The Political Economy of Meritocracy

A post-Kaleckian, post-Olsonian approach to unemployment and income inequality in modern varieties of capitalism

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Abstract

The ‘big trade–off’, described by Arthur Okun some thirty years ago, is back again. Equality or efficiency, or to put it differently again: modern highly developed economies and societies have to choose between the Scylla of income inequality or the Charybdis of unemployment. Furthermore, it looks like the continental European economies – foremost Germany and France – sided with more egalitarian ends accepting higher unemployment whilst the liberal economies such as the United States and the United Kingdom choose higher inequality for lower unemployment. In this paper it is argued, that the trade-off is not a supply-side necessity to maintain work effort in a situation of incomplete contracts, but is a politico-economic issue of particular interest groups to seek rents. However, unlike in Mancur Olson’s seminal approach, it is not the trade unions which are forming distributional coalitions on the labour market but rather the meritocracy which is happy to use Keynesian-type demand management in order to advance their material interests by pursuing a ‘Meritocratically Optimal Rate of Unemployment’ (MORU).

JEL codes: E 12, E 24, E 25, P 16, P 51

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1. By way of introduction: The age of inequality*

The so called Kuznets curve links economic development to income inequality and shows a curvilinear shape. Here, in the process of economic development, income inequality rises, but when reaching the highest stages of economic development, inequality begins to decline again.[1] But since data on income distribution at individual and household levels is becoming available and made internationally comparable[2] - particularly since growing income inequality in the United States, the United Kingdom and most other OECD-countries seems to be an established trend over the past two decades - the Kuznets curve has come under much criticism.

More importantly, the quest for equality – as a means to bolster against poverty and as the expression of social justice – has been strongly attacked as 'egalitarianism' that destroys market incentives[3] and as being incompatible with full employment in the age of the service economy. Actually, the problem has been already addressed as early as the 1970ies by Arthur M. Okun[4] under historical circumstances completely different from today's: US income dispersion was decreasing then, while unemployment was higher than in most European countries. Furthermore, the world was divided into two different, hostile ideological camps: capitalism and communism. At least from an ideological point of view in the battle of systems during the 'cold war', the alleged higher efficiency of the capitalist market economy was not to be paid for by lower equality as this would leave the question of superiority open to different preferences. Only if capitalism could combine a sufficiently high degree of equality (social justice) with superior economic efficiency (in terms of growth and employment), its superiority over communism with its notorious failure in (intensive) growth would be proven. And the economies of the European countries – being extremely close to the ideological divide - seemed to be able to fulfil these promises during the 1960ies and 1970ies particularly well.

Only after the downfall of the Berlin wall in 1989 and the end of the systems confrontation, the need to combine equality and efficiency has finally disappeared. Interestingly, the renewed (alleged) trade-off between equality and efficiency (in terms of providing high levels of employment) unites the liberal-conservative political and academic camp with most parts of the progressive, social democratic political and academic camp. However, whilst the former welcomes the implicit demand for higher

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[1] For the original paper see Kuznets (1955).

[2] Here, the OECD and the Luxembourg Income Study-project must be mentioned.

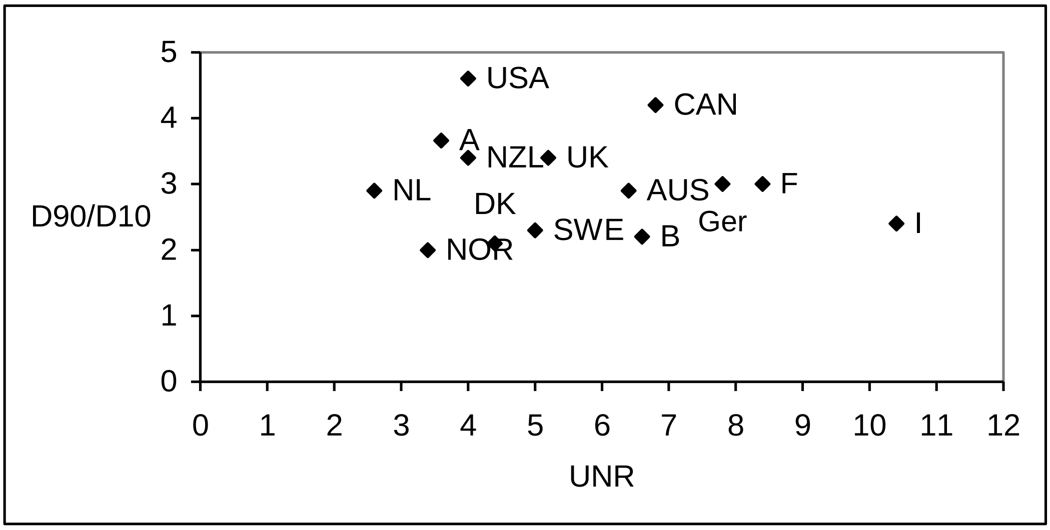
[3] This incentive problem has been put like this: ‚The poor reduce their labour supply because they earn too much and the rich withdraw their labour supply because they earn too little'. John Kenneth Galbraith's reaction was said to be: 'Who believes this, will believe anything'.

[4] See Okun (1970), Okun (1975)

inequality[5], the latter somewhat hastily demands for a (albeit hard) choice.[6] It is in this sense, that we can speak of the age of inequality: an undisputable trend with undisputable negative consequences (the correlation between raising inequality and growing poverty). It is an ideological issue ('social justice') that centres prominently in political discussions and electoral campaigns, and an academic discourse that completely focuses on the microeconomic logic of market incentives. Very few dissenting economists have tried to keep a macroeconomic eye on the issue[7] and – to my knowledge – there has not yet been a consistent political economy approach focusing on the obvious material interests involved.

A first glance at the data[8] casts some doubts about the 'big trade-off'. As fig. 1 shows, there is certainly no detectable correlation between the absolute level of income dispersion and unemployment in (selected) OECD countries. However, as both variables at a certain point in time are dependent on too many other determinants, one would not expect too much of a correlation here. Yet, if the 'trade-off argument' holds, a strong correlation between the change in unemployment since the end of the 'golden age' of industrialisation in the 1970ies and the change in income dispersion must be established. A change in income dispersion must be established because a relative cheapening of low skilled labourers will increase their employment probability and therefore reduce unemployment (which is heavily concentrated among the low-skilled) or, at least, helps reducing the increase of unemployment in the age of the service economy.

Figure 1: Unemployment and Income dispersion at the End of the 1990ies in selected OECD countries



Note: Income dispersion: ratio between the 9th and the 1st income decile, gross earnings; 'end of' refers to comparable years (positions) in the business cycle at the end of the 1990ies; OLS regression: $R^2 = 0.018$; not significant
Source: OECD-Labour Force Survey Data and OECD Employment Outlook 1996

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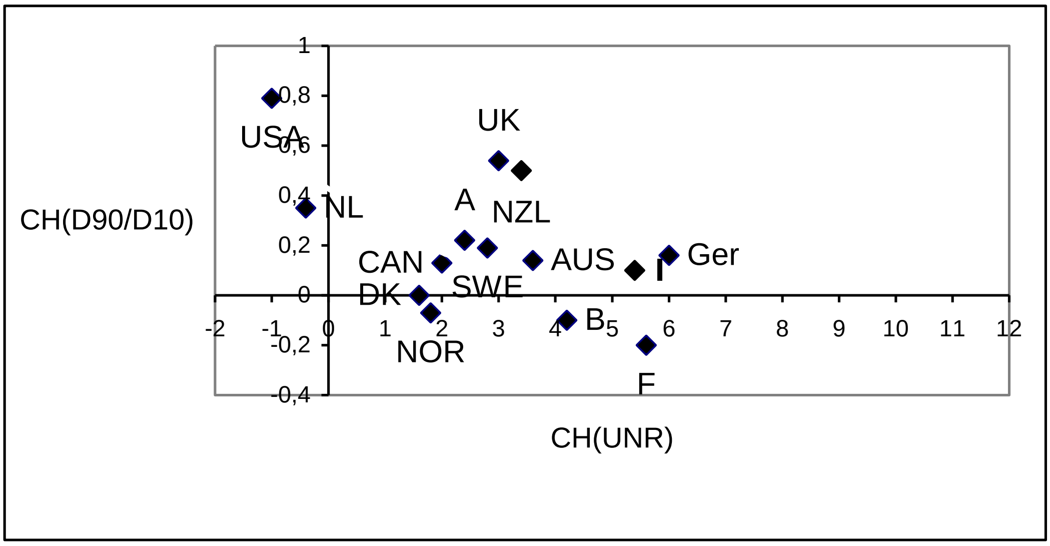
[5] See e.g. Machan (2002), Davis/Meyer (2000), Henry (1995), Kekes (2003), Methfessel/Winterberg (1998), Hank (2000), Giersch/Paqué/Schmieding (1992), Paqué (1995) and, most notoriously, Gilder (1982).
[6] See e.g. Iversen (1999), Scharpf (2001), Schettkat/Appelbaum (1996).
[7] Most prominently Galbraith (1998) and Harrison/Bluestone (1990).
[8] More about the origin, limitations and selection of data and a regression table presentation in part 5 below.

