# Pay Policy, Accumulation and Productivity

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**Abstract**

*The stock of capital goods will always be a mixture of new best-practice techniques and older vintages, associated with lower productivity and higher running costs yet still profitable to keep running if short-term variable costs are covered. A crucial determinant of the proportion of new to old machines in any industry's stock of capital goods is therefore the level and rate of change of wages. The rate of accumulation not only has these supply-side effects; it is also obviously a major determinant of activity and employment. There is the possibility of a virtuous cumulative process. To achieve this, we need to make sure that wages in all industries rise by amounts which are determined principally by the growth of overall productivity and the general price level.*

We live in an increasingly competitive environment, nationally and internationally, both with regard to industrial and commercial capital and to financial capital. One consequence of attempts to cope with this situation has been the emergence of sustained mass unemployment in the advanced capitalist economies. Yet inflation still remains

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This article is a revised version of a chapter in Jonathan Michie and John Grieve Smith (eds), *Employment and Economic Performance: Jobs, Inflation and Growth* (Oxford University Press, 1997). I am most grateful to, but in no way implicate, Willy Brown, Andrew Glyn, John Grieve Smith, Bryan Hopkins, John King, Peter Kriesler, John Nevile, Brian Reddaway, Bob Rowthorn and John Wells for their comments on a draft of the chapter/article. I would also like to thank, with the same proviso, the participants in the Post Keynesian Economics Study Group (February 1996), in the conference of the volume in Robinson College (May 1996) and in the seminar series of the University of New South Wales (March 1997) for their comments. I also thank the editors of the book and Oxford University Press for allowing me to publish this revised version in *ELRR*.

https://doi.org/10.1177/103530469700800106 Published online by Cambridge University Press

stubbornly persistent in most countries and there has also been a decline in the rate of growth of productivity in some of them. We have witnessed as well instability in major markets – those for foreign exchange, labour, property and financial assets – and great variability in the rate of accumulation around unsatisfactory average levels in many industries and in economies as wholes.

In this article I want to examine the interrelationships between these phenomena in order to try to reveal their causes and to suggest in broad outline some policy proposals through which to tackle their unacceptable effects. Though in writing it I had the UK most in mind, the analysis, I hope, does apply to the workings of advanced capitalist economies, and especially to Australia. Indeed, the discussion is crucially relevant for current debate in Australia. The move from a centralised wage system to enterprise bargaining has important implications which are related to the main theme of the article. The cures suggested are part of a larger scheme of interrelated policies which I have outlined elsewhere, see Harcourt 1995, Chapters 1-3, Grieve Smith, *et al.* 1996.

## Antecedents and Obligations

I start by setting out antecedents and obligations. I only met the late Wilf Salter a few times but, as it happens, I had something to do with virtually everything he wrote. In particular, I wrote the review article of his classic, *Productivity and Technical Change* (1960) for the *Economic Record,* Harcourt (1962; 1982, Chapter 9). His work on productivity and technical change was the major inspiration for several of my papers in the 1960s and 1970s. So when I started to think about themes for the present article, I naturally returned to his 1960 book and its splendid sequel which is buried in a 1965 IEA volume edited by Austin Robinson. I came away from the 1960 book refreshed by his crystal clear analysis of the relationship between demand, prices and investment in new techniques at the margins of the existing stocks of capital goods. I was also struck anew by the crucial relevance of his major policy conclusions and by how just about all current policies in most capitalist countries, and especially in this benighted country (the U.K., not yet Australia, though there are strong pressures to move it in that direction) are in effect the exact opposite of what Salter proposed. In particular, the current fetish for what are euphemistically called flexible labour markets and for their supposed roles in setting real wages and allocating labour, itself cruelly and unnecessarily vastly underemployed, flies in the face of common sense, good economic analysis and policy

https://doi.org/10.1177/103530469700800106 Published online by Cambridge University Press

recommendations, that is to say, of analysis of the sort which masters such as Wilf Salter consistently supplied.

Other sources of inspirations for the chapter are, first, Michal Kalecki's 1943 classic 'Political aspects of full employment', especially the crucial distinction which he made there between the political economy of *attaining* full employment, on the one hand, and of *sustaining* it, on the other. The distinction is central to the argument of the present chapter. Secondly, and this is a sad one, because it came so soon after the death of James Meade just before Christmas 1995, is the 1957 Meade-Russell paper which is a classic in the Australian literature. Meade wrote it with my other Australian mentor, the late Eric Russell, who was my closest friend at Adelaide. Any understanding of how the Australian economy works must start from this paper, but the analysis is not confined to my native land. It concerns the process of income distribution between capitalists and wage-earners in a small open economy in which the principal exports are from the primary sector and are subject to price fluctuations on world markets, see Harcourt (1977; 1982, Chapter 21) for an account of the origins and contents of the paper.

