

The Political Economy of Meritocracy Unemployment, Globalism and Inequality*

by
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In a recent article, Norbert Berthold and Rainer Fehn (1996:583) pose the important question: "... why governments so often fail to adopt policies that economists consider to be efficiency-enhancing. Indeed, it is apparently much easier for economists to give advice to policy-makers on what they should do compared to explaining why policy-makers do what they do". In traditional macro-economic textbooks, the political actor –depersonalised as ‘economic policy’– is taken to be a political and ideological ‘black box’, driven by the pursuit of enhancing the welfare of the society – the ‘benevolent dictator’.

However, at the latest since Marx and the Marxians we know that public policy is influenced, if not dominated, by particular interest groups (see e.g. Poulantzas 1968) and it was Michal Kalecki (1943/1990:577) who pointed out, with respect to employment policies, that "(t)he assumption that a government will maintain full employment in a capitalist economy if only it knows how to do it is fallacious".

The interrelation between economics, politics and society –or the *politics level of economics*– has long been ignored by economists concentrating on the theoretical foundations of economic policy in a teleological manner (*the policy level*)¹. The renaissance of political economy during the 1960s was only short-lived and did not have a strong impact on economic reasoning² – this may have been because most proponents were sociologists or political scientists striving

* This is the revised version of a paper presented at the 11th annual conference of the Society for the Advancement of Socio-economics (SASE) held from the 08. - 11. July 1999 at the University of Wisconsin, Madison. I am very grateful for critical comments by Ansgar Belke, Karl Georg Zinn and the participants of a workshop on globalisation at the Carl von Ossietzky University of Oldenburg. Patricia Janning helped to render my english less imperfect. Of course, the usual caveats apply.

1. See Fluhner 1993:255.

2. There are probably two exceptions: the french ‘Regulation School’ and its american counterpart, the Radical Political Economy.

for a ‘politicisation of economics’ (see Udehn 1996:1ff.) on an interdisciplinary base. On the other hand, the critical bias of (radical) political economy³ –critically rejecting the postulates of laissez-faire capitalism and advocating state intervention and, sometimes, revolutionary action– lost its appeal with the economic down-turn at the end of the 1970s and the collapse of the ‘interventionist’ Phillips-curve trade-off.

With the renaissance of neoclassical micro-economics and its macro-economic counterpart –monetarism–, the focus shifted from Keynesian demand management to micro-economic supply-side politics (on the policy level) and from methodological collectivism (functional relations in macro-economics) to methodological individualism (individuals as basic agents and the logic of rational choice as driving force of economic action). This paved the way for an ‘economic approach to politics’ under the guideline of ‘government failure’ (on the politics level), and yet the political level is still playing only a minor role in the way traditional economists think and argue. This verdict seems to be particularly true as far as the political economy of unemployment is concerned: “It does not suffice to cook up employment enhancing strategies with which to reduce the level of unemployment and to mobilise efficiency resources which are lying idle. We have always to consider the question of how to find majorities for such strategies within the political process. The analysis of this political economy dimension of employment policy is still in its infancy”. (Landmann 1996:436; my translation).

Against this background, Berthold and Fehn’s endeavour to contribute to the political economy of unemployment must be judged as important and, in principle, promising. However, by using the public choice approach to political economy, Berthold and Fehn attract all the criticism that has been raised against ‘economic imperialism’ (see Tullock 1972): assumptions too rigid to conform to reality⁴, the lack of concepts such as ‘ideology’ and ‘power’ and a thin empirical basis. In the following, I will firstly present an analysis of Berthold and Fehn’s argument at some length. This intervention is necessary because their approach is becoming the dominant view of the political economy of unemployment (and institutional reform; see also Saint-Paul

3. Radical Political Economy is rooted in Marxist, Keynesian and pluralist traditions; see Lippit 1996.

4. “Scientifically, it is another in the long line of failed attempts at a rigorous, axiomatic, general theory of government”. (Orchard/Stretton 1997:410)

(1993;1995;1996;1997), Fernandez/Rodrik (1991), Rodrik (1993) and CEPR (1995) (I). I will then point out some theoretical shortcomings (II) and, very briefly, the missing empirical backing (III). In the main part of the paper, I will present an alternative version to the political economy of unemployment, putting the recent controversies on globalisation and deregulation into a different context (IV).

I. The Public Choice-arguments: a short appraisal.

Berthold and Fehn begin their reasoning by claiming that “(i)t is mostly recognized that unemployment in Europe in general and in Germany in particular is mainly structural in nature, and that the cyclical component is rather negligible” (Berthold/Fehn 1996, p.584). Structural unemployment is meant to be ‘classical unemployment’ in the sense that the wage setting system does not allow the real wage to be determined in accordance with scarcity conditions in the labour market. This is the fundamental cornerstone of the following approach: “The gist of this argument is sometimes forgotten, namely that wage formation is the main determinant of employment. After all, wages are the price of labour and the demand falls under normal conditions as real wages go up” (Berthold/Fehn 1996, p. 584). Once this argument has been made explicit, Berthold and Fehn are in need of an explanation as to why real wages are permanently kept above the market clearing level. They propose three reasons:

1. The bargaining position of the employed insiders is strong
2. Employed insiders use their bargaining power for ‘rent-seeking’, i.e. they externalise the consequences of an unduly aggressive wage policy onto the unemployed outsiders.
3. “(G)enerous welfare provisions” (Berthold/Fehn 1996, p. 585) reduce the willingness of unemployed outsiders to take up low paid jobs and, thus, prevent pressure on ‘insider wages’ from rising.

Of course, these arguments have already been presented in a myriad of studies under the heading of ‘insider-outsider-theory of unemployment’⁵ – Berthold and Fehn’s original contribution is to apply the insider-outsider approach to the question of why policy-makers do not liberalise the labour

5. See e.g. Lindbeck/Snowder 1986; 1988; 1991; Paqué 1991; Blanchard/Summers 1986; 1988; Michell et al. 1992; Alogoskoufis/Manning 1988; Lindbeck 1989; 1992; Solow 1985.

market in order to re-establish the signalling and market clearing function of the real wage as it “must be item number one on the agenda for fighting unemployment” (Berthold/Fehn 1996, p. 585) and “(a) substantially better employment performance remains a chimera without greater efforts at liberalizing the labor market” (ibed, p. 594). What this means is clear: a complete deregulation of the labour market (e.g. reducing or abandoning dismissal restrictions), decentralising collective bargaining (e.g. introducing ‘opening clauses’ into collective agreements) and cutting on welfare spending (e.g. lowering the reservation wage). The blue-print is “... the rigorous liberalization of the labor market that took place in the UK under M. Thatcher” (ibed, p. 595).

