

## Introduction

How do macroeconomic policies and economic institutions jointly determine economic performance and distribution? This is a classic topic in comparative political economy, and one that preoccupies politicians at a time when high unemployment and rising inequality are tearing apart the social fabric of many societies. Yet, it is a topic that has drifted into the background in the scholarly literature as a result of the rational expectations revolution in economics. According to the new orthodoxy, macroeconomic policies in general, and monetary policies in particular, have no long-term effects on the real economy. Consequently, the analysis of macroeconomic policies and institutions has been reduced to a focus on either their short-term effects (e.g., Alesina, Roubini and Cohen 1997), or their consequences for nominal variables such as inflation (e.g., Cukierman 1992). This book instead argues that even under rational expectations, macroeconomic policies and institutions have long-term effects on unemployment and distribution of income. Hence, it seeks to reunite classic comparative political economy with modern macroeconomic theory.

There are weighty empirical and political reasons for undertaking such a project now. In most advanced industrialized countries the problems of unemployment and inequality are as pressing today as they were in the 1970s. Yet neither traditional comparative political economy nor new classical economics offer credible explanations for these problems, much less proposes credible solutions. For example, in a recent study by the OECD, the neo-corporatist idea that unemployment is determined by the organization of wage bargaining receives no empirical support (OECD 1997). At the same time, the

neoclassical notion that unemployment is caused by labor market rigidities can account for at most a small portion of the variance in employment performance (Nickell 1997). And while rational expectations macroeconomics offers a powerful critique of traditional Keynesian analyses, the theory has next to nothing to say about what governments can do to influence employment and income (Mankiw 1990).

This state of affairs is beginning to change. New classical economists are increasingly concerned with understanding the mechanisms by which macroeconomic policies and institutions affect, not only people's inflation expectations, but also their real behavior. In a new book on the topic by leading macroeconomists, for example, it is acknowledged that "contrary to what many modern macroeconomic models suggest, central bank actions often affect both inflation and measures of real economic activity, such as output, unemployment, and incomes [,] but the nature and magnitude of these effects are not yet understood" (Solow and Taylor 1998). Comparative political economists, with the help of new Keynesian economists, are likewise beginning to explore the consequences of incorporating insights from rational expectations economics into macro-institutional models of economic performance (see Scharpf 1991; Layard, Nickell, and Jackman 1991; Iversen, Pontusson, and Soskice 1999). This book is written as a contribution to this emerging literature, and it offers a bridge between modern macroeconomic theory and traditional comparative political economy.

The main argument of the book can be briefly outlined as follows. Imagine that unions and employers bargain wages for a large segment of the labor force, with each bargaining area having some effect on aggregate prices. A central question is then whether

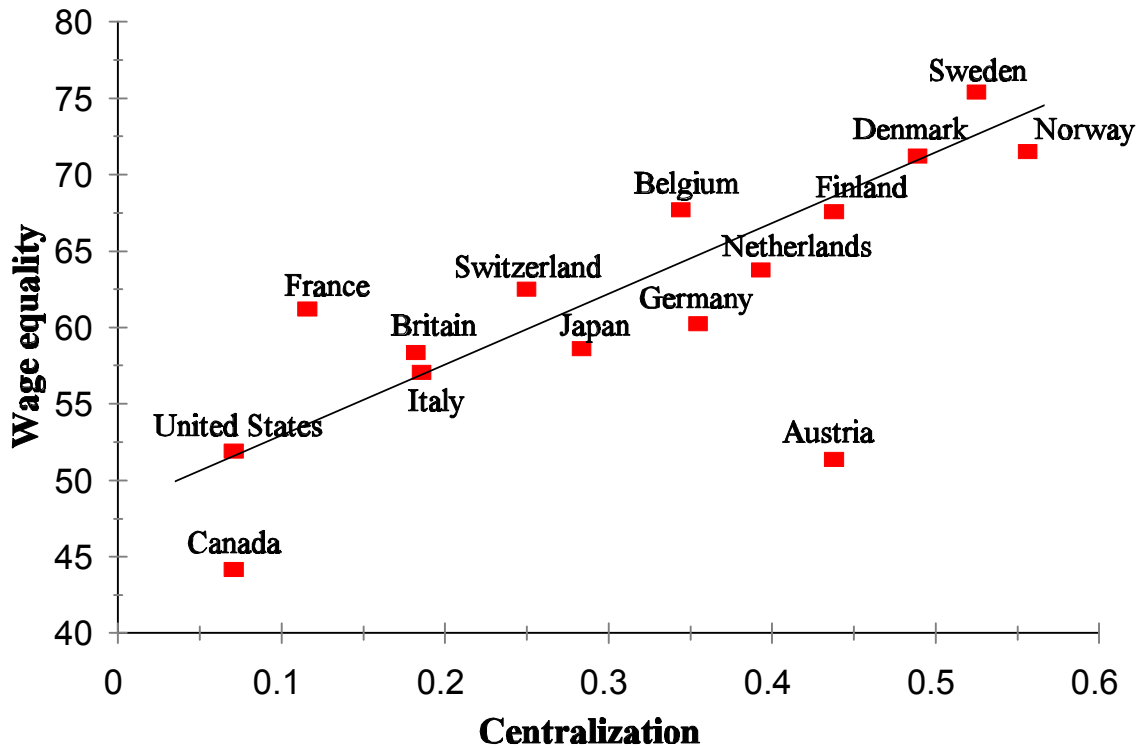
bargainers will rationally let their behavior be affected by the aggregate price effects of their actions, assuming that they care only about real variables.<sup>1</sup> The answer depends on the extent to which the aggregate price effect will translate into lower demand in each particular bargaining area; or, to put it in the language of monetary economics, whether militancy can rationally be anticipated to reduce the (sectoral) real money supply. In turn, whether this is the case depends on the monetary rule adhered to by the government. If the rule is accommodating (i.e., the monetary authority seeks to avoid a reduction in real demand) the effect on the real money supply of higher wages and prices will be low, and there will consequently be little reason for the wage bargainers to endogenize the macroeconomic effects of their actions. By contrast, if the monetary rule is nonaccommodating (i.e., the monetary authority adheres to a low-inflation target), militancy will reduce the real money supply and bargainers will consequently have an incentive to exercise restraint. With some measure of centralization, a restrictive monetary rule can thus help to alleviate the collective action problem faced by independently bargaining unions and employer associations.