Building on this paper both Eric and Wilf gave sage advice to the then A.C.T.U. advocate, Bob Hawke, for the late 1950s Basic Wage Case concerning the principles which should guide the setting by the Arbitration Commission of the Basic Wage and, in effect, the rate of increase of the average money-wage in Australia as a whole. Salter provided the statistical data, conceptual analysis and argument, Russell, the theoretical argument and statement of principles.[1] Between them they not only influenced greatly the setting of the Basic Wage through the 1950s and 1960s but they also sowed the seeds for the principles behind the various Accords which were crucial planks of the policy of the Hawke-Keating ALP government of 1983-96. The fact that the Accords were relatively successful for a number of years, both in reducing inflation and in being associated with rising employment, no doubt makes me more sanguine about the feasibility and effectiveness of incomes policies than many U.K. economists and commentators. (John King (27.3.97) pointed out to me, though, that they were less successful in offsetting the rise in the inequality of incomes.)

There is, finally, James Meade's last book, published only a few months before he died, *Full Employment Regained?* (1995).

## Wage Levels and Accumulation

Having set out inspirations, antecedents and aims, I now outline the arguments and in a general way, the package deal of policies which follow from

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the political and economic analysis. Basically, the aim is to provide a set of policies which allow sustained full employment with agreeable rates of inflation and more satisfactory rates of growth of GDP and productivity. A necessary corollary of achieving these is to raise the overall level of accumulation.

We may start by reminding ourselves of Salter's analysis. The problem he set himself to explain was why, in situations in which technical progress is steadily occurring, old machines of an inferior vintage are to be found operating alongside new best-practice techniques in most industries, a problem which was never clearly stated nor satisfactorily solved either in classical analysis (including Marx) or by neoclassical analysis, and especially not by Marshall. In fact, we may read into both sources that in the final long-period position,[2] if it were ever reached, we would only find operating machines incorporating current best-practice techniques. The capital-labour and capital-output ratios associated with these machines would have been determined by the expected movements in long-period prices and wages at the beginning of the analysis (and period). The state of knowledge the capital-labour and capital-output ratios of the array of best-practice techniques is summed up conveniently in terms of either a family of isoquants or, if there are constant returns to scale, a unique isoquant of various associations of inputs per unit of output.

Salter's crucial contribution was to show that if we suppose that technical progress in each industry is steady but discrete (and if, for the moment, we abstract from the effects of the cycle), investment in the current best-practice techniques chosen in the existing situation will, in competitive conditions, be pushed to the point where the prices established for the output which these machines and the accumulated vintages from past bursts of accumulation help to produce allow only the normal rate of profit to be received on the best-practice techniques. That is to say, *total* long-period costs including normal profits are just covered by the prices set and sales receipts received. The sales receipts associated with the outputs of previous vintages which are still operating and contributing to the current supply only have to cover their existing *variable* costs in order to remain operating – 'Bygones are bygones'. Of course, all but the marginal vintages will do better than this. Machines are retired and, sometimes, scrapped only when their quasi-rents are less than zero. In this way the benefits of technical progress are embodied in the stocks of capital goods and passed on to consumers in lower prices, yet some older vintages are able to exist side by side with the new improved ones.

Both at the level of each industry and, even more, at the level of the economy as a whole, the levels and rates of increase of wages are crucial

https://doi.org/10.1177/103530469700800106 Published online by Cambridge University Press

to the process. (Wage movements may legitimately be regarded as exogenous at the level of the firm or even of the industry in many cases, but are obviously endogenously determined at the level of the economy as a whole.) They are among the principal determinants of variable costs, both directly and indirectly, and therefore of which machines remain in operation and of how far investment in new machines may go before prices reach levels where only normal profits are received so that accumulation comes temporarily to a halt: temporarily, because technical progress is a continuing process so that new sets of best-practice techniques become available over time and the accumulation and retiring/scrapping processes start up anew. (Of course, this is an artificial way of putting it, first, because individual industries are not synchronised by time and period so that, *overall,* accumulation and embodiment are continuous; and, secondly, because we have made the simplifying assumption that technical advances occur at discrete intervals in order to make the analysis of output, accumulation and price-setting tractable. We have also concentrated on the volume of accumulation determined by wage movements, keeping at the back of our heads the effect of relative prices on the choice of the best-practice techniques, see Harcourt (1968; 1982, Chapter 11), Harcourt and Kenyon (1976; 1982, Chapter 8).