In order to answer the afore-mentioned questions, Berthold and Fehn have to set some crucial assumptions:

- Policy-makers are pursuing their own selfish interest – i.e. they are neither driven by any notion of ‘common welfare’, nor the agent of any single social group (or class as in Marxian political economy; see Downs 1957: 28ff.)
- The self-interest of policy-makers is exclusively to maximise electoral votes in order to gain access to governmental positions.⁶

Both these assumptions guarantee that policy-makers act as the agent of a principal – which is the *median voter* (see Wagner/John 1997: 254f.).

The preferences of the median voter shape the design of economic policy. If policy measures hurt the interest of the median voter, they are likely not to be taken – even if they were to increase overall welfare.

Now, the argument is that “the median voter are likely to be members of the insider group” (Berthold/Fehn 1996, p. 597) which “...possess little human capital, but are employed on a regular job” (ibed, p. 597). Policy measures of labour market deregulation and welfare state trimming will hurt the interests of the median voter because:

- the ensuing increase in income dispersion (or inequality) undermines the position of the median voter and only favours capitalists and highly skilled labour
- reduction in dismissal legislation hurts job security of employed insiders

6. “...each political party is a team of men who seek office solely in order to enjoy income, prestige and power that go with running the government apparatus”. (Downs 1957: 135)

and only favours unemployed outsiders by improving their hiring prospects

- cutting back on welfare spending will not even improve the situation of unemployed outsiders if ‘working poor phenomena’ are likely to arise.

Therefore, labour market reform on the lines of Thatcherism have not been pursued in countries with a ‘European or German model’ because the promised (long term) welfare gains are distributed mainly to unemployed outsiders (by enhancing their employment probability) and capitalists (by increasing their income level), while the median voter –the employed, low skilled insider– as well as capitalists (if the distributional struggle is intensified⁷) are likely to be on the losing side.

Berthold and Fehn (1996, p. 597) therefore conclude: “Most policy recommendations to reduce structural unemployment get trapped in the pitfall of political feasibility, as a large part of the electorate will lose at least in the short run and/or losses are concentrated on influential special-interest groups”. Lasting unemployment as the result of a government failure.

II. Theoretical shortcomings

Firstly, we have to dwell on the shaky foundations of the insider-outsider model. On the one hand, the idea of unemployment being caused by employed insiders (or their organisations) unwilling to accept a market clearing real wage rate cannot seriously be maintained after the Sraffa-Keynes critique of neo-classical economics. The famous Cambridge-capital controversy had been settled on a rejection of the labour demand curve, inversely relating the wage rate to the quantity of labour demanded – there is simply no such thing as a traditional neo-classical labour market in a world of ‘production of commodities by means of commodities’. And the distributional system has merely one degree of freedom which is settled by the determination of the (money) rate of interest on the financial market – the real wage rate simply falls in line (see Riese 1986: 45). What employed insiders can do, is merely to bargain over the nominal wage rate and, as the real wage rate is determined endogenously, pay attention to their position in relation to other wage earner groups (e.g. with respect to qualificatory, sectorial or regional characterisation). On this issue, the work of Calmfors and Driffill (1988) and David Soskice

7. I.e. the balance of gains and losses of capitalists is unclear.

(1990) has shown that the willingness to internalise external effects of wage policy (such as inflationary outcomes and the reaction of monetary policy) is strongly influenced by the degree of centralisation of, or cooperation among, collective bargaining institutions: the more centralised the collective bargaining institutions, the more willingly they internalise external effects, or to put it in terms of Mancur Olson: the more likely they are to act as 'encompassing organisations'. And, indeed, comparing the performance of the British and the German collective bargaining systems –both economies are regularly regarded as the most extreme cases of flexible and sclerotic labour markets– roughly confirms the reasoning of neo-corporatism (see Heise 1997).

Taking this criticism into account, Berthold and Fehn's (1996, p. 585) admittance of the non-unanimity of economists about policy proposals concerning the fight against unemployment is, at best, unsatisfactory and their continued claim for the need for deregulation is, at best, unsubstantiated – a growing number of heterodox and Keynesian economists is making this point quite explicitly (see e.g. Epstein/Gintis 1995; Heise 1999; Modigliani 1996; Malinvaud 1994; Marglin/Schor 1990; Kromphardt 1996; Meade 1995).

Despite these qualifications, Berthold and Fehn are surely correct in pointing out that the policy proposals for deregulation and welfare trimming are widespread among mainstream economists and, particularly in Germany, among policy advisory boards such as the *Sachverständigenrat* (Council of Economic Experts) and the *Deregulierungskommission* (Commission on Deregulation). Therefore, although the economic foundations of deregulation may be shaky (and may be opposed for very good reasons), we still have to face the conundrum that such policy proposals *are currently dominating the economic debate* and were, allegedly, shaping the policy of former liberal-conservative governments (see Hoffmann 1987: 358 and JWB 1997: 32ff.) – yet, we have to acknowledge a surprising institutional stability in Germany (particularly concerning labour market institutions; see Heise 1997). At this point, the principal-agent concept of public policy –reducing policy-makers to the function of simply fulfilling the preferences of a median voter– is definitely too rigid to realistically portray real world phenomena: on the one hand, the median voter concept rests on certain assumptions (like the single-peak assumption of voters' preferences and the single-issue assumption of electoral decisions), which are unlikely to be valid in a representative democracy. On the other hand, political parties –as the basic unit of governments– are not simply

organisational ‘black boxes’ to be filled with the electorate’s preferences. At least, this was not the case in the past and, particularly, not in Europe.

