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Market constellations and macroeconomic policy-making: institutional impacts on economic performance

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by

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Abstract:

Post Keynesian theory as opposed to Walrasian theory does not provide the foundations for a unique general equilibrium but claims the existence of multiple equilibrium positions. In this article, such a multitude of equilibrium positions is explained by different market constellations which are characterised by different sets of institutions, political and cultural factors and historical circumstance in general and can be formed by collective bargaining systems and Central Banking designs as well as implicit or explicit mechanisms of coordination between key macroeconomic policy areas in particular. A market participation theory of economic policy based on market constellations may help to bridge the gap between nomocratic policy denial and teleocratic policy euphoria.

JEL Classification: E 12, E 61

Key words: Market constellations, Central Bank Independence, Collective Bargaining system

Market constellations and macroeconomic policy-making: institutional impacts on economic performance*

1. Macro versus micro perspectives

Ever since the end of the 'golden age'[1], unemployment has been the most serious and socially least acceptable vice of highly developed capitalist economies. Moreover ever since that time, economists had been asked and expected to provide solutions to cure that vice – a very legitimate demand particularly if a discipline is addressed that often claims to have unveiled the laws of economic interaction as much as natural science has discovered natural laws. In mainstream economics[2], the story is rather simple: unemployment must be rooted in the malfunctioning of the labour market. Either the actors directly involved – employers and their organisations or employees and their unions – or the actor providing the legal and institutional framework – i.e. the government or state actor regulating labour markets or providing a social cushion that influences the decisions of the actors that are directly involved – must in some way or the other be blamed for not allowing market forces to do their job. And the bulk of theory providing ever more rational for disrupting the allocative process of labour markets has become unintelligible: efficiency wage theories, monopolistic union theories, public choice theories and, not least NAIRU theories of different origins fill book shelves to an enormous extent.[3]

Common to all such approaches is a microeconomic perspective which is supposed to provide an answer to the question why it may be rational for economic agents not to allow market forces to clear the labour market at the equilibrium real wage level. This kind of research stance can be understood as a reaction to standard Keynesian reasoning of the Hicks-Hansen type which apparently relied completely on ad hoc rigidities (price and wage stickiness) and seemed to be irreconcilable with the stagflation period of the late 1970s and, furthermore, which was too hydraulic not to be puzzled why governments would find it so difficult to restore full employment. In Germany, for instance, the Keynesian 'Growth and Stability Act' of 1967 has been recognized in helping to overcome the 1966/67 business cycle downturn, but seemed incapable of dealing with the coming recessions of the mid-1970s and early 1980s. Under these circumstances, the Keynesian focus of explaining unemployment as a systematic product of uncoordinated market behaviour – not as a temporary failure of markets to behave appropriately – has been almost completely lost: **unemployment as an equilibrium phenomenon**. Post Keynesian authors of different backgrounds have emphasized the importance of effective demand (constraints) in determining the overall volume of employment (and, hence, unemployment) independent of labour market failures.[4]

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[1] See e.g. Marglin/Schor (1990)

[2] For a reference as to what is meant by 'mainstream economics' see e.g. Keen (2001:10).

[3] Because of the extent, it is difficult to select just a few references without provoking the critique of not having mentioned an important book or article. I will, therefore, concentrate on a few references that provide overviews or international comparisons: Akerlof/Yellen (1986); Bean/Layard/Nickell (1986); Carlin/Soskice (1990); Dreze/Bean (1990); Landmann/Jerger (1999); Layard/Nickell/Jachman (1991); Layard/Nickell/Jackman (1994); Lindbeck/Snower (1989); Phelps (1994).

[4] Income distribution and fundamental uncertainty resulting in liquidity preference considerations play prominent roles in different Post Keynesian approaches; for a quick overview of Post Keynesian theories of unemployment see King (2001)

Although Post Keynesianism is far from being a well defined and coherent body of economic theory (see e.g. Dunn 2000; Holt/Pressman 2001), some basic features important for our purpose stand out[5]:

- In order to understand the determination of aggregate variables such as national income and employment (as opposed to individual income and individual labour supply or demand), not microeconomic but **macroeconomic models** must be developed. That is to say, that before we will be able to study allocative processes on single markets (i.e. the optimal use of given resources in partial analysis), we will need to determine the extent to which resources will be used (i.e. the degree of utilisation in total analysis) in the aggregate. This is most important for the factor of production which can be taken as given (i.e. constant) in the short run and which is as much a social category as a factor of production: labour supply, i.e. the number of human beings willing (or forced) to sell their services to companies and employers and being mostly harmed if they do not succeed.
- The environment under which economic agents act is necessarily a **fundamentally uncertain** one. That is to say that economic agents will never be able to dispose, collect nor process all the information that is necessary for optimal decisions featuring so prominently in neoclassical general equilibrium models. Nevertheless, in order to decide (bounded) rationally, economic agents need rules and regulations, habits, codes of conduct or institutions that reduce the number of possible alternatives.
- One institutional fact features prominently in Post Keynesian economics: **money**. Money is the institution in which not only spot transactions (barter) are denominated but also such transactions which are basic constituents to capitalistic economic behaviour: forward looking debt relations involving debtors and creditors. The decision to dispose with money (liquidity preference) for a certain period of time (into the uncertain future), i.e. to invest and create debtor-creditor-relationships, drives an economy. This also means that nominal contracts and prices – particularly money wages and nominal interest rates – become more important than real magnitudes (which do not exist in reality) without involving money illusions.[6]
- In neoclassical barter or real exchange models, markets are essentially equivalent and the Walrasian 'law of markets' accounts for an ever equilibrating process. This cannot be the case in a monetary production economy which is characterised by a **hierarchy of markets**: the motives and (trans)actions of agents (creditors and debtors) on credit markets (sometimes called 'wealth or asset markets' in order to distinguish them from neoclassical credit markets) logically proceed the (trans)actions on commodity and labour markets and, thereby, set budget constraints for all other market actors: in Keynes's terminology, it is the finance motive which builds the (liquidity preference) foundation of the investment and income generating production process (Davidson 1994: 86ff.).
- There is neither a single reference point to which capitalist economies tend to move (no general equilibrium but multiple equilibria) nor a hydraulic way of governing an economy as 'old fashioned' standard Keynesianism seemed to believe in the 1960ies

[5] Lavoie (1992) mentions four essentials of Post Keynesianism that – at least partly – coincide with our features: 1) procedural or reasonable rationality; 2) organicism or holism; 3) realism and 4) production (instead of merely allocation)

[6] Of course, economic agents are basically interested in real magnitudes. Yet, as the future valuation of all kinds of assets is unknown and uncertain (this is true for the pricing of single assets as well as for price developments in the aggregate) and contracts are always denominated in nominal terms, its nominal magnitudes and price (or inflation) expectations that count most and – as Keynes put it – we are dealing with a monetary production economy.

