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"THE LAW OF WAGES"

with particular reference to the theory of the Wages Fund.

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There is no question in economics which has been more fully discussed, or had more treatises devoted to it, than the great and important question of the nature of wages, and the laws which govern them.

It is but natural that this should be so, for the reward of labour and the remuneration of toil is a question of world wide significance, far outweighing the passing importance of tariffs, or of trade conditions, and striking at the root of every system of society and every disposition of the body politic. For upon the shoulders of that toiling Colossus, labour, rests the whole globe; and the very structure of society would tumble were that patient Atlas to renounce his task.

What can be more important, therefore, than a correct understanding of the different causes that work together to produce the phenomena discernible in questions relating to wages, and what more natural than that many minds should have devoted much toil and research to an elucidation of those problems?

In contemplating, therefore, so vast a subject it is not possible within the limits of a short essay to do more than glance briefly at the various theories that have been put forward with regard to the laws of wages, nor to attempt more than a cursory summary of the various conclusions arrived at; and, if possible, to arrive at some determination with regard to the whole subject.

<u>The Physiocrats.</u>

Beginning, therefore, with the earliest school of economists we find among the Physiocrats a peculiarly pessimistic and dogmatic view of the law of wages, which, however, was quite characteristic of their school.

Firm in their belief that there must, of necessity, be a natural law of wages, they found that natural law exemplified in the condition of the labouring classes in France at that period.

Seeing that wages were constantly at that point which barely kept the labourer from actual starvation, they concluded that this was naturally so, and that the increase of population was the determining factor in keeping wages at starvation level.

They argued that if capital increased the benefit to labour would be but transient, since population would increase in proportion, and thus force down the rate of wages.

They could not conceive that capital might increase faster than population, since they looked upon population as capable of indefinite and prodigious expansion, did not the ever present check of starvation operate in restraint.

If by some circumstance, such as plague or war, population decreased, wages would naturally go up, but the proletariate would then be able to propagate their species in greater numbers, and soon the increase of population would once more force the rate of wages down to starvation point.

This iron law, (although the phrase "iron law" is, of course, of much later origin) was, therefore, the natural law of the Physiocrats, and upheld by them with all the dogmatic tenacity peculiar to their caste.

Adam Smith.

With the exception of this view of the question of wages advanced by the Physiocrats, no attempt had been made before the time of Adam Smith to formulate any set theory, or enunciate any law.

But with Adam Smith there came a real advance, and, although even he did not formulate a definitive theory, yet he laid the foundation upon which later economists built.

Starting with a discussion on capital, he lays it down that its functions are, first to make possible the division of labour, and secondly to increase the productive powers of labour.

Building on these sound hypotheses, he argues that although, originally, the whole produce of his toil belonged to the labourer, yet this state of affairs passed away when land became appropriated and stock accumulated. Since then the labourer no longer owns what he produces, but works for a master, it is necessary that the master should advance to him his maintenance.

"In all arts and manufacturers, the greater part of the workmen stand in need of a master to advance them the materials of their work, and their wages and maintenance till it be completed".

From this he deduces as a natural corollary that there must be a fund in the hands of the masters destined to be used for the maintenance of the labourer until he produces the fruit of his labour.

In order that the masters may be induced to advance this fund for the maintenance of the labourer, and that the labourer should be induced to labour for the master, a bargain must be struck between them. Such a bargain can only be struck on the basis of the ratio between the amount of labour offering for employment and the amount of capital available to set the labour to work. From this he draws the conclusion that:- "The demand of those who live by wages cannot increase but in proportion to the increase of the funds which are destined for the payment of wages." Here we have the germ of the "Wage Fund" theory to be developed later to its fullest extent by the followers of Adam Smith.

The Wage Fund Theory.

As we have seen, the foundations of this theory had been laid by Adam Smith, and it was by his followers that it was amplified, while John Stuart Mill put the finishing touches to it.

