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Labour markets, social justice and economic efficiency

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In conventional economic theory, a trade-off supposedly exists between social justice and economic efficiency. In reality, market and other economic institutions are dominated by power relations, so that the sponsorship of social justice is a productive factor. Neo-liberal economic policies, by lifting the constraints on the exercise of unequal power, increased injustice and triggered a downward economic and social spiral. Reversing this requires a revolution in economic theory and policy focused on full employment, the working of labour markets, the organisation of work, and household organisation, social provision and self-sufficiency.

Key words: Social justice, Economic efficiency, Theory and policy

JEL classifications: E0, I3, JE, J7, R2

1. Introduction

In conventional economic theory, the initial resource endowments of individuals are taken as given and, although these may be unequal, they are essentially external to the market. Labour markets are assumed to be more or less ‘competitive’ and within them real wages reflect the quality of workers’ resource endowments (mainly human capital) and their personal efficiency and energy. That these result in a wide dispersion of labour market rewards, some of which may be insufficient to sustain a reasonable standard of life, is a demonstration, it is argued, of how widely dispersed are individual resource endowments and capabilities (Hirsch and Addison, 1986). From this perspective, any idea of social justice designed to reduce income inequalities risks damaging incentives and lowering overall economic well-being. This is the basis of Okun’s (1975) thesis that there exists an inverse trade-off between social equality and economic efficiency: that greater social (income) equality can only be purchased at the cost of lowering economic efficiency.

The alternative perspective explored in this Special Issue recognises the central importance of relative power in determining outcomes. This focuses attention on the external and internal forces structuring markets and how these differentially affect the incomes and opportunities of individuals. From this perspective, social justice requires the removal of the obstacles that inhibit individuals and groups from developing their potential and from deploying their resources to full advantage. Thus, contrary to the orthodox view, increasing social equality improves economic efficiency and leads to higher economic growth and well-being.

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Under post-World War II Keynesianism, a redistributive tax–benefit system was justified on precisely these grounds. Progressive taxation combined with benefits designed to provide a minimum social wage served to reduce income inequalities and to prevent the residualisation of those on low incomes or unemployed. At the same time, the redistributive tax–benefit system helped to underpin aggregate demand in the economy, and hence to achieve full employment and increase economic growth. This in turn widened job opportunities and led to progressive labour market upgrading, especially amongst those hitherto deprived. It was therefore not coincidental that the golden period of Keynesianism, from around 1950 to the early 1970s, witnessed historically high rates of economic growth, full employment and declining income disparities.

The policy conversion from Keynesianism to neo-liberalism from the late 1970s onwards rested on the prediction that monetary control would contain inflation, that labour market deregulation and regressive tax and benefit reform would secure full employment, and that a more unequal redistribution of income and the freeing up of markets would dramatically improve economic performance. But these expectations have not been so far fulfilled (Wilkinson, this issue) Nevertheless, the confidence policy-makers and their economic advisors have in the monetary control of inflation and market deregulation has not wavered. They simply advocate more deregulation and explain the continued high unemployment by the *unemployability* of the jobless.

There is, however, something profoundly pessimistic about the idea that the ills of an economic system can be explained largely by the quality and motivation of an *underclass* comprising the poorest of the population. This is particularly so because this *residuum* apparently disappeared between the 1930s and the 1970s only to reappear in the 1980s. Moreover, there is clearly nothing ‘natural’ or inevitable about the allocation of income and resources arrived at through the play of market forces. The notion of a ‘free’ labour market is a figment, and the idea that market equilibrium can be restored through deregulation is an illusion. The roots of social and economic disadvantage are found not in the differing capacities of individuals, but in market inequalities. In particular, relationships in the labour market are permeated by inequalities of bargaining power, structural barriers to mobility and by institutionalised discrimination, which together lead to the systematic *undervaluation* of the labour of disadvantaged groups.

From this alternative perspective, the events of the 1980s and 1990s are much easier to interpret. The change in policy in the late 1970s shifted the balance of power against the weakest in society and intensified their exploitation, triggering a downward economic and social spiral. Far from becoming welfare-dependent by some unspecified social process, an increasing number of people have been forced into poverty and away from self-sufficiency as a consequence of the undermining of the job market and a progressive erosion of employment and social rights.