and 1970s.[7] Different sets of institutions, political and cultural factors and historical circumstances (such as given international monetary systems or degrees of market saturation) determine **'market constellations'**[8] under which economic agents act and which show some persistence. The political actor or other corporatist actors (such as the social partners or Central Banks) as the agents of economic policy in a wider sense[9] can in no way be regarded as 'exogenous' to market processes. They are not simply correcting 'market failures' in a predetermined, quasi functional way but they are market participants – though important and powerful ones – that are faced with uncertain future developments and events and contingent reactions of other market participants. The contingency of economic governance becomes ever more obvious once the idea of a unitary political actor is abandoned: if the key macroeconomic policy fields of monetary, fiscal and wage policies are controlled by independent actors and an interdependence of these policy fields is assumed, the actors are set into a strategic environment in which the policy outcome depends on the expectations and anticipations of each other and the impact of such a policy depends on the expectations and anticipations of the individual market actors.

It is this Post Keynesian basis on which the following analysis is built. Firstly, a market participation theory of economic policy will be outlined in very broad strokes and a cooperative approach to macroeconomic policy-making portrayed. This will be needed to determine in which way macroeconomic demand management can be used to manipulate 'market constellations' in a systematic, though not hydraulic way. In a further step, we will inquire as to how far macroeconomic governance can be made responsible to explain different growth and employment performances of selected EU countries, or to put it differently: are there differences in the ability of nations to create favourable 'market constellations'?

2. Market participation and the creation of favourable 'market constellations'

Once the idea of a general equilibrium as the natural long-term position of any economy is replaced by a notion of multiple equilibria, unemployment becomes a systematic characteristic of decentralised market economies as opposed to merely being a 'market failure'. Therefore, economic policy towards establishing full employment is not solely a functional device of 'market repair' but must be established by a political will (normative target) and can only be pursued by way of participating in the market process. Therefore, the political actor(s) is not a subject external to the market participants (objects) but a market participant (object) himself who is constrained by market forces just like any other market

[7] We ought to remember that the heydays of standard Keynesianism coincided with the maximum belief in Cartesian controllability via well established means-ends-systems; see Dahl/Lindblom (1963), Tinbergen (1954), Tinbergen (1964).

[8] In some recent work (see Fritsche et al. 2005a, Fritsche et al. 2005b) the notion of ‚regime' has been introduced to describe what is termed ‚market constellation' here. I prefer the latter notion in order to distinguish this line of research from those socio-economic models which use the (neo-marxist) term 'regime' to describe a specific historic structure of accumulation; see Boyer (1990), Kotz/McDonough/Reich (1994). Although there are certainly similarities between the proposed and the regulationist research programme, they are based on rather different paradigmatic foundations (Keynesian the former, Marxian the latter) and focus on very different problems: uncertainty, liquidity preference and money here and profit squeeze and 'social compromise' (see Coriat/Dosi 2002) there. But, most important, the regulationist research programme is mainly interested in institutional settings in the allocational (labour markets and industrial relations) and distributional (welfare state institutions and policies) core functions of economic and public policy (see e.g. Amable [2003: 3ff.]) while the Post Keynesian research programme proposed here is principally concerned with the interventionist, stabilisation function of economic and public policy.

[9] Economic policy can be interpreted as providing public goods.

participant[10]. Governmental (and other corporatist actors) interventions will have measurable impacts on quantities and prices, but as any other market participant, the political (or corporatist) actor has finally to accept the market outcome, i.e. cannot *ex ante* discriminate between warranted quantity and unwarranted price effects.[11] Before trying to solve the problem of contingency, the lack of Cartesian policy control shall be highlighted again: the political actor is as much an object of market forces as the subject of economic policy making. However, there are means to reduce the magnitude of contingency (or lack of sharpness in policy control) by way of introducing (codified) rules and regulations or setting up or stimulating institutions that reduce the available number of options for market participants and, therefore, decreases the uncertainty about future actions. Obviously, there is a trade-off between transaction costs (due to the need to adapt to changing market situations) and uncertainty costs – which leaves the optimal mix of 'laissez-faire' and 'regulation' open to experience. Yet, uncertainty-reducing institutions and regulations are much easier to justify in a Post Keynesian framework than in a neoclassical theory of 'market failure' (see e.g. Kregel 1980, Hodgson 1989) and can help in creating a 'market constellation' which is favourable to growth and employment.

Some of these uncertainty-reducing institutions – with particular respect to our purpose – are collective bargaining systems, institutional settings of Central Banks and institutional structures to coordinate different independent but interdependent political actors in order to establish an optimal policy mix. Collective bargaining systems provide the necessary 'nominal anchor' in modern non-precious metal (fiat money) currency systems, the Central Bank design is important for securing the scarcity of paper money. Both institutional set ups reduce otherwise precarious volatility of (nominal) wages and prices: It has become common sense that there is a strong correlation between the degree of independence of Central Banks and the inflation performance of an economy on the one hand and a likewise strong correlation between inflation performance and inflation volatility. There is less agreement about the influence of collective bargaining systems on wage settlements and inflation developments. A very influential study by Calmfors and Driffill (1988) propose a 'hump-shaped' link while other evidence (e.g. Soskice 1990) argues in favour of a negative correlation: the more decentralised the collective bargaining system is, the higher wage settlements and inflation rates will be.[12] Be that as it may, there is no doubt that collective bargaining institutions and the Central Banking design may impinge in a systematic way on the degree of uncertainty about inflation developments and the valuation of assets.

Only recently, the mutual causality (*Wechselwirkung* in a Kantian sense; see Hicks 1979: 18f.)) of collective bargaining systems and Central Banking designs has been studied in depth and some 'conventional wisdom' about the (long term) neutrality of monetary policy and the 'free lunch' assumption of Central Bank independence has been shaken[13]. Moreover, it has

[10] The idea of a ‚market participation theory of economic policy' as opposed to the traditional ‚market failure theory of economic policy' has been most forcefully put forward by the German Post Keynesian economist Hajo Riese. Unfortunately, he and his disciples have published almost exclusively in German and, hence, their contributions to Post Keynesian economics went internationally almost unnoticed; see Riese (1988); Riese (1995); Riese (1998).

[11] As is the case with employment policies. In the case of disinflation policies, the price effects are warranted and the quantity effects are unwarranted, yet again it is impossible to plan them in advance.

[12] This relation becomes plausible if we assume strong trade unions at company level (‚local pushfullness') in at least bigger companies and a signalling function of wage settlements of 'key companies' (i.e. bigger, more visible companies).