Before I consider these points further, I want to express the gist of the public choice-argument in its full and uncompromising way: *unemployment exists because certain groups of labourers –the low skilled, employed insiders– are able and willing to exploit and expropriate not capital (which they are unable to do as capital has always the ‘exit-option’ of refraining from investing and, thus, is able to reduce the size of the cake to be distributed) but skilled labour and the unemployed outsider.* And trade unions are seen as their agents, also becoming expropriators in this scenario. But this is not yet the end of the fantasy. As the power to exploit and expropriate is given to trade unions by social policy, labour market regulations and institutions, policy (i.e. the government) would be able to reduce their power by way of deregulation. However, now it is the anonymous ‘median voter’ –the principal of the political agent– who prevents this from happening. Exploiting and expropriating trade unions are helped in their disdainful work by a ‘government failure’ of representative democracy – that is the full story of a truly ‘non-Marxist’ class struggle (see Saint-Paul 1997: 59).

I call this account a fantasy because its purely individualistic (micro-economic) approach to politics is flawed throughout: it is theoretically inconsistent and empirically falsified. Since the critique on the theoretical flaws is well documented (see e.g. Udehn 1996; Orchard/Stretton 1997; Self 1993), I will provide only an outline of the objections:

- Taking the ‘economic approach to politics’ seriously, we are not even able to explain *why people vote at all*. According to the coordination problem of elections⁸, the rational, selfish voter should abstain from voting.
- If, as we experience, people are voting nevertheless, they may be free to vote according to what they believe is of ‘public interest’ instead of pursuing their selfish interest “since the rational voter knows that she can make virtually no difference to the outcome“ (Self 1993: 23).
- A rational voter has no incentive to collect costly information about party programmes, political issues at stake, etc. The rational voter can therefore be regarded as an ‘ignorant voter’.

8. High information and other electoral cost versus low individual gains due to the marginal contribution of single votes.

Under these caveats –and reality proves that voters make little use of information and vote as much according to selfish as to public interest (see Udehn 1996: 60)– it seems hard to believe that political action is shaped by the median voter:

- if it is much too costly to get all the information needed for voting in a rational way –and this is particularly true if electoral decisions are made on multi-issue problems– ‘ideology’ is not an old-fashioned concept of value-biased preferences but a necessary bracket to overcome the information and coordination problem in a representative democracy.⁹
- In a multi-ideological world –as it has definitely been the case in Europe since the dawn of democracy– it is not the median voter who shapes politics but rather the *party median voter*.
- The median voter is likely to be a well-educated, better informed individual who does not have to fall back on ideological crutches. The influence of the median voter, though never the exclusive determinant of political action as in the simple principal-agent approach, is stronger the more ‘mobile’ the party median voter is in terms of ideological flexibility.¹⁰
- In the event of informational problems, the electorate’s preferences cannot simply be taken as given (as is usually done in economics in general and in new political economy in particular), but are shaped by beliefs which, of course, can be influenced, if not manipulated, by interest groups, political parties and their use of media and other instruments of public opinion.¹¹

To sum up: it is very unlikely that political action is determined by low skilled employed insiders, the median voter, needed by Berthold and Fehn to

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9. “An ideology has a practical and social function; it helps an individual to interpret social and political events and to find her way in a confusing world”. (Self 1993:54).
10. The distinction is drawn between the party patrons and the party basis. While the patrons are power oriented, the basis is oriented towards subject matters or ideologies. It seems appropriate to say that leftist party bases are more subject or ideology oriented (and less power oriented) than rightist party bases. In this sense, rightist parties are more mobile to catch the median voter preferences than leftist parties which stick to their ideologies more strongly (see Kirsch 1993:234).
11. “Human nature in politics being what it is, they (the politicians, A.H.) are able to fashion and, within very wide limits, even to create the will of the people. What we are confronted with in the analysis of political processes is largely not a genuine but a manufactured will”. (Schumpeter 1942:263).

make their story fit, who would strongly oppose deregulation as being harmful to their well-being. It is much more likely that the party median voter, who is the least tied to his ideological roots, will shape political behaviour – with a little influence from the median voter, who is likely to be a well-educated, highly skilled individual under the circumstances described above and particularly in Germany with its high share of highly skilled labour.¹² Additionally, political parties and governments are not ‘black boxes’ driven exclusively by ‘demand issues’ (i.e. the preferences of their potential voters) but also by ‘supply issues’: the self-interest of the individuals comprising a party and corporate interests of the party organisation itself (in terms of financial and ideal support). Taking into account what Keith Dowding (1996: 72) calls ‘systematic luck of capital’¹³ and affirming that mass media are likely to take a biased view on economic issues (see Udehn 1996: 134) in favour of capitalists, it seems hard to believe that a liberal-conservative government should have been unable to persuade its electorate of the fortunes of a deregulation policy.

But what is most perplexing about the public choice-approach is, that it would rather predict a strongly regulated labour market in the USA (see Bentolila 1997: 74) and the United Kingdom – both economies are, in fact, regarded as prototypes of the most unregulated labour markets: The US shows a comparatively homogenous electorate with respect to ideology and is characterised by a comparatively high share of low skilled labour. And Britain, at the end of the 1970s, was also characterised by a high share of low skilled workers and, additionally, a high level of (although uncodified, i.e. de facto) regulations. Under such circumstances, the median voter probably looks like the one described by Berthold and Fehn and we would, consequently, expect a display of great power from low skilled, employed insiders in the US and a particularly strong resistance to labour market reform in Britain – the exact opposite is true.

12. And Oliver Landmann (1996:436) is certainly right in stating that the median voter will be rather unharmed by deregulation.

13. “Some groups are systematically lucky: they get what they want without having to act because the way society is structured. ...The question for democratic parties is how to run the economy in such a way that it is successful, and that means running it in a manner in which capitalism thrives”. (Dowding 1996:71 and 73f.)

III. The missing empirical support

According to Downs' (1957: 21) verdict, "(t)heoretical models should be tested primarily by the accuracy of their predictions rather than by the reality of their assumptions". We have already seen that the predictions of the public choice approach to lasting unemployment and institutional stability do not find support in a cross-country comparison. Moreover, the model does not conform to the actual evolution of industrial and labour market relations in Germany over the past two decades as we shall see in a moment.