On the other hand, the capacity of unions to act in the collective interest increases with centralization. Hence, the need for a monetary deterrent declines as centralization increases. Indeed, at high levels of centralization restrictive monetary policies can interfere with the solution to another coordination problem, the reconciliation of competing claims within the union (con)federation. Union federations are coalitions of unions, and with centralization comes the need for compromise between increasingly diverse wage groups. Such compromise tends to compress wages (see Figure 1.1), and it produces nominal wage pressure when peak bargainers push up negotiated increases to safeguard against the

inequalizing effects of decentralized wage “drift” (unauthorized increases at the local level). When this inflationary pressure runs up against an nonaccommodating monetary policy, the result will be unemployment. There may thus be a point of centralization where the beneficial deterrence effects of nonaccommodation are outweighed by the deleterious effects of its interaction with solidaristic wage policies. The upshot of the argument is that non-accommodating monetary regimes produce inferior employment performance in highly centralized systems, but superior performance in intermediately centralized systems. Only in completely decentralized systems, where bargainers are too small to affect the macroeconomy, will monetary regimes have no lasting effects on real variables.

This relatively simple argument has remarkably rich implications, theoretically as well as empirically. From the perspective of macroeconomic theory, the most striking implication is that monetary rules and the equilibrium rate of unemployment are causally related, even if we assume complete information and rational expectations. This result collides head on with new classical macroeconomics which holds that systematic monetary policies are irrelevant for real outcomes. Second, the model shows that the economic effects of bargaining structures are contingent on the macroeconomic regime. Contrary to the view in most of the neo-corporatist literature, there is thus no reason to expect any particular relationship between bargaining centralization and performance (such as the hump-shaped relationship proposed by Calmfors and Driffill 1988). Finally, the theory throws new light on the role of partisan politics for economic outcomes. In

**Figure 1.1. Earnings equality and centralization of wage bargaining.**



*Notes:* Wage equality is measured as the ratio of gross earnings (including all employer contributions for pensions, social security, etc.) of a worker at the bottom decile of the earnings distribution relative to the worker at the median ( $d1/d5$  ratios). Figures are averages for the period 1977-93 computed from the *OECD Employment Outlook* (1991, 1996). The measure for bargaining centralization is explained in detail in the text and in Chapter 3.

given institutional environments certain policies “work better,” and governments of all stripes will consequently have an incentive to adopt similar policies. But since institutions have different distributional consequences, partisan governments and organized interests diverge in their preferences over equilibria. Who governs therefore becomes important only when the conditions for institutional change are propitious, and part of this book explains

how globalization, postindustrialization and new technology have made such change more likely.

The interaction among monetary regimes, bargaining institutions, and economic performance can usefully be illustrated with some comparative data (see Table 1.1). The monetary regime is here measured as an average of an institutional variable, central bank independence, and a more policy-sensitive variable based on relative exchange rate movements.<sup>2</sup> The centralization variable is divided into three classes: a decentralized category where firm- and plant-level bargaining dominate, an intermediately centralized category with most bargaining taking place at the industry or sectoral level, and a centralized category with an important role for peak-level bargaining between encompassing organizations of labor and capital. The monetary regime variable is simply dichotomized.<sup>3</sup>

The most interesting part of the table is the bottom row, which shows the difference in performance between cases with “accommodating” and “nonaccommodating” regimes. Note that for highly centralized systems, there appears to be an employment loss from having a restrictive regime, whereas for intermediately centralized systems the opposite holds true. For decentralized systems, where wage-setters are atomistic and therefore not interacting strategically with the central bank, there are no apparent employment effects from the monetary regime. This pattern is contrary to the prediction in both new classical economics and in neo-corporatist theory, but it is consistent with the theory developed and tested in this book.

