THE THEORY OF ADMINISTERED WAGES

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CHAPTER I

INTRODUCTION

Since the rise of classical economics, it has been generally agreed that certain economic "natural laws" have controlled the determination and distribution of wage payments. It has been believed that if these "natural laws" were left to function without interference, they would disburse fair and just wage payments on an impersonal basis. These "natural laws" saw to it that labor received the highest wage compatible with the continued growth and existence of the economy. Wages, because of these laws, tended to seek their "natural level"—a level, the fairness of which, was unquestionable. So it was believed. So it is still believed to a great extent. However, events have occasionally occurred that sometimes shook this simple faith. Trade unions, for instance, were sometimes able to get sudden, rather sharp wage increases without a subsequent reduction in the pay of other workers. The compilation of statistical data sometimes served to illustrate that average real wages could rise in the short-run without unemployment resulting. Sometimes these data also bore out the fact that labor did not share in increased productivity. Finally, the skeptic wondered if perhaps the "natural laws" had been repealed.
The wage scene at present is overcast with confusion. So numerous have been the exceptions and frictions claimed by the orthodox that skepticism has for sometime been on the increase. Extreme heretics have at times pondered the possibility of the "natural wage level" being a contrivance of man. It seems to have just happened that the "natural laws" tend to operate to labor's disadvantage and to the advantage of capital. Such capricious behavior on the part of the "natural laws" led Hamilton in 1924 to say: "The rate of wages in industry or occupation is always a man-made one; the factors upon which it rests are subject to control." Or, as a more recent writer suggests: "In the combat for supremacy between the free market and conscious policy in the determination of wages, the former--however lamentable it may be deemed--has been yielding ground rapidly." Or stated more emphatically by the same author: "It is a commonplace that wages are now determined by conscious human decision rather than by impersonal market forces." Even an imperfect competitionist states it clearly:

As the relative number of buyers are increased to a seller, or vice versa, a mechanical problem in bidding arises. One seller, for instance, does not have the time to engage in separate dealing with each one of a

2 Arthur M. Ross, Trade Union Wage Policy, p. vii.
3 Ibid., p. 4.
large number of buyers. . . . The technical arrangement of a quoted price emerges from the context. The market for many types of labor services falls into this form of technical organization; labor markets do not resemble bourses, auctions, nor closed-bid arrangements. 4

Such heresy cannot be entirely unprovoked. Surely no one would seriously contend that the wage rates resulting from the recent sliding-scale contract between the United Automobile Workers and the General Motors Corporation were products of "supply" and "demand." Also, when two supposedly competing firms like Swifts and Armour offer the same wages to the one-half cent for similar employment, 5 one strongly suspects that the "visible hand is beating the invisible to the draw."

Obviously there is at the present time a need for a great deal more study regarding the way in which wage payments are determined. Are wages determined or fixed by natural law? Or are they administered through the conscious effort of man? It will be the purpose of this study to partially investigate the determination of wages both theoretical and actual. Perhaps some insight may be gained that will give rough answers to the above questions.

There are three groups which play significant roles in the determination of wages in this country today. These, of course, are (1) business enterprise, (2) labor unions, and

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4 John T. Dunlop, Wage Determination Under Trade Unions, p. 11.

5 Personal interview with representatives of the two companies in 1948.
(3) the government. Whenever the government enters the wage picture, man-made wages obviously are the result. Such governmental behavior is, however, frequently criticized as interference with "natural law" and with the warning that society will pay eventually through unemployment of its members or a diminution in investment capital. But this will be dealt with later. Conscious wage administration by business and labor unions is not, however, so readily discernible. This is no doubt due to our inability to see reality through the extra "dark glasses" of supply and demand. This versatile principle apparently applies equally well to wage settlements between large unions and giant corporations, or the non-union worker pitted against the giant corporation, or the large union against the small-scale employer, or any other arrangement. But some of these cases require more than a "supply and demand" explanation for the non-believer. Consequently, it is believed wise to look further into the activity of business, labor unions, and government in regard to wage determination.