In a recent paper, Kathleen Thelen (forthcoming) poses the question "(w)hy German employers cannot bring themselves to abandon the German model". The answer is "that German employers are ambivalent about abandoning traditional bargaining institutions both in the sense that they *disagree among themselves* on this issue and in the sense that they are in some ways *quite unsure* of whether the alternatives to the current system would unequivocally serve their best interests" (Thelen forthcoming: 6). The argument is one of *institutional economics* instead of *political economics*:

- The clear distinction between consensus-based cooperation and co-determination between employers and trade unions at the plant level and controversial wage bargaining at the sectorial level, pacifies industrial relations. Any decentralisation of collective bargaining arrangements will jeopardise this crucial balance.
- Recent strike experience in Germany has proved the danger of 'wildcat cooperation' in the case of a 'free-for-all competition' on the labour market not among unemployed or endangered workers with (potential) employers, but between employers and their worker representatives endeavouring to quickly pacify looming industrial action.
- A high degree of industrial cooperation at the plant level and coordinated wage bargaining at industry level is seen as a cornerstone to the competitiveness of German companies acting within highly specialised, markets with high-productivity.
- The strongest proponents of decentralisation of collective bargaining and deregulation of labour markets are 'marginal firms', i.e. companies struggling for survival. Under normal circumstances their influence within the employer organisation is limited and only in times of a severe recession –as in 1993/94– is the organisational power of the 'marginal firm' considerable.

The opposition from German employers to institutional reform after the fashion proposed by neo-liberal economists such as Berthold and Fehn rather than from employed insiders (and their trade unions) can be tested against the case of co-determination legislation in the mid-1980s (see Wood 1997). It was one of the primary aims of the junior coalition partner in the incoming government in 1982 to reverse co-determination legislation in order to undermine the strength of the unions (Wood 1997:9). Yet, in the almost complete watering down of the initiative “...the virulent opposition of German unions played little role...” (Wood 1997:4). For much the same reason as given above, it was particularly the resistance of German employer organisations in conjunction with the employee’s formation within the conservative party (CDU) which preserved institutional stability: “...an alliance between the pro-business *Wirtschaftsflügel* and the Social Committees (CDA) of the CDU proved to be the crucial obstacle to change” (Wood 1997:19). And it was the CDU-leadership under Chancellor Helmut Kohl which moderated the resistance to political domination.

Wood’s (1997:25f.) final statement sums up the argument: “Undermining the strength of unions and of works councils was a priority for the FDP, the ‘neoliberal wing’ of the CDU, and the CSU, but *not* of German employers confederation, who complained consistently that these reforms were motivated by political rather than economic considerations”.

IV. An alternative approach to the political economy of deregulation

Having argued that institutional stability in Germany can be explained on grounds of *institutional economics* rather than a *public choice-approach* (which also fits in better with the facts of a cross-country comparison; see Thelen (forthcoming) for a comparison with the process of deregulation in Sweden), we are still left with two conundrums:

1. Why are German employers –at least at a rhetorical level– so dissatisfied with labour market regulations and institutions that they constantly keep questioning them, particularly under the heading of ‘competitiveness in a global world’?
2. Why is it that macro-economic policies to enhance employment are more likely to be pursued in countries with a deregulated labour market (i.e. the USA and Great Britain; for the ‘military Keynesianism’ in the US see Marshall 1995; Marglin 1990: 34f., Turgeon 1996, for Keynesian-type

demand management of Thatcherite Britain see Butschek 1994; Heise 1999) – although these policies may not be called by their proper name¹⁴?

A comparison between Germany –with its stable institutions and supposedly ‘sclerotic markets’– and the UK –having experienced a process of drastic institutional change which resulted, as the OECD noted, in the most deregulated markets– may provide a key to the answer (see Heise 1997; 1999)¹⁵:

1. Contrary to conventional wisdom, flexibility and sensitivity of the wage setting systems of both economies according to regional and sectorial characteristics and with respect to labour market conditions are very much alike¹⁶ and it is true that ‘insider behaviour’ is more pronounced in the UK than in Germany.
2. The labour market dynamics in both economies are of comparable size: both in Britain and Germany roughly every fifth worker changes jobs each year or ceases to be economically active. Even though this labour turnover is slightly regressive in trend, it does not point to any reduced flexibility in the employment system, but is due only to declining voluntary workforce mobility with increasing labour market distortion. And although job turnover in international comparison is rather low, this cannot be interpreted as an obstacle to employment growth (see OECD 1996: 165ff.)
3. Despite these similarities in terms of flexibility and sensitivity of the labour market- and wage setting institutions, *the wage dispersion has evolved along completely different lines in both countries*: in Germany, wage differentials have remained very stable, while they have increased markedly in Britain since the end of the 1970s and had reached the level of Victorian times by the late 1980s. The significant differences in wage dispersion are almost entirely due to differences in qualificatory wage differentials: again, contrary to convential wisdom, qualificatory wage dispersion has increased in Germany since the late 1970s (see Heise 1997a). Yet it has not only

14. Typically, both countries are better known as examples of supply side policies than of Keynesian type demand management.

15. It will be subject to future research to empirically test the theory I am putting forward here on a multi-country base. Some empirical hints are given in footnote 24.

16. If at all, the German wage setting system seems to be superior with respect to regional characteristics and in terms of overall wage moderation – this can be easily explained in the frame of a corporatist model; see Soskice 1990.

reached a much higher level in Britain, it has also increased at a much higher speed.

4. Germany's backwardness in the process of tertiarisation has often been lamented, but a comparison with Great Britain shows that this picture is, to a large degree, a statistical artifice: if controlled for different degrees of outsourcing of services at the company level and differences in classification at the sectoral level, the process of tertiarisation in both economies displays astonishing parallelism. Existing differences in intra-sectoral developments are mainly due to different demand and productivity conditions. What seems clear is that higher qualificatory wage dispersion in Britain has neither spurred on the overall process of tertiarisation, nor has it increased the employment probabilities for low skilled labour in manufacturing industries or services.

These results show that labour market deregulation in Britain has only served one purpose: *to increase qualificatory wage dispersion*.¹⁷ Or, to put it differently: institutional stability in Germany –which must not be misinterpreted as labour market- or wage rigidity– secured an established wage structure. And it has convincingly been pointed out that the stability of the German wage structure (see Barth/Zweimüller 1995; Zweimüller/Barth 1994) as well as the huge increase in qualificatory wage dispersion in Britain (see Leslie/Pu 1996; Machin 1997) are primarily caused by institutional stability in Germany and institutional reform in the UK.

