such policies have consequence for the cost of labour and impair the ability of companies to be price competitive but allow them to offer high quality goods. The economic activities of companies are focused on product differentiation, incremental innovation and niche production, not direct competition. This theory will be used to explain the existing differences in the institutional frameworks of the two types of political economies and help us understand why German labor market is more coordinated and develops specific skills while the UK labor market is more flexible with focus on general skills. It will be helpful for the evaluation of gaps between demand and supply of skills in national economies executed in chapter four as well as the examination of challenges faced by VET systems presented in chapter five as they are strongly related to the existent institutional framework features and are a consequence of its incentives.

### Liberal market economies

On the contrary, the institutional arrangements observed in liberal market economies are based on shareholders' interest in short term profitability and current earnings emphasizing performance in new markets and radical innovation. The core institution of capital market is the stock exchange, ensuring capital flexibility based on price signals and high liquidity of funds. The "shareholder" model of corporate governance mirrors these goals which are of significant importance to the business owners which are generally portfolio investors with small shareholdings in diverse companies (Vitols). The industrial relations are market directed ones between individual employers and employees with minimal state intervention, cooperation or economy wide wage coordination. The governments in liberal market economies are generally very autonomous with high concentration of power under their authority and rely on market incentives policies. LMEs can be presented as "uncoordinated business, unconstrained government" systems (Wood). The state is seen as

effective when it maintains and intensifies market mechanisms. The labour market is highly fluid, provoking investments in general skills which are transferable across companies. This trend is also supported by the educational institutions which generally lack vocational training and offer broad general education as well as the size of the service sector which does not require company or industry specific skills. Thus, liberal market economies have an advantage in markets where the demand is price sensitive as consumer goods or services due to the smaller production costs as employers' investment in workforce skills is absent. The deregulated markets allow firms to adjust rapidly and to cut operational costs through lay offs if necessary. The firms can not provide jointly supply side goods needed for example for vocational training but they do not depend on collective provision for the availability of transferable skills.

The advantages of wage deregulation and flexibilization are higher employment and a greater number of easily accessible first entry jobs. However, the underinvestment in skills and the lowering of wages and social benefits may lead to a "chronically impoverished post industrial proletariat and a necessity of higher income maintenance transfers" (Esping Andersen). North America and Britain support wage deregulation strategies and in the USA a clear example of their disadvantage can be observed. Such a strategy minimizes unemployment and integrates the youth and the immigrants into the labour market but supports low productivity firms and creates huge inequalities, leading to pressure on the benefits system through the poverty – trap problem. This structure does not provide incentive for skills improvement and leads to polarization of income and human capital.

The welfare goals of the system are to guarantee higher efficiency of the market economy. Since poor people have low purchasing power and cannot stimulate the increase in production and production at full capacity, government should prevent any decline in living standards and fight poverty. Thus, the welfare state presumes a widespread system of consumer credit and a support of households whose income is below the poverty line. However, the model relies on market based free choice in resource allocation and it does not assume free education and healthcare. Social programs are directed only to the poor, not to all citizens, as widespread social policies are believed to be a demotivating factor for economic activity. The inter company relations are characterized by strong antitrust regulation, technological transfer not through joint R&D efforts but through the movement of scientists as well as patent practices, venture capital presence and very weak workers representation. The corporate structure of the firms operating in liberal market economies uses top-down approach with decision making power concentrated among high authority officials. According to Kathleen Thelen, liberal market economies apply segmentalist strategies in which the individual employers shield investments from competition over the labour by creating obstacles to the outside market through the establishment of internal career ladder, seniority wages and company based training as they lack coordinating capacities using strong internal controls instead. Because employers have very low ability to coordinate among themselves and non market regulation is only represented by weak unions, they prefer deregulating the relations with the workforce too but this leads to weakening of their own institutions and capacity for collective action as well.

### 3.2.2. Globalization

The VOC approach does not support the argument that all economies are moving towards a common market model based on deregulation due to globalization and international interdependence which shifted the balance of power from labour to capital. The authors of the theory claim that nations often prosper by building on their institutional differences. Contemporary changes are not seen as movements along a continuum leading to deregulation

convergence but as continuing or even increasing divergence between liberal and coordinated market economies based on difference in micro level strategies (Thelen).

However, there have been incremental changes in the financial system of Germany as coordinated market economies have been pressed by international investors to increase the shareholder value of their companies if they want access to international capital. Some of the large banks in Germany have disengaged from their commitments to companies and commercial banking and thus have reduced the business' access to non-profit dependant capital and institutional reform in one sphere of the economy is seen by the authors as possible to have a snowball effect on other spheres and drive changes there as well. However, the changes in the financial system of Germany are at a slow pace and it is still possible for the economy to maintain long term strategies as institutional complementarities generate disincentives to radical change and policy change can be successful only if it is incentive – compatible. In coordinated market economies, according to Hall and Soskice, there are possibilities for a new equilibrium of change to be found through negotiation and compromise made possible due to existence of deliberative institutions. Thus, the coordinated market economies are slower to adjust to international capital pressures than liberal ones but the outcomes achieved through negotiation and cooperation may prove superior for welfare than the purely market ones. The international capital markets are nowadays dominated by diversified portfolio investors which are seeking higher returns. Both liberal and coordinated market economies states are trying to attract investors and gain access to capital for their companies through focusing on their areas of core competencies with two significant variations in the adjustment process approach along the dimensions of incentives (performance vs. consensus based ones) and innovation (radical vs. incremental) (Vitols).

### **3.2.3. Skills formation**

The Varieties of Capitalism framework includes a study on the formation of skills in the labour market and its relation to the type of social protection developed by Estevez-Abe, Iversen and Soskice. It will be presented briefly in the following section due to its importance in making a typology of workforce skills which is essential for the research questions of the present work. The authors claim that different types of social protection are complementary to various skills equilibriums. The logic behind their argument is that implicit agreements for long term employment and stability are a necessary prerequisite for the existence of sufficient supply of specific skills. The relative abundance of particular skills in an economy leads to a comparative advantage for the companies operating in sectors which depend on that type of skills thus directing the product market choices and the strategies of the business based on the availability of the required workforce for an activity. Thus, the business is expected to have preferences towards different social policy arrangements (Mares). The skills intensity of national production is one of the determinants for the degree of control desired to be implemented by the business on policy making. If the majority of companies depend on highly skilled workforce, the benefits of social policy with high degree of control would outweigh the costs due to the ability to provide guarantees necessary for the labour market to invest in specific skills. Welfare production regimes are presented by the authors as interrelated combinations of various product market strategies, labour market skills profiles and social, economic and political institutions which support their existence.

The typology of skills given in the study distinguishes among three main types:

- Firm-specific skills which are generally acquired through company training

- Industry-specific skills which are obtained usually through apprenticeships
- General skills which are easily transferable and are not specifically related to a firm or industry

Investment in specific skills increases workers' exposure to risk in case of unemployment as they have limited opportunities of finding another job due to the high specialization of their knowledge and training in a given sector or even company. Thus, if the economy depends in large on the provision of specific types of skills, there should be incentives for the workers to engage in acquiring them. Such an incentive may be the existence of more unemployment protection which would preserve skilled wages level regardless of the employment status and would allow workers to turn down job offers which do not correspond to their qualification and previous occupation. There are two features of unemployment protection which are essential for the security of return on skill investment in times of employment interruption – high earnings related ratio and security of benefits. Greater uncertainty is claimed by the authors to lead to a greater incentive for the workforce to develop general skills.

The correlation between social protection and skills formation in different types of welfare regimes may be used in the analysis of skill profiles in liberal and coordinated market economies further in the present work. Employment protection is also important incentive for investing in specific skills as it provides some guarantees that wage levels for jobs involving specific skills are not likely to decline significantly. This can be related to the existent systems of industry wage bargaining present in some coordinated market economies with strong institutions for collective action like unions and employers organizations. Estevez-Abe and Soskice also argue that there is a relation between the type of skills and the employment duration. According to the authors, long term employment is associated with specific skills and short term employment with general skills which can be seen in the values of the median enterprise tenure rates of companies from the different countries examined in their study.

Based on the levels of employment and unemployment protection there are four distinct national skill profiles. If both unemployment and employment protection are high, the workforce is expected to possess a mix of industry specific and firm specific skills as the authors present high employment protection as an incentive for firm specific skills and high unemployment protection as an incentive for industry specific skills. Germany is an example of a country with skills profile of that type. In a case when both unemployment and employment protection are low, the workforce tends to invest in general skills which are easily transferable as there are no security guarantees which can be observed in Anglo-Saxon states. Social policies providing high unemployment and low employment protection lead to the development of industry specific skills on the labour market which is usually observed in countries with prevalence of SMEs like Denmark. The last case, according to Estevez-Abe typology represents the states with high employment protection and low unemployment protection like Japan where firm specific skills prevail among the workforce. The high employment protection is seen in the "lifetime employment" guarantees and the low unemployment protection serves as a disincentive to leave the company.

The approach on skills formation discussed here associates skills profiles with the presence of vocational training. In the general skills regimes, the transition form academic to professional life is not institutionalized and the potential employees are evaluated on basis of their general scholarly achievement. Countries which do not provide well developed vocational training are claimed to lack stable economic future and possibilities for development for students which are not performing well academically which leads to the creation of an impoverished labour pool. In general education systems, the largest returns go to the ones with the highest abilities and most advanced academic degrees. Moreover, there are big differentials compared to the ones existent in specific skills systems where a large

number of companies depend on industry specific skills rather than academic qualifications. According to Estevez-Abe, the inequality in income rises as the availability of vocational training decreases which leads to a skewed distribution of earnings in general skills systems. The biggest differences between the highest and lowest deciles of earnings in a state are observed in Anglo-Saxon countries which are characterized by a general skills profile of the workforce while the lowest difference is measured in Sweden.

### **3.3. Globalization Challenges**

The scholars Fritz Scharpf and Vivien Schmidt conducted a study on the welfare and work in the open economy and namely the different responses of twelve countries to globalization challenges in their pursuit of international competitiveness in terms of adjustment in their employment and social policies after 1970s. In their view, national economies are not protected anymore as there are no capital exchange controls and trade barriers as the GATT and WTO negotiations lower tariff levels and movement of capital to the least tax burdensome locations has become possible. However, the authors expect that national responses to globalization challenges will vary greatly due to institutional differences and claim that effective policies are the ones which will increase competitiveness while keeping welfare goals.

Institutional rules are claimed by the authors to facilitate or hamper potential political moves and to produce motivation thus affecting the preferential outcome for the different actors involved. Some institutional settings are more or less susceptible to producing effective policy responses to given challenges and there is a relation between institutional conditions and policy effectiveness. The adoption of policy changes is more difficult in German political system which is characterized by multi actors' presence than in the single actor environment of the Anglo Saxon counties. The globalization challenges that emerged in the economic world in the 1990s are supposed to have negative effects on the post-war welfare commitments on advanced economies due to their pressure for cost competitiveness in attracting FDI. However, the welfare aspirations of nation states vary on the social policy dimension. In liberal market economies there are universal flat rate unemployment benefits and income redistribution is directed at preventing poverty while in coordinate market economies there is a status maintaining income replacements, solidaristic wage policy and equalization of primary income. Thus, the impacts of economic globalization challenges also vary across countries due to different national goals in the sphere of social policy and welfare levels.

According to Scharpf, in the last forty years of the previous century four distinctive periods of international economic challenges can be distinguished basically divided by decades. The liberalism age during the 1960s was characterized by Keynesian demand management strategies and maintenance of full employment accompanied by high growth rate and concerns over price stability. In this period, the British economy was not hindered by delayed industrialization but experienced its early decline. The British pound was an international reserves currency; the economy was characterized by decentralized industrial relations and was not suited to high unemployment levels. Social policy was based on the Beveridge model of flat rate benefits directed towards mere low income maintenance with low replacement rates, pressuring governments to secure employment as a prevention of poverty. The preferential access the country enjoyed to Commonwealth markets limited the necessity of efficiency increase in the British industry. Wage-push inflation had negative effect on the balance of payments and governments shifted towards restrictive monetary and fiscal measures. Attempts to reflate the economy in times of downsizing lead to job losses and

the stop-go pattern of macroeconomic interventions acted as disincentives for productive investment and slower rise of industrial productivity in the UK.

The 1970s were marked by the breakdown of the Bretton – Woods system of fixed exchange rates and the first oil-price crisis. The result was stagflation – which was a combination of cost-push inflation and demand-deficient unemployment in times of floating exchange rates. The new system was based on the hope that it will reflect the real value of currencies but floating currencies caused a boom in speculative currencies transactions. The fall in aggregate demand in oil importing countries was one of the causes for unemployment especially in countries engaged in monetary and fiscal retrenchment to fight inflation. The attempts of governments to fight unemployment through demand reflation caused rising inflation and the efforts to lower inflation through restrictive monetary and fiscal policies was a cause of mass unemployment representing a vicious circle of economic underperformance in times of recession. The possibility of wage restraint was an important factor in the achievement of Keynesian concertation strategies but it depends on the institutional settings. In such a setting, demand reflation measures initiated by the government and the central bank may lower unemployment and the combination with wage restraint supported by the unions may decrease inflationary pressures.

During the next decade, a second oil crisis emerged as well as rise in capital interests. National exchange controls started to erode even in countries with less liberal capital markets. There was a rise in real interest rates and fiscal reflation was no longer a viable approach to fight unemployment. This was complemented by an increase in the expected minimal return on investment as risk free government bonds started providing positive yields. It was no longer sufficient that governments support a level of aggregate demand as business employment was going to decrease in the absence of rise in business profits which could be achieved only through redistribution from labor to capital incomes. This change is essential for the globalization development which followed in the next decade. Monetary reflation was no longer a good approach as there was a great increase in the costs of public deficits and the rise in business profits was a pivotal factor for the maintenance of private sector employment. There was a difference in the strategies states adopted in this period regarding monetary and currency regimes between expansionary one based on devaluation, improved international competitiveness, rising employment and inflation and a restrictive one which was facing a mass unemployment challenge.

The challenges described so far in the form of external macroeconomic shocks invoked a standard set of macroeconomic policy responses which were adopted within the conditions of the existing institutional frameworks or demanded changes in the industrial relations systems. Thus, during the 1970s and 1980s the economic challenges affected all industrial economies in almost the same way. However, the changes in the international economic environment in the 1990s lead to very different challenges to countries depending on the structural characteristics of their economies and especially on policy legacies and that determined the form of the national employment system and the welfare state. Thus, it was no longer possible to identify a standard set of optimal policy responses and then examine the national conditions which hinder or support their achievement (Scharpf, 2000).

During the second half of the 1980s, the economies were recovering from the second oil crisis and a decade of macroeconomic shocks with oil prices falling down almost to their previous level, inflation under control and moderate levels of real interest rates. Despite these facts, some economies were experiencing a recession in the beginning of the 1990s with low or negative economic growth rates and high unemployment. This is partially due to the economic upturn in the end of the 1980s which raised inflation and interest rate levels again. Germany was experiencing economic problems after the fall of the Berlin wall due to the governmental decision to finance unification through deficit spending rather than tax

increases which lead to higher interest rates and tighter money supply on part of the Bundesbank. The international economic environment was experiencing an unprecedented process of transformation with high integration of product and capital markets leading to greatly increased competition in product markets and higher capital mobility. Since the middle of the 1980s, the fiscal constraints posed on nation states by the capital markets integration combined with the rising levels of social spending began to threaten the financial viability of the existing welfare states programs.

Increasing economic integration is seen by Scharpf as one the main determinant of international environment transformation and globalization challenges. According to the author, it is the result mainly of political decisions and events like the fall of the Berlin Wall, the return of CEE countries back to capitalism and the single market establishment in 1992 in the EC. The increased scope and effectiveness of the world free trade regime represented by the transition from GATT to WTO is another major factor leading to economic integration. It was complemented by the rapid diffusion of policies deregulating and privatizing communications, transport and other infrastructural sectors as well as a thorough liberalization of financial markets. The creation of EMU as a common monetary environment limited the national fiscal policy opportunities and intensified competition and capital mobility. “Functional mobility” between different types of financial assets also increased with the rise of portfolio investments and speculations with currencies, bonds and stocks. This emphasis on financial transactions created “secondary money market” which removed capital from the “real economy” and lead to a capital shortage. This, in turn, influenced negatively the labor market supply-demand equilibrium and expected profitability levels rose even despite the low rate of real interest rates (Watson, 1999).