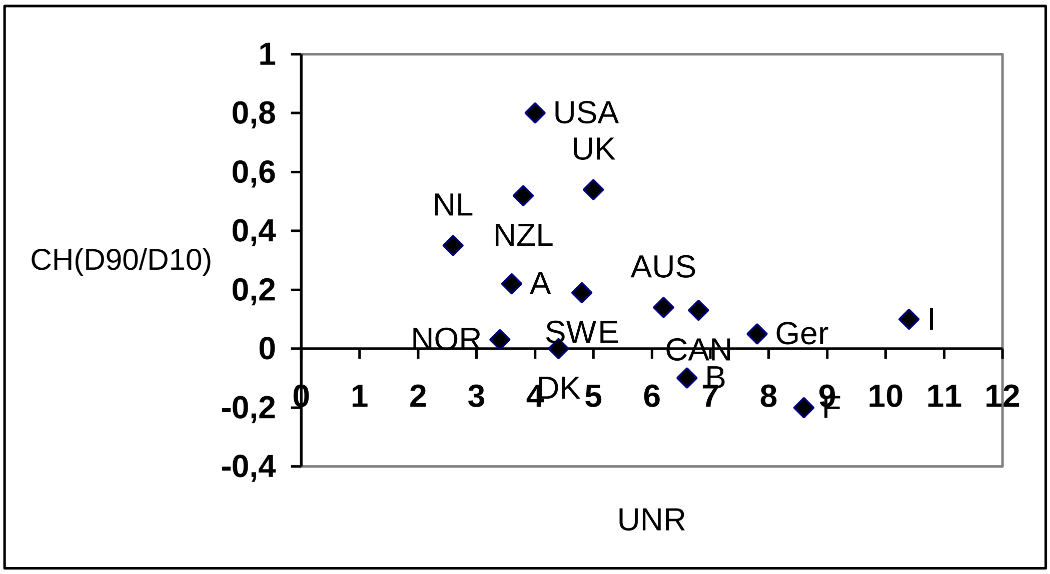
Truly, fig.2 depicts such a correlation, which is significant but not very strong. However, the correlation does not say anything about the direction of causation: does causation run from income dispersion to (un)employment or from unemployment to dispersion? If the 'trade-off argument' was true, one would also expect, and even more so than in the former case, a strong correlation between the change in income dispersion and the level of unemployment at the end of the business cycle at the end of the 1990ies: if marked earnings flexibility prevents unemployment from accruing in the first place, the change in unemployment must not necessarily be great, but unemployment in absolute terms ought to be low. However, fig. 3 reveals merely a correlation too weak and insignificant to justify this claim!

Figure 2: Change in Unemployment (mid 70ies – end 90ies) and Change in Income dispersion (end 70ies – end 90ies) in selected OECD countries



Notes: Change: absolute change in D90/D10-ratio and unemployment rates; OLS regression: $R^2 = 0.329$; significant at 5%
Source: See fig.1

Figure 3: Unemployment at the End of 1990ies and Change in Income dispersion (end 70ies – end 90ies) in selected countries



Notes: see fig. 1 and fig. 2; OLS regression: R^2 = 0.220; significant at 10%
Source: see fig. 1

This is where this paper comes in: I will try to tell a different story about the evolution of unemployment and income inequality over the past two decades, which will take a political economy approach, i.e. which will centre around the different distributional interests among societal groups in different capitalist economic settings. In part 2, I will extend Mancur Olson's seminal approach to the political economy of economic development by focusing on the labour market and by giving it a Keynesian twist. In part 3, I will recur to Michal Kalecki's famous proposition that unemployment can be used as a strong mechanism to shift power relations in the distributional conflict of capitalism, yet I will transform it into a determinant of personal rather than functional income distribution. In part 4, I will then join the different strings together and derive an unemployment situation which may be called optimal as it best serves the interests of those capitalising most from pure market outcome – the meritocrats. Furthermore, it will become apparent that such a 'Meritocratically Optimal Rate of Unemployment' (MORU) may be very divers over the range of varieties of capitalistic models. In part 5, the predictions of the MORU theory will be empirically tested. As we are dealing with vested interests often transmitted into political action through ideological infiltration, the carrier of the message himself is sometimes accused of an ideological bias[9] – that is, why any empirical test of political economy issues is so important.

2. Mancur Olson, distributional coalitions and its Keynesian twist

If the connection between income inequality and unemployment is so weak and uncertain, why should we not just leave it there? This would be unsatisfactory for two reasons: Firstly, we have only tested a linear causation – but why should the relation between the distributional struggle and labour market performance not be of any different kind? The ongoing research about different varieties of capitalism[10] has established the

[9] Obviously, 'ideology' as an object of scientific investigation is here confused with 'ideology' as a subject guiding (un)scientific investigation.
[10] See e.g. Esping-Andersen (1990), Hall/Soskice (2001), Amable (2003),

fact that different institutional settings may have a marked effect on economic performance, which alters simple linear reasoning remarkably.[11] Secondly, if we would not pursue any type of political economy research into the – at a first glance rather weak – relation between unemployment and income inequality, we might never be able to provide the 'missing link' in Keynesian economics: "Keynesian economists had failed to develop a general explanation of governments' unwillingness to supply the aggregate demand policies required to achieve full employment", as John and Wendy Cornwall (2005: 6) claim.

Mancur Olson provides the starting point as he has established one of the most powerful political economy approaches in his 'Rise and Decline of Nations'[12] that directly links income inequality and unemployment. He claims that societies produce ever more interest groups that seek to advance their particular well-being at the expense of the well-being of the society as a whole. Such interest groups are only able to pursue this kind of 'rent-seeking' behaviour – which comes as a public good to all individuals which comprise that group – if the groups are small and homogenous enough to overcome the 'cooperation trap'.[13] Although such interest groups may evolve in every market[14], unemployment is best explained according to Olson if the interest groups on both sides of the labour market are taken into focus. These are trade unions and employer's organisations. For two reasons, in a variety of microeconomic approaches (insider-outsider theories, NAIRU theories, efficiency bargain and right-to-manage models) the supply side has been set at centre stage of the investigations: Firstly, unemployment is usually associated with the notion of 'too high wages' which can better be explained if labour supply (by forming unions) is able to collude an effective distributive coalition.[15] Secondly, once we assume commodity markets as competitive, there would always be pressure to raise real wages by reducing prices – which ought to happen if Walras' Law of markets applies. Therefore, if unemployment becomes a long-term problem of advanced economies, according to Olson, it must stem from the willingness and ability of trade unions to effectively seek rent for their members – which are mostly low skilled, blue collar workers in manufacturing industries. Hence, the variance in national labour market performances obviously depends on the incubation process of interest groups in general and trade unions in particular and the time stretch without significant institutional, legal or other alterations in a particular society[16]. The longer this time stretch, the more distributional coalitions, the lower growth and higher unemployment will be. Olson's approach can therefore be described as a theory of 'societal sclerosis'.

Olson's central idea that the pursuit of vested distributional interests may impinge on the general welfare of society, is a challenging one. However his focus on the supply side of the labour market is too narrow. On the one hand, he underestimates what has been

[11] Probably best known is the so called 'hump-shaped' relation between the degree of centralisation of collective bargaining and labour market performance; see Calmfors/Drifill (1988).
[12] Olson (1982)
[13] This has been established and elaborated in his famous ‚Logic of Collective Action'; see Olson (1965).
[14] "Such action occurs through professional associations, labour unions, farm organizations, trade associations, and oligopolistic collusions of firms in concentrated industries" (Olson 1996: 74).
[15] For complementarities of modern (static) microeconomic labour market approaches and Olson's (evolutionary) political economy approach see e.g. Belke (1997).
[16] Olson (1996: 76) mentions 'revolutionary upheavals', 'totalitarian repression' or 'foreign occupations', but drastic institutional change (as, for instance, under the Thatcher era) may also be counted.

called ‘the radius of trust’ in the literature on social capital, i.e. the possibility and willingness of groups (trade unions in this case) to internalise the external effects of their actions in order to reduce the negative repercussions of rent-seeking behaviour.[17] Secondly, the empirical evidence – as seen above – is not very strong. Thirdly, the reasoning rests entirely on the microeconomics of general equilibrium theory. But if we bring Keynesian macroeconomics in, unemployment may no longer (at its core) be the result of misguided wage policy but of macroeconomic policy failures. Furthermore, here, income inequality (in an equilibrium position) would be no longer be technically determined by the marginal productivity of different jobs requiring different skills but it would depend on what society rates as ‘fair’ and ‘tolerable’. This is something James K. Galbraith (1997; 1998) calls ‘job or wage structure’.[18] Here, of course, unemployment can be used in order to change established views about ‘fair’ and ‘tolerable’ levels of income dispersion, if Keynesian-type macroeconomic policy potentials are not sufficiently used to cure unemployment when it occurs or, even worse, are redirected to create or maintain unemployment. Now, in this post-Olsonian perspective, it would be the demand-side of the labour market, i.e. employers and their organisations, that pursues its vested distributional interests by wasting capacities and reducing general welfare for the society as a whole.