**Table 1.1. Centralization of Wage Bargaining, Monetary Regime, and Unemployment for 15 OECD Countries, 1973-93.**

		Centralization of wage bargaining			<i>Low-high</i>
		Low	Intermediate	High	
<b>Monetary regime</b>	Accommodating	8.0	6.9	3.8	4.2
	Nonaccommodating	7.9	3.6	7.1	0.8
Row differences		0.1	3.3	-3.3	N=75

*Note:* Data were grouped into five four-year intervals for a total of 75 observations. Unemployment refers to standardized rates; the measurement of the independent variables is described in the text. The figures have been corrected for period differences in unemployment.

*Sources:* For dependent variable: *OECD Economic Outlook* (1992c; 1998); for independent variables: See text and Chapter 2 for details.

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### **Institutional design**

My argument about the economic *effects* of institutions also have consequences for understanding the institutions themselves. There is now a sizable theoretical debate about the role of distribution versus efficiency in institutional design (see Williamson 1985: ch. 9; Tsebelis 1990: ch. 4; Knight 1992), but most of the current literature follows a more or less explicit transaction-cost approach, conceptualizing institutions as efficient solutions to collective-action problems or time-inconsistency problems. I do not challenge the idea that

efficiency plays a part in institutional design, but since institutions have distributive effects they are also chosen in part because they favor certain interests over others. This is nicely illustrated by the data presented above. Assuming that collective-action problems could be overcome, we would expect broad support behind one of the two institutional combinations in Table 1.1 that are associated with superior unemployment performance. Yet from Figure 1.1 we know that the distributive consequences of this choice vary. Hence, the choice is ultimately a political one and will therefore be contested by actors with conflicting interests and institutional preferences.

An objection to this argument is that if efficiency varies across institutional “equilibria,” which seems likely, people can always devise some side-payment scheme that would leave everybody better off. This is the essence of Coase’s Theorem. Efficiency, therefore, would ultimately drive institutional development. Yet such side-payment schemes necessarily entail complicated rules of distribution that must be specified in a comprehensive and enforceable *ex ante* contract. Transaction-cost economics, despite its claim to account for economic institutions in terms of efficiency, essentially rules out this possibility by demonstrating the insurmountable practical obstacles to such contracts (Williamson 1985). As a result, institutional choices can be understood only if we pay attention to the political struggles between organized, and conflicting, interests whose support is required for a particular institutional outcome (“veto players”). In short, the existence of multiple equilibria with different distributive consequences forces us to adopt a conception of institutional design that pays equal attention to economics and politics.

This does not mean that the existing institutional order is constantly under partisan attack. To break up a national system of collective bargaining, for example, risks jeopardizing a time-tested mechanism to control wages. Likewise, any government will think twice before adopting a new set of economic policies unless it is confident that it can persuade unions and employers to sponsor the necessary institutional mechanisms required



to make the policies work. Failure can carry a very high price tag as, for example, the Danish social democrats learned when they lost control of the economy in the late 1970s. Once out of government, it took them over a decade to regain the confidence of voters and centrist parties to return to power. In Britain it took nearly two decades for the Labour Party to do the same after economic reforms had failed in the late 1970s. On the other side of the coin, Sweden in the 1960s and '70s illustrates how partisan politics for a long time can be hidden behind a rhetorical facade of cooperation and common cause, until it suddenly erupts with penned-up intensity, as happened when old political coalitions fell apart in the 1980s and early '90s.

The idea of politically contested equilibrium institutions puts the analytical spotlight on forces that change the relative power of veto players. Although we cannot measure such power directly (any more than the players can), it is possible to identify the forces of change that are likely to shift the balance one way or the other, and then to link such changes to the timing and cross-national pattern of institutional change. In the following I provide a brief overview of some of the main changes in economic institutions and policies that is subject to this type of explanation in later chapters.

### *<B> Wage bargaining*

Table 1.2 summarizes longitudinal data on the degree centralization in wage bargaining across 15 OECD countries.<sup>4</sup> The data are averaged across two broad subperiods: (i) the long recession from the first oil crisis in 1973 to the end of the second oil crisis in 1983, and (ii) the period of slow recovery, but also structural-institutional change, from 1984 to 1993.

Comparing the two periods, no clear patterns of change emerge, but there is some evidence of decentralization. This is quite evident in Denmark and Sweden where the combination of a devolution of authority away from the peak level, and the rise of rivaling

**Table 1.2. Centralization of Wage Bargaining in 15 OECD Countries**

	<b>Centralization<sup>a</sup></b>		
	1973-83	1984-93	$\Delta$
Norway	0.52	0.53	0.01
Sweden	0.57	0.41	-0.17
Denmark	0.65	0.58	-0.06
Finland	0.44	0.40	-0.03
Austria	0.42	0.42	-0.00
Netherlands	0.38	0.36	-0.02
Germany	0.35	0.32	-0.03
Belgium	0.36	0.27	-0.09
Japan	0.23	0.29	0.06
Switzerland	0.25	0.25	-0.00
Italy	0.18	0.14	-0.04
Britain	0.21	0.12	-0.09
France	0.13	0.11	-0.02
Canada	0.07	0.07	0.00
United States	0.07	0.07	0.00
<i>Mean</i>	0.32	0.29	-0.03

