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Research and Policy Debates — Refereed

The Systemic Downside of Flexible Labour Market Regimes: Salter Revisited

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Over 50 years ago Wilfred Salter published *Productivity and Technical Change* (1960 [1966]), a book which quickly became a classic. I have never met anybody who has read it who has not said it is one of the most influential, impressive and enjoyable books in economics that they have ever read.[1] The book itself grew out of Salter's Ph.D. dissertation at Cambridge which was supervised by Brian Reddaway and submitted in 1955. Tragically, Salter was only to live another three years after the book was published.[2] In addition to the book, his legacy to the profession includes a number of fine articles, mostly published in the *Economic Record* (Salter was a West Australian and worked with Trevor Swan at the ANU (and in the Department of the Prime Minister) after he returned from Cambridge and before he went to Pakistan where he died.)

The articles were concerned with refining and extending the themes of his book. After his death, in an IEA (International Economic Association) volume edited by Austin Robinson, Robinson (ed.) (1965), there is a most important chapter by Salter. It is entitled 'Productivity growth and accumulation as historical processes'; it extends Salter's analysis of firms and industries to the economy as a whole. Salter and Eric Russell appeared for the Trade Unions in the 1959 Basic Wage case in Australia. They presented empirical evidence and theoretical arguments based on the themes developed both in Salter's book and articles and, independently, by Russell.

I argue here that Salter's arguments, and the policy proposals derived from his work, are still, as befits a classic, of major relevance for some of today's most pressing economic and social problems.

So what were the issues that Salter investigated and what were his major policy proposals? The principal puzzle that Salter tackled was how was it possible for the latest vintages, which incorporated the 'best-practice' combinations of the services of labour and capital goods, and older vintages, which were installed when what are now inferior 'best-practice' combinations ruled, to exist side by side in firms and industries? His answer was clear and definitive: for the older vintages to survive, they only had to expect to cover their immediate *variable* costs — their expected quasi-rents only had to be positive (at the margin, non-negative). By contrast, the new vintages had to expect to cover their *total* costs,

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including (at least) normal profits. This meant that current rates of output could be supplied from both newly installed 'best-practice' machines and from fossils in capital stocks, the earlier vintages installed in past periods. Gross investment expenditure was the means by which new ways of doing things were introduced into the stock of capital goods.

In a competitive setting for an industry (Salter's work initially was a Marshallian partial equilibrium analysis), if we also assumed that technical advances do not occur continuously but, rather, periodically, the firms and the industry would approach an equilibrium level. At the equilibrium level, the combined outputs of new and old machines in the industry would have so risen that the price of the product of the industry set in the competitive market would allow only the normal rate of profit to be expected to be received on the latest 'best-practice' vintages. Accumulation then would come momentarily to a halt until the next wave of technical advances occurred. Which older vintages operated and provided part of current overall output would be determined by those whose expected quasi-rents were positive (at the margin, non-negative, ignoring complications associated with scrap value). In this manner Salter combined the characteristics of Marshall's short-period and long-period analysis to explain his original observations.[3]

The process of embodiment through gross investment had implications for the level and rate of growth of productivity in firms, industries and the economy overall (this last was the subject of his 1965 IEA volume chapter). Salter argued that if the economy was kept at full employment, overall productivity would be higher and would grow faster, the more investment in high productivity and/or expanding industries was encouraged and investment in low productivity and/or declining industries, discouraged. Such an outcome was most likely to be achieved in an economy which encouraged flexible resource movements and where changes in money wages reflected changes in *overall* productivity (plus prices, if the economy was experiencing overall inflation). As Salter (1960: 153) wrote:

> … it is particularly desirable that the market for labour should cut across inter-industry boundaries, thereby ensuring that comparable labour has the same price in expanding and declining industries. The argument that an industry cannot 'afford' higher wages is, in the long run, extremely dangerous. If it were accepted and wages were based on the 'capacity to pay', employment would be perpetuated … in industries which should properly decline to make way for more vigorous industries. Equally dangerous is the argument that industries which are prosperous because of new techniques have the 'capacity to pay' high wages. This would penalise the expanding industries on which so much depends.[4]

Higher rates of gross investment also are a necessary condition for these desirable changes to be achieved.

It was these policy proposals that Russell and Salter advocated in the 1959 Basic Wage case and, in Russell's case, throughout the 1960s and 1970s until his

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untimely death in 1977. Kaldor independently advocated similar policy proposals from 1940s on, as John King documents tellingly in his recent admirable biography of Kaldor (King 2008).