[13] See e.g. Hall/Franzese (1998), Guzzo/Velasco (1999), Cukierman/Lippi (1999), Iversen (1999a). The 'free lunch' assumption has been particularly discussed by Grilli/Masciandaro/Tabellini (1991), Gärtner (1997), Posen (1998), Soskice/Iversen (2000).

been asked whether it is sensible to delegate half of demand management to an autonomous body such as the Central Bank (see Rankin 1998, Power/Rowe 1998) – indicating a possible coordination problem between fiscal and monetary policies (see Nordhaus 1994). Both lines of discussion can be joined by realising that all actors involved – the political actor, the Central Bank and the social partners – pursue individual utility maximisation under the constraint[14] of the Phillips curve trade-off[15], but may (and most certainly will) have different preferences with respect to inflation and unemployment. In a moment, we will see how this can end up in a policy game which leaves not only the actors involved dissatisfied but also produces a sub-optimal result in terms of overall welfare. Therefore, institutions that produce incentives for the actors involved – i.e. the political actor responsible for fiscal policy, the Central Bank responsible for monetary policy and the social partners responsible for wage policy – to cooperate may be able to create market constellations – i.e. a macro-economic environment – favourable for growth and employment.

As a three actors' game is too complex to be exposed, it will be split into two separate games in which the Central Bank is the connecting piece. This seems appropriate as it is the Central Bank's monetary policy which is the mutual focus of both wage policy and fiscal policy alike, but there is no direct interaction[16] between the latter two. Let us start with the interaction of monetary and fiscal policy as portrayed in the so called Nordhaus-model (see Nordhaus 1994 or Balls/O'Donnell 2002: 101ff.): We assume that (1) the utility functions of both actors include the variables 'unemployment' and 'inflation', (2) both actors show different preferences with respect to unemployment and inflation (the Central Bank is more averse to inflation than the political actor), (3) there is a (short and long term) Phillips curve trade-off between unemployment and inflation, (4) both actors target a (different) volume of aggregate demand in order achieve the preferred combination of unemployment and inflation, and (5) the political actor additionally puts emphasis on the budgetary balance as it provides the means to offer public goods to the electorate (necessary to secure re-election). In fig. 1, the M and F curves portray the level of aggregate demand which the Central Bank (M) and the political actor (F) target respectively. They can do so by choosing a policy mix of monetary and fiscal policy here approximated by the instrument variables i (real interest rate) and S (budgetary balance): the same aggregate demand can be achieved through a more expansionary monetary policy and tighter fiscal policy (i.e. lower i and higher, or more positive, S) or, alternatively, through a more restrictive monetary policy in combination with a more expansionary fiscal policy (i.e. higher i and lower, or more negative, S).

The difference between the M and F curve reflects the autonomous relevance that fiscal policy (budgetary balance S) has for the political actor. Point A and B represent the 'optimal' combinations of fiscal and monetary policy as preferred by the Central Bank and the political actor: as the Central Bank is more averse to inflation than the political actor, it favour point B at tighter monetary policy and the political actor favours point A at more expansionary monetary policy and higher budget deficits (as an expression of the desire to have more room

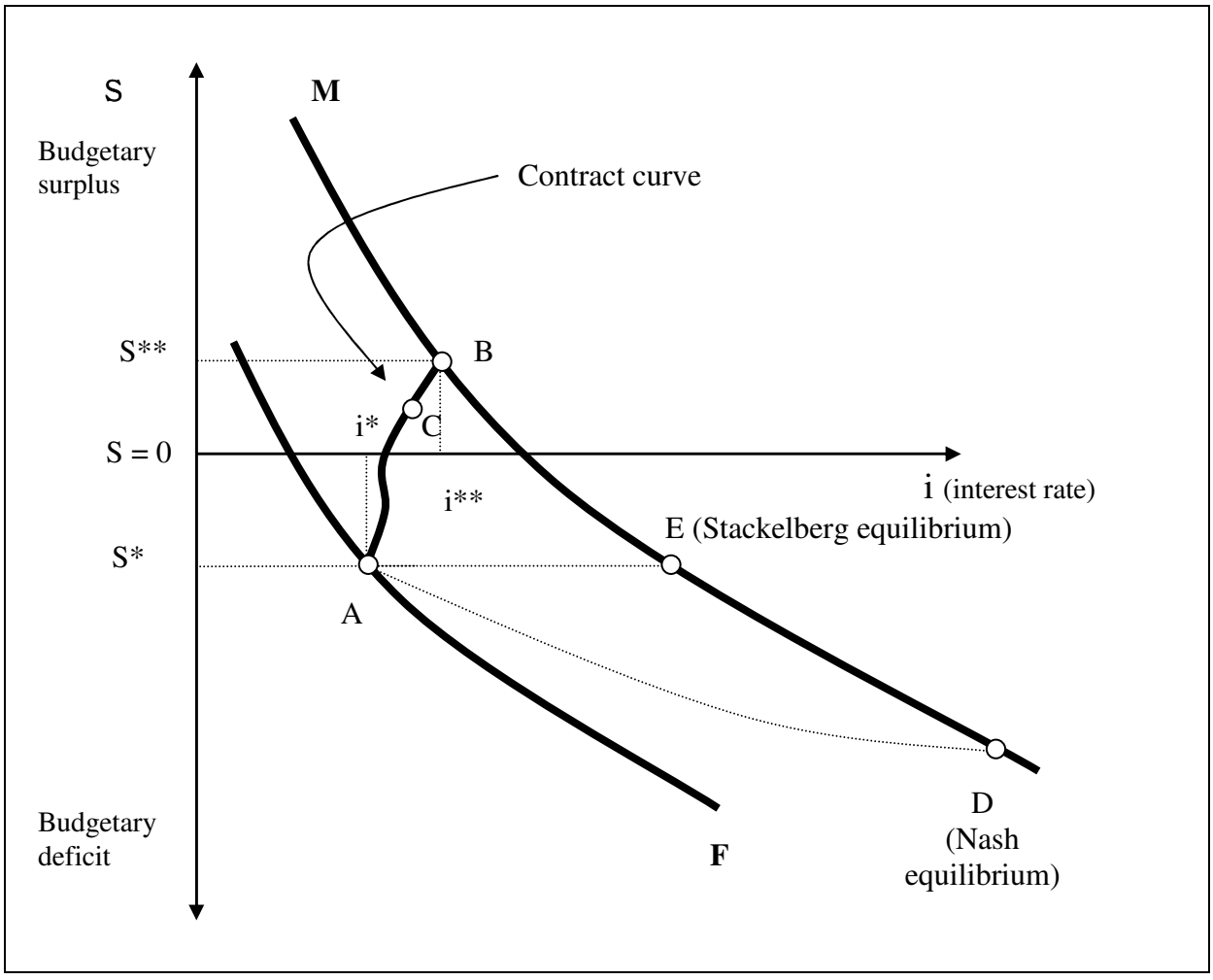
[14] At least in the short run, there seems to be consensus about the existence of this trade-off among most economic schools. In the long run, the trade off is acknowledge by Post Keynesian theories but questioned by neo-classical theories. However, as the time horizon for political action can be assumed as being rather short term, this dispute must not be decided here.