These changes can be attributed to an extent to the adoption of Anglo-Saxon capitalism model approaches in some sectors in continental Europe (Scharpf). Business investment has become more difficult to finance through long term credit and patient equity capital which made large number of goods and services required to meet profitability criteria of highly mobile investors. The internationally competitive and integrated capital markets are claimed by this theory to have increased the pressure for competition in product markets. National growth and protective barriers can not provide support for the achievement of policy goals the way they did in the postwar decades. Nowadays, the pursuit of these goals is limited by international capitalism macroeconomic coordination and union wage restraint is no longer sufficient for coping with new challenges. The capacity of overcoming globalization problems depends more on the shape of the welfare state (Scharpf).

Private sector employment is exposed to significant pressures due to the changes in international product markets based on lower cost competition from newly industrializing and CEE countries. The nations relying on high value/high cost production will have to adjust to the new conditions through its automatization or through specialization in upscale industrial products of high quality and effective services. As labor costs are claimed by the author to be “downward inflexible”, skill requirements will rise in order to increase productivity and demand for unskilled labor will shrink. Another factor for the change in international product markets is the increased competition among advanced economies shown by the volatility of increasingly specialized markets for “diversified quality production” (Streek, 1997). This lead to an increase in innovation activities aimed at cost reduction or quality improvement in order to allow flexible adaptation and to protect employment in the internationally exposed sectors. Most of the countries examined in the study conducted by Scharpf show employment growth only in the sheltered sectors like wholesale and retail trade, restaurants and hotels, and community and social services.

The EMU has limited the possibility for adjustment of exchange rates and thus the cost increases can no longer be passed on to consumers. Companies are increasingly facing

investors not restricted by national borders who examine post tax rates if return. These conditions make employers less willing to cross-subsidize less profitable production. State policies like solidaristic union wages settlement, minimum wage establishment, social policies with high reservation wages, taxes imposing non wage labor costs affect employment in a negative way possibly leading to job losses (Scharpf). The sector affected to a higher extent is the service one because job productivity is not easy to increase and is based on low skilled employment. Thus, it is increasingly difficult to use private sector employment as a mechanism for the achievement egalitarian welfare goals in times when the state revenues are constrained by economic internationalization.

Most states have cut the nominal tax rate on capital income in the last decades with the desire to attract more FDI. However, there are no major cuts in welfare expenditure partially due to the fear of social dissent. The tax burden has been shifted to less mobile tax bases which are shielded from international tax competition – consumption, social security contributions, taxes on income from labor – which however has a negative impact on employment. There is a difference in the prevalent sources of tax income among countries. In the UK, the state relies mainly on personal and corporate income tax while Germany collects most taxes from social security contributions.

According to Scharpf findings, employment in the exposed sectors is declining due to more intense competition in product markets requirements. This situation has lead to pressures on welfare states committed to full employment, social security and equality. On the other hand, the high unemployment levels and inequality in primary incomes under conditions of tight fiscal policy require the welfare states to perform even more social security and equalization functions. However, countries differ in the extent to which the achievement of their specific national welfare goals is affected by the pressures of globalization in the form of an internationalized economy. These current challenges are not subject to a universal solution based on a choice between master strategies. The Varieties of Capitalism distinction of two types of economies – a liberal and coordinated one - facing similar adaptation problems can be used to see how the two distinct groups of countries under that classification which share similar sectoral employment ratios and level of welfare states' development are responding to the impact of increasing competition.

Recently, the view that prosperity and social justice rely on the presence of highly skilled labor force has spread among the developed countries (Brown, 2001). The knowledge economy has become a central feature of the global, technological and social transformation taking place in the last twenty years. One argument supporting this notion claims that the demand for workers with deep skills has spread throughout the economy because occupational elites are not sufficient for the provision of economic competitiveness which requires the participation of the whole workforce. The rise of new economic activities demands the provision of new knowledge capital. However, the development of educational programs and the actual enrollment of students and trainees require time and obscure the ability of the state to meet the current needs of the employers. Political economies nowadays are preoccupied with the issue of global competitiveness under the assumption that nations are willing to exploit other states which overgenerous welfare provisions in the absence of fiscal rectitude and market policies. Global financial markets are trying to make dividends from states which do not perform sound government (according to market criteria) on indicators like interest rates, inflation figures, taxation and public spending.

However, competitive pressures do not stem only from the lower costs offered by emergent industrial economies but also from the desire of MNCs to realize higher profits based on the shareholder approach (Dore, 2000) especially companies competing on price. This tendency manipulates people's perception of economic development direction, presenting neo liberalism as the only viable option to respond to globalization challenges. For

example, in making strategic decision regarding investment locations, MNCs take into consideration not only the social overheads and wage costs but also issues like proximity to markets, political stability, transport infrastructures as well as skill levels and the quality of education and training. According to Brown, market individualism and neo-liberal policies in the Anglo-Saxon countries are a political choice and a path dependant direction of development rather than an inevitable response to the deregulation of global markets.

Knowledge driven economies are associated with polarization and inequality rather than convergence and equality reflecting the power differentials among the middle class and social elites (Brown, 2001). There is a trade off between skills and employment; poverty and social disadvantage are related to educational failure and subsequent low skilled employment or unemployment in countries where market competition reinforces the advantages of those from privileged backgrounds (Halsey, 1980). In the UK, the contradiction between full employment and high skills creation has been solved in favor of the former as any form of economic activity is preferred to unemployment and social benefits. This results in vast numbers of people with very low skills and low incomes which has become characteristic of the Anglo-Saxon employment structure (Esping-Andersen, 1999).

Such income polarization is not observed in Germany despite the high level of differentiation of academic qualifications in the Dual System of education and training. However, the costs of the generous unemployment benefits in Germany has started to cause dissent among the public and the government is attempting to create more flexible work conditions for the low skilled workforce in order to decrease unemployment. In the UK such a problem does not exist as most of the labor market has flexible and not very deep skills which are transferable among jobs and there is little incentive for knowledge development as such activities are left to individual choice and motivation. However, there are increasing demands on productivity which require context-specific skills and not easily transportable know-how for its improvement which may impose the need for revision of the national skill mix.

This theory explains the current necessity of the creation of knowledge economy in the developed countries as due to increased mobility and internationalization of capital; competition based on price with developing countries is not a feasible option as they exhibit much lower costs. Thus, value added and high quality output is required as well as higher levels of productivity and return to satisfy investors. These changes have an effect on the demand for skills with different impact and the challenges they present to national skill profiles will be examined in chapter four from this globalization perspective.

## **Chapter Four**

### **Skills Profiles – Competitive Challenges**

#### **4.1. Overview**

The purpose of this chapter is to examine the issue of globalization challenges posed to liberal and coordinated national economies in the area of skill provision in accordance with the globalization theory developed by Scharpf. Based on it, one may expect that the challenges are relatively the same but they differ in impact and significance and thus the adaptation responses among nations vary. This part of the paper will also investigate the nature of the gap between skills demanded and the ones supplied from the perspective of VoC which attributes the supply of skills to the product market strategies and the degree of coordination in industrial relations.

High-skilled labor market has been usually associated with the concept of national economic competitiveness. However, there is no universal method of measuring this concept or a way of its achievement applicable to all countries. Even though globalization leads to highly integrated financial markets and technology transfer there is still no best practice established for national competitiveness increase. According to the World Economic Forum and OECD, this term defines generally the “abilities of a country’s economic and social institutions to compete internationally in a way that leads to sustained national growth and high average incomes for national citizens”. Michael Porter defines national competitiveness as “the degree to which a nation can, under free and fair market conditions, produce goods and services that meet the test of international markets simultaneously maintaining or expanding the real incomes of citizens”. Some of the measures of national competitiveness are the GDP per capita, economic growth rate or indicators like the Global Competitiveness Index developed by the WEF.

Productivity is another measure which can be used as it allows for a more precise definition and often is utilized to investigate underlying or “structural competitiveness” in the economy including predictions for wages levels and living standards (Gough, 1999). Total factor productivity (TFP) is a measure that reflects both capital and labor productivity but this issue will be examined in a greater depth in the following chapter on industrial structure. Labor productivity can be measured in a variety of ways – either through output per worker, output per hour worked or output per head of the population.

National competitive advantage, however, may stem from other factors like low labor costs or foreign direct investment due to secure business and legal environment and highly developed infrastructure. Competitiveness can also be increased through the increased in output per worker through longer working hours which is the case in the Japan or through reduction in social costs through higher employment rates as in the UK (Green, 2001).

The significance of labor force skills for national economic competitiveness varies greatly depending on the dominant types of strategies pursued in the different prevailing sectors and in each country some sectors are more competitive than others due to its specialization which is in line with the Varieties of Capitalism concept of comparative institutional advantage. Thus, the skill profile of a given nation state is a consequence of the different national configurations of business competition strategies (Green, 2001).

German economy presents relatively low capital productivity as its financial sector is still underdeveloped. However, the country compensates with higher levels of labor productivity, especially in the manufacturing sector which occupies a significant portion of the industry (24.2% of the employed in 1998 compared to 18% in the UK). According to an IMD statistical data, if UK labour productivity is estimated at 100 in terms of GDP per employee per hour, the German one is measured at 117. The output per worker is high despite the short average working hours and the recently high levels of unemployment. This is explained by the high output per hour work due to high capital investment, R&D intensity and worker skills. Germany is considered a “high skills” economy or a knowledge-intense one due to the specificity and depth of the skills in the labour force especially among the people employed in basic and applied science as well as engineering, complemented by the existence of a broad distribution of general education and technical skills.

Lower productivity in the UK is seen partly as a consequence of under investment in plant and equipment which was 30% less than the one in Germany for the period 1983-93. In terms of labor market skills, the UK is characterized by highly skilled elites in the fields of basic science, finance, design and the creative professions but the distribution of general education and technical skills at the intermediary level is not as broad as in Germany (Green, 2001). United Kingdom national economic competitiveness is based mainly on the profitability of its financial sector and the efficiency of its capital markets. The labour

productivity is thus not such a focal point and is characterized by low capital investment and low level of employees with specific skills (Green, 2001). According to Albert (1993), such traits of the economy like high capital productivity and flexible labor markets may hinder the formation of high or specific skills. However, the economic underperformance does not lead to lower employment as “lower productivity is being rewarded with lower wages” (McKinsey Global Institute). Company competitiveness is based on flexible employment and cost reduction instead of value added through skills which is the German case. Such practices are characteristic of the “low skill equilibrium” (Finegold and Soskice, 1998).

The following section of this overview will examine the current economic indicators of Germany and the United Kingdom in the area of international competitiveness using the rankings provided by the 2007-08 Global Competitiveness report of the World Economic Forum as well as statistical data from OECD and CIA.

In terms of competitiveness, Germany's performance can be observed in its Growth Competitiveness Index. It ranked up 5<sup>th</sup> in 2007 from 7th place in 2006. The UK scored down 9<sup>th</sup> on this scale comparing to its second position in 2006. The ranking is based on three sub indexes which examine basic requirements, efficiency enhancers and innovation and sophistication. Germany is listed 9<sup>th</sup> on the basic requirements while UK is 16<sup>th</sup> and the difference is due to the better ranks of the former on institutions and infrastructure as the other components are close. The next sub index on efficiency enhancers places Germany on the 11<sup>th</sup> position while the UK occupies the 2<sup>nd</sup> one. The better performance of the UK on this component is based on its higher ranks on labor market efficiency and financial market sophistication as the other parts rate very close. Thus, we may expect that the comparative advantages of Germany are excellent functioning institutions and infrastructure while for the UK there are labor market flexibility and developed financial markets which is in accordance with the VoC theory on CMEs and LMEs.

However, Germany still shows low flexibility of labor markets, ranking 115<sup>th</sup> in 2007 compared to the UK which is 10<sup>th</sup> despite the fact that the other rankings show it is overcoming the economic stagnation which was problematic for the country during the last decade. Regulations increase administrative costs and hinder competition. The country ranks second in labor market regulations in 2004 which hinders business activity. It has high protection for workers job security which does not appeal to international investors. It ranks 131<sup>st</sup> out of 155 countries regarding job dismissal. The current government has undertaken reforms which are directed to lowering unemployment insurance, corporate sector restructuring, and decrease in unit labor costs and improvement in job opportunities for the low skilled workers. These are some of the challenges the county should overcome in order to compete globally and attract more FDI. The researchers from the World Economic Forum claim that structural features need to be addressed in order for long term sustainability to be achieved in the area of persistent labor market rigidities and overregulation.

The economic success of Germany can be attributed to its excellent public institutions, well functioning business sector and intense collaboration between universities and companies as well as the supply of highly skilled engineers and scientists which is reflected in the general supply of skills. The World Economic Forum experts claim that in order to keep its relatively high competitiveness position, Germany should continue focusing on creating qualified staff and investing in R&D. It should consider development in the new industrial fields like biotechnology in order to sustain its competitive technological advantage and preserve its export markets. This process of modernization will require the joint efforts of the government, the firms and the workers. The German culture of cooperation and common social contract can be of great advantage in overcoming this challenge.

The United Kingdom is lagging behind in the fields of infrastructure and institutions' performance but compensates in the area of efficiency showing high levels of labor market

efficiency and financial market sophistication. The country may need to develop its institutional framework in order to raise the provision of collective goods needed for the creation of high skilled economy and value added production like VET system. The annual change in general ranks show that the UK competitiveness is decreasing in the last years which may be attributed to the decline in opportunity for price-based low value-added competition with developing countries.

The GDP composition by sector of the two countries, according to CIA data, is quite similar. Services provide the majority of production output in both economies with a smaller share of industry and a minor one of agriculture. For Germany in 2007 the ratio is as follows: 0.9% agriculture (0.9% in UK), 29% industry (23.4% in UK) and 70.1% services (75.7 in the UK). In both countries, there is a trend towards a decrease in the share of industry in the composition of GDP and increase in the share of services from 1995 on. In Germany, the share of industry was 34.5% in 1995 (31.4 % in UK), 30.4% in 1999 (25.3% in UK) and 29% in 2006 (23.4% in UK). On the other hand, the share of the service sector in Germany grew from 64.4% in 1995 (66.8% in UK) to 68.4% in 1999 (73% in UK) and finally reached 70.1% in 2006 (75.7% in UK). Thus, the pattern of sectoral change in the composition of GDP among the two countries is the same and production profile mix can not be used as the determining factor for the development of general skills in the UK and specific skills in Germany. This trend is due to the national economic institutional settings. However, despite the fact that the ratio of service to industry is relatively the same in two countries in the last decade, this does not mean that this was the case fifty years ago and that the same attention was given by skill formation systems to both sectors in Germany and the UK.

According to WEF analysis, changes in the ‘sectoral’ composition of employment have significant consequences for the kind of skills that are likely to be required and significant changes in the structure of employment in the UK are expected to take place over the next few years. Over the period 1999-2010 it is anticipated that employment in the primary and manufacturing sectors are likely to fall. On the other hand growth is anticipated especially in business and other services, non-market services and distribution. The scale and nature of expected future skill needs, is such that meeting these evolving skills requirements will be a major challenge for government and public agencies as well as for individuals and employers.

## **4.2. Germany**

### **4.2.1. Description of the national skill profile – VoC institutions influence**

Germany skill profile is one of high skilled elites, wide skills distribution and relative income equality (Green, 2001). The country shows a relatively even dispersal of skills throughout all sectors. National policy on social solidarity and competitiveness is based on “equality of productive capacity”. The wide distribution of skills may be attributed to a high level of trust in the society and the existence of a training system which is part of social partnership framework based in dense association networks. The traditional social respect for technical skills shown in the concept of Beruf (profession/occupation) has been institutionalized in the German dual system of occupational training which prepares two thirds of the students for work life and attempts to transform most paid jobs into skilled occupations. The coordinated sectoral bargaining raises pay and skill level and motivates German producers to seek higher productivity returns. Thus, companies compete on quality rather than price which allows for one of the lowest levels of income inequality among the developed countries which is typical for product strategies in CMEs.