3. Michal Kalecki, Unemployment and Income Distribution, or: the Meritocratically Optimal Rate of Unemployment (MORU)

As John and Wendy Cornwall (2005) claim, most Keynesians[19] failed in posing the question of political limits[20] to the practice of Keynesian-type interventionist employment policies. Yet, this may be at least partly due to the fact, that Keynes himself was not very thoughtful (if not downright naïve) about the possible impact of vested interests on economic policy. Joan Robinson (1976) noted:

> “Keynes liked to believe in the power of ideas to influence the course of history. He sometimes maintained that when the principles of employment policy were understood, economic affairs would be conducted rationally, and he even went so far as to predict a happy future in which our grandchildren could devote themselves entirely to the arts and graces of life.”

And she also singled out whom she believed to be closer to the real world:

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[17] Which lies behind the hump-shaped correlation mentioned above. Of course, Olson mentions ‘encompassing organisations’, which seem to fit the requirements of a wide radius of trust. However, Olson firmly believes that these encompassing organisations are unstable and necessarily dissolves eventually.

[18] „It is a historically, socially, and politically specific set of values and pay relationships in the economy, within and between firms, within and across industries” (Galbraith 1997: 15); see also Galbraith (1998:50ff.).

[19] Particularly Philip Arestis and Malcolm Sawyer (1998) must be explicitly excluded from this charge.

[20] In a mini-symposium on ‘Is Keynesian demand management policy still viable?’ published in Vol. 17 (1994-95) of the Journal of Post Keynesian Economics, not even one of the papers even mentions political limits. There may also be economic limitations due to the lack of cooperation of different policy actors; see Heise (2001), Heise (2005a).

> "Kalecki's vision of the future was more realistic. In a remarkable article published in 1943 on the 'Political Aspects of Full Employment' he foresaw that when governments understood how to control the commercial trade cycle we should find ourselves in a political trade cycle."

Actually, Michal Kalecki (1943/1990) had not – as is often claimed – described a 'political business cycle'[21] but pointed out that 'the industrial leaders' may not be interested in full employment altogether. As he was not engaged in the investigation of the connections between the economy, economic policy and the political and electoral system, there is no hint to a political business cycle theory[22] but rather to a 'political equilibrium theory of unemployment' and an indication of how this will be achieved. This is through mystifying an active (i.e. deficit-financed) budgetary policy as 'unsound' and 'perilous' (see Kalecki 1943/1990: 350). A situation of lasting full employment would be, from the perspective of the 'captains of industry'[23], unwarranted on three accounts: 1) in general, they do not want the government to interfere with market processes; 2) they do not want the government to spend money in areas – such as public investment – where there is a potential competition with or crowding out of private investment; 3) they feel that lasting full employment changes the power relations towards the working classes and takes away an effective disciplinary device. These rather cloudy expositions have been re-framed in modern, orthodox labour market theory: in efficiency wage theories, unemployment guarantees to maintain productivity growth. In NAIRU theories, unemployment is needed to prevent the acceleration of inflation. Finally in heterodox, Kaleckian macroeconomics, full employment destroys the social structure of accumulation by squeezing profits[24]. In equilibrium, in order to appropriate profits, capitalists need unemployment or workers will be able to claim any surplus for themselves (in any combination of goods and leisure).[25]

Without engaging in fundamental discussions about functional income distribution, this Kaleckian version of a political economy of unemployment cannot easily be made compatible with two decades of post-war economic history. The co-existence of full employment and a positive profit share in most OECD countries in the 1950ies and 1960ies would either require the assumption of a disequilibrium situation for the entire period or some degree of monopolistic competition in almost very commodity market. Or, as in Post Keynesian macroeconomics, functional income distribution (and the existence of profits) does not depend on unemployment but rather on a positive rate of

[21] Politico-economic models and cycles have been introduced in the literature by William Nordhaus (1975) and R. Boddy and J. Crotty (1974) who recur to Michal Kalecki's work.

[22] Although he claims to have presented 'a regime of the political business cycle'; see Kalecki (1943/1990: 355). However, he uses the term 'political business cycle' in a completely different way than it has become customary since Nordhaus; see e.g. Henley (1988).

[23] Kalecki uses different descriptions for those, who pursue their special interests through lasting unemployment: 'captains of industry', 'industrial leaders', 'bosses', 'business leaders', 'businessmen', 'big business'. This leaves us without a clear idea of whom he really envisages: capitalists as the class of capital owners and representatives of profit-earners in functional income distribution or executive and high-ranked white collar employees (and also profit-earners) as representatives of the higher income percentiles in personal income distribution. From the context and later work, one can infer that Kalecki is referring to capital owner and, therefore, functional income distribution.

[24] See e.g. Kotz/Donough/Reich 1994; Marglin/Schor 1990; Bowles/Edwards/Roosevelt 2005.

[25] Henley (1988: 439) points to the parallels to Marx's 'reserve army'. See also Alexander (1948) and Feiwel (1974).

interest (which closes the only degree of freedom of the distributional system; see e.g. Sraffa 1960) which is determined by liquidity preference considerations (see e.g. Riese 1981). However, these qualifications do not necessarily eradicate the Kaleckian idea altogether, but might shift the focus of intention from functional to personal income distribution and from class conflict to meritocratic deliberations. As the expression 'meritocracy' is far from being clearly defined, let us refer to the *Fontana Dictionary of Modern Thought (1977: 384)*:

> "A word coined by Michael Young (The Rise of Meritocracy, 1958) for government by those regarded as possessing merit; merit is equated with intelligence-plus-effort,… Egalitarians often apply the word to any elitist system of education and government,…"

And according to Benabou (2000: 321), there is "no single, value-free definition of meritocracy, but only preference orderings about equality of opportunities and equality of outcomes". Meritocracy, therefore, must be placed between the one extreme of aristocracy, where opportunities and outcomes are structured only by decent, and the other extreme of egalitarianism, where opportunities and outcomes are entirely equally distributed among the members of a society. Obviously, modern societies have abandoned aristocratic structures and float somewhere between meritocracy and egalitarianism. Despite the degree varying considerably through redistributive welfare arrangements and institutions directly impinging on market outcomes, in every highly developed country some measure of egalitarian redistribution of opportunities and outcomes are employed.[26] The concept of meritocratic deliberations used for our purpose, therefore puts the quest for income inequality at centre stage: *in line with economic merits – defined by 'pure' market outcomes accepting an initial endowment of real, financial and human capital – any increase in net income dispersion is welcomed as improving economic efficiency.* Obviously, someone who is better endowed with real, financial or human capital would profit materially from any meritocratic policy shift – yet, I do not purport that the better-offs – or as I will call them in line with the above given description: the elite[27] – necessarily pursue meritocratic aims, as I am not claiming that the non-elite necessarily favours egalitarian ends. This may, for instance, vary considerably with the individual preference structure (materialistic, post-materialistic) or individual perception of income mobility. However, elite studies reveal a strong meritocratic orientation of the elite which has become more pronounced over the past two decades.[28]

To summarise, the above outlined post-Kaleckian version of the political economy of unemployment does not focus on the class struggle over functional income shares but puts forward the idea that unemployment may be (mis-)used by the elite in order to

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[26] Although welfare arrangements have not historically been invented for egalitarian purposes, they do have this effect; see Baldwin (1990) and Esping-Andersen (1994: 717).

[27] ‚Elite' is another ill-defined notion. Primarily, it is used for those groups of individuals that are able to take or influence collective rather than merely individual decisions: political, economic, organisational or media elites for instance. I presuppose that there is a strong correlation between being materially better-off and being part of the elite – and that is why I use 'elite', 'better-offs' and 'meritocrats' interchangeably.

[28] This is definitely true for the media, economic and liberal-conservative political elites in Germany but also the social-democratic political elite has become markedly more meritocratic over the past two decades. Therefore, it is basically the trade union elite that still takes a non-meritocratic, egalitarian perspective; see e.g. Bürklin (1997).

champion meritocratic ideas of personal income distribution. For reasons having been advanced by Lester Thurow (1971) and which we will discuss below, the elite may not want to end re-distribution and a compression of the income (and particularly the wage) structure entirely, but seek an 'optimal degree of income inequality'. Or to put it differently: the elite is tempted to address a policy pursuing a 'Meritocratically Optimal Rate of Unemployment', abbreviated as MORU.