<sup>a</sup> The index is explained in detail in the text and in Chapter 3.

union confederations to the dominant blue-collar LOs, caused a gradual (and sometimes not so gradual) decentralization of the bargaining system in the 1980s.<sup>5</sup> Several other countries such as Belgium, the Netherlands, Germany, and Italy also experienced some decentralization as corporatist coordination at the national level came to an end in the 1980s. Moreover, while not fully captured by the data, multi-employer bargaining has been on the decline in the already decentralized systems of Britain, Canada, the US and France (Howell 1992: ch.8; Katz 1993; Purcell 1995).<sup>6</sup> On the other hand, Austria and Switzerland exhibit remarkable stability, and Japan has seen an increase in centralization with the merger

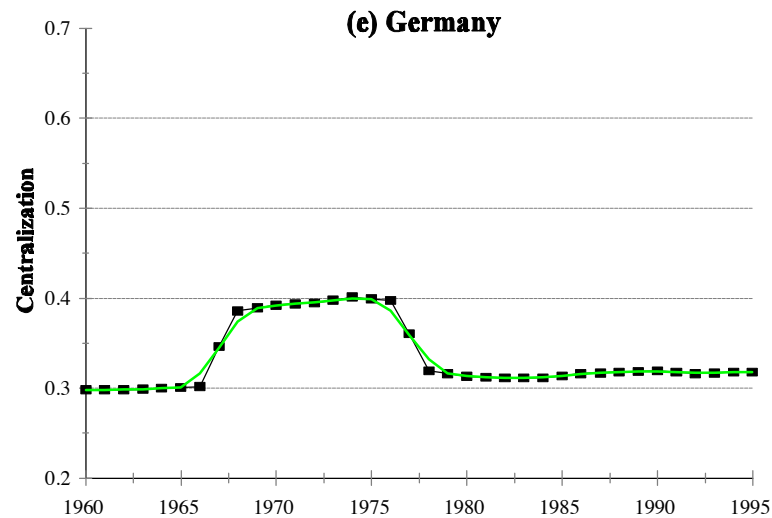
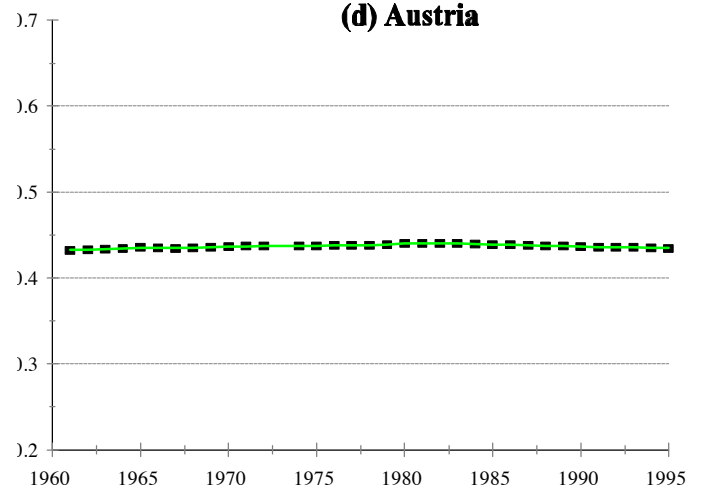
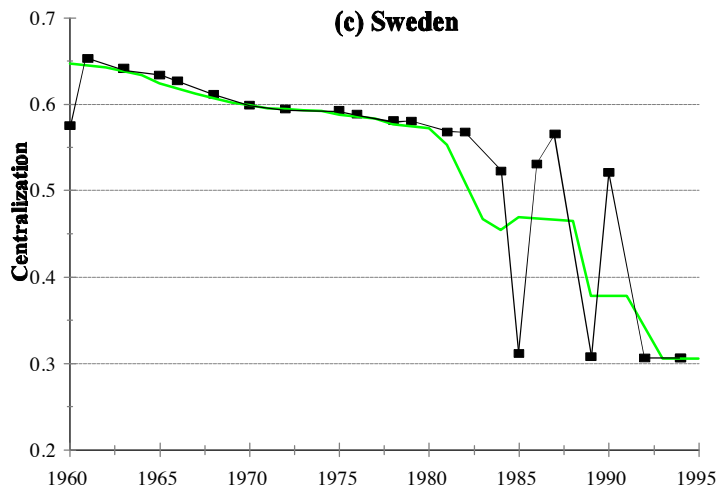
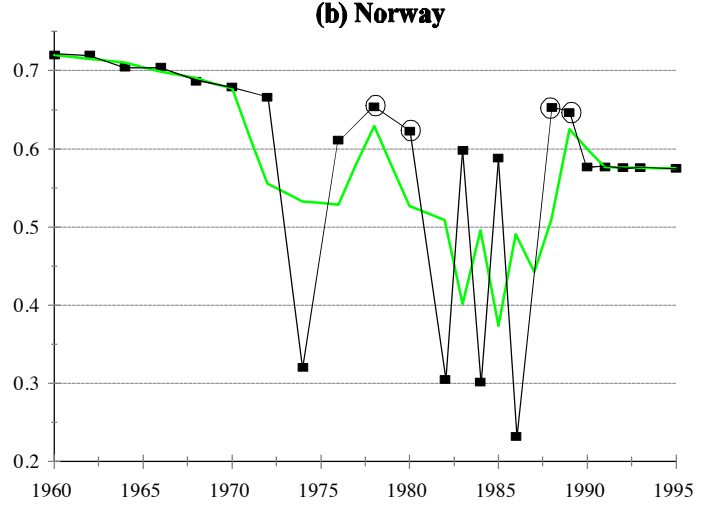
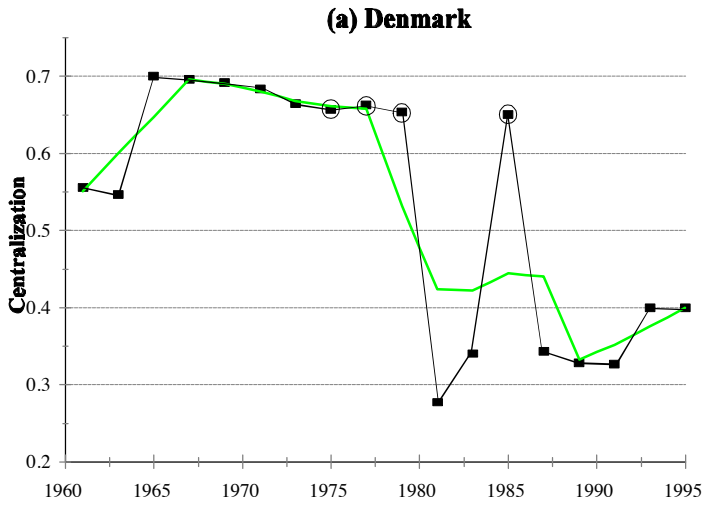
in 1989 of the four largest union confederations. Norway also went through a period of (re)centralization in the late 1980s, although this is not evident in the period averages.<sup>7</sup>