2. The four traps of neo-liberal theories and policies

It follows from this alternative analysis that neo-liberal policies have sprung four closely interrelated traps: the Keynesian unemployment trap, the low wage trap, the fiscal trap and the social deprivation trap.

2.1 *The Keynesian unemployment trap*

The impact of abandoning the full-employment objectives in the late 1970s was to lower effective demand and increase involuntary unemployment. The resulting recession in the

early 1980s reduced investment in productive industries and impeded its recovery by destroying capacity and dampening expectations (Kitson and Michie, 1996). This exacerbated the long-term deindustrialisation of the British economy and, as a consequence, the supply side proved incapable of responding fully to the credit-induced boom of the 1980s; the resulting trend increase in the propensity to import added to the deflationary bias. The ability of the economy to generate sufficient effective demand to employ the workforce fully was further weakened by the redistribution of income from the poor (most of whose income is consumed) to the rich (who save a high proportion of their income, and whose spending tends to have a relatively high import content).

2.2 The low wage/low productivity trap

The ability to pay low wages and provide only poor working conditions removes important disciplines from employers. The ability to survive despite poor management and backward products and processes by undervaluing their workforce helps explain the long tail of inefficient firms, which is a common feature in British industry. In addition, high unemployment, the growing availability of undervalued labour and the lowering of the floor of employment rights encourages competition based on cost and price cutting rather than on high quality, good design and product and process innovation. The ability to generate high levels of profits by paying low wages and reducing labour standards means that some of the largest and fastest growing firms in Britain are now in hotels and catering, contract cleaning and retailing, all of which are chronic low payers (Sachdev and Wilkinson, 1998). Moreover, such firms exert pressure on the pay and conditions of their suppliers by abusing their bargaining power in domestic markets and switching to cheap imports.

Low-paying firms and sectors are typically employers of last resort and have very high levels of labour turnover, particularly when labour markets are tight. This excessive churning means that it is not possible to build up the long-term relations to develop cooperative work organisation and a highly trained, multi-skilled, functionally flexible workforce necessary for the good design, high quality and product and process innovation upon which competitive performance increasingly depends (Kitson and Wilkinson, 2000).

2.3 The fiscal trap

The contractionary impact of macroeconomic policies lowers the tax take and increases the social welfare bill, while offsetting any incentive effect that tax reductions may have on economic activity and hence on the size of the tax base. The proliferation of part-time work, casualisation and self-employment also erodes the tax base. In the construction industry, which saw a considerable increase in casualisation and self-employment in the 1980s, both (lawful) tax avoidance and (illegal) tax evasion became widespread. The resulting loss to government revenues has been estimated at between £2 and £4 billion annually in this industrial sector alone (Harvey, 1995). Meanwhile, the opportunities given by the tax regime for competition based on tax avoidance and/or evasion have undermined quality standards and training, creating serious skill shortages. The construction industry provides a warning about the risks associated with allowing tax regimes that offer the prospects of different labour costs to enter into competition. In a similar way, the use of the benefit system to supplement wages risks throwing subsidised labour into competition with unsubsidised, and the possible driving down of wages and increasing benefit costs. These *Speenhamland* effects are already in evidence. In November 1991

there were 349,000 awards of the in-work family credit and in 1991/92 the annual cost was £626 million. By November 1999, the number of family credit awards had risen to 790,000 and the annual cost for 1998/99 had risen to an estimated £2.5 billion (Department of Social Security, 1999); to this total must also be added the billions spent on the various welfare to work initiatives.

2.4 *The social exclusion trap*

Unemployment and the increase in the number of jobs which are low paid, insecure and with poor working conditions have created a widening gap between the increasingly deprived and excluded 'under' class and the affluent 'contented' class (Galbraith, 1992). But the boundary between the included and excluded has proved to be by no means permanently fixed. Many of the previously protected white collar and managerial jobs have become increasingly precarious, as large-scale redundancies and casualisation penetrates deeper into the 'primary' employment sectors. For example, unemployment, growing poverty and cutbacks in welfare provision have aggravated the trends towards more single-parent families, and increased the incidence of destitution in such households. There is also growing evidence of a causal link between, on one side, unemployment, poverty and social exclusion and, on the other, declining physical and psychological health (Burchell, 1992; Wilkinson, 1996). These trends have deepened the vicious cycle of inadequate resources, impaired labour market capabilities, and consequent poor economic performance in which a growing number of individuals and households are trapped.