David Ricardo is the most outstanding name, (other than Malthur, who did not explicitly deal with the subject of wages), between Adam Smith and Mill. Ricardo did not believe wholly in the iron law of the Physiocrats, for, as has been shown by Professor Marshall,(1), he knew that there was no "iron law"

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that could fix the natural limit of wages, but that limit was fixed by local conditions and habits. The rate of wages according to him was measured by the ratio which the wages bore to the value of the resultant produce, rising when this ratio rose, and falling when it sank.

Ricardo says. (Principles of Political Economy - Chap. V) "By the encouragement which high wages give to the increase of population, the number of labourers is increased, and wages again fall to their natural price. The market price of labour is the price which is really paid for it from the natural operation of the proportion of the supply to the demand: labour is dear when it is scarce, and cheap when it is plentiful. However much the market price of labour may deviate from its natural price, it has, like commodities, a tendency to conform to it".

The contemporaries of Ricardo accepted the theory of the wage fund with absolute unanimity, and it only needed John Stuart Mill to set the seal to the theory and, as far as the economists of the early part of the nineteenth century were concerned, and most characteristically of that period, declare the law of the wages fund as immutable, although Heaven and Earth might pass away!

The doctrine of the wages fund as laid down by Mill in his "Principles of Political Economy", (Book II, Chap. XI.) is as follows:-

Competition is the principal regulator of wages, and, therefore, wages depend mainly upon the demand and supply of labour; or, upon the proportion between population and capital, population meaning here those who work for hire, and capital meaning circulating capital, and not the whole of that, but the part devoted to the direct purchase of labour. To this must be added all funds which, not being a part of capital, are paid in exchange for labour, such as wages of servants, soldiers, etc. This aggregation of capital is called the wages fund. "Wages therefore depend upon the relative amount of capital and population, but cannot, under the rule of competition be affected by anything else. Wages (meaning of course the general rate) cannot rise but by an increase of the aggregate funds employed in hiring labourers, or a diminution in the number of competitors for hire, nor fall, - except either by a diminution of the funds devoted to paying labour, or by an increase in the number of labourers to be paid".

It has been shown by Professor Nicholson(1) that this theory can be resolved into three propositions:-

> 1. There is always a determinate amount of capital destined in every country for the payment of labour, i.e. the wages fund.
>
> 2. The number of labourers who are obliged to wor, for subsistence whether the rate of wages be high or low is also determinate.
>
> 3. Competition governs the distribution of the wages fund among the labourers, the masters competing for labour, and the labourers with one another for work.

Thus the average rate of wages depends on the proportion between wage capital and population. This then is what Professor Taussig calls the "stern and ominion wages fund which rouses the ire of the friend of the working man."

It would here be convenient, before passing to other theories with regard to wages to glance for a moment at a developement springing from the wages fund theory put forward by the apostles of socialism, Lassalle, and Earl Marx. Stated briefly the argument is as follows:-

The power to work under present social conditions is a commodity that is bought and sold on the market, workmen being the sellers, and employers the purchasers.

But wherever there is free competition the value of all commodities is determined by the cost of production. This cost regulates the natural or normal value of goods. The same law must hold for the commodity called manual labour, and the price of labour (i.e. wages) must also be fixed by the cost of production.

Lassalle declared that the price of labour like the price of all other merchandise, is determined by the relation of supply and demand. But what determines the market price of any

(1) Encyclopaedia Britannica - article on wages by Prof. J. T. Nicholson.

Merchandise or the average ratio of supply and demand? What but the necessary cost of production?

Now the cost of production of labour is made up of two constituent parts:-

First, the value of the goods which the workman must consume to support himself and maintain his productive powers.

Secondly, the amount necessary to replace this workman by another when he becomes unfit for work, i.e. the amount necessary for raising the number of children required by society to carry on the race.