While it is thus difficult to detect any uniform trend in centralization across countries, the data in Table 1.2 hide a lot of interesting cross-time variance that can help unlock the causes of change. Compare in particular the evolution of bargaining centralization in five Northern European countries: Austria, Denmark, Germany, Norway, and Sweden (Figure 1.2a-e). During the 1960s and 1970s, bargaining in the Scandinavian countries (panels a-c) was mainly conducted at the national level by a few dominant blue-collar associations, and the gradual downward trend in centralization is due to the growth in the membership of white-collar confederations, especially in the public sector. This trend is not replicated in Austria and Germany, where the same set of industrial unions have continued to dominate throughout the reference period.

The most striking divergence in the evolution of bargaining institutions across the four countries, however, is not the result of membership deconcentration, but rather the breakdown of peak-level bargaining in Denmark and Sweden in the 1980s. In Denmark, decentralized bargaining between individual unions and their employer counterparts was initiated in 1981, and the relatively centralized bargaining rounds in 1983 and 1985 appear to have been transitory events in a general trend toward a more decentralized equilibrium. In Sweden, the first break with over two decades of centralized bargaining came in 1983, and despite considerable oscillation between centralized and decentralized forms of bargaining since then, the data lend support to the dominant view that the 1980s and early 1990s marked a more radical shift away from centralized bargaining (see Pontusson and Swenson 1996; Elvander 1988).

The Norwegian case (panel b) contrasts to the other Scandinavian experiences. Although subject to the same deconcentration trend, and experiencing a similar

Figure 1.2. Centralization of wage bargaining in five OECD countries.



- Centralization score
- 3-round moving average
- State intervention

Sources: Explained in text.

decentralization of bargaining authority in the early 1980s (accompanied by considerable volatility), in the second half of the 1980s this trend was reversed, and the late 1980s saw some of the most centralized bargaining rounds in the history of Norwegian industrial relations. Austria likewise contrasts with Denmark and Sweden by the absence of decentralization. The evolution of Austrian institutions, however, differs from all the Scandinavian cases, including Norway, by exhibiting remarkable stability. Germany is likewise very stable if we discount the failed experimentation with a weak form of macrolevel coordination from 1967 to 1977.

Remarkably, the patterns of change observed in these five countries defy virtually all existing conceptual classifications and thus represent intriguing empirical puzzles. First, the data clearly do not fit the hypothesis, proposed by Crouch (1993), that corporatist arrangements collapse only in the countries where they have not been consolidated through a long history of organizational adaptation. With the partial exception of Austria (which is stable), corporatist institutions in all five countries have evolved over a long span of time and enjoyed widespread political support. But the data also do not fit the most comprehensive comparative study of the small corporatist states by Katzenstein (1985). For one thing, the patterns in Denmark and Sweden hardly support Katzenstein's main thesis that "more severe international constraints make the domestic politics of the small European states more cohesive" (1985: 198). Nor does the pattern of change conform to Katzenstein's typology of corporatist countries, which places Denmark, Norway, and Austria in the same subcategory (with Sweden being only marginally different). Likewise, Katzenstein's analysis shows that these countries (Sweden and Germany to a lesser extent) are similarly inserted into the world economy, thus making explanations of the type Gourevitch (1978) calls "second image reversed" unlikely to account for the considerable variation in institutional development. Although technological and economic changes in the world economy have important effects on domestic bargaining institutions, as discussed in

later chapters, differences in the institutional consequences of these changes must be mediated by domestic structures and processes.<sup>8</sup> This brings us to the role of macroeconomic policies and institutions.