It may be that subsistence theories, wages-fund, and marginal productivity theories are as Hamilton says, "magical words beyond which the inquirer should not seek to go." If by chance one should go beyond these magical words, he might

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6 Hamilton and May, op. cit., p. 28.
find them having a considerable human savor and not, after all, so magical. At any rate, the next two chapters will be devoted to looking beyond these purported "magical" orthodox wage theories to see if their so-called "natural law" foundation is adequate. Then a somewhat lengthy chapter will be given over to an effort to analyze the actual role in the determination of wage payments of the three groups mentioned: business enterprise, labor unions, and the government. Finally, if any significant conclusions are drawn, they, too, will be stated.

A more detailed and lengthy study would require the inclusion of information dealing with foreign experiences, especially British, but space restricts the present work exclusively to the American economy, with the sole exception of the section dealing with economic theory. This is justified upon the grounds that ideas do not easily respect national boundaries.
CHAPTER II

ORTHODOX WAGE THEORIES

Perhaps few present day thinkers claim a high degree of validity for the early classical theories of wages, but it nevertheless appears worthwhile for the purpose of this study to briefly give a historical resume of the major theories. It is believed here that though the names of the theories were changed the main body of thought remained relatively unchanged. Actually all orthodox wage theory seems to have a common foundation in a group of "natural laws." For that reason it is deemed necessary to point out these continuities by a short discussion of the main trend. This should allow these natural law continuities to be more easily viewed and illustrate somewhat their purported role in wage determination.

The Subsistence Theory

One of the clearest expositions of the subsistence theory of wage is that given by Ricardo:

Labor, like all other things that are purchased and sold, and which may be increased or diminished in quantity, has its natural and its market price. The natural price of labor is that which is necessary to enable the laborers, one with another, to subsist and to perpetuate their race, without either increase or diminution . . . .

The market price of labor is the price which is really paid for it, from the natural operation of the proportion of the supply to the demand; labor is dear
when it is scarce and cheap when it is plentiful. However much the market price of labor may deviate from its natural price, it has, like commodities, a tendency to conform to it. It is when the market price of labor exceeds its natural price that the condition of the laborer is flourishing and happy, that he has it in his power to command a greater proportion of the necessaries and enjoyments of life, and therefore to rear a healthy and numerous family. When, however, by the encouragement which high wages give to the increase of population, the number of laborers is increased, wages again fall to their natural price and indeed from a reaction sometimes fall below it.  

It is easy to see that the "natural" or "subsistence level" of wages is supposed to be fixed or determined through the operation of several "natural economic principles." First we see the "Law of Supply and Demand" operating through the "Law of Competition." This is the theoretical force which regulates wages during the short-run. Secondly, the "Law of Diminishing Returns" is readily discernible. This, coupled with the Malthusian theory of population growth, sets wages in the long-run at subsistence level. The one fact that man can control his numbers is actually sufficient to destroy the subsistence theory, but we need spend no further time with the "Iron law." Suffice to say that the very fact that the classicists were compelled to abandon it speaks sufficiently of its invalidity as a wage theory. However, they did not abandon the "natural laws" on which the theory was largely predicated. The subsistence argument could only hold for the

very long run. Until the colonial areas became more thickly populated, a good case could be made for a wage above the subsistence level. Then Malthus' second essay introduced moral restraint as a means of controlling population. Also the constant growth of technology made it increasingly difficult to rationalize low wages. The natural laws of economics were not questioned by orthodox economists—only the mechanics of the particular subsistence theory.