In a series of papers, I have argued that the Kaldor, Russell, Salter approach could be a successful way of tackling what I call the Kalecki dilemma — the cumulative difficulty of sustaining full employment (as opposed to reaching it from a deep slump) mooted by Kalecki in his extraordinary 1943 (!) paper, 'Political aspects of full employment' (see, for example, Harcourt 1997, 2001, 2010). Here I wish to take up another issue which follows from Salter's analysis and which is set out in the quote above. What Salter describes there is, in effect, the objective of the concerted efforts in recent decades to create in advanced capitalist economies what are euphemistically called flexible labour markets. I conjecture that if we examined the postwar experiences of the United Kingdom and Australian economies, for example, by classifying them into periods which either had or did not have flexible labour markets, we would detect in the evidence outcomes which Salter's analysis predicted would occur.

Major changes have occurred in the United Kingdom and Australian economies since Salter wrote. Of special importance, as I noted, is the much larger role that services, especially financial services in the UK, play in generating the national product and income; and the change over from the Bretton Woods regime of fixed exchange rates and capital controls to a regime of freely floating exchange rates and free capital movements. In my view, because the narrative that Salter told in terms of the manufacturing sector applies in principle to the services sector as well, his analysis remains as relevant now as when his book and articles were first published.

I now sketch out conjectures and the puzzles that we face.

I conjecture that the following would be the characteristics of three 'long runs' in the postwar period in the UK

1) **The Golden Age of Capitalism** — *the end of 1950s–1973 or so*: Full employment, high rates of accumulation in many industries, average wages in most industries increase in line with overall productivity (plus prices), growth of productivity the greatest in UK history (though relatively down on those of its main competitors).

2) **Stagflation** — *1973–1983 or 1984*: Lapses from full employment, average wage increases in most industries ahead of overall productivity plus prices; lower rates of accumulation, lower rates of growth of overall productivity.

3) **Flexible labour market era** — *1983–present*: Considerable periods well below high (let alone full) employment; much greater variation in changes of average money wages by industry; above the Salter rule in relatively high productivity, expanding industries; below the Salter rule in relatively low productivity, declining industries. Overall productivity growth disappointing relatively to that of the Golden Age; accumulation in many industries sluggish.[5]

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Finally I itemise problems and suggestions for further work:

1) Does the increasing importance of services fundamentally alter the Salter story? My provisional answer in principle is 'no'.
2) How do we measure whether accumulation is dynamic or sluggish when there are different I/Y and I/L ratios in different industries? Salter analyses embodiment in terms of both how much and what sort of investment to do (choice of technique)? Should we average these ratios for the three periods for all the industries we examine? Should they be supplemented with measures of volatility around the averages?
3) What is (are) the best measure(s) of deviations from the Salter norm rate of change? Average deviation? Standard deviation? Both.
4) Should we measure the Salter norm rate of change for each of the three periods? And/or the entire postwar period?
5) I would characterise the strength of competition in the three periods as follows:

   The Golden Age was characterised by price-leading oligopoly in many industries (Kaldor's stylised fact).
   Stagflation: an intermediate regime.
   Flexible labour markets: a cumulatively increasing competitive environment, nationally and internationally, making Salter's competitive model more and more applicable.

I write this paper in part as a set of speculative conjectures in the hope that others (younger and better equipped) might expand and provide empirical support (or rejection) for the Australian, United States and United Kingdom economies.

Notes

1. I wrote a review article of Salter's book in the September 1962 issue of the *Economic Record*, Harcourt (1962 [1982]). I concluded that Salter's book 'set an example which other books on applied economics could follow profitably. The main problems … are kept clearly before the reader, and the theory … developed with these ends and the limitations of the … data in mind' (1982: 136). In my entry on Salter in King (ed.) (2007), I wrote that Salter's 'researches and writings provide superb examples of how to fashion elegant and relevant theory, which at the same time is in the appropriate form to provide inferences which can be tested through careful empirical studies' (Harcourt 2007: 245).
2. See Trevor Swan's obituary of Salter in the December 1963 issue of the *Economic Record*, Swan (1963).
3. Salter also showed that similar processes could, but not necessarily would, occur with monopoly, and in imperfectly competitive and oligopolistic industries (see Salter 1960: 90–93).

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4. He adds: 'Ideally, the only means by which the wage structure should be linked to the fortunes of particular industries are through skills and incentives to transfer from one industry to another. As industries decline, specialised skills become obsolete ... Closely related is the need for an expanding labour force in progressive industries ... These industries may need to offer higher than average wages (though not necessarily a higher than average rate of increase in wages)' (Salter 1960: 153–154).
5. I was comforted to see that the late Kurt Rothschild in a recent article (2009) which examines the EU's experience from 1960 to 2007 adopts a not dissimilar periodisation.

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