### <B> *Macroeconomic regimes*

A frequently used indicator for the “conservatism” of the monetary regime is the independence of the central bank, meaning the autonomy and capacity of central banks to pursue low-inflation targets. In standard models of monetary policy, democratically elected governments are shortsighted and inflationprone, making delegation of policy-making power to an independent central bank a precondition for low inflation (see, for example, Cukierman 1992; Grilli, Masciandaro, and Tabellini 1991; and Alesina and Summers 1993). This book agrees that central bank independence is one useful measure of the character of the monetary regime, and I will make liberal use of it in later chapters. Yet central bank independence indexes are not very useful to gauge changes in policy regimes over relatively short periods of time, and they simply miss the fundamental changes that took place in many governments’ economic policy priorities from the 1970s to the 1980s.

Table 1.3 provides some indicators for this shift, with countries listed in the same order as in Table 1.2. (i.e., by centralization). Note that in most countries real interest rates rose considerably during the 1980s while inflation was everywhere forced down. Inflation remained above average during the 1980s in Britain, Finland, Italy, Norway, and Sweden, but the cross-time trend toward a reduction is universal. Another indicator of monetary policy, which highlights relative changes between countries, is the movement of exchange rates. More than figures for interest rates and inflation, exchange-rate movements reflect policy expectations of currency markets, and therefore indirectly indicate the nature and appreciating currency.<sup>9</sup>

**Table 1.3. Monetary Policy Indicators for 15 OECD countries**

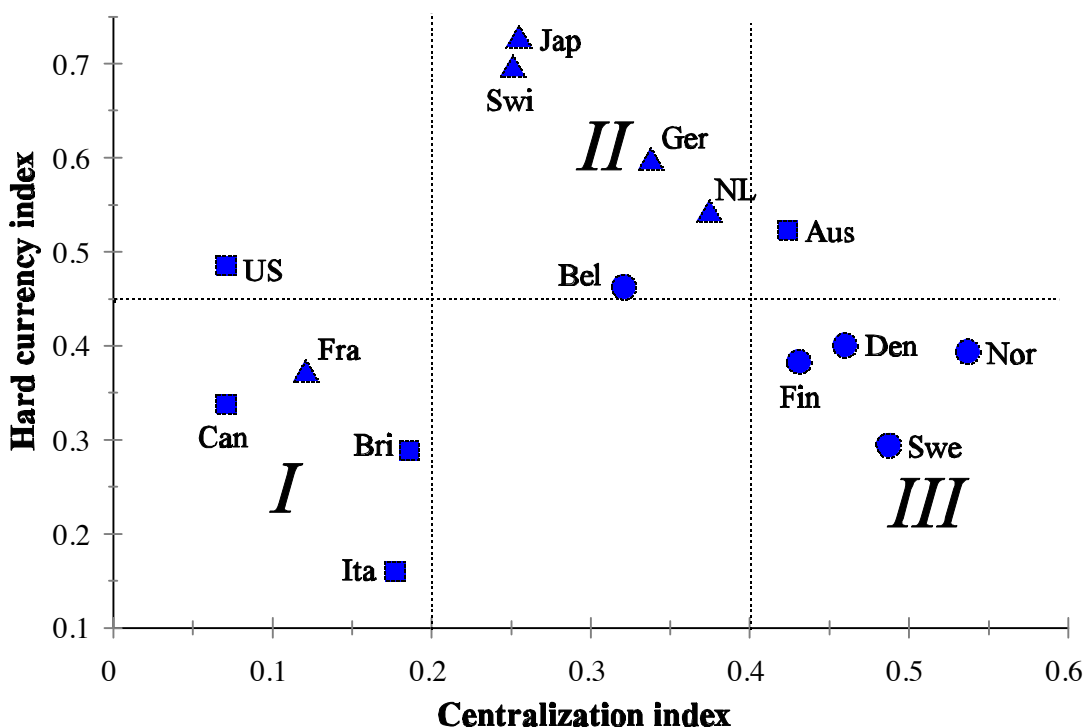
	Real interest rates <sup>a</sup>			Inflation <sup>b</sup>			Hard currency index <sup>c</sup>		
	1973-83	1984-93	Δ	1973-83	1984-93	Δ	1973-83	1984-93	Δ
Norway	-0.3	6.1	6.4	9.5	5.1	-4.4	0.43	0.36	-0.07
Sweden	0.5	4.8	3.3	9.9	6.4	-3.5	0.30	0.28	-0.02
Denmark	4.7	6.6	1.9	10.4	3.7	-6.7	0.34	0.49	0.15
Finland	-1.1	5.9	6.4	11.8	4.7	-7.1	0.36	0.41	0.05
Austria	2.9	4.5	1.6	6.2	3.1	-3.1	0.54	0.50	-0.04
Netherlands	2.5	5.6	3.1	6.6	1.8	-4.8	0.54	0.54	0.00
Germany	3.3	4.8	1.5	5.0	2.5	-2.5	0.60	0.59	-0.01
Belgium	2.1	6.0	3.9	8.0	3.0	-5.0	0.42	0.51	0.09
Japan	-0.0	3.7	3.8	8.1	1.7	-6.4	0.66	0.80	0.14
Switzerland	0.2	1.8	1.6	4.7	3.2	-1.5	0.72	0.64	-0.08
Italy	-2.1	5.5	7.6	16.6	6.4	-10.2	0.05	0.29	0.24
Britain	-0.2	4.6	4.8	13.3	5.2	-8.1	0.30	0.28	-0.02
France	0.3	5.8	6.1	10.9	3.6	-7.3	0.30	0.47	0.14
Canada	1.3	6.1	7.4	9.3	4.0	-5.3	0.30	0.39	0.09
United States	1.3	4.8	3.5	8.2	3.8	-4.4	0.49	0.47	-0.02
<i>Mean</i>	1.0	5.1	4.1	9.2	3.9	-5.3	0.42	0.47	
<i>Std.</i>	1.7	1.2		3.1	1.4		0.17	0.14	