The German economy relies to a great extent on its manufacturing sector which is highly specialized and diversified and includes large firms where most of the capital is concentrated as well as small firms sector. According to Michael Porter, German manufacturing is characterized by deep industrial clusters characteristic for coordinated economies especially in chemicals and machinery production. The high employment and social costs firms incur have not been an obstacle for successful competition in high value international markets due to the incomparable range of quality products the country offers, especially through the large firms in autos and chemicals and small firms in the machine tools sector. In 1993, German share of total world exports was 10.1% compared to 4.8% for the UK.

According to Andy Green, the contemporary German high skills society is based on the institutional traditions in the country like the existence of powerful trade associations, solidaristic national training and social insurance system and the prevalence of national finance through domestic banks rather than foreign capitalization which lead to the creation of a distinct form of social market. These are the institutions stated by the VoC theory as essential for determining the level of coordination in an economy. The policy of post-war Germany is described as a complex form of neo-corporatism where markets are highly regulated within a centrally determined framework. However, powers are largely spread among government levels, independent organizations and social partner organizations which have different but legally constructed roles. Thus, the German government has less power for establishing a selective industrial policy than the other continental governments and the UK. The role of the central authorities is to empower social partner organizations, to regulate standards and to provide infrastructural support. The Federal Government regulates the apprentice training system through the Bundes Institut fur Berufsbildung (BIBB), investing in research and development using also intermediary technology transfer organizations.

The following characteristics of the German skill profile and the institutions influencing its formation also describe it as characteristic of a CME. Social organizations in Germany play a pivotal role in policy decision making and implementation at all levels. At the sectoral level, employer associations and trade unions set product standards and wage levels and participate in skills agreements. The Chambers of Commerce require mandatory membership and cover most sectors, including the Dual System of apprenticeship training. The social partnerships established in Germany are claimed to have had an influential positive effect on the national economic performance allowing German companies the provision of collective goods which is problematic for firms in the UK. The sectoral agreements on wages and skills lead to higher standards for employee qualifications and prevent poaching among employers. Co-determination which gives employee rights and voice in company decision making, together with labor market regulation is seen as influencing skill enhancing practices among employees in a positive way.

Job tenure in Germany is longer than in most of the other advanced economies with an average value of 7.5 years compared to 3 years in the USA (Streeck, 1996) which is motivates skills development. The flat hierarchies characteristic for German firms also encourage the distribution of responsibility and skills. The company law in the country promotes long term investment and establishes an environment supporting enhancement of skills as companies are legally obliged to put the interests of the stakeholders above those of the shareholders. The predominance of bank finance and non voting shares limits the private shareholder influence over company policy as well as the pressures for short term profit which supports long-termism and investment in training and R&D.

The German economy can be described as a high-skilled one regarding the skills profile of the labor force together with other measures of knowledge intensity (Green, 2001). Although its ratio of higher education graduates is lower than that in the UK, it offers high

quality especially in science and engineering. In 1992, one fifth of all degrees accomplished were in engineering compared to 13% in UK. The higher education system is divided in two levels – Magister graduate level (equivalent to UK Master degree) and vocational courses offered at the Fachhochschule. First and higher university degrees as well as Meister and Techniker qualifications are equal to level 4 and above in the UK and were held by one fifth of the population aged 16-64 in 1997. Although this is a smaller proportion than the one observed in other developed countries like the UK, most of the university graduates have a degree higher than the Master one which makes the stock of qualified people very highly educated. Postgraduate scientists and engineers are more prevalent in R&D departments in the electronics industry in Germany than UK (Mason, 1998).

The qualifications of employees at the intermediary level are significant as well. The ones obtained after three years of apprenticeship as well as Abitur and Fachhochschulreife (which gives access to university and Fachhochschule) are equivalent to level 3 National Vocational Qualifications (NVQ) in the UK (Green, 1997). Half of the working age population in Germany had level 3 qualifications in 1997 compared to 18% in the UK and only less than 10% do not possess at least a skilled worker qualification.

Another indicator of the knowledge intensity of the German economy is the high level of R&D spending which is above the UK and OECD average (OECD, 1991). The same is valid for the ratio of research scientists and engineers per 10 000 of the labor force and the country also shows the third highest value of patenting in the world after the US and Japan. Generally, German labor force shows highly skilled employees and wide skills distribution complemented by significant social capital seen in its cooperation capacity.

The wide distribution of skills at the intermediary level provides for diffusion of general learning abilities and professional habits and shows the social valuing of occupational skills. The Beruf provides not only theoretical knowledge and practical skills but also social identity. Employees enjoy the benefits of highly skilled workforce as technically professional elites are provided in the areas where they are most necessary and the employees at the technician level are qualified enough so that management does not have to compensate for skill lacking at lower positions which is the case with the UK (Steedman, 1987). This wide distribution of occupational skills especially in manufacturing allows flat hierarchy existence and multi skilled team working which is characteristic of the advanced production systems in Germany.

Higher academic education and vocational training are seen by students as security measures in the increasingly insecure job markets. Globalization pressures for competitiveness and labor mobility put different emphasis on the significance of qualifications and the purpose of apprenticeship may change with more students using it as a first step to progress their training further. About 50% of the German workforce in 1995 was having jobs matching their vocational qualifications. According to Heinz, 24% of car mechanics continued their studies for higher degree in 1999 and the reason was not unemployment but the higher aspirations created by the Dual System.

#### **4.2.2. Challenges for the skill mix – Globalization theory - lower labor costs and larger service sector requirements in order to compete for mobile capital**

The most knowledge intensive sectors are manufacturing areas like chemicals and engineering which present the main part of the national exports. Fields like finance, marketing and advertising are less developed in Germany than in the UK and thus there is a lower concentration of professional elites in these areas. Other underdeveloped sectors include software, multimedia and biotechnology which consequently lack highly qualified employees. One explanation for this phenomenon is given by Soskice who claims that the high degree of

structuring in scientific professions' career routes leads to research traditionalism which hinders the research development in high risk areas. However, the BIBB has started to develop new apprenticeship programs which to cover such fields.

Germany was facing some serious economic problems – the unemployment in 2001 was 9.3% and GDP growth in 2000 was only 1.9% which was below the EU average (The Economist, 2001). There are numerous causes of this not quite satisfactory economic performance. One of them is the unification burden on public budget which require high taxation levels due to the necessity of transfer payments from the west to the east caused by lower productivity in the latter. Another explanation is the very high labor costs in Germany – hourly labor costs in 1999 were estimated at 16.40 pounds while in the UK they were 9.80 pounds (Conradi, 1999).

There is also a great increase in competition in consumer electronics as well as in the high value markets in autos and machine tools which are essential for German manufacturing as these are its main export markets which are becoming now more price-sensitive. In order to keep producing high value goods, the country needs to find additional markets for East Germany production exports and to remain a leading force in technology. However, innovation in Germany may not be high enough to keep the economy ahead in a sufficient number of sectors – like software and biotechnology where no real advances are made so far – to keep its high wage, high price production regime (Green, 2001).

Some big German companies like Siemens and Volkswagen are responding to globalization pressures by moving their operations abroad. Some of them are also introducing “lean production” techniques to reduce costs (Streeck, 1996) or even abandoning the sectoral agreements (mainly in East Germany) which are the pillar of labor market coordination (Soskice). According to Albert (1993), more firms are looking for foreign capitalization and German FDI abroad is increasing (though in 1998 it was only 6% of capital spending – Max Planck Institut). This may have negative effect on domestic jobs and increase the social insurance costs.

Thus, the increase in the significance of international capital casts doubt on the future of the “Rhinemodel” of production which rests on patient capital and social partnership (Albert, 1993). The reduced importance of domestic banks shifts the emphasis towards short-term profits and threatens the basis of the coordinated market economies. Such changes may lead not only to a decline in R&D spending but also to a reduced motivation for companies to commit to training, especially if more companies exit the sectoral agreements which so far prevented poaching problems. The number of companies which are not “co – determined” has increased with 20% since the 1980s and despite the fact that the government policy still maintains co-determination, it has been acknowledged that greater flexibility and emphasis on local bargaining is needed (Max Planck Institut, 1998). Thus, the German skill formation system also needs to adapt to the changing economy and its successful performance in the future depends on the ability of the state to preserve the institutional basis for high skill/high wage production in the face of global pressures.

#### **4.2.3. Gaps in the skill profile between supply and demand – VoC competition strategies – Germany quality based competition – need for general skills (service sector)**

The German economy has been experiencing significant strain due to globalization competitive pressures and unification costs. There is a concern that the Dual System does not provide the enough places. Since 1991, a decline in the available places has been noticed despite the existing academic drift and decrease in the age cohort which until 1999 ensured the absence of places deficit. Nowadays, many of the large companies are providing for fewer apprenticeships due to the increasing costs of training caused by higher wages and reforms

reducing the time on the job of the apprenticeship and enhancing theoretical requirements. As a consequence, only one third of the students can acquire and apprenticeship with an employer. Large companies are more and more aiming at hiring graduates following competitive pressures for higher productivity and increasing numbers of students choose the higher education path which may cause a long term decline in both supply and demand for places.

The changing nature of skills demanded by the economy is one of the major challenges that the Dual System is facing. There is a growing necessity for training in areas like multimedia and biotechnology but also in generic skills (Green, 2001). This is due to the fact that there is a growing number of occupations which require a broad range of skills and some general competencies which can be applied to various fields thus demanding breadth of knowledge and adaptability (Wolf, 1999). However, this trend is a bit contradictory to the traditions of the German Dual System which relies on heavy occupational identity and specificity of skills and has emphasized so far precise technical skills and competences. Nowadays, changes in the work organization and occupational roles lead to an increasing demand for generic training and key skills like IT, team working, communication and leadership. However, the focus on such skills has not caused a decrease in the importance of specialist skills which is the case in the UK.

## **4.3. United Kingdom**

### **4.3.1. Description of the national skill profile – VoC institutions influence**

The United Kingdom model of skills formation can be described in terms of polarization between elites rich in skills in sectors where competitiveness is based on labor productivity and low skilled workforce in the sectors where the latter is derived from capital productivity and flexible labor markets. This limited distribution of skills among employees in different areas is associated with high rates on income inequality and low level of social capital. As a consequence, there are deficits in labor productivity especially in the manufacturing sector partially covered by higher capital productivity combined with social problems (DTI, 1998). However, the country shows substantial skill-based competitiveness in areas like banking, financial services, aerospace, pharmaceuticals, telecommunications, media and entertainment (Finegold, 1999). The relative strength in such hi-tech industries is compatible with the large sector of the economy relying on low skill and low productivity which competes on low labor costs (Green, 2001). According to Finegold and Soskice (1988), the UK economy represents “low skills equilibrium” with the majority of companies employing poorly trained managers and workers and producing low quality goods and services. The main reason for that practice is claimed to be the existing network of social and state institutions which hinders the demand for improvement in skill levels (Green, 2001).

This view is in line with the Varieties of Capitalism theory used in the current research which claims that institutional frameworks and relationships determine the economic outcomes in various spheres and the varying national preferences for different business strategies. The institutional legacy is presented through the education and training systems, industrial relations, financial markets, the organization of industry and work process all of which differ significantly between the UK and Germany (as is explained in the theoretical framework on LMEs and CMEs). The British companies rely on competitive strategies which are based on participation in protected markets, takeover growth, and investments abroad, cost cutting and new variants of Fordism (Keep and Mayhew, 1998). Such an approach can be successful in the UK as there are large numbers of consumers with low disposable income

using cheap retail discounters, economy air services and low cost domestic retail banking. The shareholder or “consumer” capitalism established in the UK poses lower demands on skills than the stakeholder or “producer” capitalism in Germany due to the dominant financial sector (Hutton, 1995). It allows large profits from mergers and acquisitions, and financial instruments trade which leave high skilled productivity behind in importance (Soros, 1998).

The early and prominent industrial revolution in the UK together with the powerful City institutions did not provide supportive environment for state mass education. The weak institutionalization of secondary and post secondary schooling, the significance of elites and the low perception of technical and vocational training are remnants of Victorian educational voluntarism (Green, 2001). In the 1980s there were low portion of people in post compulsory education as well as no high status vocational tracks with a system dividing sharply academic and vocational tracks, the latter of which providing no general knowledge.

The same pattern is observed regarding workplace training hindered by institutional indifference. In 1964 some attempts were made to introduce training levies through the Industrial Training Act but were abolished in 1973. Employers are not legally bound to provide any kind of training and are not obliged to become members of the Chambers of Commerce. There is lack of coordination which is typical of LMEs. Workers do not have the right to training leave and there are no sectoral agreements connecting occupations and income with qualifications. The intervention leading indirectly to a higher supply of skills is shown in the measures taken to enhance product and process standards. The lack of social partnership and regulations discourage employers from investment in training due to poaching opportunities. Employees are not represented in company decision making bodies like in Germany and the UK did not sign the Maastricht Social Chapter agreements even though its large companies compete mainly in the EU Market (Green, 2001). This leads us to the point that social capital is underdeveloped in the country and individualism is prevalent.

The UK educational and training system shows dualism regarding different sectors requiring either highly skilled elites at professional level or low skilled labor at the intermediary level. There has been an increase in students at the graduate level with 89% between 1989 and 1996 and 28% of the aged 25-29 years old have university qualifications compared to 15% in Germany (Mason, 2000). However, the UK has a lower portion of scientific graduates compared to Germany (29% to 33% in 1996) due to its smaller manufacturing sector. In 1994, 40% of the age cohort (aged 19-21) had a level 3 qualification while in 1998 this figure rose to 52% (NACETT). Thus, the higher percentage among young people of level 3 graduates raises the national average. In 1998, only 55% of the people aged 25-29 did not have at least level 3 qualifications which is less than the national average of 59% but still way higher than the one in Germany for the same age group which is 20%. According to Green the unequal access to initial education and training are one of the major causes for the polarization of the UK skills system.

Regarding on-the-job training, the results of the European Commission Continuing Training in Enterprise Survey from 1994, conducted among twelve member states show that the UK rates very high on incidence of training but relatively low on duration and quality. Moreover, the training opportunities are claimed to have been unequally spread among employees directed towards managerial and professional staff rather than manual workers (Keep, 2000) reflecting the polarization in skills’ development between groups. As a whole, one third of the adults in the UK have not been provided with any formal training after graduation. However, the underinvestment in training leads to shortages in skills and 23% of employers reported hard to fill in vacancies in the 1998 Skills Needs in Britain Survey. A study conducted in 2000 by Hogarth shows that 15% of companies claim hard to fill vacancies with more than half of them in professional and technical occupations on the intermediary level of production.

However, the banking sector does not seem to be influenced negatively by skill shortages. It has shown a 64% increase in gross output during 1991-6. Its successful performance may be attributed to the specificity of its labor organization and requirements which match quite well the supply of skills provided by the dualist UK system. The workforce employed in the sector can be divided in two categories – highly skilled specialist professionals on one side and desk officers and routine process operators on the other. These characteristics are being well complemented by the polarity of the national skill formation system.

#### **4.3.2. Challenges for the skill mix – Globalization theory – higher productivity and value – added requirements in order to avoid price based competition**

The overall competitiveness of the UK remains “indifferent” and in 1997 the country was nineteenth in the world regarding GDP per capita, lagging behind most of the developed EU nations. The UK also ranked fifth among G7 countries in R&D business investment in 1995 and capital investment per worker in the country was 65% less than that in Germany in the late 1990s (O’Mahoney, 1999).