[15] In the case of the social partners, it is the original Phillips curve (linking nominal wages increases to unemployment) which is important.

[16] As is common, I use the term ‚interaction' although this is not quite correct. 'Interaction' describes the actions of two (or more) actors in direct relation to one another as, for instance, on markets. In the case of monetary, fiscal and wage policy, the actors do not act towards each other but towards financial market participants (monetary policy), the electorate (fiscal policy) and their members (social partners). However, their actions are interdependent and this interdependence has to be taken into consideration.

to manoeuvre). Obviously, both points A and B cannot be realised at the same time: either, there is some kind of coordination between fiscal and monetary policy and some point C on the contract curve will eventually be reached[17] or, in the case of conflict (or non-cooperation), we will end up at point D – which is a non-cooperative Nash equilibrium – or at point E which is a Stackelberg equilibrium[18]. Whether the cooperative point C will be preferred as compared to the non-cooperative points D and E depends on the preference structure of both actors: The more averse to inflation the Central Bank and averse to unemployment the political actor, the less likely it will be that the cooperative point C will be preferred (see Heise 2001: 62ff.). Or to put it differently: if both actors do not care only for one of the two policy goals of 'low inflation' and 'high employment', a cooperative effort will be able to establish a policy mix which both actors prefer to the non-cooperative solutions of the Stackelberg or Nash equilibria[19]. However, such a preferred policy mix will only be achieved if the famous cooperation trap of the 'prisoner's dilemma' can be overcome.

Figure 1: Monetary and fiscal policy game



[17] Where exactly on the contract curve such a cooperative point C will come to lie depends on the bargaining position of both actors. This position is determined by the preference structure of the actors.

[18] A Stackelberg equilibrium can easily be imagined if the political actors accept the structural strength of the Central Bank to enforce its level of aggregate demand, although it maintains the enforcement of its preferred budgetary balance.

[19] The willingness to cooperate can, therefore, be interpreted as a litmus test of whether they really pursue not only a single target policy. Autonomous Central Banks (and the Bundesbank in particular) have often been reproached with only pursuing price stability and neglecting employment and growth completely.

Here we are not concerned about (institutional) incentives necessary to increase the likelihood of cooperation (see Heise 2001: 73ff.) but will pose the question whether the underlying conflict can be mitigated by bringing the social partners into the picture. Indeed, this would be the case, if the social partners were able to prevent inflationary developments (to which the Central Bank is more averse than the political actor) to accompany increasing employment (which the political actor favours more than the Central Bank) – i.e. if they were able to suppress the Phillips curve logic. As the Phillips curve is based on the 'original Phillips curve' linking inversely nominal wage increases to falling unemployment, social partners may well have a stake in the game. From a large number of studies[20] we know that the potential to control the Phillips curve logic depends on the ability of the social partners to create external effects (i.e. nominal wage claims in excess of the distributional margin given by labour productivity growth and the tolerated inflation rate) and the willingness to internalise such external effects: decentralised collective bargaining systems (acting at company level) are said neither to expose a willingness to internalise external effects nor to have the ability to create such external effects (Calmfors-Driffill case). Centralised collective bargaining systems[21], in which the social partners (and, most importantly the trade unions) act as 'encompassing organisations', do have the ability to create external effects but will also be willing to internalise them. They will do so once they have realised that any nominal wage increase will (*ceteris paribus*) be completely passed on to prices and leave the real wages unaltered. Intermediate collective bargaining systems (acting at regional or sectoral level), however, have the ability to create external effects, yet they are not willing to internalise them as the effect of the nominal wage increases on the overall price level will be a restricted one (for the restricted scope – regional or sectoral – of their bargaining power) and, hence, enables them to alter their (sectoral or regional) real wage rate[22]. This may also be the case with respect to decentralised collective bargaining systems if we allow for signalling effects of key companies and 'local pushfullness', i.e. strong and myopic trade unions at company level (Soskice case).

Fig. 2 depicts the different settings: w^r_b is the real wage rate which trade unions (as the crucial part of the social partners in this argument) are targeting[23] with respect to the level of employment. LF is the labour force which is, for the sake of simplicity, taken as given. w^r_p is the real wage rate which the employers are willing to accept (which is given by labour productivity growth and a mark-up accounting for imperfect competition on commodity markets). In the case of a centralised bargaining system, for a considerable margin trade unions are willing and able to suppress the 'Phillips curve logic' – from a level of employment L^N_1 onwards, they will not ask for higher (targeted) real wages but increase the utility of the labour force (as their political aim) by increasing employment. Above employment level L^N_2, which can be interpreted as the point at which the number of unemployed equals the number of vacancies[24], real wages will start to increase either through higher collective claims or by way of wage drift. Below employment level L^N_1, pressure on

[20] See e.g. Franzese (2001), Franzese (2002); Franzese/Hall (2000), Hall (1994), Hall/Franzese (1998), Hein (2002a), Iversen (1999b), OECD (1997), Traxler (1999), Traxler/Kittel (2000).

[21] Centralisation means that the collusion of heterogeneous interests into credible commitments is possible; i.e. decentralised but highly cooperative trade unions and employers' organisations may be *de jure* decentralised but act *de facto* as a centralised collective bargaining system in the above sense.