2.5 *The interaction of the four traps*

The Keynesian unemployment, low wage, fiscal and social exclusion traps are mutually reinforcing. The economy is caught in the fiscal trap because of the exchequer cost of the Keynesian unemployment trap and competitive failure due to the low wage trap.¹ Similarly, individuals caught in the Keynesian unemployment trap can be expected to be in the low wage and/or the social exclusion traps. Moreover, any lack of education, skill and motivation can be seen as both cause and consequence of being caught in the low wage and social exclusion traps.

2.6 *A fifth trap: economics, politics and policy*

The single greatest obstacle to adopting policies designed to eliminate the four traps and reverse the widening of economic and social inequalities is the continued belief in the monetary control of inflation and supply-side economics, and the continuing reliance on these notions for policy. There is, in other words, a fifth trap, that of policy impotence, the dealing with which is a precondition of dealing with the other four.

Monetarism and free market economics have served to mystify the underlying problems and have provided governments with the justification for concentrating the cost of economic crisis on the *have-nots*, whilst salving the conscience of the *haves* by assuring them that, although the income distribution is unequal, it is efficient. The twin neo-liberal notion that higher incomes are required to motivate the rich, whilst lower wages and cuts in benefits and lower wages are needed to get the poor into work have been used to justify a more unequal distribution of income and cuts in taxes on high incomes. The adoption of

¹ On the costs to the exchequer of both unemployment and low pay, see Kitson *et al.* (1997).

these views as the conventional economic wisdom has lifted responsibility for unemployment and poverty from the government and shifted it on to the jobless and the poor themselves.

The idea that a more unequal distribution of income is superior on efficiency grounds also forms the basis for an opportunistic alliance between vote-seeking political parties offering tax cuts and market deregulation, and the rent-seeking contented classes, who stand to benefit from the tax cuts, the availability of low-paid labour and the opportunities for profits created by deregulation (Galbraith, 1992). Four reinforcing processes have strengthened this alliance. First, the victims of the downward economic and social spiral triggered by policy change have become increasingly alienated from the 'democratic' process, so that political exclusion has been added to economic and social exclusion. Secondly, this political exclusion has been progressively reinforced as political parties of the Left have abandoned their traditional class allegiances and embraced the new economic and social orthodoxy to compete for the so-called political centre ground. Thirdly, the growing problems of long-term unemployment, poverty, crime and social dislocation over the past two decades have increasingly polarised society, and the contented classes have found themselves more and more threatened by the *dangerous classes*. Fourthly, those promoting the conventional economic wisdom to policy practitioners have continued to justify their failed predictions by developing theories explaining unemployment, under-employment and poverty in terms of labour market imperfections, welfare state dependency and the low quality and poor motivation of the unemployed, the under-employed and the working poor. By doing so, they have provided continued justification for damaging economic and social policies by the age-old expedient of blaming the victim (Ryan, 1971).

It is now virtually impossible for political parties to propose any radical alternatives to those policies supported by the neo-liberal conventional wisdom. Any party advocating policies with implications for additional taxation are considered at grave electoral risk. Any government contemplating monetary and/or fiscal policies designed to reduce unemployment and alleviate poverty risks opposition from the increasingly independent central bankers and the threat of financial crises in increasingly unregulated and volatile capital and foreign exchange markets.

3. The issues

The removal of the dead hand of the policy trap requires an active campaign targeted at economic re-education and the reform of policy. An important first step is the debunking of the widespread and erroneous belief that unemployment is a pre-condition for controlling inflation. This theoretical cul-de-sac is constraining the options of policy-makers to improve economic performance and well-being objectives. This obstacle is removed by the recognition of the institutional basis for inflation and hence the possibilities of institutional solutions (see Wilkinson, this issue). Important objectives also include: a workable definition of full employment for designing effective macroeconomic policies; a better understanding of how the operation of labour markets and work organisation determines competitive performance as a basis for improving industrial and labour market policy; and greater awareness of how labour market activity, household organisation and social provision interact in determining the self-sufficiency upon which to build effective social policies. In each of these areas, the emphasis will need to be on social justice as a productive factor.