Surveys conducted by the National Institute for Economic and Social Research (NIESR) conducted in plants in UK, France, Germany and the Netherlands show lower productivity levels in the UK despite the similarities in market niches and machinery used. The higher productivity in the continental countries is attributed to the ability of their workforce to perform a wide array of tasks leading to higher quality products and services. The study shows that in German clothing manufacturing an average of 40% of technicians had vocational qualifications compared to zero in the UK. Thus, the lower levels of skills in the UK plants are claimed to be impeding productivity.

#### **4.3.3. Gaps in the skill profile between supply and demand – VoC competition strategies – UK price based competition – need for specific skills (intermediate level productivity)**

There is a steady decline also in sub-degree qualification in engineering like the Higher National Certificate (HNC) and the Higher National Diploma (HND) despite the fact that sub degrees can be obtained in a shorter period of time and offer better rates of return (Deardon, 2000). The shortage of skills in the UK is noticed at the intermediary level where a lot of the employees have no or very low qualifications – only 18% of the adult population had at least level 3 qualification in 1999 compared with 50.6% in Germany despite the current increase in numbers. Surveys show that 15 of firms claim they have company specific skill-shortage vacancies and the majority of them comprise of practical and technical skills (Hayward, 2004).

The highly skilled elites’ minority in the UK allows the country to compete successfully in industries like advanced materials, biotechnology and opto-electronics (Hendry, 1999). However, there are not enough skilled technicians and project managers in these sectors as well at the intermediary level and mass production of goods in these areas is being exploited by other countries. There is a lack of workers with specific production skills which to raise the productivity performance. The UK skills profile is suitable for the development phases of these industries but not for commercial exploitation. However, the system of skill transfer in the UK is claimed to provide for greater innovation compared to the German one. The latter uses intermediate research institutes for skills transfer, especially to SMEs and this institutionalization discourages work in risky innovative hi tech areas (Green, 2001).

Different national sectors pursue different market strategies and thus do not utilize the same type of skills. Science and the creative arts rely on specialized skills; other sectors like pharmaceuticals, biotechnology and media require labor market flexibility (general skills) while the banking sector in the UK depends both on high specialized and general low skills. However, the manufacturing industry necessitates the presence of intermediary specific skills which is absent in the UK and is reflected in the performance of the sector. Despite the fact that manufacturing does not occupy major part of the overall national production, other industries and services essential for the economic performance of the UK also rely on intermediary level skills which are undersupplied.

The institutional background behind the current UK policy on education and training reflects conflicting interests and goals between flexible labor market (essential for company profitability) and social partnership (required for national prosperity) as well as high technology sector requirements and intermediate technology manufacturing (Green, 2001). High skilled sectors like chemicals, electrical goods and aerospace in the UK rely on cost competitiveness strategies through low wages or efficiency based on labor flexibility but such conditions may be detrimental for the development of other sectors with positive outcomes for long term growth and equality. According to Finegold, the high tech industries may be quite productive but they employ just a minor share of the workforce and do not contribute significantly to the GDP. The UK seems to be following the American model of high technology and workforce flexibility which creates skills and income polarization (Due, 1991).

#### **4.4. Comparative Remarks**

Both the UK and Germany can be considered highly competitive economies on various criteria. The post unification slow growth in Germany has cast doubts on the social inclusion abilities of the system. Still, living standards are higher than the ones in UK due to higher incomes, lower living costs and generous social benefits but it is not clear whether Germany will be able to sustain its welfare system and its high social costs. Static market share in manufacturing can not be easily compensated by job creation in the service sector. Some of the large German companies have started to follow a profit-maximizing strategy as a way for overcoming globalization pressures. Employers create more low-paid and low-skilled jobs, thus providing a basis for the polarization of the traditional flat skills distribution. However, if the option of creating a low skilled service sector in order to decrease unemployment is chosen, then the problem of underemployment of highly qualified staff arises. In the United Kingdom, a significant decline in many sectors of manufacturing is observed, leading to erosion of craft leveled skilled employment (Green, 2001).

Another difference between coordinated and liberal market economies in the field of skills formation is the ability to diffuse knowledge. Of great importance is the transfer of skills to SMEs due to their growing participation in international markets through exports. Education and training systems and labor market structures predetermine the spread of occupational information – the structure and degree of integration of labor markets influence the efficiency of knowledge exchange (Lauder, 2001). The links between the German ET system and the labour market are highly standardized and stratified (Allmendinger, 1989) providing consistency of qualifications and job stability. Knowledge of innovations is spread throughout the economy from large companies to SMEs through apprentices who spend some of their training time at the leading companies. The Chambers of Commerce are deeply involved in ET policy making, gathering information on training needs from the employers through training advisors who visit companies and also convince them in the need for training. However, occupational training in Germany created exclusive in depth knowledge in

a specific area which is beneficial for incremental innovation but hinders basic innovation. This may be seen as a disadvantage of the system as today's globalized world depends on adaptability to rapid changes in the latter. The ET systems which are at the core of high performance through the provision of skills differ among nations reflecting historical, cultural and political backgrounds (Lauder, 2001).

Skills' diffusion in the UK rests on individual social networks mainly through job switching and poaching rather than institutional ones which lead to knowledge transmission in the internal market only. This pattern corresponds to the level degree of coordination of the economy, high poaching opportunities and individualism characteristic for LMEs. It leads to the inclination of workers to keep valuable information to themselves with the intention to use it in another job position. Such a highly individualistic culture may hinder production of collective goods essential for sustainable development. Enhancement of skills is left to the personal motivation of employees and is difficult to be achieved in cases when unskilled people have long work hours and marginal wages. The prevalence of generic management at UK companies also influences innovation potential and skills diffusion as their priorities are quick profits and not value creation. However, British companies wanting to move up the value chain claim that skills shortages are essential obstacles in the process (Waterson, 1999).

Another important factor for skill diffusion and transfer of technology is the activity of large multinational companies (MNC). Global economic integration involves higher integration of nation states through trade, direct investment and other capital flows as well as digitalization and increasing importance of technology (Lauder, 2001). However, some of the MNCs use overseas plants for simple assembly activities with little training and research investment. Recently, German companies are showing increased participation in global markets through the acquisition of foreign firms, especially American and British ones (Meyer, 2000). Large enterprises in Germany are essential for skill diffusion and innovation towards SMEs and whether this traditional system of exchange will abide in the long run depends on the advantages they have from the participation in the Dual System compared to costs. Such costs are the regular political and economic losses from exit and the start-up costs of training aboard which act as strong countering forces to those of globalization and keep companies within the Dual System. Thus, the near future prospect are that the Dual System will adapt and survive as MNCs perceive it as pivotal for national competitiveness with the probable disengagement from costly industrial bargaining policies (Lauder, 2001). Interviews conducted by Hugh Lauder with officials from leading German companies show they support the Dual System and try to replicate it at their subsidiaries abroad in order to guarantee the success of their ventures. They also claim that the high productivity in intermediate manufacturing is a result of the highly skilled workforce. In Germany, specialization in one area is highly appreciated and is part of the social status which is a trait not observed in the UK.

The UK answers to globalization challenges through neo-liberal strategies aimed at attracting foreign investment in conditions of international competition for capital with MNCs looking for lower costs and higher returns. Such a response corresponds to its LME product market strategy based on price competition which is supported by the incentives provided by the institutional framework. However, MNCs usually do not engage in raising skill levels abroad, keeping their skilled work in the country of origin and investing generally in the flexible low-skilled sectors. Thus, the UK has adopted the view that economic activity as such is more important than productivity. The UK policy emphasizes a reduction in worker protection and higher adaptability to changing demands due to new technology advancement through labor market flexibilization. Thus, workers are deprived of trade unions protection and rely on the generality of their skills and knowledge to adapt to changing job demands. Their security may be increased in the future if companies adopt the view that high

performance work practices are crucial to raising productivity and consequently competitiveness. The difference in access to capital has determined some major differences in industrial sectors' development in the UK and Germany. The stable ownership in German companies allowed them to pursue competitive advantage in the intermediate manufacturing while Britain is competitive in hi tech electronics as a result of frequent job change and workforce turnover (Lauder, 2001). Thus, it is difficult to establish equal levels of general and specific skills across national contexts as they are related to ownership and corporate governance specifications. In accordance with the Varieties of Capitalism theory, institutional settings and industrial relations are the major determinant of the prevalent type of skills developed in an economy.

In the UK, skill formation policy is influenced mainly by the interests of the employers and not trade unions with the government having very limited authority in industrial policy (Brown, 2001). High deregulation of financial markets and heavy reliance on market mechanisms in the country have been often criticized but the 1990s economic growth and growing stock market prices combined with "full employment" in some parts of the country were used as counterarguments supporting globalization and free markets. In Germany, globalization is seen as a threat to the institutional basis of social partnership and thus to the high level of skills achieved among the workforce, undermining the Dual System of training through the pressures for large companies to exit costly sectoral agreements. This may lead to more flexible labour markets and higher share of the shareholder approach in corporate governance (Brown, 2001).

The gaps between the types of skills required and the one provided, their sectoral and occupational characteristics, lead to requirements for adaptation in order to reach an equilibrium state. As VET systems play a pivotal role in the supply of skills in national economies, in the next chapter the responses produced by liberal and market economies to bridge the gap will be examined in order to see if they differ and in what direction they are heading.

## Chapter Five

### National VET Systems – features and transformations

The following chapter investigates the reforms undertaken in the VET systems of Germany (CME) and the UK (LME) and evaluates their direction. It starts with a description of the institutions of VET in the two countries which differ significantly along the VoC indicators of coordination and the degree of development of human or social capital. The second part of the national VET systems discussion presents their recent transformation and evaluates the reforms in terms of general or specific skills' direction. Thus, the purpose of this chapter is to provide the reader with the features of VET systems in Germany and the UK from the VoC perspective and then evaluate their response to demands on skill provision in terms of creation of general or specific skills at low or high level respectively of VET development.

## **5.1. Germany**

### **5.1.1. Description of the VET system and its institutions as well as the challenges it is facing as a part of the coordinated market economy framework, evaluating its development from the social capital perspective**

One of the goals of the vocational training, according to the framework agreement from 1991, is to “develop occupational flexibility in order to cope with the changing demands of the working world and society”. Thus, there is a challenge for the Dual System in terms of reaction to the economic changes caused by the German unification, EU membership and globalization in general which is related to the ability of the national economy to preserve its distinctive social partnerships.

The economic stagnation noticed in the 1990s in Germany has influenced companies’ participation in training as providers of learning work places within the dual system of VET. As a whole, just one fourth of the enterprises are currently providing training with their proportion increasing with enterprise size. However, the distribution of trainees by enterprise size categories shows that SMEs provide the majority of training places and thus the decline in the proportion of companies offering training in this group is crucial (Cedefop, 2007). Since 1999, there has been a substantial decline in the number of in-company training places. While the officially recorded demand has not fallen significantly which leads to a gap in training provision. With just 562,816 training places on offer, the year 2005 marked the low point in this trend. This downward trend lasted until 2005 and had a particularly far-reaching impact because the number of pupils completing their general secondary schooling grew steadily between German reunification and the year 2006/2007. As a consequence, the computed placement rate (the number of new training contracts per 100 school-leavers) fell from more than 70 to less than 59. The target level for improvement set by the government was reached for the first time again in 2007 with a rate of 66.2%. This was the case in both the western states (66.0%) and the eastern states (66.7%). However, the positive development seen in 2007 was not enough to ensure an adequate number of training places to meet the demand: the lower rates during the last years generated a growing number of unplaced applicants from previous years.

The decline in the number of companies offering training increases poaching opportunities which is threatening the security pillar of the VET. This trend may be attributed to the company’s perception of rising costs of apprenticeships. A report done by the Federal Institute for Vocational Training in 1997 shows that 75% of the companies consider the dual system as beneficial but 35% claim it is too expensive. Another problem is the increasing number of students choosing to follow academic education which is more valued in service jobs. When the number of highly prestigious apprenticeships available decreases, higher education becomes more attractive to school leavers. The ratio of apprentices that continue their education in universities has reached 15% in 1999 but this is claimed by Finegold to be merely reflecting higher integration between vocational and higher education rather than representing a decrease in the youth interest towards apprenticeship qualifications. The high skills equilibrium will be under threat if the dual system is unable to provide the skills production companies need for DQP or if this method of production ceases to be used by the enterprises (Culpepper, 1999).

The growth of the service sector, however, should not be underestimated. According to Hall (1998), these jobs and not manufacturing are the main source of employment growth in OECD in the last decade of the twentieth century. A drawback of the VET system is there

are still few service profession certificates compared to manufacturing ones in the dual system so there is uncertainty whether service companies will perceive the VET system as beneficial to their activity and efficiency the way industrial firms did in the past. The Federal Institute for Vocational Training claims that the growing need for further training expressed by service companies is not a sign for the inadequacy of apprenticeship but a desire for an expansion of the areas it covers (BBWFT, 1998). However, the creation of a more flexible system for further training together with growth of providers and establishment of recognized standards may drive companies away from the more rigid and regulated apprenticeship system (Culpepper, 1999). Of course, this is just an assumption which is highly dependant on the areas covered by flexible further education and the quality it provides. The service sector, represented by great numbers of small innovative firms which are entering the market now, has been neglected so far by the traditional craft-based German system. The training infrastructure, expected to be established in this branch, is a more heterogeneous one and more similar to the Anglo Saxon flexible approach to skill formation (Deissinger, 2001).

The Dual System of apprentice training which is based on social partnership and distributed control is seen as one of the essential institutional foundations of the German highly skilled society. The system usually involves a three and a half year contract (in 95% of the cases) prescribed by the BIBB regulations. The apprentices spend three days a week in the company being trained under the supervision of a technically and pedagogically qualified Meister and two days a week at the Berufsschule where they acquire general education and theoretical background in their occupational field. Two thirds of the German youth participates in such programs and around 90% of them qualify in the end as skilled workers having a solid understanding of occupational theory and skills complemented by general education. This educational foundation prepares them for future training as well – 20% of the apprentices continue their qualifications further as Meisters (Wagner, 1999). Thus, the system functions not only as a mechanism for meeting the current needs of employers but also as one for raising the skill levels.

Employers in general support the Dual System for legal and internal reasons as it provides skilled labor force at acceptable costs. Sectoral agreements reduce the risk of poaching and allow them to see training investment as self interest and a collective good worth supporting. The students are also motivated to enroll in vocational training as such qualifications allow them entry to various professions they can not practice otherwise due to federal law requirements and sectoral agreements aimed at credentializing access to jobs. The Dual System covers most of the employment fields and provides high quality education. There are tight specifications of the national standards through the tripartite BIBB supported by the close scrutiny of the Chambers of Commerce at local level and work councils at company level. The assessment system also is based on social partnership – training committees and teams of apprenticeship juniors represent each party's interests in the Kammern.

The next part of the section will present a general overview of the institutional framework and organizations operating in the field of VET in the Federal Republic of Germany. The Federal Ministry of Economics and Technology together with the Federal Ministry of Education and Research are responsible for the legislation in the form of training directives. The latter ministry provides funding to the Federal Institute of Vocational Training (BIBB) which in turn distributes financial assistance to training enterprises delivering dual in-company courses. Together with the VET committee and employers' and employees' representative organizations, BIBB is responsible for examinations as well. On the local level, there are 16 Landes (regions) authorities that deal with part time vocational schools which are seen as public sector goods and are under Land legislation deciding on their curriculum. The Conference for Ministers of Education and Culture (KMK) harmonize the course content in

the 16 areas. Finally, the Federal Agency for Employment (BA) provides vocational guidance and funding for training places on both local and national level. The training partners in the economy are industry, commerce, agriculture, the liberal professions, public administrations, health services, and over 900 inter-company training venues. The various Chambers are responsible for advising companies, registering trainees, certifying trainers' specialist aptitude, accepting examinations and issuing certificates as well as conducting social dialogue at regional level. Thus, we can see a highly coordinated system of VET based on collaboration for the provision of collective goods which is based on the high level of social capital typical for CMEs.