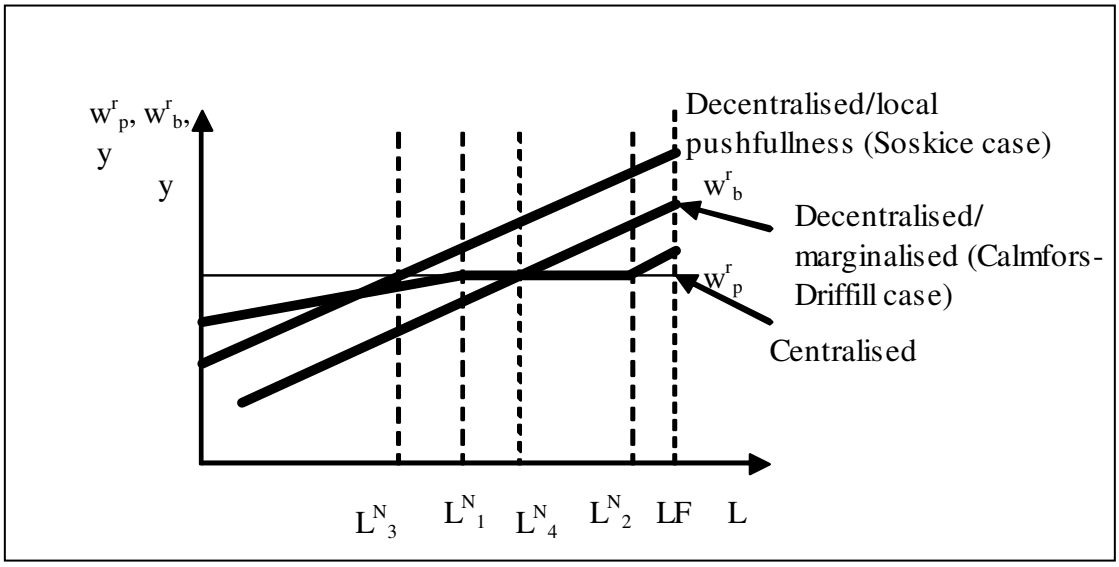
[22] Soskice (2000: 47) spells out the necessary, yet realistic assumptions: (1) industrial trade unions indeed only care about employment and wages of the labour force in their own sector, (2) they bargain independently.

[23] 'Targeting real wages' means that trade unions bargain nominal wages under the expectation of price inflation. The assumption is that their expectations are met, i.e. no revision of plans is necessary.

[24] This is the 'Beveridge definition' of full employment.

trade unions will force them to accept lower (targeted) real wage increases than employers would be willing to pay at full employment levels.

Figure 2: Monetary and wage policy game with independent Central Bank



Whether a fiscal and monetary policy mix will be able to establish employment level L^N_1 or L^N_2 depends on implicit or explicit coordination mechanisms: 1) if an institution – a concerted action or macro-dialogue – empowers the actors involved to credibly commit themselves to pre-established policy rules, the Central Bank may be willing and forced to allow for a level of aggregate demand which reflects the preferences of the political actor and the social partners - L^N_2 in this case. This may be called 'ex ante' coordination. 2) If the Central Bank pursues a monetary policy of 'testing the waters'[25] and the political actor and the social partners can bring themselves not to exploit the Central Bank's pragmatism, L^N_2 may also be reached – this may be termed the 'Fed strategy' for it has allegedly been the policy stance of the US Federal Reserve Board during the 1990s (see Bibow 2001, Hein 2002b). Almost the same scenario would be imaginable if the political actor was to take the more active (fiscal) policy stance, yet the Central Bank would not react in a restrictive manner but allow for aggregate demand to increase (i.e. any point on the contract curve in fig. 1; see also Collignon 2003: 128ff.) – both cases may be called 'ex post' or implicit coordination. However, they seem to be a very fragile and rather coincidental forms of cooperation (see e.g. Horn 1999; Fritsche et al. 2005a: 102f.) as the incentives for the actors involved not to defect (i.e. not to exploit) are not very strong – that at least is what game theory teaches us. 3) If cooperation cannot be established, the Central Bank will enforce its level of aggregate demand (at Nash- or Stackelberg equilibrium) preventing employment from rising above L^N_1 – this may be termed 'monopolistic coordination' (see Spahn 2004: 288ff.) or the 'Bundesbank strategy' for it has allegedly been the policy stance of the German Bundesbank ever since it pursued an independent monetary policy (see Hein 2002b). 4) If the Central Bank were to accommodate whatever wage and fiscal policy stance[26], again L^N_2 would be at reach, yet at a comparably high inflation rate (the exact amount of which depends on the inflation aversion of the social partners; see Guzzo/Velasco 1999, Hall/Franzese 2000).

[25] A monetary policy stance of ‚testing the waters' implies a policy of direct inflation targeting with symmetric reaction functions (see e.g. Siklos 2004). 'Testing the waters' means that Central Banks risk expanding monetary policy as long as no inflation potential arises.

[26] In this case, the Central Bank either shows a low degree of independence or is led by a ‚populist Central Banker' (as compared to the 'conservative Central Banker' of price stability orientation).

As is summarized in tab.1, the market constellations look quite differently when we focus on decentralised, non-coordinated (company or industry level) collective bargaining systems: (1) If the Central Bank accommodates whatever wage claims and fiscal policy stance arise, the inflation rate will certainly be very high and possibly accelerating. As high inflation rates are typically associated with high inflation volatility, liquidity preference considerations of wealth owners will curtail investment spending, economic growth and employment – hence, employment will be below L^N_2 , but probably above the level which a non-accommodating Central Bank under 'Bundesbank strategy' would enforce[27]; for instance at level L^N_4 . (2) An (explicitly) cooperative constellation including a non-accommodating Central Bank and non-coordinated social partners is hard to imagine as the number of actors (particularly on the side of the social partners) is too numerous for a strategic and credible commitment. (3) In the case of a non-accommodating Central Bank, the result will be high unemployment (L^N_3) in combination with low inflation whatever the Central Bank strategy is. This is at least true as long as we assume an intermediate bargaining level (industry or region) or 'local pushfullness' at company level (i.e. the Soskice case). (4) Only under the condition of 'marginalised', decentralised social partners (i.e. the Calmfors-Driffill case) and a 'Fed strategy', employment may rise to levels between L^N_4 and L^N_2 – the exact position of the w^r_b curve (in fig. 2) depends on the extent of 'marginalisation'[28]. Nevertheless, this is likely to be an unstable constellation once disinflationary developments turn into a deflationary process due to the lack of a nominal anchor[29].

Table 1: Unemployment and inflation in various market constellations

		Monetary and Fiscal Policy mix			
		Accommodating	**Non-Accommodating – monopolistic coordination (Bundesbank strategy)**	**Non-Accommodating – ex post coordination (Fed strategy and/or active fiscal policy)**	**Non-Accommodating – ex ante coordination (Cooperative)**
Wage Policy	**Co-ordinated**	UNR: low (**L^N_2**) INF: medium	UNR: medium (**L^N_1**) INF: low	UNR: low (**L^N_2**) INF: low	UNR: low (L^N_2) INF: low
	Non-Co-ordinated	UNR: medium (L^N_4) INF: high	UNR: high (L^N_3) INF: low – deflationary	UNR: high (SOSKICE) (L^N_3) Medium - low (Calmfors-Driffill) (L^N_4 - L^N_2) INF: low – deflationary	--

[27] It must be admitted that this is a very risky statement – above all based on empirical observations (see Hall/Franzese 2000: 195). Whether an accommodating Central Bank is able to provide market constellations that are more favourable to growth and employment than the market constellations provided by a non-accommodating Central Bank under the 'Bundesbank strategy' may well depend on the extent of 'local pushfullness' of decentralised social partners and the degree of uncertainty about whether this scenario may turn into accelerating inflation.