<sup>a</sup> Average yearly yield on long-term government bonds minus consumer price inflation (OECD 1992c, 1998); <sup>b</sup> Average annual change in the consumer price index (OECD 1992c; 1998); <sup>c</sup> Based on relative changes in nominal effective exchange rates (IMF, Financial Statistics).

Note that the countries that have extreme scores on the centralization index, Britain, Canada, France and Italy at the decentralized end, and Sweden, Norway, Denmark and Finland at the centralized end, have low scores on the hard currency index, while those with high scores all are positioned in the intermediately centralized category, including Japan, Germany, Switzerland, and the Netherlands. This curvilinear pattern is perhaps more apparent in Figure 1.3, which shows the position of countries in terms of both bargaining centralization and the “conservatism” of the currency regime. Countries with either

decentralized or with highly centralized bargaining systems exhibit “soft” regimes (fields I and III), whereas countries with intermediately centralized bargaining systems constitute a hard currency block (field II). These clusters of countries are further distinguished by differences in the degree of wage inequality, with reduced levels of inequality as we move from field I to field III.

**Figure 1.3. The position of 15 OECD countries on centralization of wage bargaining, hard currency regimes, and wage inequality.**



**Key:** ■ High wage inequality; ▲ medium inequality; ● low inequality.

**Sources:** See text for centralization indexes. Wage inequality refers to the ratio of gross earnings of a worker at the median in the earnings distribution relative to the worker in bottom decile (d5/d1 ratios) (OECD 1991).



In terms of change over time, the most unstable cases are found at the extremes. Monetary policies have been tightened in countries with previously lax regimes (using the whole set of monetary regime indicators), with the result that there has been a partial convergence in policies (as seen in Table 1.3 by the decline in the standard deviations of the indicators). There is some agreement that this trend is at least partly due to the liberalization of capital markets. When exchange rates are fixed, high international financial capital mobility undermines monetary policy autonomy, and hence the ability to pursue expansionary monetary policies (Frieden 1991; Soskice 1999). In semifixed exchange rate systems of the sort currently adhered to by most OECD countries, high capital mobility makes the pursuit of independent and inflationary monetary policies costlier because markets assess an interest rate risk premium against “profligate” governments (see Scharpf 1991; Helleiner 1994; and Andrews 1994). Even governments that are little concerned with inflation are therefore forced to combine macroeconomic stimulation with an offsetting rise in interest rates.

For most countries the impetus for this liberalization had a strong external or foreign component. As described by Scharpf (1991), Helleiner (1994), and Soskice (1999), once financial market liberalization got underway in important countries like the UK and the United States, and once the U.S. Federal Reserve embarked on a radically deflationary strategy, the German Bundesbank (given its self-imposed role as the guardian for the international value of the DM) was compelled to follow suit, and this pulled the rest of Europe down a deflationary monetary path. Even Garrett, one of the most skeptical commentators on the globalization literature, concedes that high capital mobility makes expansionary macroeconomic policies more costly (Garrett 1998: ch. 4; see also Garrett and Lange 1991).

The rise in the costs of accommodating, full employment policies helps to explain

changes in highly centralized bargaining institutions because it shifted the relative political power in favor of those supporting decentralization. Thus the movement in Belgium and especially Denmark away from peak-level bargaining was accompanied by tightening of monetary policies and the adoption of hard currency regimes. In essence a move from field III to field II in Figure 1.3. Sweden also attempted (in 1991) to commit to a hard currency policy after peak-level bargaining had collapsed. But the realignment behind decentralization was clearly also facilitated by changes in technology and by postindustrialization. New technology placed a premium on greater wage flexibility, and the rise of services, which lagged manufacturing in productivity growth, exacerbated sectoral divisions, especially between the private and public sector. In all cases the shift away from centralized bargaining was associated with cutbacks in unemployment benefits, a rise in earnings inequality, and an increase in unemployment among the lowskilled.