4. MORU in the varieties of capitalism

Many studies have shown that unemployment is a strong and significant factor in determining income inequality in general and wage dispersion in particular measured by a gini-coefficient or by the ratio of highest to lowest income decile (P90/P10).[29] Easy to understand, nominal wage increases in relation to labour productivity growth and (expected) inflation – i.e. the 'distributional margin' – will come under pressure if wages are to play any role in signalling relative scarcity. This is one of the best established empirical relations in economics that lies behind the (original) 'Phillips curve'. Here, on the one hand it will, at least temporarily (as long as disequilibrium lasts), shift functional income distribution in favour of capital owners – who may be supposed to belong to the higher income deciles. On the other hand, unemployment always has a strong bias towards the less skilled – i.e. the wages of the less skilled, which can be supposed to belong to the lower income deciles, come under the most pressure. Adding both trends up, high income earners relative to low income earners will profit from unemployment – which simply means that wage dispersion and overall income inequality will rise with growing unemployment. However, the 'inequality elasticity' of unemployment depends on several factors: the overall strength of the social partners at the negotiating table (in terms of union density and coverage rate; see Volscho [2004]) and particularly, the collective bargaining system, the state's involvement in collective bargaining and also labour market and welfare state regulations (EU Commission 2004: 109ff.). There is a clear and very strong relation between the degree of corporatism[30] of a collective bargaining system, the strictness of labour market regulations and the generosity of the welfare state and a

[29] See e.g. Förster (2000) or Volscho (2004) for a comprehensive overview. Jäntti/Jenkins (2001) take a more sceptical view – yet they do not deny the relationship but point to a more complex interaction between unemployment, inflation and inequality. Below, I will discuss in more detail which income variable to be taken in order to capture the inequality visions of the meritocracy. Suffice to say here, that wage dispersion will serve as proxy as wage income is still by far the most important source of income for the vast majority of the people and the link between wage income and unemployment (both being determined on the labour market) is the closest. Furthermore, it has been shown that recent trend in income inequality largely stem from the underlying trends in wage dispersion; see Förster (2000: 8).

[30] By corporatism, I not only mean the *de jure* centralisation of the wage bargaining system (i.e. at company or regional or nation-wide level) but also its *de facto* cooperation between regional and sectoral levels, union density and coverage rates and state involvement. Germany, for example, is often taken at face value – i.e. wage bargaining struck at regional-sectoral levels -, yet the high efforts of cooperation of the trade unions under the roof of the Deutscher Gewerkschaftsbund is not praised accordingly. Moreover France, for instance, shows low union density and *de jure* decentralised wage bargaining, but a very high coverage rate, a decent degree of cooperation of unions and a high state involvement in labour market regulations which would not be correctly mirrored if France would be rated at low corporatism level.

solidaristic wage policy stance in terms of the compression of the qualificational wage structure.[31]

The different characteristics will be clustered to form two 'models': a 'corporatist' and a 'liberal model' (see tab. 1). Since Esping-Andersen's (1990) famous distinction between different 'worlds of welfare capitalism', many attempts have been made to group different countries.[32] While Amable (2003) proposes as much as five different ideal types of capitalism (market-based , social democratic, Asian, continental European and South European models), Michel Albert (1991) differentiates between an Anglo-Saxon and a Rhenish model of capitalism and Hall/Soskice (2001) identifies the liberal market economies (LME) and the coordinated market economies (CME). Without spending too much time on comparing the different categorisations, I will – for the sake of simplicity and measurability and sufficient for my limited scope – side with Albert and Hall/Soskice in broadly distinguishing, at this point, a 'corporatist bargaining model' which is very much in line with Albert's 'Rhenish capitalism' and Hall/Soskice's CME and a 'liberal bargaining model' in line with Albert's 'Anglo-Saxon Model' and Hall/Soskice's LME.

Table 1: Varieties of bargaining models

	Corporatist model	**Liberal model**
Collective bargaining system - union density - coverage rate - degree of centralisation - degree of cooperation - state involvement	- High density or high coverage - High degree of centralisation or high degree of cooperation or high state involvement	- Low density or low coverage rate - Low degree of centralisation and low degree of cooperation or state involvement
Labour market regulations	Strict labour market regulations (employment protection, minimum wages, etc.)	Few labour market regulation
Welfare system	High level of social protection (Bismarckian welfare system or generous Beveridge welfare system)	Low level of social protection (means tested Beveridge welfare system)

As tab. 2 clearly shows, the selected OECD countries fit the characteristics of the two distinct collective bargaining models extremely well – if at all, France's very low union

[31] See e.g. Barth/Zweimüller (1995), Zweimüller/Barth (1994), Moene/Wallerstein (1996) and, particularily OECD (1997) where the combinations here termed 'corporatism' are tested. There are but two exceptions from this very close link: Austria and the Netherlands which both manage to provide a rather wide qualificational wage dispersion under a very centralised wage bargaining system – both countries will get a special status in this study.

[32] Gelissen (2002) provides an overview. The different specifications obviously depend on the indicators or dimension (i.e. welfare systems, labour market systems, collective bargaining systems, industrial relations systems, etc.) by which they are clustered.

density rate and decentralisation at the prevailing company level and Australia's stunningly high coverage rate stand out as not quite fitting. Yet, in the case of France, the degree of cooperation and state involvement as well as labour market regulations and welfare state characteristics prove the point that France definitely rather sides with the corporatist than with the liberal model, while in the case of Australia, precisely these characteristics point out that it must be grouped within the liberal bargaining model.

In the upper-right quadrant of fig. 4, the above described positive relation between unemployment and income inequality has been depicted and two different income-dispersion curves (IP) marking the institutional differences as exposed above as 'corporatist' and 'liberal' collective bargaining systems. Only for the sake of simplicity, a linear relationship has been assumed: A rise in unemployment by a certain measure will, therefore, cause higher income inequality in the liberal bargaining model (steeper ID curve) than in the corporatist model because the former's institutions are ill-prepared to safeguard the lower income deciles against their weakened market position or, to put it the other way around, achieve better market results for the higher income deciles.

Table 2: Mapping of characteristics of the different models

	Union Density	**Coverage Rate**	**Bargaining level**	**Degree of cooperation[a]**	**State involvement[b]**	**Labour market regulation[c]**	**Welfare system[d]**
Corporatist Model							
A	30	**92**	Industry	**High**	Low	**High**	**High**
B	69	**96**	**National**	**High**	**High**	**High**	**High**
DK	**88**	69	**national/ industry**	**High**	High	Medium	**High**
F	***9***	**95**	*Company*	**High**	**High***	**High**	**High**
Ger	30	**79**	Industry	**High**	Low	**High**	**High**
I	35	**82,5**	Industry	**High**	**High**	**High**	Medium
NL	27	**82**	Industry	**High**	Low	**High**	Medium
N	54,3	**82,5**	Industry	**High**	**High**	**High**	**High**
SWE	**79**	**92**	Industry	**High**	Low	**High**	**High**
Liberal Model							
AUS	24,5	***82,5***	*industry*	**Low**	*High*	**Low**	**Low**
CAN	28,1	**32,0**	**Company**	**Low**	**Low**	**Low**	**Low**
NZL	22,7	**27,5**	**Company**	**Low**	**Low**	**Low**	**Low**
UK	29	**39**	**Company**	**Low**	**Low**	**Low**	Medium
USA	12,8	**14,0**	**Company**	**Low**	**Low**	**Low**	**Low**

Notes: **bold** = fitting characteristic of respective model; *italic* = unfitting characteristic of respective model; [a] = OECD coordination and centralisation score < 2 means 'low', > 2 means 'high' level of cooperation; [b] = governmental involvement index according to Golden/Lange/Wallerstein < 8 means 'low', > 8 means 'high' governmental involvement in collective bargaining; [c] = OECD employment protection index score < 1,5 means

'low', >1,5 but below 2,0 means 'medium', > 2,0 means 'high' labour market regulation; [d] = social expenditure as percentage of GDP < 20% means 'low'; > 20% but < 25% means 'medium' and > 25% means 'high' level of social protection; * = although France is ranked as 'low' according to the Golden/Lange/Wallerstein index, this has convincingly been disputed by others: Ruysseveldt/Visser (1996); Lehmbruch (1984)
Source: EU Commission (2004: 79); Amable (2003); OECD-Social Expenditure Database (SOCX), 1980-2001; Wallerstein/Golden (2000); OECD Employment Outlook 1994; OECD Employment Outlook 1997; OECD Employment Outlook 1999; Golden/Lange/Wallerstein (2002)