[28] ‚Marginalisation' would be complete – and thus, the w^r_b curve would cut the w^r_p curve at point L^N_2 – if the actors on the labour market were pure 'price takers'.

[29] It needs to be remembered that there may be an equilibrium real wage rate at $w^r_b = w^r_p$ but definitely no equilibrium nominal wage rate. Yet, the ghost of deflation can possibly be banned if demand-management can be used efficiently to control employment levels and/ or if downward barriers to nominal wage decline – such as effective minimum wages – are introduced.

Tab. 1 captures possible outcomes for employment and inflation under different market constellations which depend on collective bargaining systems, Central Banking designs and explicit or implicit mechanisms of coordination between the key macroeconomic policy fields. Assuming that the individual members of a society receive positive utility from low inflation and high employment (or, rather, low unemployment), it becomes clear that a non-accommodative monetary policy, either under the 'Fed strategy' or in cooperative orientation, coupled with a centralised collective bargaining system provides the best and preferred market constellations. However, these results merely show that macropolitics matter as much as the institutional setting makes a difference[30]. But it should not be forgotten that these results are 'normative' in the sense that they solely mark out the ability of the political actors to govern. In no way do they positively prove to what extent actual governments and corporative actors use their room to manoeuvre. In the next chapter, we will explore empirically to what extent differences in macroeconomic performances can be explained by different macropolitical governance.

3. Macroeconomic governance and economic performance in selected countries

As the focus of investigation will be on monetary, fiscal and wage policy under particular external conditions, and as we have realised that the institutional embeddedness of macroeconomic governance is crucial for the understanding of rooms to manoeuvre and the creation of market constellations, a multi-country cross comparison does not seem an appropriate method to capture the differences in performance as the implicit non-linearity of instrumental relations will be better recorded by a narrative approach[31]. Moreover, it seems more appropriate to focus on a few countries only than on country clusters ('models' or 'regimes') as has become common in modern social science[32] since different macroeconomic market constellations may well cut across different 'models'. The selection of such countries follows the comparativistic research designs[33] *'most similar with different outcome'* and *'most different with similar outcome'*. As can be seen from fig. 3, Germany, the Netherlands and Austria show rather different labour market outcomes in terms of levels and developments of unemployment, yet they are ordinarily clustered commonly as 'coordinated market economies'[34] showing very similar labour market (allocational system) and welfare state institutions (distributional system): While Austria experienced an above-average employment

[30] Fritsche et al. (2005b) also name the ‚external economic scenario' as a cornerstone of a particular market constellation. Although exchange rate developments may clearly impinge on the growth and employment performance of a country (as we will see later) and may also cause monetary and wage policy reactions, I have so far not explicitly included the 'external economic scenario' into my investigation for one reason: for the longest time in the period under investigation, the exchange rates among EMS countries had no instrument status as they where fixed among each other. However, real exchange rates being influenced by the wage policy of the social partners may well be a strategic variable particularly in small, open economies in fixed currency systems.

[31] For an introduction to the 'narrative approach' in comparative economics see Miron (1994), McCloskey (1987), McCloskey (1990), McCloskey (1994). As compared to highly sophisticated econometric analysis, which may be an important tool in 'data-mining', the narrative approach is better able to study complex interactions in detail, to identify critical junctures and non-linearities (as may be expected in our case).

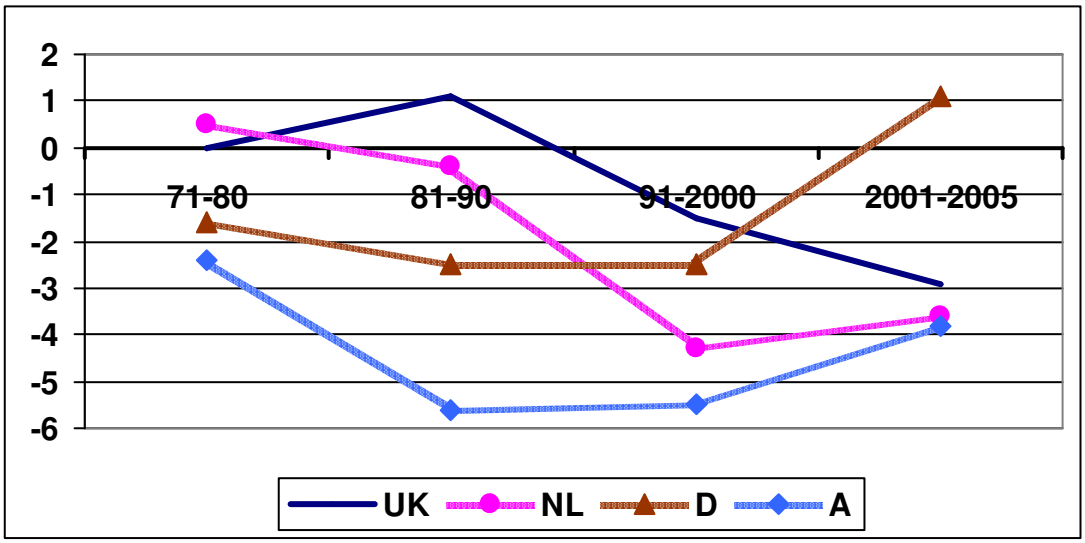
[32] See e.g. Esping-Andersen (1990), Coates (2000), Amable (2003).

[33] For the methodology of comparison as 'quasi experiment' see e.g. Dogan/Pelassy (1984), Gregory/Stuart (1999), Przeworski/Teune (1970).

[34] The distinction ‚coordinated market economies' and ‚liberal market economies' is borrowed from Hall/Soskice (2001). Quite similar distinctions are called 'corporatist model' versus 'liberal' model' or 'Rhenish model' versus 'Anglo-American model' (see Soskcie 1999; Albert 1991) or 'Keynesian welfare national state' versus 'Schumpeterian competitiveness state' (see Jessop 2002).

development over the whole period under investigation (with only a slight divergence from that trend since the beginning of the last decade), Germany's development was much closer to the EU-15-average for the first three decades and has sharply moved below average (i.e. showing higher unemployment) since the beginning of the last decade. The Netherlands, moreover, produces a very average result during the first two decades under investigation only to move sharply above average during the 1990s and to keep that position ever since.[35] And the United Kingdom reveals a quite similar outcome as the Netherlands despite considerable differences in labour market and welfare state institutions which commonly groups it with the 'liberal market economies'.