In Germany, financing of vocational and continuing training is based on a system of mixed public and private financing. The school-based element of dual vocational training is financed by the Land and local authority public funds. Enterprises are responsible for financing the in-company training element – the individual enterprises decide independently whether and in what training occupations they will provide training, how many trainees they will take within the framework of the statutory provisions, and how much they will spend on this. In addition to financing by individual enterprises, in some sectors financing regulations have been collectively agreed upon. In these cases, all enterprises pay into a joint fund on a particular assessment basis like the amount of the total wage bill (wages fund financing). The expenditure of training enterprises is partially or wholly reimbursed from this fund. On the whole, business enterprises provide the major part of funding for VET (71% in 2005), complemented by Federal and Lander funding (17% in 2005) and Federal Agency for Employment (12% in 2005). The high level of compulsory private financing show the extensive degree of involvement of private actors for the provision of collective goods characteristic for coordinated economies as well as their interest and need for highly skilled employees due to their competition strategies based on quality value added production.

After finishing compulsory education at the age of 16, a great deal of young people in Germany who are no longer in full-time education attend a part-time (vocational) school for three years. The dual system is far and away the largest field of education at upper secondary level, with approximately 53 % of an age cohort training for a recognised training occupation. Vocational training schools include the Berufsfachschulen (full time vocational schools), Fachhochschulen (which is at tertiary level and offers qualifications close to the one from colleges) and vocational academies which also provide in company training but allow access to a Master degree. This shows a high degree of specific skills' development.

Apart from dual apprenticeship, the German VET system offers school-based, fulltime courses for young people of which only a minority however lead to a work related qualification. In these 1 full-time schools 40% of the students obtain a qualification outside the system of recognised skilled qualifications, compared to less than 10% of the apprentices in the Dual System. Thus, the Dual System can be seen as “the core segment” within the German VET considering provision of recognised labour market relevant vocational qualifications. According to the Vocational Training Act, qualifications may be obtained in a vocational full-time school as well, but few students actually attend these schools in specific occupational areas. The overall acceptance of the DTS as the major route for non-academic training is also backed by the fact that the system of skilled occupations based on dual training is virtually an exclusive route, as there are no other options of company-based training available which would find acceptance on the labour market. The conditions of skilled apprenticeship hence are closely linked with the prerequisite of homogeneous training schemes based on governmental training ordinances. The mandatory contents of a training ordinance are specified in the Vocational Training Act of 1969 (Deissinger 2000). The so-called ‘principle of exclusiveness’ makes sure that training ordinances represent the only way leading young people into skilled employment. However, this makes the system more rigid

and inflexible which may be needed to change in order for fast changing general skills requirements to be answered adequately and in time.

After completing their training in the dual system, the majority of participants then take up employment as a skilled worker – later on, many of them make use of the opportunities for continuing vocational training. This feature shows the coordination between educational institutions and employers typical for CMEs. Under certain conditions, however, those who have qualified may also obtain the academic standard required for entrance to a Fachhochschule in one year at school full-time, and go on to higher education. Successful participants in continuing vocational training are also increasingly permitted to study at colleges. Generally there are many points of transition between school-based and dual vocational training and from vocational training to colleges. In 2005, some 20 % of those beginning academic studies had completed a course of training in the dual system (Cedefop, 2007).

German distribution of students shows a high ratio of upper secondary level graduates (vocational schools) which can be attributed to the longstanding tradition of the dual system of vocational training. In 2005, Germany surpassed the EU average in respect of upper secondary level qualifications, with 60 %. In terms of higher education (university), Germany is only in the middle of the range compared with the EU as a whole. In order to provide prospective student with the financial means necessary to pursue further education, general student loans were introduced in 2006 Kreditanstalt für Wiederaufbau (KfW – Reconstruction loan corporation) which to complement the Student Aid Act.

An important feature of German VET system is its ability so far to provide technically educated employees necessary for the manufacturing production based on incremental innovation which is typical for the country and is often called diversified quality production (DQP). However, as already mentioned, changes in financial markets, productive organization and industrial relations may have a destabilizing effect on the apprenticeship system (Culpepper, 1999). Thus, it is changes in these spheres in the economy supporting the dual system which may have a negative impact on its future existence and sustainability rather the efficiency of the system itself. However, the internationalization of financial markets have not affected to a significant extent the long termism in training practices of large German companies, according to studies conducted by Federal Institute of Vocational Training and the National Employment Office. Regarding production trends, some companies had problems introducing lean production techniques and team work due to the strong occupational identities of German workers as generalist teams oppose the traditional view that each skilled worker possesses differentiated technical skills. However, some firms managed to overcome this difficulty through increased responsibility on the production line without blurring the Beruf concept and flattening hierarchies giving more power to teams and their Meisters (Finegold and Wagner, 2000). Industrial relations are experiencing problems of lower coordinating capacity as some companies are exiting the industrial associations also due to the difficulty to achieve a common strategy for large and small firms which exhibit different demands. However, the employers' associations still possess a strong capacity for information-circulation and collective deliberation not seen in the UK which can provide satisfactory assurance levels to their members (Culpepper, 1999).

### **5.1.2. Reforms of the VET system in response to skill gaps – initiatives and direction**

The German VET system is facing challenges nowadays by globalisation, structural change in industrial life and technological advances. However, the government has taken measures in the last decade to answer the demands arising from these changes. One of them is directed towards the permeability of the education system. Existing frontiers between

individual areas of education are being decreased, so that qualifications in one area can provide entry to another, transferring also the knowledge already obtained in a program instead of learning the same thing again. This may be seen as an attempt to develop higher flexibility of the system which is more typical of training in general skills as they do not require great depth and specificity of knowledge. From the VoC perspective, such an initiative may be interpreted as a slight move towards a more liberal type of qualification structure as coordinated economies are characterized by rigid boundaries between occupations.

There are also other measures taken to adjust the Dual system to the threatening patterns of change. The deficit in places in East Germany is covered by additional federal funding and some state funded private skills centers are established besides the vocational schools. There were plans by the authorities to introduce a levy to fund increases in apprenticeship places which were rejected and other measures will be needed if there is long term undersupply of places. According to David Soskice, the apprentice wages in the lower paid sectors will have to be decreased in order to increase the supply of places. These trends – for rejection of levies and introduction of government funding for places – reflect patterns typical for liberal market economies like the UK. However, the reason for them in Germany is not that there is lack for highly skilled workers but that the costs of apprenticeship are perceived by some employers as too high in a world of global competition.

In order to bridge the gap between skills' demand and supply in sectors which are expanding but were unattended before, apprenticeship training is being introduced into areas it was not prevalent in before. The Cedefop 2007 analysis of employment and training trends in the growing service sector have shown that there is a significant ground for improvement especially in the higher education sector in which practical training is not widely adopted.

The BIBB and employers have jointly discussed provision of new places and the establishment of new training occupations leading to the creation of eleven new ones between 1999 and 2001 (Richard Koch, 2001). Complementary to the creation of new occupations, the existing training profiles have been reconsidered and reformed so that they provide a broader training in a smaller number of areas. The broader training profiles represent a focus on more general skills in fewer occupations rather than the existence of traditional numerous but quite specific ones. New systems have been established which to speed up the process of developing new training profiles which usually takes quite a while due to the need of approval from social partners. Nowadays, new ordinances are being issued in two years term which reflects the desire for greater flexibility of the system – so far it was quite rigid and slow due to the high degree of coordination and power concentration in the government.

A BIBB report from 2007 shows that the occupation patterns in the vocational training offered since 1994 in the German dual system are dominated by service occupations. According to this survey, there is a steady upward trend in service occupations growing from 290 000 places in 1994 to 351, 261 places in 2007. The pattern for manufacturing occupations is just the opposite – a downward trend with the numbers falling from 300, 000 places in 1994 to 254, 519 in 2007. The sharpest decline is noticed among construction and ancillary occupations. This is not a surprising trend as it reflects the evolution of production – from manufacturing to services – which is inevitable in advanced economies, according to human capital theory. Thus, the direction of the new profiles developed for VET is towards the formation of general skills which are demanded by the service sector. As a CME, Germany so far was emphasizing specific skills and industrial output but globalization challenges put pressures on it to develop its so far uncompetitive sheltered sectors. This does not mean, however, that the country can not sustain its traditional national comparative advantage – it can transfer the basis for it into the service sector and develop it accordingly in concert with its coordinated market economy tradition.

In June 2004, the Federal Government and the employers' associations of German industry also concluded a Memorandum of Understanding, the Nationaler Pakt für Ausbildung und Fachkräftenachwuchs in Deutschland (known as the apprenticeship pact) for a term of three years, in which the partners undertook to offer training provision to every young person desirous of and capable of undergoing training, in close cooperation with the Länder. As a result of this the number of training contracts signed in 2004 and 2006 has risen (Cedefop, 2007). This pact reflects the social desire to keep the pillars of the VET system typical for CMEs which are traditionally based on collaboration and coordination with and among the private sector.

Additional initiatives were undertaken as part of the pact to raise the supply of training places like the 'Job starter - training for the future" program. It was launched in 2006 and is directed towards improvement of the regional supply of in-company training places and is funded by the state. The positive responses to the Job Starter program from both students and employers show that the Dual System is well appreciated by the German society and is still needed for the functioning of its economic institutions despite the fact that it needs some tuning to the needs of the service sector for more general skills which are underdeveloped in CMEs. It is directed towards the supply side of the skill equilibrium which is also the basic policy line in the UK. However, in Germany, there is demand for skilled workers and the reason for decrease in the supply is the financial burden of high labor costs to companies. Government funding seems to be a solution only in the short run, paying companies for their training costs but in the long run reforms should be undertaken so that companies providing training on their own can still be competitive – either through lower wages for apprentices or lower taxes.

Going back to the issue of higher permeability of the system mentioned in the beginning of the chapter an approach proposed by Deissinger for modernization and higher flexibility achievement in the German VET practice will be presented. It is based on the creation of a modular system with variable access opportunities and flexible levels of qualification standards. This is similar to the one in England where it was aimed at providing amelioration in out of date traditional qualifications as well as bridging the gap between general and vocational education. It shows the trend towards generalization of vocational training or vocationalization of general training. Inclusion of training profiles in general skills in German VET is not expected to undermine the existence of specific skills apprenticeships as long as there is demand for them by the production in the country. Thus, Germany will be able to keep a highly skilled workforce both in industry and services on which its quality based competition rely.

However, concern has been expressed on the ability of such a general system to satisfy the quality standards underlying the Dual System. Deissinger argues that "implanting modules within courses of training as didactical elements need not necessarily result in the dumping of occupational skill formation". The author sees the long run acceptance of modular training among employers and employees as essential for the success of such a strategy. This requires strong quality control and limited number of occupations which may allow easier modernization of training content.

This option is seen by Deissinger as leading to adaptation of VET to technological change as well as matching training to firm-specific needs satisfying both specialisation and modernisation needs. This model is reflected in projects of the German Chambers Association which give employers more independence and freedom regarding training contracts. If following this model, companies will be allowed to reduce training contract to two years, add or remove modules from the fundamental occupational part of the program and achieve more flexible examination procedures. This will allow them to lower labor costs and provide more places as well as to have greater flexibility in customizing training to their needs.

One of the concerns related to such a practice is that vocational quality of the training will decline on behalf of individualized companies' needs. Reforms that imply a too radical change of the occupational tradition may be difficult to implement due to resistance from social partners like unions and industry associations if they doubt the marketability and quality of the new courses and qualifications. Thus, the changes discussed so far in German VET sphere and the proposed reforms are generally directed towards the creation of general skill profiles as an addition to the additional ones and higher organizational flexibility which represents the main direction regarding educational development but does not imply any radical changes in the structure of VET institutions. From the VoC perspective, reforms in German system of VET do not threaten the existent institutional framework typical for CMEs based on coordination and specificity but seek to enhance its coverage to the specific skills formation needed by the service sector.

## **5.2. United Kingdom**

### **5.2.1. Description of the VET system and its institutions as well as the challenges it is facing as a part of the liberal market economy framework, evaluating its development through the human capital perspective**

The consequences of the problems and inefficiencies present in the UK vocational training system are the increasing concerns that the state lags behind other advanced countries in the level of skills among the workforce (Green, 1997). Such an assumption has been supported by the results of a study conducted by Manacorda and Manning in 1999 which provide evidence for an existing skill mismatch in the UK. The study also made a claim that the supply of skills is greater in Continental Europe based on multi-country comparison techniques. According to Greenhalgh (1999), the UK need to take measures to upgrade the average skills present in the labor market if it is to transform its factor endowments for international trade and growth and to escape the “low-skills, low-quality equilibrium” described by Finegold and Soskice (1988) and confirmed by Redding (1996) in his “exogenous growth” model.

Redding argues that “an economy's deficiencies in education and training may be intimately related to firms' investments in product quality” like R&D activities. This supports the view established in the previous chapter that the UK is lagging behind in productivity. According to him, “the incentives for both forms of investment are interdependent; both determine the economy's growth rate”. In a comparative study of clothing manufacture, Steedman and Wagner (1989) cite differences in workforce skills or training as one major explanation for the greater innovativeness of German firms: “In the course of their two or three-year training the German machinists had mastered the whole range of operations required for garment making; consequently, when a new style was to be made they needed only a short time (an average of two days) to reach one hundred per cent speeds .... Only a small minority of machinists in the British plants visited had mastered more than a few basic operations during their shorter training; not surprisingly, much longer periods (several weeks on average) were required.”

According to the British Department of Employment (1988), expertise in the provision of specialist goods and services rather than mass production of standardized goods is expected to raise economic performance. If not adopting such a strategy, the country is said to be relying on low productivity and low wages in competition with the developing countries which would have detrimental effect on living standards in the long run. This claim is supported by Scharpf globalization theory view that advanced countries can not compete successfully on costs after some point due to competition for developing states where

production is much cheaper due to lower living standards. However, the extent to which skills are being upgraded differs across firms and industries and is related to the adoption of new technologies as demand for skills has risen more rapidly in technologically intensive sectors and skills are thus concentrated in similar industries (Machin, 2001).

A research report conducted by Prof. Mike Campbell in 2001 on skills in England shows that despite the development and growth of vocational options in recent years, it remains the case that more than half of the economically active population holds general / academic qualifications with only just over a quarter holding vocational qualifications. The lack of esteem associated with vocational qualifications is a potential barrier to achievement of the national skills targets, and the Skills Task Force has expressed concern that individuals with general rather than vocational qualifications may not have had sufficient opportunity to develop the skills needed in the labour market. Successive governments in England have sought to bridge the gap between general education and vocational training by achieving parity of esteem between the different qualifications. Achieving this has been a major policy drive for the reform of 14 to 19 curriculum and qualifications and for the review of the national qualifications framework.

The government realizes the need for improvement in VET system as a prerequisite for the country to achieve a knowledge economy and increase value added competitiveness and production levels as is shown in its policy statements. One of the major educational goals for the UK government, stated by the Secretary of State for Education and Skills, Ruth Kelly in the 2005 White Paper on “14-19 Education and Skills” is to “provide better vocational routes which equip young people with the knowledge and skills they need for further learning and employment”. Recognition about the undersupply of high skills and the necessity of improvement in VET is obvious in the following quotes from this policy document:

“The costs to individuals, the economy and society of educational failure are high.”

One of the reasons for underdevelopment of the system may be the fact that “Vocational education and training for young people have low credibility and status in this country”. Of course, the main reason may be the low demand for specific skills and highly qualified workers due to the incentives provided by long standing liberal institutions for low quality production strategy and price based competition with emphasis on employment rather than productivity. Factor endowments determine the industrial profile and relations which lead to the development of more or less coordinated institutional frameworks providing incentives for different market strategies which require varying types of skills.

These views are reflected once again in the White Paper from 2006 on “Further Education – Raising Skills, Improving Life Chances” which starts with the following statement by Tony Blair: “Our economic future depends on our productivity as a nation. That requires a labour force with skills to match the best in the world – as a nation we should raise our ambitions for skills”. However, recognition of needs and government desire for change does not automatically mean political will and finance for such a policy implementation.