3.1 *The meaning of full employment*

The importance of full employment is that it ensures that the full potential of the economy is utilised, guarantees the right to work as a foundation for developing effective labour market and work organisation strategies, and provides income security as a foundation for effective social policies. Moreover, in a social system where the right to self-sufficiency is based on the duty to work, it is socially necessary for people to find employment sufficiently rewarding to allow them to enjoy their rights and to fulfil their responsibilities.

The combination of productivity-enhancing new technology, natural constraints and the expanding labour market participation of women has rendered obsolete the idea that full-employment is equivalent to a 40-hour week for male breadwinners. In this changed economic and social environment, one way of thinking about full-employment is to base it on the idea that there is a *customary standard of life* which is both desirable and sustainable (in technological, environmental and competitive terms). Then, given the level of productivity (mainly determined by technology), full employment would be that number of hours per week each household would need to work to achieve that customary standard of life.

This definition raises important issues about the standard of life and sustainability and how these should be measured, and especially how domestic employment and resource creation should be accounted for. As discussed by Gardiner (this issue), the changing interconnections between employment, family structures and welfare systems need to be considered if the concept of full employment is to become meaningful. As Gardiner argues, it is essential to recast the image of an employee—from that of a single person with no outside commitments or a married man with a wife who provides family care, to that of a person with a range of competing domestic and other commitments which will vary over their lifetime. The effect of this broader household basis for employment raises issues for self-sufficiency arising from gender and other forms of discrimination in labour markets and welfare provision.

Generally, full employment as defined here is not independent of the income distribution. Cormier and Craypo (this issue) evaluate the long-term increase in the working poor in the US; they argue that the problem of low-wage jobs is not so much worker inadequacy as the inequalities they face in the labour market and the collapse of job opportunities. Low-wage workers participate in the labour market process over which they exercise no control—they have little or no impact on the jobs or the terms and conditions they can secure.

3.2 *The working of labour markets*

The labour market processes identified by Cormier and Craypo result from segmentation on both the supply and the demand side. The supply-side structuring of the labour force arises from, among other things, inter- and intracommunity and family differences in resource availability, expectations and knowledge of job opportunities. Labour markets are also 'balkanised' or segmented geographically (see Martin, 2000). As a consequence, individuals have different degrees of access to the socialisation, educational and training processes that provide credentials with high labour market value. Such tendencies create non-competing groups, which widen the income and job opportunities of members and limit those of non-members. These differences are reinforced by the unequal distribution of domestic responsibilities, differences in state provision and labour market regulation, and by sexual, racial and other forms of discrimination. These forces lead to what can be described as the *out-market* undervaluation of labour.

Out-market undervaluation interacts with *in-market* undervaluation in creating vicious cycles of deprivation. A shortage of resources in deprived households militates against the development of socially recognised skills and labour market attributes. This is compounded by *in-market* undervaluation arising from the structuring of labour markets by social, organisational and legal forces. This relegates the socially disadvantaged to labour market segments where their capabilities are further reduced because wages are low relative to the real value of labour input. This can be contrasted with the virtuous cycle by which ample household resources endowment is reinforced by interaction with labour market privilege in an upward spiral of economic advantage.

Greater labour market equality is the key to reducing pre-tax income inequality, enhancing individuals' and households' ability to be self-sufficient and avoiding the need for extensive income transfers through the politically sensitive tax-benefit system. It is also imperative for improving the incentives for mobility, education, training, retraining and the other requirements of a flexible labour market, and for creating the conditions for securing full employment.

Felsted, Ashton and Green (this issue) evaluate the empirical evidence on the distribution of skills amongst the employed workforce in the UK. Their analysis suggests that, although overall work place skills are equalising, some groups are experiencing less rapid increase in skills than others, and pockets of disadvantage remain, especially among part-time and other 'non-standard' workers. They conclude that policies designed to promote and encourage 'non-standard' employment are likely to make it more difficult to achieve a 'fairer and more cohesive society' in terms of skills. Peck and Theodore (this issue) echo this concern in their analysis of the UK Governments' 'New Deal' welfare to work programme and its emphasis on 'employability' and the promotion of *readiness* for jobs in the lowest levels of segmented labour markets. This focus exaggerates the potential impact of the programme and burdens it with unobtainable political and economic expectations. More realistic strategies require welfare-to-work measures to be based on personal development, job improvement, a *social economy* dimension to employment and active social redistribution of job opportunities.