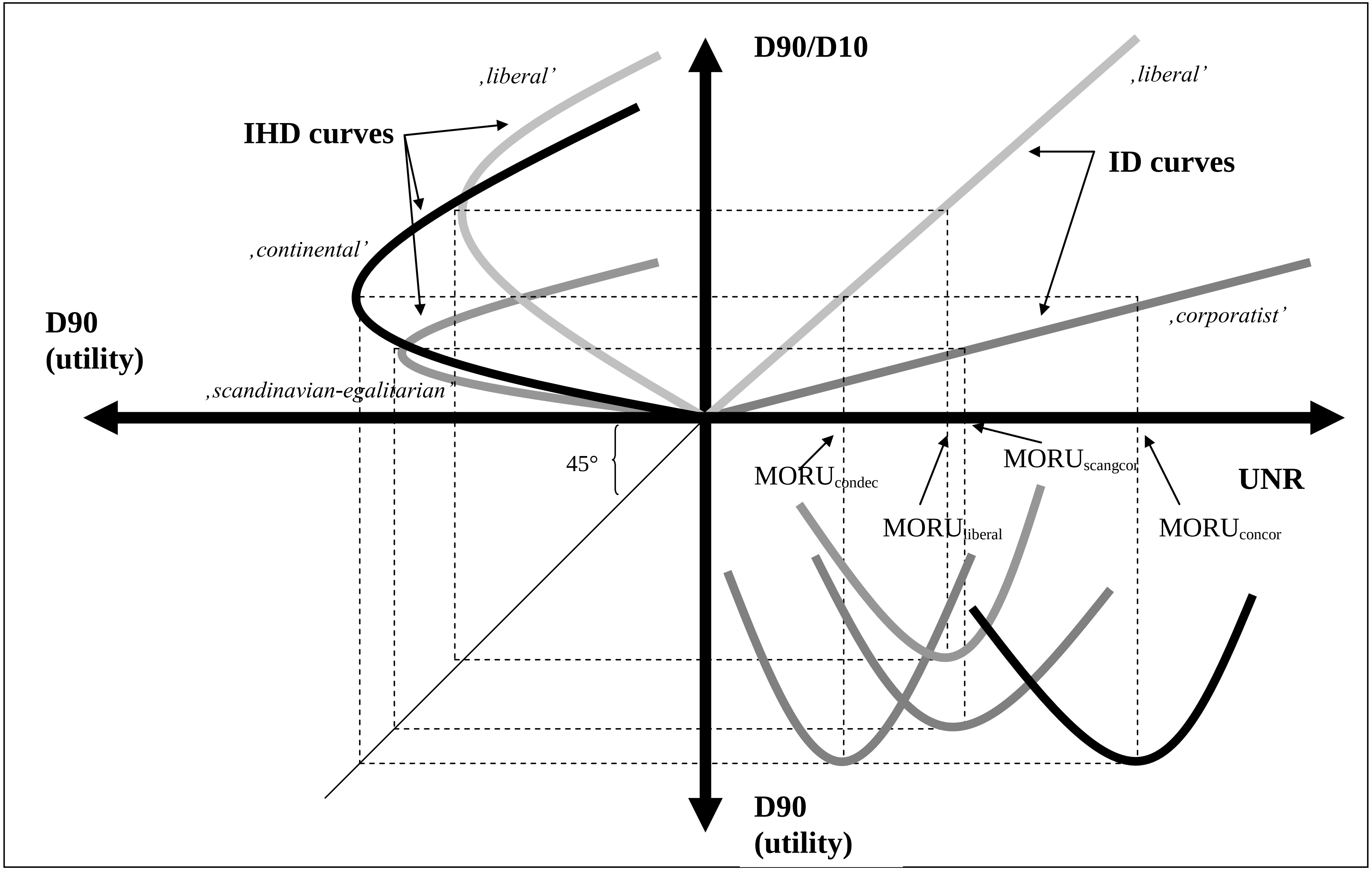

Figure 4: MORU in different institutional and cultural settings

In the upper left quadrant of fig. 4, a link between the level of income inequality and the interests of the meritocracy is established. For reasons exposed above, the highest income decile[33] is here taken as proxi for those comprising the elite which I have chosen to call 'meritocracy' – and the utility derived from their (absolute as well as relative[34]) income measures the interests of the meritocracy, and there are several reasons why the utility (and even underlying income) may eventually reach a maximum with growing income inequality, i.e. with growing relative income: a) increasing inequality is accompanied by growing political instability which may harm economic growth and (gross) income generation in general, but may also impinge on crime prevention and property protection cost in particular and may, thus, be detrimental to the (net) income of the meritocracy (see e.g. Persson/Tabellini 1991 and Thurow 1971); b) increasing income inequality, simply by reducing the overall marginal propensity to consume, may reduce aggregate demand expectations and, therefore, reduce private investment outlays and, subsequently, private consumption spending (see e.g. Heise 1999)[35]; c) research into social capital has established a clear (negative) link between income inequality and social capital in a society and also created a clear (positive) link between the stock of social capital and economic growth (see e.g. Halpern 2005) or d) it may, as Lester Thurow (1971: 327) puts it, depend on the "aesthetic taste for equality or inequality similar in nature to a taste for paintings". However, as can also be seen from fig.4, the 'optimal degree of inequality' (i.e. where the utility function of the meritocracy reaches its maximum) will vary according to the established cultural embedding of individual tastes and values. As is well known from several studies (see e.g. Alesina/Di Tella/MacCullock 2001; Delhey 1999), we may not only distinguish between the liberal and the corporatist economies, but distinguish also amongst the corporatist economies between Scandinavian-egalitarian and continental economies.[36]

IHD curves in fig. 4 portray this relationship: the more egalitarian values and attitudes a society professes, the higher will be the cost (in terms of growth detriment and crime prevention) of growing income inequality and, therefore, the lower the 'optimal degree of inequality'. Important to notice is that this inference has been made from the perspective of a meritocracy embedded in a specific cultural setting.[37] Finally, it is only a small step to explain the 'Meritocratically Optimal Rates of Unemployment' (MORU). If there is

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[33] It would be very reasonable to choose the highest income quartile (P75) as proxi for the meritocracy in order to wider the scope of investigation. However, if at all (see below) comparable data are only available for the lowest, the middle and the highest income deciles. Despite these qualifications, a very limited sketch of P75/P25-ratio is exposed in appendix 1 in order to show the robustness of the argument.

[34] „Individuals are not just interested in their own incomes. The incomes of other individuals may appear in their own utility functions" (Thurow 1971: 327).

[35] Das (1993) has established an impact of income inequality on (the business cycle patterns) of GDP-growth rates on the grounds of a standard neoclassical model.

[36] The main difference between the two value systems is the stronger belief in meritocratic attitudes and status ascription in the continental model; see Delhey (1999: 7).

[37] If the value side of different models is coupled with the labour market and collective bargaining side, the IHD curves not only become distinguishable in their degrees of compression but also in the maximum income positions being related to the productivity potential of different models. Many studies (see e.g. Soskice 1999) have revealed that more corporatist economies may hold a productivity advantage over more liberal economies, i.e. providing a 'bigger cake' to be distributed. However, this is a facet of institutional comparisons that is of no concern for the arguments produced here (but may, for instance, explain why German employers cannot bring themselves to abandon the (superior in terms of productivity performance) German model; see Thelen (2000).

anything like an optimal position in personal income distribution and unemployment is a strong explanatory variable in income inequality, there must certainly be a magnitude of unemployment which can be associated with the establishment and maintenance of those model-specific distributions. In the bottom right quadrant of fig. 4, such MORUs are determined: it is the highest, if a corporatist bargaining model is coupled with a continental value system showing an intermediary egalitarian stance ($MORU_{concor}$). The MORU is lowest, if a corporatist bargaining system that allows for high(er) wage dispersion meets a continental value system ($MORU_{condec}$).[38] And there are two intermediary MORUs if a liberal bargaining system is mixed with a liberal, non-egalitarian value system ($MORU_{liberal}$) or if a corporatist bargaining systems meets a Scandinavian-egalitarian value system ($MORU_{scancor}$).

Table 3: Varietes of MORUs

	Bargaining model	**Value system**	**Incentives**
High MORU			
$MORU_{concor}$	Corporatist (centralised)	Continental	Low inequality elasticity + intermediate inequality tolerance
Medium MORU			
$MORU_{scancor}$	Corporatist	Scandinavian-egalitarian	Low inequality elasticity + low inequality tolerance
$MORU_{liberal}$	Liberal	Liberal	High inequality elasticity + high inequality tolerance
Low MORU			
$MORU_{condec}$	Corporatist (decentralised)	Continental	High inequality elasticity + intermediate inequality tolerance

In tab. 3 an overview of the different collective bargaining model and value system mixtures is given and the institutionally embedded incentive structure sketched. It should be emphasised here, that the 'Meritocratically Optimal Rate of Unemployment' is solely an analytical tool in order to understand the motives of (potentially very influential) pressure groups – it is not an equilibrium position to which any economy is naturally converging in the long run.

[38] I am not describing all possible MORUs but only those, which will be tested empirically. If there were economies that would couple a liberal bargaining system with an egalitarian value system, we would expect them to have the lowest MORU.

5. The empirics of MORU

Before we will now take a closer look at the empirical backing of the exposed political economy of meritocracy, let us first formulate some hypothesis that can be derived from what has been unfolded above. In a meritocratically optimal equilibrium, we would expect the continental economies to have the lowest unemployment rate to be those which organise a high level of wage dispersion within a corporatist bargaining setting, i.e. show rather high income inequality. In liberal economies, we would expect a simultaneity of high income inequality and an intermediate position with respect to unemployment. Although the Scandinavian corporatist economies also would be expected to hold an intermediate position with respect to unemployment, income inequality must be much lower here. Moreover the corporatist-continental economies would be expected to show an intermediate position with respect to income inequality, yet the highest unemployment rate of all country clusters (see tab. 4).