In the UK, the connection between the education and labor is based on individual judgment and choice with very few structured career paths (Lauder, 2001). In many cases this causes economic costs in terms of mismatch between individuals and jobs as well as psychological costs when jobs related to the training are lacking. This practice is supported by human capital theorists who see individual rational motivation as the only efficient mode of development. The UK VET system is largely outcome-based. Training providers have flexibility to plan learner-centred delivery systems to meet user needs. The modular or unit structure of vocational qualifications opens up possibilities for modular delivery and credit transfer. This allows for greater flexibility which is required for meeting the general skill needs of the service sector, combining training subjects in mixtures of profiles.

With the adoption of the Industrial Training Act in 1964, the UK government attempted to address the problem of under investment in vocational training inherent in the country. This was done through the introduction of a levy scheme which regulated the provision of training by firms. However, this policy was entirely abolished by the Thatcher cabinet as it was seen as an unacceptable interference in the market and nowadays the British policy in the area is focused on subsidized training schemes. This development path is typical for the liberal market economies. During the 1980s, the state emphasized mainly training which provides the unemployed with basic skills while in the 1990s, the part of the programs directed to the youth were based on higher level skills acquisition through the introduction of the Modern Apprenticeship. This pattern of subsidized training providing merely basic general skilled to the least qualified coincides with the social policy which takes the form of a safety net targeted at the poor ones.

Some of the explanations given by human capital theory on under investment in training include credit constraints, the uncertainty faced by trainees and the imperfect competition in the labor market which lead to poaching opportunities. According to that theory, vocational training has greater economic values than other forms of investment in human capital because it creates productive skills which can be traded in labor markets. Individuals are expected to invest in their human capital until the marginal returns become equal to the cost incurred. Thus, companies are more inclined to support firm-specific rather than general training due to the enhanced security of the return. As expected from the VoC theory, the low level of social protection decreases the individual motivation for investment in specific skills due to insecurity of returns and the low level of coordination lowers the desire of employers to invest in this type of skills due to poaching opportunities. Liberal market economies, thus, creates mainly general skills as the investment in training is left to individual choice relying on the assumptions of human capital theory that this is the most effective way of development in the field.

The traditional method of apprenticeship called the Bound Apprenticeship was based on legally binding contracts for both parties. In the beginning of the training period, the employer was bearing the costs and with the increase in the skills of the apprentice, the employer was recouping them through the additional productivity achieved with the payment of a lower wage. The firm was protected by the contract from the trainee leaving before a certain period has passed in which to cover for the training costs with their work. However, this system declined in the 1950s (Keep, 1988) due to the inflexibility of contracts, the potential for exploitation by employers and the control of unions over labor supply.

The Industrial Training Boards were blamed for providing training customized to their needs based on obsolete apprenticeship schemes while overlooking the requirements for transferable skills. The change towards lower coordination and greater flexibility began. Out of 27, there is only one Industrial Training Board still existing after their abolition in 1982 - the Engineering Construction ITB which has the power to raise a training levy of 1.5 % of wages. Thus, we can see that the engineering sector is based on the employment of specific skills and we can make the assumption that if the UK industrial production was dominated by sectors requiring intermediary technical skills like manufacturing and construction, then probably VET would have been more developed and coordinated.

The organizations responsible for the implementation of vocational training programs like MA, NT, OT and WBTA are the seventy nine Training and Enterprise Councils (TEC) which are independent and employer-led, promoting training on local level. This structure of administration of training programs, based on local organizations divided by the geographical principle leads to some problems which will be addressed later in the paper. The Industry Training Organizations and Occupational Standards Councils formed fifty-five National Training Organizations (NTOs) in 1998, which are independent and employer-led but

recognized by the government and are in charge of identification of sectoral needs and developing of NVQs standards. The introduction of the UK-wide Sector Skills Development Agency (SSDA) in 2002 promoted the desire of the state to evaluate training and qualifications needs excessively by labour market demand. This shows the intention to move closer to sector evaluation of skill needs and development of training profiles which fit specific requirements despite the low coordination and voluntarism of the liberal system.

After the abolition of the levy scheme, the British state was trying to make employers invest in skills but did not use compulsory measures. The Labor Party's intention to re introduce that practice was given up in 1997. Thus, the state continues its policy on voluntary participation of the business while in the same recognizing the need of increased vocational training in policy documents like the 1998 White Paper "The Learning Age" which proposed the creation of a University for Industry. However, government intentions or political claims find hardly any practical implementation.

The present policy of the UK government consists mainly of subsidies financed through general taxation which are administered by TECs. In the Modern Apprenticeship program, the subsidy is which is paid to a company is negotiated by the latter and the local TEC. However, as the TECs are employer organizations, they may represent the interests of the trainees in an insufficient degree. Thus, the use of sectoral organizations like the NTOs may be more efficient in the distribution of subsidies as they deal with the assessment of skill shortages on sectoral, not regional level, and are better prepared to address coordination problems between investment in technology and skills (Stevens, 1999).

The businesses represented by the TECs are brought together on geographical criterion and thus operate in different sectors and may not have common training needs other than in basic fields like literacy and numeracy. This may lead to the creation of training requirements covering just general skills. This is an obstacle for the creation of highly skilled technicians which are needed at the intermediate level as the analysis on skill profiles has shown because they need training in specific skills. The level of funds received by TECs for adult training are also insufficient to cover the full costs of the programs and companies are not motivated to participate financially as they are not protected from poaching due to the voluntarist nature of the system and the high level of inter-firm mobility in the UK (Greenhalgh, 1999).

Moreover, there is another problem related to a subsidies system based on general taxation which is the lack of political will to raise public expenditure in the field of vocational training to a level which will lead to sufficient investment. This situation is aggravated by the traditional resentment towards a grant-levy system among British employers. According to Stevens, this may be attributed to the lack of well formed definition of appropriate training. The 1964 Act did not manage to make a distinction between specific and general skills and companies had the opportunity to influence the general training outcomes providing training which was matching their own needs. Thus, a well functioning monitoring system is required and employers are expected to accept such an interference more easily if it is enforced by an organization which is also paying for the training (Prais, 1995). Poaching opportunities and lack of cooperation lead to underdevelopment of VET systems and the absence of dense associations and networks create the lack of available credible authorities which to oversee the training process.

### **5.2.2. Reforms of the VET system in response to skill gaps – initiatives and direction**

In the UK, there is a policy commitment to raise the skill level of the workforce which is hindered by long lasting inadequacies in education and training as well as low employers' motivation to invest in such programs. The 2000 Report on National Taskforce (DfEE) shows that the issue of skill formation is perceived as a supply-side one and requires further

consideration of employers' needs. As seen in the previous chapter on skill profiles, some companies would like to compete on quality basis like the ones in CMEs but the institutional structure is not supportive of such product market strategies and thus there is low supply of highly skilled workers and low incentives for the development of such training.

The dual profile of skills in the UK is seen once again in the message from the UK Department for Trade and Industry White Paper (1998) on industrial development which may be interpreted as reinforcing polarization. The development of high tech industry as a way of creating a knowledge driven economy is proposed instead of skill diffusion among occupational groups and ranks. This emphasis on specific field upgrading would reinforce the discrepancy among occupational skill levels by sectors as shown in the description of skill profiles in chapter four. However, the paper calls for a more active government regarding industrial policy, one that does not leave the functioning of the industrial sector to purely market conditions but functions as a "catalyst and investor" improving the supply side of the economy (DTI, 1998). Through the VoC perspective, this can be seen as a desire for higher coordination in industrial relations which is present in CMEs.

Some of the suitable measures regarding market failures that can be taken by the UK government include improved access to finance, lowering obstacles to R&D investment, increasing company collaboration and supporting improvements of workforce skills (Green, 2001). All these measures can be seen as steps towards the establishment of a more coordinated environment regarding VET in order to increase the demand not only the supply for it. This conclusion stems from the fact that the indicators mentioned like easy access to patient capital and business networking are typical for CMEs training.

There have been a few initiatives undertaken aiming at higher skills production (programs for the young unemployed, the Modern Apprenticeship and the University for Industry) which have had hardly any impact on employers' demand for skills so far. There are just minimal requirements for license to practice laws and no legal motives for companies to change their corporate governance practices in a way which may stimulate long term investment in R&D and training. Thus, the failure of these reforms can be attributed to the lack of incentives for the development of higher skills among the workforce. This empirical finding supports the view presented in the VoC approach that liberal market economies have institutional frameworks which do not encourage provision of collective goods.

The UK has been characterized by a "voluntarist paradigm" in vocational education which is very difficult to overcome despite the creation of Learning and Skills Council and the attempts of the government to promote partnership through initiatives like Union Learning Fund which are also on voluntary basis. This is one of the major causes in the country for the difficulty in providing places for apprenticeships. And as companies do not have incentives to collaborate because networks are almost non existent in LMEs, loose and not binding partnerships can not secure the provision of collective goods. Institutional structures, regulatory frameworks and normative regimes all influence the investment in skill formation (Green, 2001). This institutional tradition of a liberal market economy has great influence on the system of VET as shown in the theory on VoC.

Investment in VET is seen as individual choice in liberal market economies due to their desire for limited government intervention and individualistic societies and the UK is no exception. Supply-side approaches to knowledge enhancement may serve as a supportive social mechanism for individual decisions and raise the participation in learning programs but may fail to match the areas where skills are most needed in the labour market. The goal of such programs may help the provision of collective goods of VET through financial support but the issue of demand for qualified workforce should be addressed as well.

One of the obstacles to development of VET is capital market problems. Liberal market economies like the UK do not provide patient capital to companies and put strong

shareholder pressure for high returns. The Modern Apprenticeship scheme is not adequate to provide a solution for that problem. Its duration is limited to the receipt of qualification which guarantees quality to some extent but not cost recovery to companies. According to Stevens (1999), capital market problems may be solved through government support for loans and income insurance using subsidies for training financed by a tax on skilled wages. Layard (1995) proposes that the government should subsidize fees for vocational training not only for academic education in order to encourage risk-averse trainees to participate. This means higher coordination between training organization and employers in order to reach a decision that will provide the latter with greater security over their investment if apprenticeship wages are not funded by the government. If they are, this may lead to higher government intervention in the labor market which is not typical for LMEs according to the VoC theory.

Career Development Loans were made available in 1988 by four commercial banks with the government covering the interest during training for job-related courses but their use is still quite limited due to uncertainty of return. A substantial obstacle for adults who would like to participate in continuous vocational training is the inability to generate income during training as full time students are not eligible for unemployment benefits even if they were working and paying their social security contributions. The low success of this reform can be attributed to the high individualism in the UK as a LME and the reliance on the human capital approach with low levels of social protection which discourage investment in specific skills.

Another initiative launched in 2004 is the creation of Centre of Vocational Excellence (CoVE) aimed to deliver specialist work based training. This is a status given to departments in further education colleges (and some third party training companies) in England. It is intended as a kind of quality guarantee for vocational teaching, and is awarded by the Learning and Skills Council in order to improve the public opinion of vocational training which was already mentioned as a problem for VET development in England. It seems that this is the only policy directed at the demand side of the VET system equilibrium, trying to increase the appreciation and need for such qualifications instead of just aiming to provide more training places on the supply side. The main initiatives the centers undertake in order to engage employers in mechanisms for skill priorities establishment are forums for networking and information on course development as well as employers' representation on CoVEs steering groups. This may be seen as an attempt to address the general problem of lack of coordination in the LME and to increase demand for VET training otherwise the supply of such places will be artificial and possible only through external financing like subsidies (Measuring Progress: The Impact of Centers of Vocational Excellence Program, 2002; GHK Consulting for LSC).

Recent policy initiatives have focused on improvement of the information flow on training and skills needs among companies, workers and the authorities (Stevens, 1999). Their aim is to achieve greater collaboration between institutions. TECs and NTOs evaluate skill needs on local and sectoral level. They rely on the Investors in People standard which sets best practice examples for integrating training in the business life as a means to increase awareness of training benefits for employers. The IiP initiative is attempting to make private actors more involved in the field of vocational training as the state is realizing that collaboration is needed for the provision of this collective good and its absence in liberal market economies is an essential obstacle for its creation.

In total, about 1 million vocational qualifications (of all types) were awarded in 1999/2000. This is an increase of 25% on the 861,000 vocational qualifications awarded in 1995/96. The subjects in which the highest number of NVQs is awarded tend to be in the newer, service sector related areas as business and sales. An examination of changes in registration by subject areas provides some indication of the potential for a shortfall in supply to some technical disciplines. In particular, it should be noted that registrations on engineering

and construction courses have fallen considerably. On the other hand registrations on IT courses have grown very considerably (Skills in England 2001 – The Research Report, Policy Research Institute- Leeds Metropolitan University). This shows that the traditional focus on development of general skills for service occupations typical for LMEs because of their comparative advantage in price competition due to flexibility is still preserved.

However, if places for specific training in technical disciplines are not provided, then improvement in productivity levels is not highly likely to appear. The supply of places in engineering and construction depends to a great extent on the need of the employers and more specifically on their product strategies. And if some of these sectors were not fully utilized in the past and were sheltered by the borders of the national economy, nowadays they should be competitive on the international markets in order to survive. But unless companies find incentives to compete on quality and higher productivity, there are little chances that they would require highly skilled workers which to motivate them to create apprenticeship places.

Liberal market economies like the UK do not allow great autonomy to the educational system (Gleeson, 2004) as it is dependant on market mechanisms and enterprises which can be explained by the consumerist and individualist nature of its society and low level of collectivist arrangements. It lacks strong input from multilateral agents. Another problem regarding provision of VET in England is the desire of employers to shift the costs of it to the state and the individuals requiring a greater share of education to take place in the public education system. Companies in the UK have abandoned compulsory provision of apprenticeship places long time ago and rely on higher education system for intermediate and technician level skills. Thus, development of specific skills is left to universities and individual choice which does not seem to be efficient and is shown in the low productivity levels of the country. The UK has traditionally been characterized by the development of skills that are generic which also make people more employable as there is low social protection and ideological aversion towards vocationalism (Hayward, 2004). The emphasis on service sector requires this type of skills but nowadays it turns out that they are not as general as thought so far and require on the job preparation and learning – by – doing. Thus, it is not surprising that attempts are made in the VET system with a focus on the services as well as technical disciplines.

According to Reader (1979), education has a subordinate role to employers. The state relies on the demands of employers for provision of skills but their proper judgement on that issue is doubtful as the primary purpose of business is creating profit. Thus, the reliance on purely market mechanisms regarding education in liberal market economies may hinder beneficial long term development which is seen in the inability of the current non coordinated VET system to deliver skills.

One of the drawbacks of current government policy is that establishes targets for the percentage of students participating in VET but does not set ones for the level of employers' engagement and their subsidies. The system turns out to be “employer-led but voluntaristic in nature” which is called “voice without responsibility” (Gleeson, 2004). Moreover, employers and education do not interact directly as in coordinated economies but through the state which decreased further communication and efficiency. Apprenticeships are managed through private providers and only 5% of them are sponsored directly by companies which show in terms of VoC that the UK preserves the pillars of low coordination and high flexibility regarding VET practices.

The government policy is one of subsidization instead of change in labor market regulation (Keep, 2005). Thus, it addresses issues of supply and not demand as it is more difficult to change the pillars of a liberal market economy in the areas of social protection and employment patterns. It is clear from the programs described in the previous part that the state has developed a financial support scheme as a substitute for labor market demand. There is

not much done to change the traditional view of VET as low-status one and it is still perceived as a method of supply of workers for the low paid market which did not have any other chance.

Another proof of the supply-side nature of the current reforms in UK VET system is the focus on sophisticated pedagogies, curriculum designs and assessment models which are seen as essential to deliver higher participation (Keep, 2005). However, they are not as influential for the creation of demand as would be the establishment of some form of licenses to practice, stronger bargaining rights of trade unions, paid time off for studies, legal requirements to create training committees in organizations for better communication and provision of work-related placement (Gleeson, 2004). But such measures are strongly related to the institutional structures of the economy and changes in them in direction of higher coordination and obligatory participation is against the liberal tradition present in the UK and characterized by labor market flexibility. How a knowledge society and diffusion of high skills can be compatible with such an economic system is yet to be figured out.