The analysis is essentially Marshallian in spirit but overcomes the vagueness and misleading inferences of Marshall's own long-period analysis (but see Dennis Robertson's defence of the master (1956), that there were two concepts of the long period in Marshall, one abstract, theoretical, the other more attuned to real life. John Nevile has also proved that it is, as ever, 'all in Marshall' by referring me to footnote 1 on p. 352 of the Eighth Edition (*Papermac*) of the *Principles*). Moreover, Salter (1960, 90-93) shows that if we have imperfectly competitive or even oligopolistic market structures, much the same processes tend to occur though the forces driving decision-makers to install and retire may be neither as strong nor as persistent as in the competitive situation. This view was first set out by Marx though not as explicitly or as convincingly. Salter considers either profit-maximisation or strategic behaviour in the non-perfectly competitive situations. We consider later the implications of some of the mark-up theories which link the profit margin and price setting to investment requirements.[3]

## Policy Conclusions

For the purposes of the present article, it is the systemic implications of these industry processes which are most relevant (Salter extended his analysis to the system as a whole in (Salter 1965)). From what we have argued so far, if we are interested in overall growth of output as a whole

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and of output per head,[4] the most favourable conditions for achieving high rates of growth in both is that declining industries and expanding industries do so quickly. For this to occur, the last thing we want is a flexible labour market for its proponents tell us that the money-wages of labour should reflect the respective levels and rates of change of productivity in their particular industries (or even firms, as stressed by the proponents of enterprise bargaining on all sides of the political fence in Australia).[5] But this means money-wages *for the same sorts of labour* will be low and the rates of increase low in the declining industries, so that they linger on, their existing vintages still profitable to keep operating, *cet par.* By contrast, the industries that should be expanding rapidly have the required accumulation process held back by high money-wages based on the capacity to pay! The outcome is certainly a lower level of productivity in the economy overall and probably a lower rate of increase of productivity overall, than would be the situation if the levels and advances of money-wages were to follow the more efficient and equitable course for which we argue below.[6]

In brief, the guiding principle should be that money-wages are adjusted for changes in the cost-of-living and effective productivity – the overall change in productivity adjusted for any permanent change in the terms of trade. Thus Salter drew these basic policy conclusions from his analysis (see Salter 1960, 153-54) which may be summarised as follows:

(a) government economic policy should be directed towards creating a flexible economy which enables an easy transference of resources from declining, high cost and price industries to expanding, low cost and price ones.

(b) wages policy should be national in scope rather than related to the circumstances of particular industries. Relating earnings to the 'capacity to pay' of particular industries tends to bolster declining industries and hamper expanding, progressive ones. It delays the introduction of new techniques and has a harmful effect on overall economic growth.

(c) a high rate of gross investment is necessary to allow the structure of production to change quickly and, given the structure of demand, increase the output and productivity of those industries where technical advances are most rapid.

In Salter' s book the level and rate of growth of aggregate demand were external to each industry. But when discussing pay policy and full employment, this cannot remain so. It is here that Kalecki' s distinction, mentioned above, becomes vitally relevant. While business people are happy (or at least, used to be!) for some government activity to be taken to lift an economy out of a deep slump which has reduced their profits and dimmed

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their animal spirits, they are not at all happy with the social and political conditions which emerge when full employment is reached and then sustained, despite the obvious advantage which high demand brings them. The sack ceases to be effective as a regulator of work effort and wage changes, since the balance of political, social and economic power tends increasingly to pass from capital to labour. Yet if animal spirits are to be revived and maintained, the maintenance of something akin to sustained full employment is necessary – witness, for example, the experience of the Golden Age of Capitalism. But unless continual and persistent action is taken about pay policy, the situation will be increasingly threatened by cumulative inflationary pressures associated especially with the setting of money-wages. For though real wages are an ultimate determinant of the standard of living and increases in it, in a monetary production economy, i.e. our world as we know it, the wage bargain may only be made in monetary terms, as Keynes taught us long ago.

So we must be able to implement an incomes policy, despite the fact that each employer would like to be free of the inconvenience which the policy brings to him or her. The policy must include as one of its features, increases which are consistent with the control of inflationary pressures, as determined by our international situation, yet which also allow the great potential benefits of the Salter processes to be realised in the growth of productivity associated with operating at full employment output levels. Such a position will, of course, be favourable for the support of the animal spirits necessary to allow the accumulation processes identified by Salter to be implemented. All this coming together will reward the economic communities for agreeing to money income restraints, so allowing everyone to share fairly and fully in the rising prosperity – a virtuous, cumulative, reinforcing process will have been created.