Income inequality

The political economy of unemployment, therefore, must be understood not as an expropriation of unemployed outsider and highly skilled insider by employed, low skilled insider (as in the public choice-approach), but must be understood as a struggle over *personal* income distribution – the better-offs (i.e. functional capitalists, corporate managers or, in general, the meritocra-

17. In the study mentioned above, I have been concentrating on wage income and wage dispersion. However, several study show that there is a strong correlation between wage differentiation and overall income dispersion due to tax policies (as part of supply-side measures) and a parallel development of non-wage income categories; see Tiemann/Kaulisch (1998) for Germany and Giles et al. (1998) for a Anglo-German comparison.

cy¹⁸) seek to increase their share in national income.¹⁹ At any rate, this is the hypothesis that I present in figure 1:

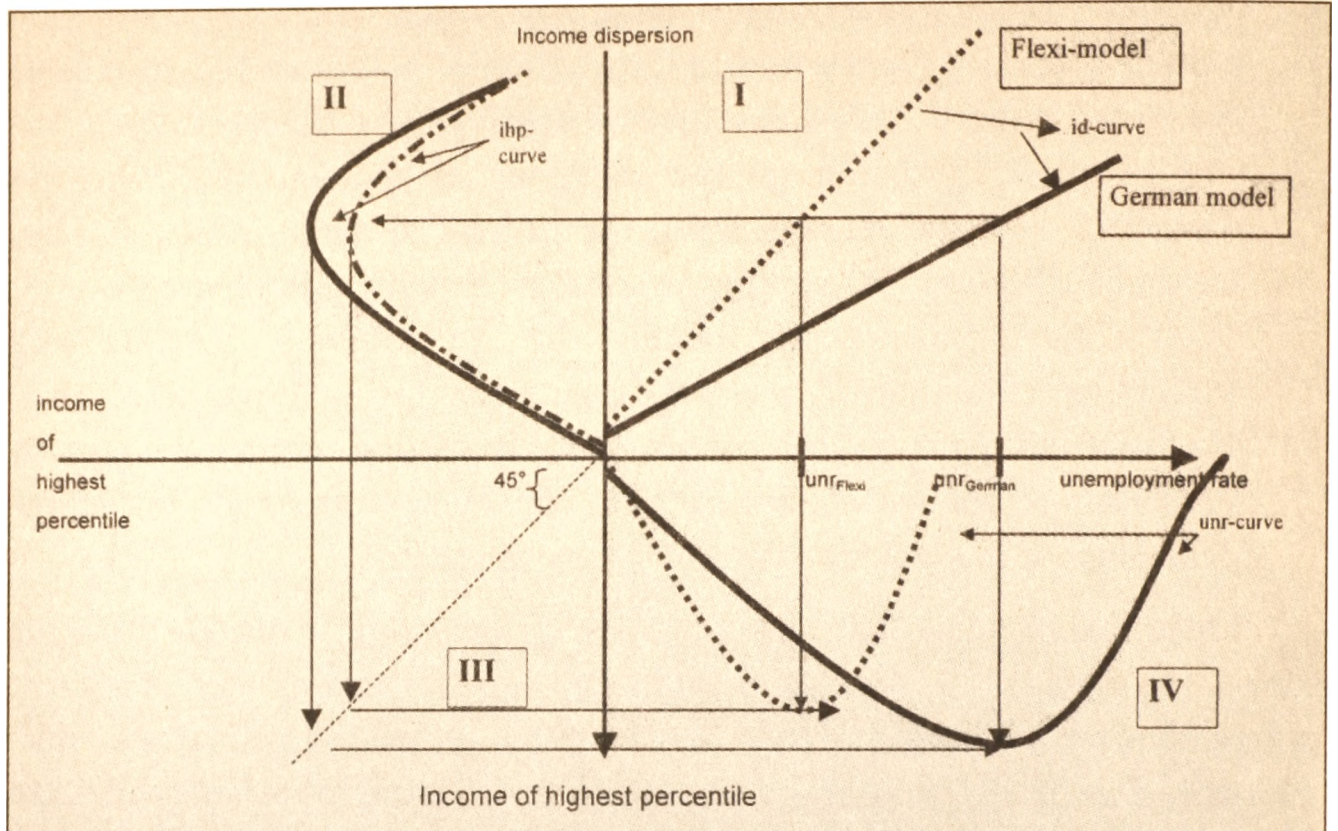


Figure 1: Political Economy of Meritocracy

In the first quadrant of fig. 1, a relation between the level of unemployment and income dispersion (capturing not only wage dispersion, but also means of income (re-)distribution by way of taxation or social contributions and non-wage income) is depicted. The idea is that a growing labour market distortion increases the pressure on wage bargaining (and taxation) to bring about greater income inequality. For the sake of simplicity this relation is

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18. The concept of meritocracy seems also to be more appropriate than the Marxian concept of plutocracy as it is based on human capital rather than physical capital as was appropriate in the times of the industrial revolution. Of course, from a sociological point of view, the meritocracy is a grouping which needs further social stratification. However, employers' organisations can be seen as supporting the cause of meritocratic income desires (besides their particular business interests) as the individuals behind their corporate members are exactly the 'better-offs' mentioned above.
19. Of course, increasing wage dispersion not only directly impacts on income (in-)equality but can also be interpreted as a 'subsidy' to those consuming goods and services produced by low paid employees – which are, particularly in the case of personal or household services – the 'better-offs' rather than the low paid themselves.

assumed to be linear. In any case, different models of labour market and collective bargaining relations (here termed as 'German model' and 'Flexi model') are reflected in the different positions of the income dispersion (id-) curve as indicated. The second quadrant represents the relation between income dispersion and the (net) income of the highest income percentile (ihp). The shape of the ihp-curve encapsulates the idea put forward in a variety of recent studies (see Alesina/Perotti 1996; Alesina/Rodrik 1994; Persson/Tabellini 1994; Heise 1998; UNCTAD 1997) that a growing wage dispersion may harm the process of income generation by hampering capital formation and overall consumption demand. Hence, *total* income of the highest percentile may fall, although its share in (falling) total income (i.e. *relative* income) rises. As the dotted ihp-curve indicates, the exact position of the ihp-curve depends on the underlying institutional framework.²⁰ Finally, the unemployment (unr-) curve in the fourth quadrant is derived from relating the income of the highest percentile to the unemployment rate. It is now easy to establish an '*optimum unemployment rate*' –optimum from a meritocratic point of view– at which the income of the highest percentile reaches a maximum. And it also becomes evident that this optimum point of unemployment may be very different in different institutional frameworks as indicated by the dotted lines and the distinction between the German and the Flexi model.