Thus wages are necessarily determined by the minimum that is absolutely necessary for the support of the labourer and his family, or, more generally,- wages cannot long remain above or below the amount necessary for the maintainance and propagation of the labouring class.

Marx in "Das Kapital" argues that at the present time all those who do not possess any capital have to work for such wages as will keep them alive, and any gain from inventions and industrial economies fall to the capitalists alone. And so through his helplessness the labourer is forced to work for the wages which will give him the bare necessaried of life, but on the other hand to produce far more than his cost, the surplus going to his employer. This is the "Brazen Law" of Lassalle.

The tendency of the labouring population to increase beyond the means of their employment is a benefit to the capitalist in the periodic expansions of enterprise following on new inventions, while when trade is slack the capitalist merely flings him aside. This theory directly follows, its holders argue, from the wages fund theory as stated by Mill, and is the only logical corollary to it.

Attacks on the Wages Fund.

The theory of the Wages fund has been repeatedly attacked, and indeed with such effect that Mill himself in an article in the Fortnightly Review abandoned the theory, persuaded thereto by a book by W. T. Thornton entitled "On Labour".

Thornton's argument is that although he does not deny that wages were paid from capital, yet he conceives this to be an elastic fund and not a fixed one, and one in the hands of the managers and employers of the labourers.

The national wages fund must be made up of the wages fund of many employers. Does any individual possess such a determinate and elastic fund? Undoubtedly not a fund set apart wholly for wages, but the money funds of the employers constitute the real capital applied to wages. This indeterminateness and elasticity, in the sense of money funds available for the direct employees Mill was brought to admit, and hence it followed that men might get better wages by means of strikes, a possibility which was of necessity denied by the wages fund doctrine.

The Productivity Theory.

That Production furnishes the measure of wages was the theory put forward by F. A. Walker, the eminent American economist.[1]

Wages, says he, are not dependent on capital, because men without capital can employ labour, knowing that the labourers will produce enough value to enable them to pay the labourers out of the product and leave a balance for the employer.

Employers can do this either by supporting the labourer until he has produced, and then paying hin from the proceeds, or by borrowing capital, paying back the loan when he has obtained the fruit of the labour. He says in Chap. VIII, "I hold that wages are paid out of the product of present industry, and hence that production furnishes the true measure of wages. The employer purchases labour with a view to the product of labour, and the kind and amount of that product determine what wages he can afford to pay."

Walker will not allow any truth in the wages fund theory, and in Chapter IX of the Wages Question he capitulates the arguments against it, which may be very briefly summarized as follows:-

(a) Wages are paid out of current production and not out of capital.

(b) It disregards the efficiency of the labourer.

[1] "The Wages Question," F. A. Walker

(c) It disregards all inventions and improvements.

(d) The theory holds that every addition to the number of labourers must lower the rate of wages.

This disregards the contribution which the new comer makes to the production of the community. The wages fund regards him as an addition to the divisor, and does not recognize that his labour must add something to the dividend. From the product of labour the capital employed must first be paid its due interest, in order to induce it to contribute, and so, if we can reckon the value of the product and divide it by the number of persons employed, we find the average rate of wages expressed in money.

Wages are thus a result, and their rate must be determined by the value of the product.

The natural deduction to be drawn from this theory is that to raise wages the efficiency of the labourer must be increased, and thereby the product will be increased. By doing this the labourer will enjoy an increasing share of an increasing product.

The share of capital will diminish because as wealth increases capital will be forced to compete more for opportunities to be employed, and this competition will lower the rate of interest and thus leave more to be alloted to the labourer.

In the wealthiest countries interest is lowest and wages are highest. By the increase of machinery, the product is increased and therefore the share of the labourer.

This theory, as expanded by ~~Labor~~ later economists (notably Marshall), has become known as the Residual Claimant Theory.

This regards the labourer as the residual legatee or claimant of the product of industry after the prior claims of the capitalist, the landlord, and the employer have been satisfied by the payment of interest, rent and profits.