## Practical Problems

An obvious implication of Salter's analysis is that the guiding principle of wage setting should be that, *cet par*, money-wages change by amounts dictated by changes in the cost-of-living and effective productivity. This guiding principle is just, as well as efficient. At the level of the economy as a whole capital and labour are complements and so jointly contribute to the rise in overall productivity. It is just, therefore, that all citizens should share in the benefits that flow from this. Including the change in the cost-of-living insures people who are unable to protect themselves against a decline in their real incomes from sustained inflation, thus removing a major cause of anxiety and insecurity and, incidentally, making it easier for people gener-

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ally to agree to money-income restraint in an overall package policy deal.[7] This deal nevertheless will not be easy to secure because it has to pay some heed to past ruptures of established relativities, the need to match job opportunities with some (limited) financial incentives and the need to have a floor to the level of money-wages (and other incomes) in a minimum wage, for reasons which are related to the efficiency-wage hypothesis.[8]

As to the main guide line, while it may be *relatively* easy to get agreement on what constitutes the cost-of-living index and its increases – certainly that is something which trade union, employer and government representatives could profitably get together on – a real problem of principle may arise in the measurement of effective productivity changes in a world dominated by floating exchange rates. Why? Because with floating exchange rates and deregulated financial markets, we have a classic case of markets where stocks dominate flows and speculative influences dominate real economic factors in the setting of both day-to-day market prices and the average of prices over the medium to longer term. This state of affairs is compounded when we take into consideration that in a dynamic world economy in which the Salter processes are of very unequal strength as between different countries and regions, the notion that there exists an underlying set of stable long-period equilibrium exchange rates, only awaiting to be found by market forces, is, to say the least, problematic.

It follows that the idea of effective productivity – domestic productivity adjusted for changes in the terms of trade – is an elusive concept in theory and certainly in practice as far as agreed upon estimation is concerned. Yet some rough agreement, some compromise, would need to be found between interested groups. No doubt the institutions set up to tackle the problem of ruptured relativities could also be expected to make reviews and periodic adjustments for the effects of revisions of estimates of effective productivity as well. Clearly this requires people of good will – are there any left? – but all consensus and sensible and, ultimately, efficient policy making requires this anyway.[9]

We mentioned earlier that Salter processes are at their most effective when competitive market structures, or something akin to them, may be assumed to be present. But much effort has been devoted in Post-Keynesian circles (and others, of course) to describing noncompetitive (or imperfectly competitive) market structures and their implications for pricing and the investment decision. Ball (1964), Eichner (1976), Wood (1975) Harcourt and Kenyon (1976; 1982, Chapter 8), Coutts, Godley and Nordhaus (1978), Kaldor (1986), are obvious examples. Much of this work is microeconomic in character and the systemic effects have at best only been sketched. Nevertheless, there are some disquieting aspects that need to be thought

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about.[10] Before doing so, let me conjecture that with the increase in international competitiveness of the last two decades, both in goods and in services, especially financial services, the world economy *may* be closer to the competitive model, albeit a ruthless jungle red in tooth and claw, than it was when the writings referred to above were first developed. If so, our minds may be put more at ease on that score anyway.

The most disquieting microeconomic result is an implication of the work which I did with Peter Kenyon. There, we argued that prices in oligopolistic industries characterised by large price-leaders are set by profit margins designed to raise the internal funds needed to finance investment and that there was a process of mutual determination involved. It follows that margins would be greater the greater was the investment that was planned, *cet par*. But investment would be less, the higher were the margins and therefore the prices set, because this would allow older vintages to remain in operation that much longer, thereby reducing the shortfall in expected output which new investment would be needed to cater for. In microeconomic terms at least this is a drawback on accumulation, productivity growth and attaining and sustaining full employment. Moreover, the higher price levels, *cet par*, may make the control of inflation more difficult. I am not sure that these arguments go through at the level of the system as a whole, but at the very least, they need to be explored.

These may also be another source of inflationary bias involved in non-competitive situations. Firms with below average increases in productivity will have rising costs which may be passed on in prices in order to avoid bankruptcy. Those with above average increases may nevertheless not allow the consequent lower than average rise in costs to be fully reflected in prices because they wish to retain profits for extra investment. Overall therefore, the price level will tend to rise. How important this tendency is depends on how fast demand for particular commodities is growing, and on the feedback effects of this on the system's behaviour.[11] Another limitation is that, because services have risen in importance, we need a comprehensive analysis of Salter processes in service industries.