The Wages-Fund Theory

It gradually became obvious to orthodox thinkers that wages could for fairly lengthy periods be held above a bare physical subsistence level. For instance, John Stuart Mill made the following observation:

Mr. Ricardo ... assumes, that there is everywhere a minimum rate of wages; either the lowest with which it is physically possible to keep up the population, or the lowest with which the people will choose to do so. To this minimum he assumes that the general rate of wages always tends; that they can never be lower, beyond the length of time required for a diminished rate of increase to make itself felt, and can never long continue higher. This assumption contains sufficient to render it admissible for the purposes of abstract science; and the conclusion which Mr. Ricardo draws from it, namely, that wages in the long run rise and fall with the permanent rise of food, is, like almost all his conclusions, true hypothetically, that is granting the suppositions from which he sets out. But in the application to practice, it is necessary to consider that the minimum of which he speaks, especially when it is not a physical, but what may be termed a moral minimum, is itself liable to vary.²

Thus Mill allows for some change in the wage rate, but he quickly places an absolute maximum above which it is impossible for wages to go:

Wages . . . depend mainly upon the demand and supply of labor; or as it is often expressed, on the proportion between population and capital. By population is here meant the number only of the working class, or rather those who work for hire; and by capital only circulating capital, and not even the whole of that, but the part which is expended in the direct purchase of labor . . .

. . . wages not only 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 laborers or a diminution of the number of competitors for hire; nor fall, except either by a diminution of the funds devoted to paying labor, or by an increase in the number of laborers to be paid.3

Although Mill leaves the way open for an increase in wages through the limitation of population, and though he speaks of a variable moral minimum, he, nevertheless, states:

It is but rarely that improvements in the conditions of the laboring class do anything more than give a temporary margin, speedily filled up by an increase in numbers. The use they commonly choose to make any advantageous change in their circumstances, is to take it out in the form which, by augmenting the population, deprives the succeeding generation of the benefit.4

And with specific reference to trade unions, Mill later states that the trade union movement is futile as far as the entire laboring class is concerned. A particular group can raise its wages only at the expense of the rest of the working class or by forcing unemployment through monopolistic practices.5

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3Ibid., p. 203. 4Ibid., p. 211. 5Ibid., pp. 563-66.
According to Mill's analysis, wages are paid from accumulated capital, which was considered literally "advances of wages" to workers while they were in the process of producing for sale in the future. This wages-fund placed a very definite ceiling upon the "wage bill." Mill, as was pointed out, also accepted the Malthusian theory of population growth to a very large extent. Thus a limited wages-fund and a tendency toward very rapid population expansion would appear to force wages to a "moral minimum" subsistence level.

The wages-fund theory is not, then, drastically different from the subsistence theory. It is slightly less rigid, but due to the "Law of Diminishing Returns" and the rapid growth of population, wages still tend to seek their "natural" subsistence level. Also, the wages-fund theory leaves wages determined by the same "natural laws" that were operative in the case of the subsistence theory. It was a very clever device, especially adapted for combating trade unionism, which surprisingly enough was, with a good deal of difficulty, just beginning to emerge as an actual threat.

The fact that the unions were able to increase wages for certain groups without diminishing the wages of other laborers throws doubt on the wages-fund doctrine. Minimum wage legislation also began to appear, especially in England, without the predicted results. Also, this theory assumes a production period which simply does not exist in an industrial society.
Again the fact that the classicists abandoned the theory speaks loudly of its shortcomings. Even Mill later repudiated the theory:

There is no law of nature making it inherently impossible for wages to rise to the point of absorbing not only the funds which he (the employer) had intended to devote to carrying on his business, but the whole of what he allows for his private expenses beyond the necessaries of life. The real limit to the rise is the practical consideration of how much would ruin him, or drive him to abandon the business, not the inexorable limits of the wages-fund. 6

In point of time the wages-fund doctrine did not reign supreme for long among the orthodox economists, but it died slowly, being revived as late as the 1920's in order to combat minimum wage legislation in the United States.

Here, again, we have a theory based upon natural law. The theories were repudiated, but not on the grounds of a poor foundation.