At this point we are able to solve the first conundrum of why German employers cannot bring themselves to abandon the German model, yet keep on criticising and threatening it: *they want to get the best of both worlds*. Clinging to the German model guarantees a higher potential for income generation, but also involves a higher level of optimum unemployment in order to achieve a warranted income dispersion. This may not only consume time (depending on how 'sclerotic' the bargaining process proves to be) but may also be politically opposed. However, abolishing the German model may not only cause higher income inequality (at lower unemployment rates) but may also depress the income of the highest income percentile. From this point of view it seems plausible to preserve the German model (i.e. to stay on the higher (bold) ihp-

20. An 'economic model' which systematically provides incentives for human capital formation, the pacification of industrial relations and a corporate governance system which prefers stake holding to mere share holding can be regarded as superior in terms of wealth and income generation -- the 'German or Rhenish model' as opposed to the 'Anglo-American flexi model' seems to be characterized by such incentives; see Albert 1991; Streeck 1997.

curve), yet to criticise and threaten it in order to relax the resistance to income inequality (i.e. to achieve an upward shift of the id-curve in fig. 1). In this respect the German situation differs completely from the one in the UK in the late 1970s, when the existing industrial relations and collective bargaining system was indisputably a part of the growth- and productivity problem termed as the 'British disease'.²¹

Monetarist macro-economic policies

A theoretical 'optimum rate of unemployment' has been derived from a meritocratic point of view, i.e. it is an unemployment level which will not necessarily prevail in a laissez-faire economy but *it must be actively aspired to*.²²

Assuming an 'unemployment equilibrium' to be the natural position of capitalist economies²³, fiscal and monetary policy must be directed towards 'fine tuning'. The depressing effect of monetary policy of monetarist orientation –i.e. favouring price stability and denying responsibility for output growth and employment– has often been stressed (see e.g. Winkler 1991; Ciocca/Nardozi 1996; Spahn 1988; Mooslechner 1990). An independent central bank –as is the case in Germany– which is unconstrained by any 'checks and balances' (such as an accountability to a democratically elected body) is all the more prone to pursuing a restrictive policy which is detrimental to employment and growth (see Nordhaus 1994; Sibert/Weiner 1988). And the effects of fiscal policy can only be denied in a theoretical framework assuming the validity of Barro's 'Ricardo Equivalence theorem' – the underlying assumptions of a market clearing model and 'rational expectations' are here taken as too rigid and unrealistic to be followed.

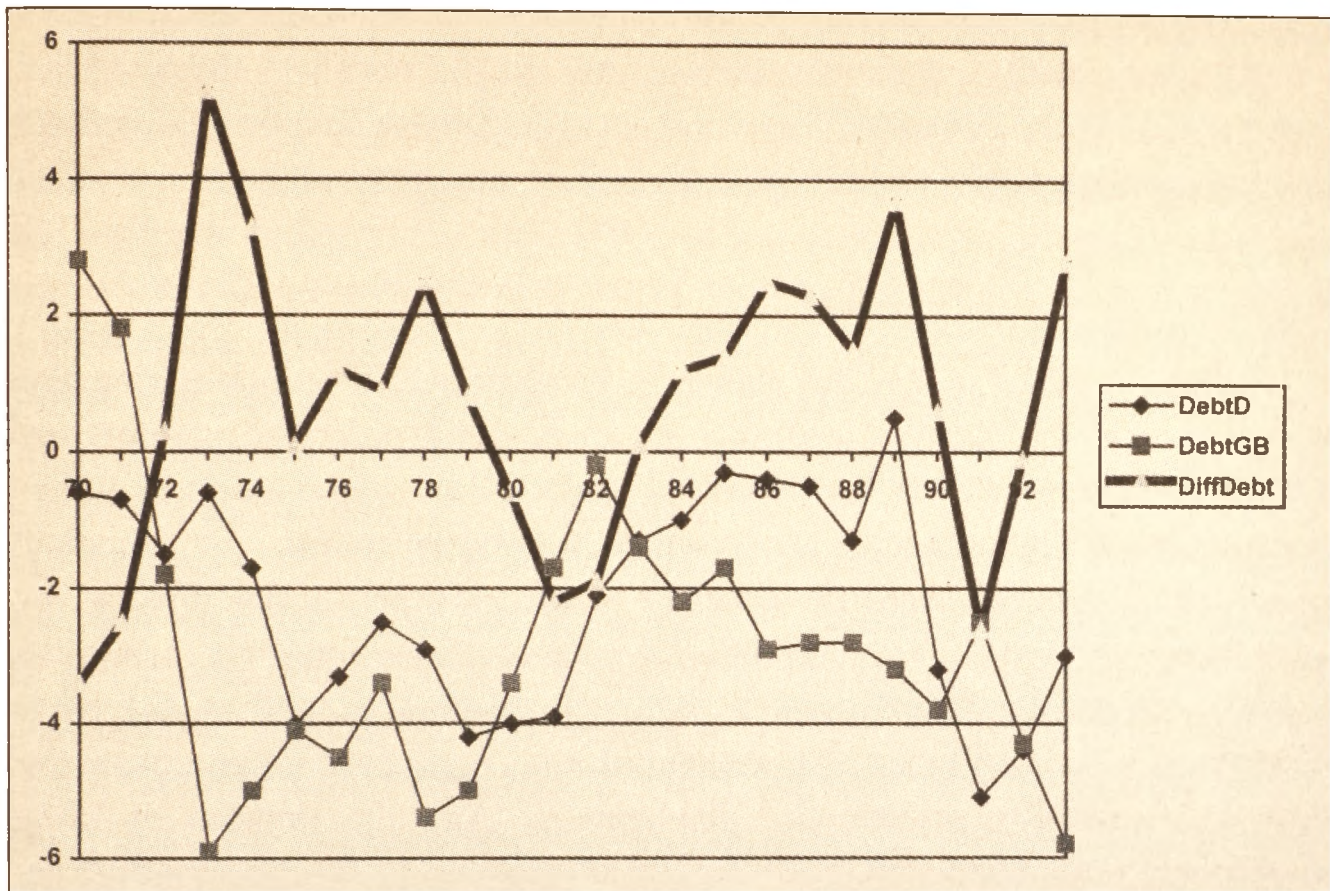
In a recent paper comparing UK and German fiscal policy (see Heise 1999) I have shown that differences in labour market disequilibria can be brought down to differences in the fiscal policy stance to a considerable