## Concluding Remarks

Let me conclude: by relating the nature of Salter processes to their policy implications for incomes policy we have identified interrelationships which promise a virtuous, cumulative performance of higher growth and higher employment, a performance which has some possibility of being sustained, if reasonable skill is shown over macroeconomic policies (notably demand management). For the policy measures promise to create an environment

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where animal spirits may be more consistently robust, even dynamic, and the resulting potential rise in the standard of living rewards the community for acquiescing in a policy of money-income restraint. I do not wish to over stress the cosy side of the story. There are deep-seated structural problems present in many advanced industrialised countries, not least the UK and Australia, so that bottlenecks and balance of payment constraints are only too real and often bite. Moreover, while it may be possible to create favourable climates for business people there is no guarantee that they will necessarily do their thing or do it properly – this was certainly the experience of Australia during many years of the Accords when the level and composition of investment were far from what was needed. It may be that governments can give some general pointers by the use of broadly based investment-incentive schemes, as I suggest in Harcourt (1995, 38, n.3). But whatever misgivings we may have,[12] what is proposed is surely more efficient and more just than the present hotchpotch of non-policy and one-sided attacks on the standard of living and employment opportunities of wage-earners.[13]

## Notes

1. Eric subsequently published his principal arguments for such a policy for Australia in *Australian Economic Papers* in 1965 (Russell 1965).
2. It is an equilibrium of long-period supply and demand in the neoclassical case.
3. Brian Reddaway has pointed out to me that both Salter and I are 'assuming away' a host of problems which spring from the presence of imperfect competition, especially the implications of non-homogeneous commodities. I do rather feebly try to tackle this later in the chapter. He added that 'uncertainty is largely responsible for non-investment and retention of old models'. I can only respond by saying that if the analysis of this chapter is correct and if the package deal of policies proposed were to be implemented, the environment so created might well reduce the effects of uncertainty and allow higher rates of accumulation to occur.
4. Not only are they desirable in themselves, they are also the necessary prerequisite for obtaining and sustaining full employment and of having some chance of implementing an incomes policy which is consistent with an overall rate of inflation that maintains the competitiveness of the economies concerned.
5. Bryan Hopkin has challenged me to quote chapter and verse for this. It does seem to me to be the implications of the arguments currently in the public domain for the virtues of flexible labour markets and enterprise bargaining.
6. Bryan Hopkin has pointed out a potential *non sequitur* here: it is low productivity industries which should go, high productivity ones which should grow and they are not necessarily synonymous with declining and expanding industries respectively. Salter does obliquely cover himself on this point, see Salter (1960, 153).
7. The confident tone of this argument probably reflects Australian experience where we have had many periods in which cost-of-living adjustments have been an

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integral part of national wage cases and/or automatic. Bryan Hopkin is deeply sceptical, calling the proposals the 'principle of hope over experience' in the light of U.K. experiments in the post war period; but he is in favour of incomes policy in principle.

8. Willy Brown has pointed out that there are serious social problems for some regions as well, in that even if there were to be full employment, children may have to move from regions dominated by declining industries in which their parents were initially employed. This could be offset, to some extent anyway, by encouraging investment in new industries to go to the regions containing these communities.
9. John Wells has kindly pointed out to me that *Economic Trends* carries estimates of the terms of trade by quarters from 1970 on and has drawn my attention to an annual series of UK GDP per capita in real terms adjusted for the terms of trade from 1950 on. Bryan Hopkin reckons I have over emphasised the difficulties (this reflects the fierce debates on this issue in Australia in the 1960s) and that some rough approximation could well be agreed to. In Australia, we could start by revisiting the work of Russell and Salter.
10. At this point Brian Reddaway made a typically down-to-earth comment: 'The fact that commodities are not homogeneous and have varying amounts of services attached to them is particularly awkward for the would-be producers of elegant analysis.'
11. I am indebted to Peter Kriesler for this argument.
12. Andrew Glyn has drawn my attention to Rudolf Meidner's 1993 paper on 'Why did the Swedish Model Fail?' The economic analysis is similar to that of this article and some salutary lessons from history are documented; but see Rowthorn (1992) and Stegman (1987), the conclusions of which made me more optimistic about the possible success of the policies proposed in this article.
13. John King (27.3.97) feels there is 'a significant flaw in the argument: the pressures for increasing wage inequality are so powerful that even centralised wage determination... proved unable to overcome them [so that my] argument is stronger as a statement of principle than as a practical proposal'. Still, you have to try.

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