The Marginal Productivity Theory

With the gradual decline of the wages-fund idea, a new doctrine or "law" of wages arose. "After several decades, which witnessed the rise and fall of many restatements of the law of supply and demand," a 'productivity' theory of wages came into general favor."7 This theory more than compensated for whatever preceding theories lacked as effective justifications for prevailing wages. It is such a masterly piece of

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7Hamilton and May, op. cit., p. 25.
rationalization that it deserves being dealt with at somewhat greater length than the others. And, too, it has enough life in it to occasionally fool the unsuspecting. Even a comprehensive three volume treatise little older than a decade found the authors turning directly in a discussion of wage theory to "that theory of distribution most generally held by twentieth-century economists, that of marginal productivity, which predicates in substance an equivalence between the reward of each factor of production and its production of exchange value."9 And the same contemporary authors think the marginal productivity theory calls "only for modification, not for complete abandonment of the theoretical scaffolding, for many of the forces of competitive free enterprise are powerfully operative."9

To J.B. Clark goes a great deal of the somewhat dubious distinction for the earliest complete statement of the marginal productivity theory. The purpose of one of his most famous "works" he stated, was "to show that the distribution of the income of society is controlled by a natural law, and that this law, if it worked without friction, would give to every agent of production the amount of wealth which that

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8Harry A. Millis and Royal E. Montgomery, Labor Progress and Some Basic Labor Problems, p. 175.

9Ibid., p. 205.
agent creates. The task in more than 400 pages undertook to show that labor received its just reward—what it produced. For the best concise account of the workings of this theory, we turn again, however, to Millis and Montgomery:

Entrepreneurs, endeavoring to discover and maintain the most economically advantageous combination of the several productive agents, stand ready to increase the number of units of land, labor, and capital they utilize until the price they must pay for the last added (or marginal) unit. Their funds will be apportioned so that the last dollar spent in wages adds as much to the product of the business as the last dollar spent for capital equipment. And in any given state of the industrial and economic arts, there exists a certain proportion between expenditures for capital and those for labor which is more profitable than any other.

The price of labor, or the wages it tends to receive, is therefore determined by the product yielded by the marginal unit. Employers calculate how much will be added to the total product of their factories or other productive units if they employ additional units of labor or of capital; and this calculation governs their demand price for labor and capital. This worth to the employer, and therefore his demand price for labor, is determined by the principle of diminishing productivity, since the product of each unit of a factor diminishes as the number of units is increased, the units of the other factors remaining constant or not increasing to the same extent. On the assumption that the supply of labor seeking employment is constant, the wage that can be commanded just equals the amount that is added to the total product by the marginal units of the supply. Wages cannot rise above this point without causing marginal units of the supply to be left unemployed, since the price of labor would then be in excess of its worth and competition among the unemployed for jobs, taking the form of offers to work for lower wages, would, in turn, tend to bring wage rates back to the former level.

10 John Bates Clark, The Distribution of Wealth, p. v.
... The wage level, in other words, is dependent upon two variables: the demand price of employers, a function of not marginal productivity; and, second, the supply of labor forthcoming, which determines in part productivity at the margin. Entrepreneurs under the compulsion of competition distribute the total value product among the various agents according to the worth of those agents to them, the aggregate going to each factor being commensurate with the work of the marginal unit times the number of units employed.\footnote{Millis and Montgomery, \textit{op. cit.}, pp. 175-76.}

Thus we have here a unique contrivance which endeavors to demonstrate that the worker is paid what he produces. A wage, of course, is the fairness and justness which few would dispute. The marginal productivity theory did mark a considerable improvement over the preceding theories. It allowed for a great deal more flexibility than the earlier theories.