These three shares are strictly determined in their respective amounts, whereas the worker's share possesses the advantage of not being fixed.

Before going further it would be well to examine the theory of profits as held by the leading exponents of the Residual Claimant Theory.

Profits are the remuneration of the entrepreneur, and are a species of the same genus as rent. Just as in the theory of rent there is a portion of the land which may be regarded as "no rent land", so there is, theoretically, a no-profit state of production, and, as in the theory of rent, the amount received as rent by the landlord is not paid either by the agricultural labourers, or by the consumer of the produce, and rent forms no part of the price of agricultural produce, in the same way profits do not form a part of the products of industry, and do not cause any diminution of the wages of labour.

That this is so may be seen when we consider that the successful management of business is generally due to exceptional abilities, and there are several degrees of ability in the whole class of people who conduct business.

There are, first, those of exceptional and brilliant ability, men of genius who make very large fortunes. Secondly, we have men of grea t ability who fail of being in the first class. Thirdly, we have men who succeed fairly well and who make up for the lack of the highest qualities by pains and diligence. Fourthly, the class of men who sometimes do fairly well and who make up for the lack of the highest qualities by pains and diligence. Fourthly, the class of men who sometimes do fairly well, more often ill, and very often fail altogehher. This is the "no-profits" class, and it is from this class uowards that we must measure profits.

Thus we see that the profits made by the man of great ability represent the value of the addition which his work makes to the produce of capital and industry, and his earnings do not come from the price of manufactured products.

We can now see that profits are not subtracted from wages, because the no-profit employers must pay sufficient wages to induce men to work for them. These wages are an essential part of the cost of production. The fact that they are so high is the very reason why the no-profit employer makes no profit. The higher grade employer naturally will not pay any higher wages, for the labourer is just as efficient if he works for a weak as for a strong man, and there is no reason why he should be paid more in the one case than in the other. The difference in the produce is due, not to the labour, but to the abilities of the organizer, and profits are not taken from wages, but are the measure of efficiency between the different degrees of efficiency of the employers

Upon this theory of profits wages are the residual share of the product of industry, being enhanced by every cause which increases the product of industry, without giving to any of the other three parts of production a claim to increased remuneration, and if any of the parties to production are so engaged in any given increase of the product as to become entitled to an enhanced share in its distribution, their shares atill remain subject to positive reasons, while wages receive the benefit of all that is left over after the claimants are satisfied.

Now, when some improvement takes place in the quality of the labouring class by which their finished product is worth so much more, the question is who will receive the increased benefit of the increase?

The answer is, the labouring class in ~~enahnced~~ enhanced wages. It will not go to the landlord because no greater demand is made upon land, and hence cultivation is not driven down to inferior soils, and therefore rent cannot be enhanced, since rent represents only the excess of produce on the better soils above that of the soils of the lowest production.

Will the capitalist benefit by an increase of interest? No, for an improvement in the industrial quality of the labouring class does not necessarily increase the amount of tools, etc., required for production. Since then there is no greater demand for capital, there is no increase in the rate or amount of interest which depends on the greater demand for capital. Will the employers benefit?

An improvement in the industrial quality of workmen would not require an increase in the number of employers, and hence it would not increase the aggregate amount of profit. We are therefore led to conclude that the labouring class is the one that benefits.

Before leaving the Production Theory of Wages, and its corollarythe Residual Claimant Theory, it would be well to glance for a moment at one important development of the productivity theory, namely what is known as the Differential Law of Wages.

The statement of this law by the best authorities contains four leading propositions.

First, the labour force in a country with varied industries is a force of varying efficiency per labourer unit.

Second, the character of the industrial organization of a particular time and place determines the nature and degree of segregation of labourers into groups of varying efficiency. The two most fundamental groups are those of skilled and unskilled labour.