An interesting explanation for the scant effects of policy initiatives taken so far in the UK with the goal to escape the low-skill equilibrium is provided by Ewart Keep in 1999. According to him, current reforms are directed to the supply side of skill formation with little attention paid to the demand side while in concertation with Hall & Finegold theory from 1988 such a demand for high skills among employers may indeed be absent. The abolishment of Industrial Training Boards decreased the opportunities for private sector coordination at the sectoral level and policy administration was transmitted to the local Training and Enterprise Councils. The control of the central government over higher education increased trying to prevent market failure through higher regulation and supervision which is exemplified by the establishment of a national curriculum for VET. According to Keep, however, there is no significant evidence showing that the gaps existing in the 1970s in UK VET training have decreased.

The shift from manufacturing to service provision in the British production of output has supported a focus on softer interpersonal capabilities in skill formation which are suitable for the providers of mass-production goods but do not satisfy the requirements of the high tech enterprises described by Finegold where deep theoretical knowledge of leading edge developments is essential. Pharmaceutical companies, for example, are not satisfied with the emphasis on general skills in higher education and require “scientifically able” employees but meeting the demands of one group of employers is contradictory to the demands of another one (Gleeson, 2004). The low demand for highly skilled workers in the UK may be explained with the production of low-spec goods which have few distinguishing characteristic and are based on Fordist production methods as they do not require customization. Unless production patterns and types of output are changed, public as well as private investment in higher skills would not be justified. Thus, according to Keep, the existing VET system which is designed so that it satisfies the needs of the lower service sector may be quite an obstacle for the state if it really aims at creating a knowledge based economy as stated in the Competitiveness White Paper from 1999 ( Our Competitive Future: Building the Knowledge Driven Economy). The main reason for the low success of the reforms so far attempting to increase VET participation, is the structure of the economy as a liberal market one due to the low levels of cooperation, security and trust which also affect production patterns.

However, the economic goal of the government is to create a knowledge economy as stated in the Competitiveness White Paper:

“British business has to compete by exploiting capabilities which competitors find hard to imitate. The UK’s distinctive capabilities are not raw material, land or cheap labor. They must be our knowledge, skills and creativity...” (DTI, 1998).

The success of such a policy, however, is highly dependant on models of product market strategies and managerial choice as well as institutional support and incentives. The Competitiveness White Paper acknowledges these constraints and realizes that the creation of a high skilled economy involves more than mere skill supply issues and needs to address major structural characteristics.

So far, traditional UK policy in the field has been based on the assumption that an increase in the supply of skilled workers will lead on itself to economic change and enhanced competitiveness and productivity (Keep, 1999). The government assumes that the biggest share of employment growth is provided by the high skilled sector which necessitates the upgrading of skill levels. This reflects the legacy of dual skill profile. However, there is a large portion of employees even in hi-tech companies that perform merely routine tasks; implementing Taylorist model in both manufacturing and service sector but this is an issue of job design which is a subject for another research.

Simply increasing the supply of formalized skills is not expected to lead to the desired outcomes unless business competitiveness issues are investigated. This is due to the fact that present interests of the companies are based on the incentives provided by existing institutions and may differ from the wider needs of the economy regarding growth and stability (National Skills Task Force, 1998). Liberal market economies encourage companies to compete on price as they are pressed by return demands. However, according to Keep, policy reforms that imply a radical change would require the participation and coordination of various policy makers and agencies covering a wide range of activities which may be difficult to achieve in the British environment based on fragmented incrementalism.

The expected changes in the UK VET system are most likely to appear in the form of fine tuning of the existing training institutions and profiles, attempting to increase the involvement of private actors. However, this depends on the incentives companies have to participate in the system and their competition strategies – unless firms experience a need to shift to more value added production which requires higher productivity, a demand for skilled workers and thus provision of apprenticeship places is not reasonable. Thus, the main issue to be taken into consideration when evaluation the impact of the VET reforms and the underlying factors behind its meager results is the institutional characteristics of the UK as a liberal market economy which hinder coordination and investment in collective goods as well as quality based production.

### **5.3. Concluding Remarks**

Thus, in both countries radical reforms in VET systems are not highly probable due to the lack of social support. Traditional institutions are based on existent industrial relations, production patterns and product market competition strategies and thus are providing incentives which support the current framework. Unless demands for changes in production appear, there will be insignificant need for transformation of the skill profile and consequently VET. Nowadays, attempts are made in both countries to achieve a more balanced skill profile which is shown in the direction of their reforms – towards more specific skills and higher emphasis on VET in the UK and towards the development of training profiles on general skills and higher flexibility in Germany. However, this is not a significant sign of convergence of the system as it is just an enhancement of the focus which was limited to the creation of one prevalent type of skills in a nation so far – determined by the type of capitalism adopted. We should point out that this enhancement does not require changes in the institutional pillars of the VET systems and is evoked by different reasons in the two countries related to their competition strategies. In Germany, the desire for higher competitiveness, regarding capital investment and shareholder requirements, as well as the growing service

sector require general skills which have been neglected so far. On the other hand, in the UK, the basic driving force behind the reforms is the need recognized by the government (but not by the companies yet) to develop a knowledge based economy which to exit price based competition markets and establish higher productivity levels and quality goods creation. However, it is still too early to say what the effects of such changes will be – whether they will have a snowball effect in other economic areas in the long run or just raise national competitiveness, or maybe simply rest with the realm of political intentions which will be later forgotten.

## Chapter Six

### Conclusion

The research of the current paper is based on three major theories which are complementary to each other, applicable to different aspects of social and economic life which were used as a basis to explain the main issue of investigation. The goal of the study was not to test the credibility of these theories in practical environment but to utilize them in answering the main research question – namely, if there are any changes in national VET systems due to globalization and in what direction.

According to human capital theory, nations will increasingly depend on human capital due to globalization and technical innovation. Increased demand for knowledge workers is expected and a decline in low skilled jobs in the creation of a knowledge economy which is seen as inevitable evolutionary process of technical progression. Educational investment is a way to increase individual employability and thus economic opportunity and status. The theory claims that such a policy can be universally applied as it complies with economic development laws and advanced countries are expected to participate in the “global knowledge wars” for capital through value – added sectors.

However, human capital theory disregards the social construction of skills and motivation and assumes an evolution from low skilled to high skilled workforce, ignoring the existing institutional frameworks. Social capital is a crucial factor for the provision of collective goods and for personal involvement and depends largely on existence of networks, collaboration and trust.

The Varieties of Capitalism theory complements the social capital notion stating that national differences in industrial relations, corporate governance, financial systems and level of collaboration between associations influence the incentives for specific competitive product market strategies and thus the direction of education and training which provides the skills necessary for them. The structure of political economy also affects the types of social policy which through the degree of social protection leads to the establishment of different skills equilibrium. Higher uncertainty is claimed to lead to the prevalence of more general skills and higher income differentials. According to Hall and Sockice, a greater specialization in national industrial profiles is expected, thus exploiting further national comparative advantages as a response to globalization rather than convergence towards a best practice.

The main theory on globalization used in the study is developed by Scharpf and Schmidt and confirms the view of the Varieties of Capitalism by claiming that replies to globalization challenges vary greatly among countries due to institutional differences and variation in welfare goals. The new global pressures on competitiveness are stemming mainly from increasing economic integration and importance of capital which has become highly mobile. High-value added and high cost production will require an increase in skill levels in

order to increase productivity in internationally exposed sectors as a way of avoiding competition with developing countries based on price indicators. These challenges are claimed to be no longer a subject to a universal solution based on a choice between master strategies through a standard set of macroeconomic responses. Nations are expected to be willing to exploit the ones which are less competitive due to higher social costs and MNCs are more interested in profit benchmarking among locations than before. However, investment decisions also depend on the institutional framework and infrastructure and neo liberalism is not the only feasible efficient response to globalization but a path dependent feature of the Anglo-Saxon systems (Scharpf & Schmidt).

All of the three theories have been quite adequate and useful in the analysis part of the study and more specifically in answering the research questions which will be presented below.

The challenges posed to the Western European welfare states in terms of economic performance and competitiveness in relation to the skills of their workforce vary in their impact and focus between the two nations examined in the study as explained by Scharpf and Schmidt theory. The analysis of national skill profiles shows that in Germany there is a great number of highly skilled professionals in the areas of basic and applied science and a great distribution of general education at the intermediary level. There is a lower ratio of higher education graduates but the high quality of the education in science and engineering with high ratio of graduates with doctoral degrees. However, the institutional framework is more risk averse and supports incremental innovation which hinders basic innovation. The country is facing the challenge of developing the more high-tech sectors if it wants to keep its high value-added production advantage (WEF, 2007). One of the goals of the state stated in 1991 is to develop occupational flexibility as export markets are becoming more price sensitive. Another challenge Germany is facing in the area of skill formation is the fact that more companies are abandoning sectoral agreements which are a crucial pillar of the Dual System of VET which requires more flexible training practices and focus on local bargaining.

The UK skill profile is characterized by polarization between high skilled elites in the sectors depending on labour productivity and low skilled workforce in the sectors based on capital productivity. The low distribution of general skills at the intermediary level hinders general productivity as shown in the analysis on national skill profiles. Thus, the country faces the challenge of raising product and process standards as the UK is doing well at the developmental stage of goods but later their mass production is usually exploited by other countries. Other challenges stemming from the low skill equilibrium in the UK are income polarization and inequality as the government so far has been focusing its trade and industry policy towards the creation of clusters rather than social partnership. In the White Paper of the DTI a sign of desire to overcome this problem is seen in the claim that the state should act as a “catalyst and investor” and not leaving the functioning of all sectors to purely market mechanisms. So far, in the UK, economic activity has been a priority more important than productivity. However, some companies want to move up the value chain in order to compete on quality rather than price and the state is challenged to meet their skill needs.

According to the analysis, there is a gap between the skills provided by the labour market in the economies examined and the contemporary industrial demand present in them. The presence of some of the gaps can be explained using the Varieties of Capitalism approach. German competitiveness is based on value-added strategies due to the institutional framework and industrial relationships in the country, typical for coordinated market economies. This structure may be beneficial for the creation of high skill equilibrium but hinders flexibility which is gaining importance especially for the service sector. There is a growing necessity of training in general skills as discussed in the fourth chapter of the study which require the speedy development of new training profiles with broader training in smaller number of areas.

On the other hand, the UK relies on competitive strategies based on cost reduction and flexible employment. The analysis shows that social and state institutions hinder the demand for skill improvement with a sharp divide between academic and vocational tracks. As a liberal market economy, the institutional framework present in the country do not provide incentives for investment in specific skills as there is lack of social protection and regulation and employers face the threat of feasible poaching. The manufacturing sector occupies a smaller share in industrial production than in Germany and vocational training is seen as inferior to academic one. There are sectors that are served well by the polarized dual skill system in the UK like the banking one. However, there are gaps between supply and demand in other sectors where companies aim at competing on a quality basis and high productivity. Thus, the challenge of achieving higher productivity can not be answered successfully unless the gap in the supply of intermediary level skills is met through broader distribution of education and more specific skills. This gap in supply and demand of skills reflects to an extent the conflicting interests of companies competing in the low skill sector which support flexibility and the long run national prosperity requiring social partnership and knowledge diffusion.

The third research question is directed towards the way states are responding to these changing needs of the labour market in the area of skills formation through their vocational training policies. Chapter six of the study examined reforms in the national VET systems in Germany and the UK. A significant feature of the VET in Germany is that it is financed through a combination of public and private funding. Levies collected by in funds by industrial associations from member enterprises are used to reimburse companies for the on the job training part of the Dual System. This practice exhibits high level of coordination and an extensive degree of social capital in the provision of collective goods. Appreciation of vocational training is socially constructed and leads to high perception of technical skills. However, the system is a bit too rigid with the virtually exclusive power of the government to issue training ordinances. One of the major reforms undertaken is the adoption of the Apprenticeship pact in 2004 and the launch of the Job Started programme in 2006. Both of them are supply side policies aimed at increasing the number of training places provided. Improvement is required in the availability of places answering the training needs of the growing service and high-tech sectors. New ordinances have been established as an attempt to provide modernization of existing profiles and the introduction of new ones but it is still uncertain whether the service sector would be able to benefit from them the way manufacturing did in the past. The majority of employers perceive the Dual System as beneficial but claim that its costs have become quite high. However, as long as they rely on high quality diversified production, one may expect that they will need highly skilled professionals with specific abilities and will continue to support the system. Unless highly prestigious apprenticeships in these sectors are established, the students would prefer academic education in these spheres. Under consideration is the creation of a more flexible modular system which to answer specialization and modernization needs. However, a radical change may be opposed by the social partners like unions and industry associations if they doubt its quality and marketability.

In the UK, extensive coordinating mechanisms are lacking. After the abolition of the levy scheme in the 1980s, vocational training and investment in specific skills are hampered by credit constraints, uncertainty and labour market poaching opportunities. In accordance with the human capital theory view, motivation for investment in skill development is left to the individual and is hardly supported by the state. Career Development loans are available but there is high uncertainty regarding their return and students are not eligible for unemployment benefits. Enterprise participation in industry associations is voluntary and is not complemented by any obligation to fund training. However, the government has

recognized the need of increased VET in the White Paper on Competitiveness from 1998. Thus, it funded several policy initiatives like the National Skill Academies and Centres of Vocational Excellence. A reform has been set to rationalize sector qualifications and establish a credit framework. However, the analysis shows that investment in the development of VET has been insufficient and the government lacks the political will to increase expenditures as they are financed through general taxation due to the traditional aversion of employees towards levies. The Department of Employment claimed that the “provision of specialized goods and services rather than mass production of standardised goods would raise economic competitiveness”. Government agencies state that the UK lags significantly behind other developed countries in workforce skills and needs to raise them if it is to transform factor endowments in international trade with the desire to make “knowledge, skills and creativity” the distinctive capabilities of the state. However, the current reforms are directed to the supply side of the equilibrium without having the institutional setting which would support a demand for them. The present industrial relations and conditions of capital markets provide incentives for companies competing on basis of low quality, low price production thus creating a clash between business and national goals. A radical change in production profiles in order to raise the demand for high skills would require degrees of participation and coordination that are not present in the fragmented political economy of the UK. One possible solution is for the government to subsidize further the increase in skill levels provided it has the social support for such expenditures.

In conclusion, despite the differences between institutional settings among liberal and coordinated market economies and the variation of product market strategies, both Germany and the UK show an increase in ratio of the service sector and a decline of the industrial one as shares of GDP. Thus, we may partially agree with the human capital view of evolutionary technical progress that the increase in value added production (and services ratio) is inevitable as the economy advances. The major challenge for the UK, however, is to raise the quality of its production in order to avoid price based global competition with developing countries which enjoy the advantage of much lower costs. In order to achieve this, the state needs higher level of skills in the majority of the workforce, not only the elites. On the other hand, Germany is facing higher demands from investors and companies for shareholder return. Thus, it needs greater flexibility of the education system in order to lower social costs and provide new training profiles for the emerging demands of the service sector. Thus, taking into consideration the assumption made in the methodology part of this study that higher level of VET means prevalence of specific skills and low level of VET – prevalence of general skills, a conclusion can be made that the UK is currently developing specific skills with the increased emphasis on vocational training while Germany is focusing on general skills enhancement through an attempt for flexibilization of the latter.