Figure 3: Comparative unemployment development in four EU member states (difference of unemployment rates to EU-15-average)

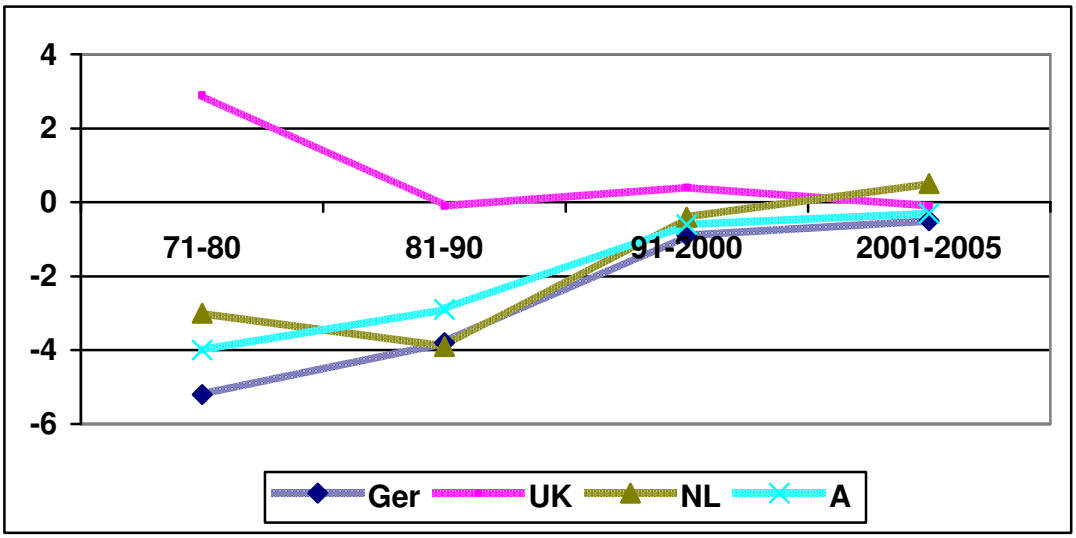


Source: European Economy, Statistical Annex, autumn 2005, own calculation

With respect to inflation (see tab. 4), the three continental EU members (as 'coordinated market economies') show a very similar development: during the 1970ies and 1980ies, price stability was clearly higher than at EU average – yet, the Netherlands improved their record during the 1980s after having fixed the Dutch gilder to the deutschmark and the legendary 'Wassenaar accord' in 1982. During the 1990s and the first half of the following decade, a marked trend to price stability convergence can be detected – partly a world-wide phenomenon of growing importance attached to price stability, partly a European phenomenon on the 'Maastricht road' to European Monetary Union. The UK (as 'liberal market economy') differs with respect to the early decades under investigation but has joined the 'price-stability gang' since the 1990s.

[35] Seemingly, the EMU countries Germany, the Netherlands and Austria have all done worse (to differing degrees) than the non-EMU country Britain – one is tempted to establish a link to the budgetary policy rule of 'zero deficits' enshrined in the European Stability and Growth Pact. As experience is still too short, this cannot be tested here but clearly shows that the institutional settings marking a relevant market constellation must be expanded in future research to budgetary policy designs (such as the 'golden rule' versus 'zero-deficit rules').

Figure 4: Comparative inflation development in four EU member states (difference of inflation rates to EU-15-average)



Notes: Inflation as measured by final consumption deflator
Source: European Economy, Statistical Annex, autumn 2005, own calculations

In the following, two questions will be posed: a) Are the comparative unemployment and inflation developments (each compared to the EU-15-average as reference) explicable in terms of different market constellations created by distinguishable macropolitical governance and b) do these results positivistically match the normatively derived hypothesis summarised in tab. 1? It must be remembered that a possible mismatch does not necessarily reject the underlying theoretical frame but may hint to the fact that political and corporatist actors may refuse to use their room to manoeuvre. In any case, a mismatch would demand further investigation.

Let us start with putting the selected countries into the frame of probable market constellations provided by tab. 1. Before we can do so, we have to qualify the monetary policy stance of each country as to whether it must be judged as 'non-accommodative' or 'accommodative' and if non-accommodative, whether it follows the asymmetric 'Bundesbank strategy' or the symmetric 'Fed- or cooperative strategy'. Additionally, we will have to qualify the collective bargaining systems with respect to their degree of corporatism[36] and 'marginalisation'[37]. Numerous studies[38] have provided different indices to measure monetary policy orientations. Although the focus of each study differs with respect to legal, institutional or functional independence of Central Banks, they all claim to measure the 'conservativeness' of Central Bankers concerning the priority given to price stability against alternative targets (e.g. employment and growth). Or to put it differently: the more conservative a Central Bank, the more non-accommodative its policy orientation. However, there is a major problem with all these indices: They do not take into account that legally, institutionally or functionally dependent Central Banks may, nevertheless, pursue a non-accommodative policy by pegging the exchange-rate of their currency irrevocably to some other currency (see e.g. Goodman 1992). However, this is very important in the case of our country sample, where the Netherlands and Austria completely pegged their currencies to the deutschmark – leaving no

[36] ‚Corporatism' or, synonymously 'coordination', means the *de facto* ability to behave as ‚encompassing organisation' as compared to the *de jure* degree of centralisation of a bargaining system.
[37] See footnote 24.
[38] See e.g. Alesina/Summers (1993); Grilli/Masciandaro/Tabellini (1991); Cukierman (1992); Bade/Parkin (1982); Iversen (1999).

room whatsoever for discretion. The Austrian Österreichische Nationalbank (OENB) handed monetary policy over to the Deutsche Bundesbank in 1976, the Dutch Central Bank de Nederlandsche Bank (NLB) followed in 1984 – implying that their respective monetary policy stance can henceforth only be judged as 'non-accommodative/Bundesbank strategy'. Even prior to 1976, the OENB was seen as fairly independent (non-accommodative) while prior to 1984 the NLB was definitely more accommodative than the Bundesbank (resulting in a continuous fall of the Dutch gilder relative to the deutschmark). After pegging their currencies to the deutschmark, the 'macroeconomic policy game' changed in the Netherlands and Austria: neither fiscal nor wage policy had to take monetary policy actions into account when fixing their policy stance. While wage policy in both countries was embedded in an institutional framework[39] in order to secure (international) competition-led wage settlements, fiscal policy was free to target employment or alternative goals (e.g. fiscal consolidation). The British Bank of England (BoE) was only granted (instrumental) independence in 1998 by the New Labour Government under Tony Blair. Until then, it was a subordinated part of the Treasury which was commonly translated into a (very) accommodative monetary policy stance. However, monetary restriction as part of the monetarist macroeconomics favoured by Margret Thatcher's governments since 1979 can hardly be described as 'accommodative'. Yet, as monetary and fiscal policies were still combined in the hand of a unitary actor (The Treasury), no non-cooperative strategic policy game was to be feared and a strategic policy-targeting (breaking the inflation expectations in the 1980s, stabilising aggregate demand and employment in the 1990s[40]) was still possible.