These trends and patterns are not well accounted for within the existing literature. For example, neo-corporatist theory emphasizes the benefits of centralized bargaining and Keynesian accommodation and cannot explain why some countries have abandoned both. Likewise, Calmfors and Driffill's (1988) application of Olson's collective action logic cannot explain why the most stable cases are found in the intermediately centralized category, where the conditions for good economic performance are purportedly the worst. In a similar vein, new classical economics fails to explain why countries are not converging on a neoliberal model with decentralized labor markets and a restrictive macroeconomic regime. Finally, none of the emerging arguments about the interaction between bargaining institutions and monetary institutions are consistent with the curvilinear relation between centralization and monetary regimes. Lange and Garrett (1985) imply that nonaccommodation is beneficial only in decentralized systems, whereas intermediately centralized systems are bad for performance.<sup>10</sup> Hall and Franzese (1998) imply that nonaccommodation makes sense only in highly centralized systems, whereas Cukierman and

Lippy (1998) argue that especially intermediately and highly centralized bargaining systems would benefit from accommodating regimes. Finally, standard monetary theory simply does not allow the possibility that monetary regimes and centralization are causally related (Bleaney 1996).

The argument in this book deviates from other explanations primarily by emphasizing the multiple equilibria nature of institutional interaction and by underscoring the political nature of “choosing” between these equilibria. Thus, the comparative analysis will show how exogenous changes in technology, capital market integration and deindustrialization affected the balance of power between governments and private agents, triggering political realignments that led to the patterns of change observed in the five cases introduced above.

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### **Plan of the book**

The book is divided into two parts. *Part I* focuses on the economic *effects* of institutions and policies on outcomes, and *Part II* focuses on explaining the institutions and policies themselves. Both parts are subdivided into a (mostly) theoretical and a (mostly) empirical chapter. The main text of the theoretical chapters (Chapter 2 and 4) presents the arguments in nontechnical terms, while the accompanying appendixes formalize the arguments and spell out underlying assumptions and nonobvious steps in the logic. It is not necessary to read the technical appendixes to understand the arguments, but for the technically inclined it is possible to read *only* the appendixes (along with the chapter introductions). It is also possible to read either part of the book separately, although Part II cannot be fully appreciated without having read Part I.

Concerning the empirical analysis, Chapter 3 focuses exclusively on the quantitative evidence and is essentially an empirical study of the linkages between macroeconomic institutions and performance. Considerable energy goes into developing good time-sensitive

measures of bargaining centralization and monetary regimes, but most of the chapter is devoted to a statistical analysis of economic performance in 15 OECD countries over a 21-year period. Chapter 5 uses a case-oriented method to explain change and stability in wage-bargaining institutions and macroeconomic policy regimes in the five countries discussed above: Austria, Denmark, Germany, Norway and Sweden. Chapter 6 summarizes the findings and discusses their theoretical and empirical implications.

## Notes

1. Recently models have been proposed that assume that wage bargainers also have preferences over monetary variables (see Skott 1997; Cukierman and Lippi 1998). These models come close to assuming money illusion, and I wish to avoid this route. I do, however, share their concern for the real effects of monetary policies.
2. The index of central bank independence is an average (after standardization) of three widely used indices by Bade and Parkin (1982), Grilli, Masciandaro and Tabellini (1991), and Cukierman (1992). The exchange rate index is based on OECD data for relative growth in nominal effective exchange rates.
3. The data consists of five four-year intervals between 1973 and 1993 for a total of 75 observations.
4. The data are discussed in detail in Chapter 3.
5. Decline in trade-union membership is sometimes argued to provide further evidence of decentralization (Katz 1993). However, the fall in density rates is often of little consequence for bargaining due to the widespread use of extension laws that legally obligates employers to follow collectively negotiated pay rates (OECD 1997). Exceptions are Britain and the United States. Conversely, growing unionization, which has occurred in the Scandinavian countries, does not necessarily imply centralization since much of the membership growth has come outside the previously dominant blue-color unions, causing deconcentration of union membership. This tendency is mirrored in the centralization data.
6. Bargaining over non-wage issues, especially work time, has increasingly taken place at the plant-level in Germany and Austria (Thelen 1991, 1993; Traxler 1992).
7. The difficulty in detecting a universal trend is echoed in Hyman (1994), Wallerstein,

Golden, and Lange (1997), and Kitschelt, Marks, Lange, and Stephens (1999).

8. In the case of Germany, Katzenstein does not offer a detailed comparison with the smaller states, but he *does* note that the country "comes closer than any other large state to the logic by which political life in the small European states is organized" (1985: 31).

9. The construction of the index is explained in detail Chapter 3.

10. In a later piece, however, they are more cognizant of the possibility that intermediately centralized systems may exhibit good economic performance, and therefore also of the possibility that they will be stable. See Garrett and Lange (1995).