In both Germany and the UK, reforms have been undertaken to provide for a more balanced mix of skills so that the majority of educated workforce do not possess only general or only specific ones. International market requirements raise the level of skills needed for successful competition in more areas than before as the number of exposed sectors has increased. Still, there are no significant signs of convergence towards one best practice of VET as changes are nationally tailored and customized through adjustments of existent systems and not the introduction of radical ones. Both countries have expressed desire for transformation of VET but these take the form of government intentions regarding educational outcomes which have not lead to significant reforms of the institutions of VET or their funding patterns. Assuming that general skills are more needed in the service sector, Germany has to develop them further in order to meet the needs of this production sphere which have been so far neglected to an extent. On the other hand, UK reforms have focused on the development of specific skills through apprenticeships which are assumed to be

required by the industrial sector in order to raise productivity and compete in high value markets. However, both countries aim at preserving their comparative advantages and institutional frameworks to a great extent. The reforms undertaken in national VET systems are aimed at lowering the gap in the type of skills the labour market lacks and are more complementary to the existing production strategies rather than attempting to achieve a radical transformation. Thus a conclusion can be made that the changes in VET system in Germany and the UK represent the intention to enhance the focus of the programs towards the development of skills unattended for so far rather than a transformation of the institutions performing VET.

In the end, the intention of this paper was to answer three main questions regarding the challenges of globalization in the area of skill provision posed to European welfare states. The author was curious what are the adaptation challenges posed by globalization on national competitiveness regarding skill profiles in two types of economies and if they vary. The empirical part of the study shows that there is a demand for higher productivity in the UK (and development of specific skills so that the country can compete on quality) and for higher flexibility in Germany (and development of general skills for the service sector as well as achievement of lower labor costs as they have become too high for some German companies which want to compete internationally). This outcome was expected on basis of Scharpf globalization theory which states that this process has different impact on national economies and there is a need for flexibility and knowledge economy among the developed countries as it is not possible anymore to compete on price in international markets. Thus, if an economy lacks one of these two features, it should develop it in order to stay competitive. From the VoC approach, it was expected that Germany lacks flexibility and general skills and the UK lacks adequate productivity and specific skills.

The second issue under investigation in the present work is whether there is a gap between the supply and demand of skills. The empirical part shows there is such a discrepancy which is not a surprise as countries depend on particular product market strategies with competition based on the utilization of general or specific skills. This emphasis on some production areas which vary across the VoC line, lead to development of a comparative advantage but also disadvantages elsewhere. Nowadays, when national economies are not protected, sheltered sectors are being exposed to international competition and require investment if they are to be sustained in the future. Demand for high skilled workforce varies among countries due to their different production patterns. The empirical part of the present work shows that Germany and the UK are preserving their national comparative advantages. However, they are not based on the existence of specific sectors and can be transmitted to the underdeveloped ones in the same institutional national environment. Germany can use its high cooperation levels in the creation of general skills for the underdeveloped service sector with an emphasis on higher flexibility in answering demands. The UK may take advantage of its flexible education system when creating specific skills for its industrial sector in order to raise its productivity. The common feature between the two economies would be they both possess highly skilled workforce.

Thus, the question comes of how nation states are responding in order to bridge the gap in skill provision through reforms in their VET systems. There is a change in VET both in the UK and Germany which was expected as in conditions of discrepancy in the social sphere, governments generally attempt to re-establish equilibrium. Investment in skills in these two countries is seen through a different lens – human capital creation in the UK and social capital one in Germany which is due to the variation in coordination levels. However, the need for investment in the skills which the labor market lacks has been realized by the authorities and reforms have been undertaken in the UK for the creation of specific skills and in Germany in

the direction of general skills. The scope and effect of these reforms is to be seen in the future but it is not expected that they will lead to radical changes of the VET institutions.

## **Chapter Seven**

### **The Bulgarian Political Economy after 20 years of transition – LME or CME?**

The last topic covered by this study is the direction in which SEE countries in transition are heading towards, regarding the type of capitalism they have adopted in the last twenty years of transformation from a centrally planned economy to a market one. In examining this issue, the author has chosen to use as an example the Republic of Bulgaria. The main question investigated in this chapter is whether the country would follow the coordinated market economy path which is closer institutionally to the structural legacy of communism or it will take the liberal market economy direction instead.

The theory on transition economies used by the author is the concept of Bob Deacon of “political globalization”. He claims that the political globalization and the increasing influence of international financial organizations lead to adoption of neo liberal strategies in SEE countries. Deregulation and liberalization is presented in their programs as the only viable way to reach economic prosperity and stability through the creation of free markets. Some of these organizations require the adoption of privatization and residualization strategies as a prerequisite for capital lending.

There is another economic model to be added to the two types discussed in the Varieties of Capitalism theory – the one of a centrally planned economy which existed in countries in South Eastern Europe until the collapse of the communist dictatorships in Europe in 1989. It is important to look at the Balkan countries in transition and their former economic model in a study that deals with globalization change in European welfare states, because some of these former communist countries are nowadays a part of the European Union and the others are probable future members. Centrally planned economies are characterized by high levels of centralization and coordination, excessive government intervention and state ownership of enterprises. In the following part of this chapter, a brief description will be given of the communist welfare regimes in CEE. In this way, a basis will be established for the further discussion of the transition to a market economy taking place in the Bulgaria in the last two decades evaluating its current institutional framework taking into account the communist legacy.

Old communist welfare model is described by Deacon (1991) as an agreement between the party (which represented the state), the nomenclature and the citizens which provided highly subsidized prices in order to assure the political consent of the population and held down the cost of living. The money wage was low for all, not sufficient to provide for adequate savings to cover interruptions and there were modest wage differentials. The mass employment for the average citizen was a substitute for the general lack of unemployment benefits. A job was available for nearly everyone (both men and women), but this was often a way for the government of hiding the unemployment because very little productive work took actually place at the work place. This means, according to Deacon, that the regime pretended to pay workers, meanwhile the workers pretended to work. In several of the communist countries the wages were so low that people had to take a second or even a third job in the unofficial economy to be able to keep up an acceptable standard of living. The social protection was universalistic and employment related. Most of the services – like healthcare and education were provided by the state free as well as provision for holiday stay for the

employed. Labour representation organizations were present but they had limited power in decision making and membership in them was related to party membership. During the communist regime, the national product distribution was left to the state which used a system of central allocation supplemented by strict wages, prices and interest rates policy.

According to another scholar investigating the emergence of new welfare states, Guy Standing, the centrally planned economy grew while it was protected from international competition but it developed very inefficient practices. The social protection was not properly targeted and provided very poor quality services; there was a distortion in the distribution of benefits focused on enterprises; labour mobility was very low as long term employment was adopted as a social norm and there was occupational and industrial segregation of the labour force. The industrial development was not merely a national issue but was also a subject of supranational planning as communist economies in East Europe were members of the COMECON organization which attempted to achieve international cooperation in the sector level.

Nowadays, most of the South Eastern European states are trying to establish an effective market economy and some type of Western European welfare state. However, due to high social costs of transition to price and trade liberalization, the former communist parties were re-elected in some of there countries (Deacon).

There have been major changes in the political economy of Bulgaria in the last two decades stemming from the process of economic transformation from centrally planned economy to a market one. According to Dimitrov (2001), the country has adopted the model of Anglo Saxon capitalism complemented by liberalization, successful economic stabilization and little progress in structural reforms.

The IMF sponsored program represented neo liberal ideas which were the basis for the dominant doctrine of international financial organizations since the 1980s (Dimitrov, 2001). It was based on the assumption that the removal of state control and the stabilization of macroeconomic environment would lead directly to the establishment of competitive market economy. However, this view did not acknowledge institutional features and national differences. Economic actors were expected to respond in an economic rational way no matter the environment. The IMF program had the benefits of clarity and simplicity and was presented in the time following the ideological collapse of communism and notions of state intervention. Thus, it was well accepted by the centre right government in 1990, especially provided that there was basically no other option in this time of national bankruptcy, lack of access to international financial markets due to a memorandum on external debt payment issued by the previous government and shortage of even basic consumer goods. The liberal agenda was welcomed in a period of disappointment and collapse of the former coordinated institutions.

Some of the results of the reforms in the transition period will be presented in the following section of the chapter. There have been changes in the policy on social welfare especially in the field of health care with the introduction of Health National Insurance Fund and the establishment of private practice. Even though state budgetary financing system in the area is retained, there is an increasing inequality in the access to service in areas requiring more than general practice competence as the private cabinets and clinics have much better equipment than the public ones but are more expensive. There are also reforms introduced in the field of pension and social services programs lowering the level of the flat rate universal mandatory contribution and introducing private second and third pillar in order to decrease labor costs. These are features typical for the liberal market economies. Such changes are explained by Deacon as a response to a perceived need to reduce social provision in order to become more competitive in the global economy which is combined with the influence of global actors like the IMF and World Bank promoting residualist policy.

The directions of the emerging social policy strategies in SEE including Bulgaria, according to Deacon are aimed at facilitation of marketization through compensating the ones paying the highest cost for transition. Thus, social policy is becoming more marginalized, serving as an income maintenance mechanism rather than egalitarian instrument. Targeted and means tested social provision aim at preventing the main victims of the economic transformation from falling into poverty (Standing, 1998). According to this author, there is a mismatch between the increasing number of people in need and the decline in total social expenditure due to resource constraints. Benefits are directed towards the new unemployed and subsidies on a lot of goods are abolished. Early retirement as an alternative to unemployment raised the burden on pension funds. There are increasing differences in income levels especially among the population in rural areas and small towns and the one living in the capital and other big cities (Pickles, 1998). A great portion of the elderly citizens live with incomes which are near the poverty level while universal child benefits have been so strongly eroded by inflation that have symbolic value. After the reforms, there is a decrease in government expenditure as percentage of GDP and the practice of tax evasion and the existence of grey economy put harsh constraints on budgets.

The main determinants of the current social policy are claimed by Deacon to be the desire to attract FDI (economic globalization) and the influence of global financing actors like the IMF and WB (political globalization). Now that the financial system is fully privatized, net FDI flows increased to 16.8 percent of GDP in 2006 from 6.8 percent in 1999. However, the “shock therapy” executed in Bulgaria, removed guaranteed employment, social protection through subsidized prices and the availability of enterprise based social benefits (Standing, 1998). Income and status inequality rose not only among rural and city regions but also among occupations. A level of statutory minimum wage was introduced which was used as an instrument to hold down social expenditures which were calculated on basis of it. However, the average level of benefits is generally below the subsistence income thus cutting down passive social policy and trying to increase the incentives to work.

Transformation of the education system is still minor and privatization is not wide spread as Bulgaria has been traditionally committed to subsidizing this sector showing its commitment to high standards in academic education. However, the World Bank recommends that tuition fees should be increased and student loans be introduced instead of scholarships – which implies a shift from public financing towards private one and is more typical of liberal economies with low levels of social capital. Moreover, there is insufficient funding for the vocational training sector partially due to decline in industrial production which was the basic source needing specialization of skills during the communist regime (NSI, 2007).

The ratio of different sectors on the GDP profile has changed – the industry and agriculture possess a smaller share which is made up for by an increase in services (CIA, 2007). Job gains are noticed in the service and agricultural sectors. Large state enterprises are privatized, in most of the cases with speculative purposes. Nowadays, the industrial base has largely deteriorated due to obsolete equipment and lack of investment in its transformation so it is unable to meet global competition requirements. Bulgaria’s traditionally strong agricultural sector has been hampered since 1990 by slow reform of the centralized communist system and privatization of collective farms. The industries developed by communist governments were not suited for the world competition they encountered in the 1990s. In the early and mid-1990s, those factors caused a steep drop in agricultural and industrial productivity, from which Bulgaria has recovered steadily since suffering a major national economic crisis in 1997 and 1998.

There are still major challenges in front of the country according to 2007 World Bank report. Per capita income in that year is estimated at only 37 percent of the EU-27 average. To accelerate its convergence to EU income levels, Bulgaria has to raise its growth of

productivity to 5% per year. Unemployment should be addressed as well as the stop and go nature of structural reforms. Labor shedding in the country was among the steepest ones in the region with 1.2 million jobs lost between 1990 and 2000 with 1 million in manufacturing. The share of youth unemployment is high which is typical for liberal economies as their level of coordination between educational institutions and employers is low. Unemployment also has a regional dimension which preserves high values even in periods of declining total unemployment.

However, the successful solution of these problems depends on the further development of the infrastructure and an increase in production and income levels. The description provided above signals a transition of the Bulgarian economy towards a liberal market one on variety of indicators. The role of the state has decreased in the post communist decades and it does not intervene in market relations unless there is a market failure. There is no central industrial policy aimed at developing specific branches the way it was in the past with the heavy industry. The large service sector and low level of manufacturing leads to a demand for general skills which is reflected in the emphasis on academic rather than vocational education and training. Social protection for the unemployed is low and does not provide guarantees for investment in specific skills which can be seen also in the high values for workforce turnover. The goals of the social policy are not full employment and equality typical for coordinated market economies but rather income maintenance and efficient use of resources.

In the recommendations given by the World Bank in its report from 2001 ("Bulgaria: The Dual Challenge of Transition and Accession") the direction of development towards the creation of institutions typical for a LME can be seen. The country is expected to establish a framework which to boost further private investment through a more supportive business environment which requires flexible labor and capital markets. It claims that since 1997, the banking sector has been improved and shows acceptable liquidity and profitability but the rest of the financial sector is still underdeveloped and capital markets are inactive or non transparent. The labor market is described as a sclerotic one close to the worst performing EU markets which are hampered by rigidities. Most of these obstacles like high unemployment benefits and high minimum wages are not present in Bulgaria but there are high payroll taxes and strict employment protection legislation which should be decreased according to the WB. Employment incentives should be enhanced and eligibility criteria should be tightened. The overall union membership in Bulgaria is seen as high with 65% of workers in state owned enterprises and a trend towards a more decentralized bargaining structure is not observed. However, production of industrial state owned enterprises has just a minor share in national employment and output. The World Bank recommends a revision in the restrictive provisions in the Labor Code which present rigid procedures for the implementation of collective redundancies and require difficult coordination with trade unions which are obstacles to firm level restructuring. According to the WB, the employment termination of individual contracts is technically easy but dismissal is practically difficult due to the "jurisdictional bias in favor of labor." This evaluation shows that there are signs of the communist institutional legacy which is based on high coordination in Bulgarian political economy like the high level of union membership and labor protection legislation. However, as we may see in the recommendations given by the organization, the direction for Bulgaria is to overcome these obstacles on its way to a market economy and to establish a more flexible labor and capital markets as well as more residualist and targeted social policy all of which are features typical for LMEs.

The analysis shows that the country has been adopting the Anglo-Saxon model of capitalism and is moving in the direction of a liberal market economy. This trend can be attributed to the establishment of a currency board in 1997 and the influence of international financial organizations like the World Bank and the IMF. The country analysis support the

claims made by Deacon regarding “political globalization” about global financial actors installing their doctrine of liberalism and free markets. This can be seen in the features of the current political economy which are much more similar to a liberal than a coordinated one. There is marginalization in social policy, deregulation of financial markets and weak business coordination mechanisms. The higher education system is characterized by academic establishments delivering general skills as VET is currently underdeveloped after the decline in manufacturing since 1989. Moreover, there is a traditional preference in the country for academic qualifications over vocational ones which are seen as less prestigious. There is low job tenure and low unemployment and employment protection which, according to Estevez Abe, lead to a preference for development of general skills. Thus, we may conclude that Bulgaria is a liberal market economy with an emphasis on flexibility rather than knowledge intensity in skill formation.

Finally, Bulgaria, under the influence of IMF and WB as provider of capital has been transforming towards a liberal market economy in the last two decades of transition. It may be expected that it will also adopt the product strategies typical for LMEs based on price competition and general skills. This may be a feasible approach now when Bulgaria can still offer labor costs’ competitiveness as the actual wage is even lower than the productivity based wage. However, as income and infrastructure levels rise so will do labor costs and the competition with developing countries on that indicator will be impossible. With the advancement of the nation to a more developed economical stage, there will be a demand for value added goods and services, according to the human capital theory view that this is the universal path of economic evolution. In such a case, Bulgaria will probably face the same problems like the ones pressing the UK now regarding the transition from price-based competition to a quality-based. It will need highly skilled workers which to answer the demands for higher productivity, innovation and utilization of new technologies. The approach the state chooses to adopt in the future to overcome rising inequality and regional underdevelopment may be essential for the future direction of the political economy. However, a dramatic shift towards a coordinated economy is not highly probable given the individualistic nature of Bulgarian society.

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