It seems easier to place the selected countries in the 'coordinated-non-coordinated' range of collective bargaining systems. Although many studies[41] claim Germany and the Netherlands legally as intermediately centralised bargaining systems (with dominant industry bargaining level), the high coverage rate (80 – 90%) and cooperative organisational structures within the employer's and employee's organisations allow us to group them alongside Austria as 'coordinated collective bargaining systems' while the UK must be regarded as 'uncoordinated' (with dominant company bargaining level). Moreover, there are signals that the 'local pushfulness potential' of company-level actors has suffered during the reforms of the Thatcher administrations (see Heise 1999: 89ff.; Glyn/Wood 2001) and we have come a long way down from the 'Soskice case' towards the 'Calmfors-Driffill case'.

[39] In the Netherlands, the tripartite ‚Socio-Economic Council' and the bipartite ‚Stichting van de Arbeid' must be mentioned, in Austria it is the tripartite 'Economic and Social Council'. At this point, we will simply ignore the specific institutional designs and incentive systems.

[40] For the sequencing of economic policy during the Thatcherite monetarist reforms see e.g. Minford (1988); Healey (1993).

[41] Schmitter (1981); Calmfors/Driffill (1988); Cameron (1984)

Table 2: Unemployment and inflation in different market constellations – hypothesis and reality

		Monetary and Fiscal Policy Mix							
		Accom.		**Non-Accom. – monopolistic coordination** (Bundesbank strategy)		**Non-Accom. – ex post coordination** (Fed strategy and/or active fiscal policy)		**Non-Accom. – ex ante coordination**	
Wage Policy	**Co-ordinated**	UNR: low INF: medium ***Netherlands (until 1984)***	**NL UNR:6,0 INF: 6,5**	UNR: medium INF: low ***Germany***	**Ger UNR:5,1 INF: 3,2**	UNR: low INF: low		UNR: low INF: low ***Austria (since 1976)*** ***Netherlands (since 1984)***	A UNR: 3.3 INF: 3.2 NL UNR: 5.5 INF: 1.8
	Non-Co-ordinated	UNR: medium INF: high ***United Kingdom (until 1979)***	**UK UNR:3,8 INF:14,0**	UNR: high INF: low – deflationary ***United Kingdom (during 1980ies)***	**UK UNR:9,6 INF:6,3**	UNR: high (SOSKICE) Medium - low (Calmfors-Driffill) INF: low – deflationary ***United Kingdom (since 1990ies)***	**UK UNR: 7,0 INF:3,0**		

Notes: ***Italic-bold = country example (hypothesis)***; **Bold = empirical average;** UNR = standardised unemployment rates; INF: GDP-deflator; figures show averages since 1970 (or as otherwise stated)
Sources: European Economy, various issues; own calculations

Taking into account that the figures in tab. 2 show averages over periods of different length and have different levels to start from[42], there seems to be no obvious mismatch between the hypothetical levels of inflation and unemployment in different market constellations and the empirical picture of the selected countries: the continental economies of Germany, Austria and the Netherlands combining a non-accommodative Bundesbank strategy with highly coordinated collective bargaining systems have done considerably better in both inflation and employment performance[43] than the UK and its non-coordinated bargaining system in the realm of monetarist non-accommodative monetary orientation since the 1980s. Yet, the UK has seemingly gained from its move to a more Fed like Central Bank design since the early 1990s and changes in wage-setting behaviour in line with the Calmfors-Driffill case (see e.g. Barrell/Weale 2003). However, presupposing the developments portrayed in fig. 3 and 4, it remains to be clarified why the Netherlands did not do better, particularly with respect to

[42] The UK, for instance, displays an unemployment rate of 3.8% on average during the period 1970 – 1979 and 7.0% on average during the period 1990 – 2004. The former is assessed as 'medium' while the latter is assessed as 'medium to low' – which seems odd. Yet 3.8% during the first period was, after the 'golden age' of the 1960s, just about European average, while 7.0% is, after the stagflation period of the 1970s and stagnation of the 1980s, well below the European average and, particularly, masks a rapidly falling trend.
[43] Both dimensions are often combined to form the 'misery index'.

unemployment, during the period until 1984, and why Germany has been doing so badly in recent times[44] – both of which are not quite explained by the predetermined market constellations.

4. Conclusion

This paper only made a start to explaining and assessing economic policy-making in the analytical frame of market participation and the creation of market constellations. It has been argued that a set of institutional, cultural and political factors form peculiar market constellations if they show some persistence. These market constellations may, on the one hand, explain the exact position of an economy where the theoretical foundation – e.g. a Post Keynesian model – is merely able to describe multiple equilibrium positions. On the other hand, market constellations may also be shaped by institution-building and may, thus, reduce the magnitude of contingency in policy control without propagating the idea of hydraulic policy control[45] – i.e. formability (*Gestaltbarkeit*) without Cartesian creatability (*Machbarkeit*).

Of course, there are still many more questions to pose and answer: Can the general impression given in tab. 2 be confirmed once a more detailed empirical investigation follows? If a non-accommodative monetary policy orientation mixed with a coordinated collective bargaining system establishes a market constellation most favourable to general welfare, which institutional setting may guarantee a cooperative or Fed-strategy to systematically prevail as opposed to coincidental outcomes depending on personal attitudes (of Central Bankers)[46]? Are more uncoordinated collective bargaining systems really prone to instability – the UK experience over the past decade seems to suggest a less sceptical outlook (see e.g. Glyn 2005). Or are there institutional incentives not yet detected? Can different budgetary policy designs (i.e. 'zero-deficits rules' versus 'golden rules') be identified and integrated into the market constellation framework? If market constellations only provide the room to manoeuvre, which institutional incentives can be given to be sure that any room to manoeuvre will be used?

Research into market constellations and macroeconomic policy-making is work in progress. However, eventually it may fill the wide gap between nomocratic policy denial on Hayekian premises and teleocratic policy euphoria on (standard) Keynesian premises which has led the theory of economic policy into disarray for the past three decades.

[44] A politico-economic interpretation is given in Heise (2005a) and Heise (2005b).

[45] One of the most eminent Post Keynesian scholars, Thomas I. Palley, speaks of ‚structural conditions' favourable to Keynesian demand management (Palley 1998: 103). The foregoing analysis has provided an interpretation of what Palley might have meant.

[46] There is a long tradition on attributing considerable importance to such personal factors; see e.g. Friedman (1962); Deane/Pringle (1995); Toniolo (1988) or Blinder (1998).

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