3.3 *The organisation of work*

Anglo-American traditions of work organisation are rooted in managerial prerogative in which negotiations are confined to the outcomes of managerial decisions. This has long-term detrimental effects on industrial performance by generating job insecurity, low morale and antagonistic, non-cooperative, low-trust work relations (Fox, 1974). Furthermore, as shown by Forrant (this issue), it actively discouraged US workers from active and positive involvement in work organisation. The cost of this was demonstrated by the successful challenge to the 'Fordist model' by what Best (1992) described as the *new competition*. This is broadly based on rapid product and process innovation, improved design, greater variety, high quality and keener prices. It came from European and Japanese producers¹ whose employment relations are overtly cooperative and whose inter-firm links are *relational* rather than hands-off. As a consequence, they are more effective in mobilising

¹ Applebaum and Batt (1994), in their extremely valuable study identified four main systems of cooperative production: Japanese lean production; Italian flexible specialisation; German diversified quality production; and Swedish sociotechnical systems. The Japanese and Swedish systems are more firmly rooted in Taylorist mass production than the German or, particularly, the Italian system. But what the four systems have in common is the importance given to high levels of worker training and the success they have achieved in closely involving workers at all levels in the organisation and management of production, in product and process innovation and in the development of organisations and institutions.

the commitment, skills and knowledge of workers and suppliers and in deploying this to raise efficiency, improve quality, and generate faster rates of product, process and organisational innovation.

The importance of high-trust work organisation is now widely recognised. But two decades of high unemployment, progressive deregulation of the labour, product and capital markets, and the globalisation of product and financial markets have strengthened the hands of consumers, corporate managers and, especially, shareholders, but weakened those of workers. Increasingly, customer expectations and their greater market power have fuelled demands for higher quality products, greater variety, more frequent product innovation, '*just in time*' delivery and keener prices. At the same time, the changing balance of power in the capital market has put greater emphasis on shareholder value, and this favours a shift away from the long-term investment necessary for creating cooperative forms of work organisation towards short-term cost-cutting and a continuous downward pressure on the number of workers firms employ (Burchell *et al.*, 1999). Similar effects have been triggered in the public sector by the anti-tax bias in politics, voter demands for increased quality of services, privatisation and the growth of managerialism in public provision (Biracree and Wooley, 1997).

The emphasis on shareholder value has led to significant corporate restructuring, which has had a major impact on labour. In their analysis of corporate restructuring in the UK, Froud, Haslam, Johal and Williams (this issue) show that labour is usually the first casualty—although the overall impact is complex, as there may be, in the short term at least, 'winners' as well as 'losers'. Furthermore, they suggest that any benefits to capital are transitory and that corporate restructuring is not a generally beneficial and efficient process of resource allocation by the capital market.

What has been happening is that in both the public and private sectors power has become increasingly concentrated in the hands of top management, whilst managerial layering and work reorganisation has increasingly decentralised responsibility to the shopfloor. Moreover, largely *unconditional* demands are being made of workers by their employers, whilst commitment to job security, and the other promises by employers to those they employ are conditional on markets, the whims of dominant stakeholders and organisational change. Thus, whilst responsibility for performance is being collectivised, risk and uncertainty is being decollectivised as workers are made more readily disposable and the mutuality upon which high performance work systems depend is being undermined (Burchell *et al.*, 1999; Forrant, this issue).

3.4 Household organisation, social provision and self-sufficiency

Self-sufficiency depends on the ability to sustain at the least some minimum customary standard of living throughout life. In industrial countries, this depends on waged work, domestic production and social welfare. The ability of individuals to function economically so as to achieve and maintain self-sufficiency is critical to the achievement of full employment and a high road to economic growth (Gardiner, this issue). Economic functioning, however, is only in part determined by the individual's own efforts and decisions, the other main factors being embedded in the economic, social and political systems within which the individual is located. These systems structure the incentives, disincentives and barriers which increase or restrict the quality and quantity of economic and social participation of individuals and hence their capacity for self-sufficiency.