Table 4: Hypothetical equilibrium levels of unemployment and income inequality in varieties of capitalism

		MORU		
		Low	**Medium**	**High**
Income inequality Culture	**Low**		Scandinavian, corporatist	
	Medium	Continental, decentralised		Continental, centralised
	High		Liberal	

For at least three reasons, we should also take a look at trends (i.e. changes in time) rather than exclusively levels: 1) no economy will ever be in a position of stable equilibrium and, 2) we cannot expect the meritocracy to be able to completely achieve its goals in terms of pushing the economy towards a position which would best serve their interests; 3) comparable data on unemployment rates as well as income inequality still show a high degree of imponderability with respect to levels (see e.g. Moran 2005), but should be more reliable with respect to developments. Therefore, we would have to work out what development we would expect of the different country clusters to take if they were all to start off from the same position, which would be a position of (near) full employment coupled with a rather egalitarian wage and incomes structure – i.e. a description which fits very well the situation at the end of the 'golden age' in the 1970ies: In tab. 5 the 'golden age' shows in a low average unemployment rate of only 2.2% in the early 1970ies in almost every of the selected OECD countries (low variance!) and the lowest income inequality in the post-war period in every of the selected OECD countries (low variance, yet different values and attitudes are certainly discernible).

At the end of the 1990ies, after three major economic crisis, the picture has changed: unemployment has not only more than doubled to an average of 5.6%, the variance has also more than doubled – i.e. some countries must have coped much better than others. The same is true for income inequality (and underlying wage dispersion): Over the past two decades it has not only considerably increased but the texture of inequality has also become pronouncedly different (much higher variance!). Again, some countries have suffered (or allowed for) much more dispersion than others – and it will be our task to see whether there are distinguishable patterns. We would expect the Scandinavian, corporatist economies to show only a moderate increase in unemployment and income inequality as they produce a medium MORU and are very reluctant to inequality. On the premises of the exposed theory, the liberal countries will be expected to show a moderate increase in unemployment and rather high change in income dispersion, while the continental countries would have to pay its only small increase in income inequality with a marked increase in unemployment – something which those continental countries would have been able to prevent (small increase in unemployment) which allowed for an at least moderate increase in inequality (see tab. 6).

Table 5: Unemployment and income inequality in the early 1970ies and late 1990ies

	UNR (mid-70)	**UNR (end-90)**	**Change UNR**	**Income dispersion (end-70)**	**Income dispersion (end-90)**	**Change ID**
NL	2.9	2.5	-0.4	2.56	2.91	+0.35
DK	2.8	4.4	+1.6	2.15	2.15	+0.0
Ger	1.8	7.8	+6.0	2.88	3.04	+0.16
SWE	2.0	4.9	+2.9	2.03	2.22	+0.19
NOR	1.5	3.3	+1.8	2.05	2.08	+0.03
F	2.8	8.5	+5.7	3.25	3.05	-0.20
B	2.3	6.7	+4.4	2.30	2.20	-0.10
I	5.0	10.4	+5.4	2.32	2.40	+0.08
A	1.3	3.6	+2.3	3.45	3.66	+0.21
USA	5.6	4.0	-1.6	3.78	4.57	+0.79
CAN	5.0	6.8	+1.8	4.02	4.17	+0.15
UK	2.0	5.0	+3.0	2.91	3.45	+0.54
NZL	0.5	3.9	+3.4	2.89	3.41	+0.52
AUS	2.7	6.3	+3.6	2.73	2.87	+0.14
(unweighted) Average	**2.7**	**5.6**	**+2.8**	**2.81**	**3.01**	**+0.20**
Variance	**2.2**	**5.08**	**+4.79**	**0.399**	**0.603**	**+0.204**

Note: 'mid-70' refers to the respective year with lowest unemployment in the first half of the 1970ies; 'end-70' refers to the last year before inequality started to rise – never later than 1979; 'end-90' refers to the end of the business cycle in the late 1990ies/early first decade of 21st century (unemployment rates) and respective year for income dispersion (if available; otherwise the latest available year is taken)

Source: UNR = internationally standardised unemployment rates: OECD (2005); Income dispersion = 9th decile/ 1st decile; daily, weekly or monthly gross earnings: OECD-Labour Market Statistics DATA and OECD (1996a) for Austria and Norway. For Norway, data is only available for 1991. See appendix: earnings documentation

Table 6: Hypothetical trends in unemployment and inequality in varieties of capitalism

		ΔUNR		
		Low	**Medium**	**High**
ΔID	**Low**		Scandinavian, corporatist	Continental, centralised
	Medium	Continental, decentralised		
	High		Liberal	

Before we will go into the empirics, let us discuss which variable we would ideally like to look at and, under the constraints of only limited comparable data availability, which proxy to take. First of all, it must be remembered that we are going to take the perspective of the meritocracy. 'Meritocracy' has been proxied by the 'highest income percentiles' which is usually taken as the highest income decile (which is, for methodological reasons, the 9th decile). But what income category ought to be taken: gross or net income, individual or household income, wage or overall (including capital) income? As a meritocratic perspective is taken – i.e. earnings according to merits depending on the endowment with human, financial and real capital and its putting to use on different markets –, individual, overall, net income seems to be most appropriate. However, although differences in absolute levels of income dispersion between different concepts may be quite substantial and some reordering of country rankings may be possible (which is probably most pronounced in the case of Austria; see e.g. Pontussen 2000: 297ff. and Guger/Marterbauer 2004), the differences in gross and net income varying across the different countries and country clusters and non-wage income seems to be more important for the meritocracy than for any other income-group in society, the results are not very sensitive with respect to the income concept chosen (particularly if trends rather than levels are measured) for the following reasons: 1) trends in disposable income distribution and individuals gross earnings are very similar (see e.g. Smeeding (2002: 195) and compare with inequality trends as displayed in tab. 5); 2) redistributing welfare systems narrow inequality levels but follow the exact trend of market inequality, i.e. more egalitarian economies (with respect to market (gross) income) show higher levels of redistribution (with respect to outcome in net incomes) than less egalitarian economies[39] and the trends in rising market income inequality are mirrored by the trends in lowered redistribution (see e.g. Kenworthy/Pontussen 2005; Burniaux 1998); 3) the most important factor in determining levels and trends of income inequality is by far the underlying levels and trends of wage dispersion – and this result is robust to changes in the method of decomposing earnings into different income categories (see e.g. Burniaux 1998; Förster 2000).

[39] Which has been called a ‚paradox of redistribution' by Iversen/Soskice (2004).

Table 7: Unemployment and income inequality at the end of the 1990ies in varieties of capitalism; absolute levels

		MORU		
		Low	Medium	High
Income inequality	Low		(SWE; DK; Nor) UNR:4.2 *[0.67]* ID: 2.15 *[0.01]*	
	Medium	(A; NL) UNR: 3.0 *[0.605]* ID: 3.28 *[0.281]*		(Ger; F; B; I) UNR: 8.4 *[2.4]* ID: 2.67 *[0.192]*
	High		(USA; UK; AUS; NZL, CAN) UNR: 5.2 *[1.7]* ID: 3.69 *[0.453]*	

Notes: italic numbers in square brackets show the variance among country clusters. The overall variance in unemployment rates is 5.08 and in income dispersion 0.603.
Source: See tab. 5

There are basically two sources that would be able to provide internationally comparable data on levels and trends of income inequality: the Luxembourg Income Study (LIS) and the OECD Labour Market Statistics. As the LIS provides disposable income data based on household income rather than individual income, this study relies on the OECD Labour Market Statistics. Although the national definitions and sources are not entirely similar (see appendix 2) and the data does not cover the same time period for all countries, this seems to be as close as we can get to standardised and comparative data and, for the reasons outlined above, it will surely suffice with respect to income trends but may also be taken as moderately reliable with respect to a comparison of levels.

In tab. 7 fourteen OECD countries have been clustered and their respective (unweighted) average unemployment rates and income inequality scores (D9/D1-ratio) displayed. Denmark, Sweden and Norway form the Scandinavian, corporatist model, Germany, France, Italy and Belgium comprise the continental, centralised model, Canada, the United States, the United Kingdom, Australia and New Zealand make up the liberal model and the Netherlands and Austria are taken separately to form the continental, decentralised model. The country clusters not only happen to follow exactly the hypothetical patterns put forward above (compare tab. 7 to tab. 4!) but show also only small variances – which is to say that differences among the countries forming a cluster are low (which one would expect, if the cluster make sense).

Table 8: Changes in unemployment and income inequality in varieties of capitalism (absolute change since 70ies)

		ΔUNR		
		Low	**Medium**	**High**
ΔID	**Low**		(SWE; DK; Nor) UNR: +2.1 *[0.490]* ID: +0.04 *[0.018]*	(Ger; F; B; I) UNR: +5.4 *[0.482]* ID: -0.01 *[0.028]*
	Medium	(A; NL) UNR: +1.0 *[3.645]* ID: +0.28 *[0.008]*		
	High		(USA; UK; AUS; NZL, CAN) UNR: +2.0 *[4.628]* ID: +0.42 *[0.086]*	

Notes: italic numbers in square brackets show the variance among country clusters. The overall variance in changes in unemployment rates is 4.79 and in changes in income dispersion 0.204.
Source: See tab. 5

The picture does not change at all, if we take a look at the trends in unemployment and income inequality: Again, as was the hypothesis, we see a very distinct pattern of changes across the varieties of capitalism with, partly, extremely high degrees of coherence amongst the country clusters[40] - i.e. the overall variance is an inter-model variance, not an intra-model variance. The results are clear: Scandinavian, corporatist economies have done better in terms of unemployment increases as they are, on the one hand, less tolerant to inequality and, on the other hand, allowed for a slightly stronger increase in inequality than the continental, centralised countries. The liberal economies experienced a strong rise in inequality which was triggered by a modest increase in unemployment while the continental, decentralised economies paid for the good labour market performance by an intermediary rise in income dispersion despite its low tolerance for inequality (as compared to the liberal model).