21. I.e. Thatcherism not only shifted the id-curve upwards, but also –and contrary to what might be expected in Germany– the ihp-curve outwards.

22. The so determined 'optimum rate of unemployment' may change over time (with changes in institutions and the changing 'acceptance level of unemployment' which determines the point of political unrest) and is not to be confused with an 'equilibrium level of unemployment' in a Keynesian tradition.

23. This, of course, involves the rejection of traditional general equilibrium reasoning in favour of a Keynesian approach.

extent²⁴: the evidently more restrictive fiscal policy in Germany (see fig. 2)²⁵



*Figure 2: Comparative fiscal policy in the UK and Germany;
public deficit (-) or surplus (+) in % of GDP*

Note: 'Debt' stands for 'structural public deficit' according to EC measurement.

Source: Europäische Wirtschaft, Nr. 60, 1995.

24. It is now that some empirical facts of an 11-OECD-country comparison (involving the UK, USA, Canada, Australia, Japan, Austria, Denmark, Sweden, France, Germany and Norway) can be put forward in order to generalise my argument: there is a strong and statistically significant (inverse) correlation between the change in the wage structure (growing dispersion) and the change in labour market distortion (growing unemployment) between 1980 and 1991. However, the argument put forward by traditional labour economists that a growing wage dispersion signals the allocative functioning of the labour market resulting in falling unemployment in due course cannot be substantiated: firstly, there is no correlation between the level of unemployment and the level of wage dispersion, secondly, there is no correlation between relative wages of low skilled labour and the incidence of low skilled unemployment. Both would be expected outcomes if the allocation argument was correct. In line with my argument put forward above, however, there is a clear and significant (negative) correlation between structural debts of public households and the change in labour market distortion: fiscal policy is most restrictive in such country where strong and stable institutions prevented wage (and, more general income) dispersion from increasing severely.
25. The bold line in fig. 2 represents the difference in the fiscal policy stance: a positive number indicates a more expansionary fiscal policy in the UK as compared to Germany.

not only aggravated the unemployment problem but also hindered budget balancing (which was exactly the proclaimed target of such policy).

To sum up we may conclude that a monetarist policy stance –fixed on price stability and fiscal consolidation– can be regarded as an essential tool to actively pursuing a policy of an ‘optimum rate of unemployment’.

Supply side politics and globalism

Taking a monetarist policy stance to be meritocratic in orientation, *how can it become the dominant strategy in an ideologically polarised environment?* The simple idea of a ‘class dominance’ or ‘ruling class’ which exerts its power on the rest of the society is surely under-complex in nature. An economic policy which only improves the position of the meritocracy but directly (by increasing job insecurity) or indirectly (by milking the vast majority in order to pay for increased unemployment) harms the median as well as the party median voter is only likely to be pursued, if it is regarded as doing exactly the opposite: increasing growth and employment. And the impulse of many mainstream economists and most ‘interested non-experts’ to disagree with my verdict on monetarist policy as being harmful to growth and employment proves exactly the point: in academia as well as in politics and the public opinion, the monetarist position successfully claims its competence for handling the twin problem of growth and unemployment²⁶. Sided by influential ‘think tanks’ (see Cockett 1994; Schui et al. 1997), supported by the majority of printed and electronic mass media (see Voltmer 1997), simple intuition and what Tenbruck (1963) called ‘social reinforcement’²⁷, monetarist macro-economics and neo-classical micro-economics became the almost unchallenged economic orthodoxy under the catchwords of ‘supply side politics’, ‘Reaganomics’ or ‘Thatcherism’ (see Minford 1985). And only to the extent that the supply side doctrine became dominant and a political party ideology

26. See e.g. OECD 1994; Barro 1996; Epstein/Gintis 1995: 9ff.; Minford 1984.

27. I.e. the idea that individual perception is always embedded into the social context of inclusiveness which forms the *Zeitgeist*: “If it be true that all governments rest on opinion, it is no less true that the strength of opinion in each individual, and its practical influence on his conduct, depend much on the number which he supposes to have entertained the same opinion. The reason of man, like man himself, is trivial and cautious when left alone, and acquires firmness and confidence in proportion to the number with which it is associated”. Hamilton/Jay/Madison 1937: 329; see also Zinn 1996: 313f.

was pegged against it (see Swank 1998), the meritocracy's perspectives shaped political behaviour.

At least in Germany, austere macro-economic policies and micro-economic policies of deregulation (at least on a rhetorical level) reached the pinnacle of their dominance only after 'globalism' entered the stage of political and academic debate in the early 1990s. At a time when the prospects of supply side economics –being primarily based on the alleged need for functional redistribution in favour of capital in order to stimulate capital formation, growth and, hence, employment– seemed gloomy as the self-imposed policy target of sustained growth became evidently a chimera, its twin –locational or competitiveness policy (*Standortpolitik*) in the age of globalisation– took over and inflicted not only a policy of profitability-restoration (in order to gain or maintain competitiveness) but also a policy of income inequality as a reaction to global labour markets and a shift in the proportions of the factors of production in a global world. Where there are still 'traditional opponents' to supply side policies –particularly trade unionists and social democratic politicians–, the pressures of globalism (*Sachzwang Weltmarkt*) have silenced most of them: trade unionists are seeking orientation, social democratic parties are reorganising along the lines of 'New Labour' and 'Neue Mitte' which favours a 'pragmatic' –vulgo: an adaptive– approach (see Sassoon 1996).