Third, the labourer of least efficiency in each group receives a waged which contributes the minimum wage of the group. This minimum wages is at least equal to the highest wage that the least efficient labourer in the group could earn in the other forms of employment open to him.

Fourth, the more efficient labourers within the group receive the minimum wage of the group, plus a supplement proportionate to the excess of their efficiency over that of the least capable labourer in the group.

It is essential to observe that the differential law covers only a part of the general theory of wages, for however large, or however small the labour divided, it may be apportioned among the labourers according to their efficiency, and consequently it is not allowable to conclude from the fact of labour being rewarded according to efficiency that therefore labour gets what it produces.

Cf. Journal of Royal Statistical Society, Oct. '07, article on the "Differential Law of Wages" by H. L. Moore.

Theory of Final Productivity. Arising out of and as a corollary of the Residual Claimant Theory, is the theory of wages which now finds most general acceptance among the new order of economists; namely that wages depend on the final or marginal productivity of the workman.

Following on the lines laid down by von ~~Theunen~~ Thuenen and the Austrian school this theory now finds its ablest exponents in the American economists, notably T. B. Clark, and E. R. A. Seligmann, both of the Columbia University. To quote Professor Clark, the theory may be enunciated as follows:-

"Labour, like commodities, is subject to a law of marginal appraisal. The rate that the market puts on the final unit of the supply of each of them, it puts on the entire supply. As the last unit of consumer's goods is a price making one, so the last unit of labour is the one that fixes wages."

The method of stating this theory is the familiar one of stating the law of marginal utility. An employer is imagined as putting necessive men or gangs of men, to work on a certain job, until the last man employed just pays by his productivity for his employment, while one more would be a loss to the employer. That is the point at which no employer will hire more labour, and wages cannot therefore be greater than the productivity of the last labourer employed.

There is a profit on labour, so long as the men in a working force are paid less than the final one produces, but competition will annihilate that profit and to make the pay of labour equal to the product of the final unit of it.

It will readily be seen that this theory is practically a restatement of the productivity theory, for however bargaining between individuals may adjust wages, the rates of pay that result from these bargains tend to equal that part of the product of industry which is directly attributable to the labour itself.

It should be hoted that this is more a point of view

T. B. Clark - "The Distribution of Wealth". New York, The Macmillan Co. 1908 - Cap. XII, p. 180

than the statement of definite law.

It states that no one law of wages exists, but that wages depend on the value of the employee to the employer, that is to say on the margin of employing each worker will get what his labour is worth to the employer at the time when his wage is decided upon. What the labourer is worth depends upon the state of the market, the ability of the labourer, the standard of living, etc.

Before passing to any critical examination of the various theories with regard to wages, we must not omit mention of some few theories which have been advanced with regard to wages, but which have not, by reason of their highly controversial nature, been accepted to any considerable extent by the orthodox economists, being merely, for the most part the doctrinaire arguments put forward by the leaders of political parties.

<u>The Standard of Living Theory</u>. This theory put forward by Mr. George Gunton in his book "Wealth and Progress" is connected with what is known as the "Short Hour Movement"; an agitation for curtailing the hours of labour. Briefly put the theory is as follows: "The chief determining influence in the general rate of wages in any country, class or industry, is the standard of living of the most expensive families furnishing a necessary part of the supply of labour in that country, class or industry."

Competition, he argues, will reduce wages to the lowest point at which a man will work, but it cannot reduce it lower, because then, rather than work for such wages, he will either starve or go on strike.

The price of labour depends on the cost of production, and a skilled labourer will receive more than an unskilled, because more has gone to the production of the skilled, than of the unskilled.

An oriental will work for less wages than a white man because he lives in a lower way; city wages are higher than country, because it costs more to live in the city than in the country.

This goes to show, argues Mr. Gunton, that wages do not depend, as the socialists say, on what will barely support the labourer's life, but according to the standard of living he considers necessary. Therefore the one way to raise wages is to raise the