[40] The rather poor performance of the continental, decentralised cluster with respect to variance in unemployment trends is not really a surprise as we only have a sample of two countries. Furthermore, in the case of the liberal economies, the rather high variance stems only from the exceptionally well development of unemployment in the US as compared to the early 1970ies which is due to a number of very distinct factors. Only one is that unemployment rates in the USA are seriously underestimated as a large part of long-term unemployment show in prison inmate figures rather than unemployment figures; see e.g. Katz/Krueger (1999) or Western/Beckett (1999). If the data was corrected for these underestimations, the variance would drop to below 1.0!

To make the empirical picture complete, let us come back to the correlations shown in fig. 1 – 3. We started off with realising that there is no correlation between the level of unemployment and the level of income inequality but a rather weak, yet significant correlation between the change in income inequality and the change in unemployment (see tab.9, regressions 3 and 5). Although the 'big trade-off'-causality has been questioned above on the grounds that there is only a weak correlation between the change in inequality and levels of unemployment (see regression 6 where reported DW figures also suggest a misspecification), if the inverse causation running from unemployment (changes and levels) to inequality (changes and levels) suggested by the exposed MORU theory was correct, the rather weak and insignificant correlations would depend on the model-specific variations resulting in non-linear relations between dependent and independent variables. Once this is taken into account by introducing a simple variable catching the affiliation of individual countries to specific country clusters, we would expect a clear rise in the strength and significance of the relationships. As we can see from regressions 1 and 4 in tab. 9, this is actually the case – rendering not only the independent variables 'change in unemployment rates' significant (in equation 1 and more significant in equation 4) but also the variable 'Model' and the whole specification (see F test) and it reduces clearly the risk of misspecified functions (as in equations 5 and 6).

Table 9: OLS regression results – Inequality and Unemployment

	(1) IDEnd90	**(2) IDEnd90**	**(3) IDEnd90**	**(4) ΔID**	**(5) ΔID**	**(6) ΔID**
UNREnd90	-	-	- .041	-	-	-.055*
ΔUNR	- .173*	- .138	-	- .079***	- .069**	-
Model	.376**	-	-	.106*	-	-
R-Square	.425	.151	.018	.517	.329	.220
F test	4.063**	2.142	.219	5.876**	5.877**	3.427*
DW test	2.282	1.515	1.390	1.869	1.033	.937
N	14	14	14	14	14	14

Notes: IDEnd90 = P90/P10-ratio at the end of the 1990ies; ΔID = absolute change in income distribution between the end of the 1970ies and the end of the 1990ies; UNREnd90 = internationally standardized unemployment rate at the end of the 1990ies; ΔUNR = absolute change in unemployment rates between early 1970ies and late 1990ies; Model = variable catching different model affiliation; *** = significant at 1% error level; ** = significant at the 5% error level, * = significant at the 10% error level; DW test = Durbin-Watson test on autocorrelation; N = number of cases
Source: See tab. 5

Although we do not want to go into country details in this study, it might still be worthwhile having a few words about the model standing out in this comparison, namely, the continental, decentralised model represented by Austria and the Netherlands. How did those two countries, although they seem to show very much the same features with respect to labour market regulations, welfare systems and the collective bargaining system as the rest of the continental countries under investigation here, manage to provide a higher level of income inequality and a stronger increase in inequality than the rest of Europe – which seem to be rewarded with a better employment record? In the case of Austria, most of the dispersion can be attributed to a high inter-industry differentiation with a strong impact of gender-biased, tourism oriented service sectors (see Guger/Marterbauer 2004; Pontussen 2000: 295). In order to keep the Austrian touristic industry competitive (particularly with respect to German tourists and a fixed parity of the Austrian Schilling to the Deutschmark), Austrian trade unions partly cured the 'cost disease of services' by accepting a high and growing wage dispersion.[41] In the case of the Netherlands, it is more difficult to explain. Undoubtedly, the situation changed only after the famous tri-partite 'Wassenaar agreement' attempted to solve the 'Dutch disease'. A quite substantial cut in collective social welfare spending (replaced by private provisions; the so called 'Cappuccino model') and special agreements on industry-wage bargains seemed to have paved the way for higher inequality. Yet, in both cases, the reward in terms of a superior employment performance did not come about through supply-side channels but almost exclusively through macroeconomic policy channels (i.e. fiscal policy; see e.g. Heise/Tüselmann 2004; Schettkat 2003) and unit labour cost advantages of small countries facing a fixed exchange rate with their most important trading partner (Germany in both cases). [42] Furthermore, the very recent unemployment trends in both countries seem to put their achievements at risk as – certainly according to this theory – macroeconomic policy management to establish the respective MORU must be matched with the ability to conduct such a policy. This problem will be taken up again further down.

6. Conclusion: MORU and the policy of full employment in the EU

The empirics are so strong that the proposed political economy of meritocracy cannot easily be ignored. However, this is not the place for a conspiracy theory of unemployment. It would certainly be oversimplifying to argue that the political actor – i.e. governments and central banks – care only for meritocratic interests. Even if the very individuals who are acting on behalf of the political actor were taken as part of the meritocracy, in a democratic electoral environment it would be difficult for them to pursue their interests outspokenly if they cared for being re-elected. Again, Michal Kalecki foresaw already as early as the mid-1940ies, how meritocratic politics will nevertheless prevail, even if the meritocracy represents only a tiny minority of society and their interests stand against the interests of the general public welfare: By way of de-legitimizing or de-capabilising Keynesian macropolicies[43] in academic and public discourses and enthroning orthodox policies of 'sound money' and 'sound finance'[44], the economic policy maker gets the instruments of coarse-tuning meritocratic unemployment

[41] Marin (1983) mentions a 'principle of centralism by decentralization' suggesting a lack of top-level coordination of relative wages.

[42] Partly, an intentional ‚beggar-thy-neighbour-policy had been pursued, partly the exceptional wage increases in the aftermath of the German unification boom in the early 1990ies played a role; see e.g. OCED (1996b).

[43] In a first round, the ‚monetarist counter-revolution' made Keynesian policies accountable for the stagflation problems and growing public indebtness of the 1980ies and 1990ies, in a second round, globalisation has been claimed to undermine the capabilities of Keynesian policy making at national levels. Both blows taken together were severe enough to even turn progressive, non-economic social scientists and social democratic policy maker away from Keynesian demand management; see e.g. Scharpf (1991); Iversen (1999).

[44] The actual transmission from interests to ideology to public policy in modern media democracies, I have presented against the background of German Social Democratic Politics; see Heise (2005b).

at hand whether he is aware of it or not. By way of 'under-cover, hidden' Keynesian macropolicies he, nevertheless, has instruments to fine-tune unemployment if the respective MORU is close at reach[45] – and academics fail to address the obvious discrepancies between outspokenly neo-liberal, supply-side advocates ('read my lips') and the very same having pursued a macropolicy which most closely resembles Keynesianism: the Reagan and George W. Busch administrations in the USA and the Thatcher administration in the UK! What seems to be a puzzle and can, therefore, only be addressed as 'ironic', as has been done by Norbert Andel in his presidential speech to the International Institute of Public Economics[46], is perfectly understandable in the context of a political economy of meritocracy.