Economic performance depends on resource endowment and capability. The resource endowments of individuals include their labour power, accumulated assets and entitle-

ments (net of contributions) to private and public transfers.¹ Resource endowments vary widely in both level and composition between individuals and over an individual's lifetime (Tarling and Wilkinson, 1997). Given their resource endowments, the economic functioning of individuals is determined by what can be described as their *capabilities*. Capabilities, in the sense used here, depend on an individual's personal efficiency and energy but also on the opportunities they have to utilise their resources to the best advantage. The capabilities of individuals in the labour market, for example, depend on employment opportunities and terms and conditions of that employment as well as on the effectiveness and intensity of work effort. Capabilities in domestic and other forms of non-market production also have important institutional and organisational dimensions. Together with their resource endowment, the capabilities of individuals determine their economic functioning: the flow of resources at their disposal and therefore their ability to maintain themselves and accumulate reserves.

Inter-community and inter-family differences in wealth, expectations and information give individuals variable degrees of access to socialisation, educational and training processes and to job opportunities which enhance the resources and capabilities of the privileged and reduce those of the deprived whatever their inherent qualities. Household organisation also serves to reduce the capabilities of women. Unequally distributed responsibility for domestic labour inhibits the labour market activities of women, depending on the collective resource endowment of the household members and the willingness of other members to use their resources (either labour or capital) to provide substitutes for the cooking, cleaning, child care and other domestic services traditionally provided by women. The greater the domestic responsibility of a woman (and hence the greater her transfer to others in her household), the less favourable are likely to be her labour market opportunities.

The state represents the third major force differentially influencing the economic functioning of individuals by its labour, industrial and social welfare legislation and by providing child and other forms of care. The growth of the welfare state can be regarded as counteracting social, economic and other disadvantages and therefore breaking down the barriers to effective labour market participation. However, whether individuals can take advantage of education and training to enhance their resource endowment will depend on the willingness and ability of households to support non-economically functioning members and their experience, expectations and information about education, training and labour market opportunities, all of which can be expected to discriminate in favour of resource rich-households (Bowles and Gintis, 1976). Moreover, whilst the resource endowment of the better-off can be expected to be enhanced by state education and training provision, social security, the element of state expenditure to which the worse-off have greatest recourse, tends to impair their economic functioning. For example, the capabilities of social welfare recipients are reduced by means-tested benefits, which are reduced as incomes rise. This effectively imposes high marginal taxes on the low-income households and ensnares them in the poverty trap (Parker, 1995).

4. Conclusion

The employment, work organisation, labour market, household and social provision dimensions of social justice outlined above are addressed in this Special Issue and frame the research agenda the papers represent. The central questions addressed are twofold:

¹ The most important private transfers are within the household; others include private intra-community income sharing, inter-generational transfers and charities.

what constitutes full employment and how does this relate to the sustainability of living standards? These issues are framed by the speed and direction of technical, environmental constraints, patterns of working hours and how these are distributed within and between households, the structures of occupational, gender, part-time/full-time and other types of pay differentials, and the inter- and intra-household distributions of job opportunities and income. In the sphere of production, the quality of working life and dynamic efficiency is closely bound up with the way work is organised and the possibilities for cooperation. This relates to the potential for greater worker involvement, autonomy and self-management, the underpinning of this by effective independent representation, and the role of trade unions in wage bargaining and dispute resolution. Whether the objectives of mobilising the full potential of the workforce can be achieved will also depend on the extent to which the necessary expectations of income and job security are compromised by the forms taken by management organisation and corporate governance, the operations of stock markets, funding and regulation policies in the public sector, and macro-economic policies.

Within the labour market, delivery of equality of opportunity and the effective deployments of human capabilities rests on how technical, social and other skills, as well as the responsibility, discretion and other attributes required for work, are recognised and rewarded. This depends on the provision and social validation of effective education and training systems, the removal of institutional and other obstacles to employment opportunities and occupational mobility to ensure equality of opportunity and the underpinning of *job* security with *employment* security. Securing these objectives will depend also on the quality and independence of worker representation.

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