I have used the term '*globalism*' instead of speaking of the '*process of globalisation*'. Although nobody is denying a growing regional integration of formerly national economies in terms of trade exchange and capital mobility, this does not necessarily translate into a complete impotence of national macro-economic stabilisation policies (see e.g. Epstein 1996; Boyer 1996; Wade 1996) nor an undisputed need for 'mercantilist' competitiveness policies in a 'win-lose-dichotomy' (see Krugman 1994; 1996; Group of Lisbon 1995) nor a personal income distribution left to unfettered labour markets (Gregg/Machin 1994) – *the characteristics of 'globalism'*.²⁸ Finally, globalisation is only partly the product of market forces and new technologies²⁹, but basically a political project of deregulating financial markets, lowering trade and capital barriers and the lack of re-regulation on a supra-national level (see Bienefeld 1996).

28. For a distinction between 'globalism' and 'globalisation' see Beck 1997.

29. Particularly new information- and communication technologies are supposed to have reduced transaction and information cost of trade and capital flows significantly.

To twist the ‘process of globalisation’ into ‘globalism’ certainly serves the purpose of preventing an active macro-economic policy from re-appearing on the political and academic agenda (although, as we will see later, such a policy may well be pursued ‘under-cover’) and to claim a neo-liberal policy stance (see Berthold/Fehn 1996, 607ff.).

We are now able to solve the second of the afore-mentioned conundrums: why are macro-economic policies to enhance employment more likely to be pursued in countries with deregulated labour markets such as the USA and Great Britain? Once the process of deregulation has been effective, unemployment is no longer needed to maintain pressure on institutions and regulations. On the contrary: unemployment may easily surpass its ‘optimum level’ –which is rather low under such circumstances– and the meritocracy is harmed (see fig. 1 and a shift from the ‘German model’ to the ‘Flexi model’). But, perhaps more important for a government seeking re-election, macro-economic policies increasing employment can be instrumentalised as a proof for the superiority of deregulation – particularly and only, if macro-economic policies are never explicitly conceded.³⁰

V. Political feasibility of full employment – some conclusions

Our analysis has established that the proponents of deregulation seem to be right for the wrong reasons: they are right in that deregulation seems to be the precondition for enhancing employment growth, but they are wrong in believing this to be the case because of the superior functioning of unregulated markets. Rather, deregulation paves the way for the political feasibility of using macro-policies under the conditions of a dominant supply side doctrine: it renders deregulation policies successful and prevents economic and social instability.

However, deregulation policy is no feasible option for an economy and society based on corporatist structures and consensual decision making – as the German one: a leftist government cannot pursue such a policy without be-

30. Minford/Riley (1994) are bold enough to concede the (mis-)use of macro-economic policies only to explain the restrictive ‘stop-phase’ in Britain’s ‘stop-and-go-cycle’ but forget to mention the expansionary effects in the ‘go-phase’; see also Matthews 1993; Crafts 1998: 35. Political parties having borrowed authority from *Zeitgeist*-currents on economic policy in the first place, must guarantee the ‘efficacy’ of such a policy by any means (see Swank 1998).

traying its own median voter as being ideologically opposed to deregulation.³¹ And a rightist government will find it difficult to push deregulation forward as it harms the process of income generation in general, and business interests in particular. Yet, institutional stability is not guaranteed eternally: if either trade unions are strong enough to resist labour market pressures (in terms of keeping an existing wage structure intact) or if the pressure of the marginal firm on employers' associations becomes strong enough to shift their policy target or if globalisation changes corporate governance from stake holding to share holding (see Goodhart 1994: 59ff. and Streeck 1997: 253ff.), deregulation may be turned from rhetorical into practical policy (as in the UK and Sweden).

But there are also other options:

- *Reality bites back*: monetarist austerity policy is claimed to be necessary for sustained growth and employment enhancement. But if the promised results do not materialise –as was the case in Germany for most of the 1980s (before the unexpected and 'Keynesian style' unification boom)– dissatisfaction grows despite a multitude of excuses (external factors, 'reform blockade' of the oppositional Lower House of Parliament (Bundesrat), trade union resistance to deregulation and wage moderation, etc.) and the possibility of creating a 'political business cycle' prior to elections. There is a growing mass of academic and popular literature which expresses this dissatisfaction and which may, eventually, turn the tide.
- *Marketing political alternatives*: the turn of the tide can be supported and intensified by a coherent, alternative macro-economic strategy which takes the altered economic environment (i.e. the process of globalisation and immense public deficits) seriously and, hence, avoids a 'back-to-the-seventies' approach. Such a strategy, which will be the foundation of 'political marketing', is yet far from being close at hand (see Heise/Kromphardt/Priewe 1998).
- *Organising the unemployed*: the willingness to adopt active employment and labour market policies crucially depends on the degree to which society will tolerate unemployment. Organising the unemployed in order to socially and economically destabilise the economic system will increase the

31. The new Schröder-government in Germany tries exactly to do this after the resignation of Finance minister Oskar Lafontaine. Prospects look moderately certain that they will fail.

pressure on a ruling government to increase employment because the meritocracy fears a fall in income generation (which can be depicted by a shift in the optimum level of unemployment in fig. 1) and the political party in office fears a drain on its electorate. However, this approach to political mobilisation is not without imponderabilities: due to the 'information problem' of the electorate, the excluded unemployed are prone to fall for extremist parties (examples can particularly be found in eastern Germany as the last elections in the east German state of Saxony-Anhalt) – particularly, if neo-liberal economic policy measures of deregulation, welfare trimming and fiscal consolidation are exactly the economic approach of the extreme right (see Schui et al. 1997). A process which once started as a check to the power of the meritocracy may eventually turn into something uncontrollable (when extremist parties become socially recognised and a 'bandwagon effect' sets in).

In tackling unemployment, not only are new means and institutional settings of macro-economic stabilisation policy needed (see Sawyer 1994), but also a political environment which puts less stress on individualistic solutions and achievements from a meritocratic point of view. Hopes had been casted on the newly elected social democratic governments throughout Europe – evidence, so far, casts some doubts upon it.

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