What are the consequences of the political economy of meritocracy exposed above? Firstly, it is important to address the interests and hidden agenda involved. Quite as it was Mancur Olson's approach, in order to let the public welfare prevail, distributional interests must be rejected and 'distributional coalitions' abolished. This, however, is not as easy as it sounds because the meritocracy does not 'seek its rents' through organisations that act as monopolies on markets but rather through elite pressure that monopolises public opinion ('pensée unique'). In such a state, only educating the public can work and a less uniform ideology of mass political parties (i.e. veritable 'political competition') would help. Secondly, one may be tempted to think of reducing the inequality tolerance of society by, for instance, a collusion of those suffering most from the policy of meritocracy: the low skilled unemployed. However, this may turn out to be a politically very costly and probably uncontrollable path if it helps radical parties to settle and grow in the political spectrum. Thirdly, one might think of joining the continental, decentralised model by increasing the inequality elasticity of unemployment. However, there are also drawbacks to this solution: On the one hand, there seems to be a trade off between inequality and efficiency in terms of productivity growth. An egalitarian wage policy has, for instance, always served as 'productivity whip' in Sweden and a productivity slowdown is alleged to have accompanied the good employment performance of the Netherlands (see Naastepad/Kleinknecht 2004; Kleinknecht 2003). On the other hand, dispersing the wage scale particularly at the low skilled end may reduce employer's incentives to train the workforce and can severely harm production systems that are based on vocational education (e.g. Germany; see Rogers Hollingsworth 2000: 284ff.). But most importantly, this solution is based on the capability of the political actor to use – although this will not necessarily be the announced policy – monetary and fiscal policy measures in order to fine

[45] Which is a very important part of the story as the political situation may easily become unstable if growing inequality (and poverty) would be paralleled with rising unemployment – remember the infamous 'Toxteth riots' at the beginning of the Thatcher era when unemployment soared and inequality began to rise dramatically! The meritocracy has no interests in surpassing 'its MORU'. Again, the actual making of the policies must not necessarily be downright meritocratic, but may, for instance, come about by a 'pragmatic' monetary policy taking unemployment (or the 'output gap') in a symmetric way into consideration (i.e. the policy reaction function includes output gaps just as much as inflation gaps). This may explain why the monetary policy of the FED is typically regarded as more 'pragmatic' than the monetary policy of the ECD or its forerunner, the Deutsche Bundesbank (see e.g. Fritsche et al. 2005 or Skilos 2004). On the other hand, the anti-inflation bias associated with 'sound monetary policy' plays a crucial in role in keeping up pressure on inequality (directly and via unemployment; see e.g. Lippi 1999: 63ff.).

[46] „It is ironic that in the same country where the counterrevolution against the keynesian revolution originated, the conservative government uses dept finance to an extent without any parallel in the time of peace" (Andel 1986: 11).

tune the economy. If, albeit, governments have 'tied their hands' to principles of 'sound money' and 'sound finance' not only ideologically but also institutionally – as is the case in the European Union with the independence of the European Central Bank and the establishment of the 'Stability and Growth Pact' -, they may find it difficult to pursue the kind of expansionary macropolicy needed to reward growing wage dispersion and income inequality.

We have to face reality: in economic particulars, everything is directed towards the distribution of outcomes. This is the case in direct economic encounters on markets, this is also the case in societal encounters most directly through social policies and, of course, through economic policies in general. To believe, as Keynes seemed to have done, that there are 'objective' economic policies based on the 'correct' understanding of the 'real economic world' and which are 'functionally' addressed to cure economic problems (as the dentist cures tooth aches[47]) does not take into account that economic policy is embedded within a political system that has to accommodate divers interests. Mancur Olson (1996: 92) concluded a summing up of his theory in the following:

> "The most important implication of the analysis, however, is that the only real solution is for societies to acquire a better understanding of economics and of the present argument. … No historical process that is understood is inevitable."

Despite my disagreement with Olson's particular approach and my alternative way of looking at politico-economic matters, this general statement can certainly and wholeheartedly be embraced.

[47] „But, chiefly, do not let us overestimate the importance of the economic problem, or sacrifice to its supposed necessities other matters of greater and more permanent significance. It should be a matter for specialists – like dentistry. If economists could manage to get themselves thought of as humble, competent people, on a level with dentists, that would be splendid" (Keynes 1930/1972: 332).

Literature

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Apendix 1: P75/P25-ratios at the end of 1990ies

	P75/P25-ratio
NL	1.67
DK	-
Ger	1.67
SWE	1.44
NOR	-
F	1.76
B	1.56
I	-
USA	2.32
UK	1.95
NZ	-
AUS	1.78
A	1.70
CAN	-

Note: - : no data available.
Source: OECD Labour Force Statistics Data

Appendix 2: Earnings Documentation

Australia

Definition: Gross weekly earnings in main job (all jobs prior to 1988) of full-time employees.

Source: Household survey (annual supplement, usually in August, to monthly labour force survey).

Publication/data provider: Australian Bureau of Statistics, *Weekly Earnings of Employees (Distribution)*.

Workers not covered: No exclusions.

Note: The data refer to the most recent pay period prior to the interview. Earnings deciles are Secretariat interpolations of the published data on the distribution of employees by earnings class.

Austria

Definition: Gross daily earnings, standardised to a monthly basis, taking into account the recorded number of days of insurance contributions (excluding civil servants).

Source: Social security data.

Publication/data provider: Austrian Central Statistical Office.

Workers not covered: Most civil servants and all apprentices.

Note: The figures include special payments such as holiday and Christmas remuneration. Earnings above the ceiling for social insurance contributions are recorded at the level of that ceiling, precluding the calculation of D9 for certain years.

Belgium

Definition: Gross weekly earnings of full-time workers (including civil servants).

Source: Social security data.

Publication/data provider: Belgium Institut national d'assurance maladie-invalidité (INAMI).

Workers not covered: No exclusions.

Note: Earnings deciles are Secretariat interpolations of the provided data on earnings distribution. Earnings above the ceiling for social insurance contributions are recorded at the level of that ceiling, precluding the calculation of D9 for certain years.

Canada

Definition: Gross annual earnings of full-time, full-year workers.

Source: Household survey (*Survey of Consumer Finances*).

Publication/data provider: Analytical Studies Branch, Statistics Canada.

Workers not covered: No exclusions.

Note: Special adjustments have been made to improve coverage and comparability between the years shown.

Denmark

Definition: Gross hourly earnings.

Source: Tax registers (annual earnings data) and social security data (hours worked).

Publication/data provider: The data were supplied by Professor Niels Westergård-Nielsen, Centre for Labour Economics, Aarhus Business School.

Workers not covered: Workers with wage rates lower than 80 per cent of the minimum wage.

Note: The data are derived from annual wage-income (including all types of taxable wage-income) recorded in tax registers, divided by actual hours worked, as recorded in a supplementary pension scheme register.

France

Definition: Net annual earnings of full-time, full-year workers.

Source: Salary records of enterprises. (*Déclarations Annuelles des Données Sociales*).

Publication/data provider: Institut national de la statistique et des études économiques (INSEE), *Séries longues sur les salaires*.

Workers not covered: Agricultural and general government workers.

Note: The data are adjusted for annual hours worked to represent full-year equivalent earnings. The data for 1981, 1983, and 1990 are estimations by INSEE. Earnings are net of employee social security contributions but not of income tax.

Germany (western Germany)

Definition: Gross monthly earnings of full-time workers.

Source: Household survey (German Socio-Economic Panel).

Publication/data provider: Secretariat calculations.

Workers not covered: Apprentices.

Note: Data include 1/12 of supplementary payments comprising 13th month pay, 14th month pay, holiday allowances and Christmas allowances.

Italy

Definition: Gross monthly earnings of full-time employees.

Source: Social security data collected by the Instituto Nazionale de Previdenza Sociale (INPS).

Publication/data provider: Data provided by Claudia Villosio, Ricerche e Progetti, Torino, based on the INPS Panel Dataset.

Workers not covered: Agricultural and general government workers.

Netherlands

Definition: Annual earnings of full-time, full-year equivalent workers.

Source: Enterprise survey (*Survey of Earnings*).

Publication/data provider: Sociaal-Economische Maandstatistiek, Dutch Central Bureau of Statistics.

Workers not covered: No exclusions.

Note: Earnings deciles are Secretariat interpolations of the published data on the distribution of employees by earnings class. Occasional payments (overtime, holiday, etc.) are included.

Norway

Definition: Hourly wages.

Source: Household survey (*Norwegian Level of Living Surveys*), 1980, 1983, 1987 and 1990.

Publication/data provider: The data and decile calculations were provided by Erling Barth and Halvor Mehlum, Institute for Social Research, Oslo.

Workers not covered: No exclusions.

Note: For workers not paid by the hour, their weekly or monthly wages are divided by the corresponding number of hours worked. Observations of less than 25 and more than 1 000 kroner per hour (in 1991 prices) are excluded. Age limits are 19 to 55 years.

New Zealand

Definition: Usual gross weekly earnings of full-time employees.

Source: Household survey (*Household Economic Survey*).

Publication/data provider: Estimates provided by the New Zealand Department of Labour.

Workers not covered: No exclusions.

Note: Non-regular payments are included.

Sweden

Definition: Gross annual earnings of full-year, full-time workers.

Source: Household survey *(Income Distribution Survey*).

Publication/data provider: Statistics Sweden.

Workers not covered: No exclusions.

Note: New basis, consistent with 1991 change in tax base and spliced onto old series prior to 1989.

United Kingdom

Definition: Gross weekly earnings of all full-time workers (i.e. on adult or junior rates of pay).

Source: Enterprise survey (*New Earnings Survey*).

Publication/data provider: (former) U.K. Department of Employment.

Workers not covered: No exclusions.

Note: The data refer to employees whose pay was not affected by absence and include overtime and other supplementary payments.

United States

Definition: Gross usual weekly earnings of full-time workers aged 16 and over.

Source: Household survey (*Current Population Survey*).

Publication/data provider: U.S. Bureau of Labor Statistics.

Workers not covered: No exclusions.

Note: Earnings deciles are Secretariat interpolations of the unpublished BLS tabulations of the distribution of employees by earnings class.

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