Here there was at least a chance for wage increases through increased productivity. However, its major break with prior theories was its partial escape from the dismal Malthusian concept of population growth. As we have seen, it, too, is a natural law theory. The "Law of Diminishing Returns" along with the "Law of Supply and Demand" operating through competition are the very determinants of the marginal wage. Of course, as is usually the case, several other assumptions are made on which the proper functioning of the theory depends. These are generally characteristic of most orthodox wage theories and will be appropriately dealt with subsequently. In the main, these assumptions can generally be considered as
collectively making up the concept of competition. The marginal productivity theory is fairly tight as far as logical consistency is concerned. As usual, the assumptions on which it rests must be attacked. However, the theory does appear to be subject to several weaknesses which might be mentioned briefly. What determines the rate of profit below which an entrepreneur will not produce? Could his rate of profit drop to the subsistence level? If profits will not fall to the subsistence level, something like custom and habit must be holding them up, even assuming that "natural laws" are operating. How can it be proved that profit measures the exact amount that should go to the capitalist? How did the capitalist get the capital in the first place? Then, of course, despite a good deal of effort, rent for all practical purposes remained a monopoly return which would increase as the population grew larger even though Clark said: "What it earns for its owner is determined directly, not residually."12

These were a few of the questions still needing to be satisfactorily answered. However, the validity of the theory, even if the questions could be answered, will rest entirely upon the outcome of the subsequent analysis of the orthodox assumption and "natural laws."

12 Clark, op. cit., p. 345.
Keynes on Wage Theory

There is no complete, systematic theory of wages in the Keynesian analysis. Due to the rather extensive influence of his writing, it is deemed necessary to point out, however, what he did have to say on wage theory. Keynes was primarily interested in wages from the standpoint of full employment, and most of the discussion of wages was incidental to the main purpose. But the Keynesian analysis greatly suffers from this failure to formulate a consistent theory of wages. Actually The General Theory is so contradictory and inconsistent in regard to wages that it can be used to bolster almost any wage policy. However, an attempt will be made to state what is believed to be the main Keynesian theory of wages in the belief that a sufficiently clear picture can be drawn to warrant Keynes a place in the orthodox camp.

In Chapter XIX, Keynes differentiates between money wages and real wages. These two wage rates fluctuate independently of each other. Here Keynes was led to an important disagreement with the classicalists, who thought the two wage rates were equal, and that a reduction in money wages was tantamount to a reduction in real wages, which would in turn, increase employment. But Keynes says:

Now the assumption that the general level of real wages depends on the money-wage bargains between the employers and the workers is not obviously true. Indeed it is strange that so little attempt should have been made to prove or to refute it. For it is far
from being consistent with the general tenor of the classical theory, which has taught us to believe that prices are governed by marginal prime cost in terms of money and that money-wages largely govern marginal prime cost. Thus if money-wages change, one would have expected the Classical school to argue that prices would change almost the same proportion, leaving the real wage and the level of unemployment practically the same as before, any small gain or loss to labor being at the expense or profit of other elements of marginal cost which have been left unaltered.\(^\text{13}\)

And furthermore, if this price decline did not occur, effective demand for the whole economy might very well fall and even less employment would be forthcoming.\(^\text{14}\) Now, according to Keynes, real wages are determined by the rate of investment, which in turn is determined by the propensity to consume, the rate of interest, and the marginal efficiency of capital. This, then, leaves the whole labor movement sterile as far as a gain for all the workers is concerned. They fight for a money-wage which will only raise prices and leave them in the same relative position. "In other words, the struggle about money-wages primarily affects the distribution of the aggregate real wage between different labor groups and not its average amount per unit of employment."\(^\text{15}\)

As for the distribution of money-wages, Keynes subscribes completely to the orthodox marginal productivity theory of wages:


\(^\text{14}\) Ibid., p. 258.  
\(^\text{15}\) Ibid., p. 14.
In emphasizing our point of departure from the classical system, we must not overlook an important point of agreement. For we shall maintain the first postulate (the wage is equal to the marginal product of labor) as heretofore, subject only to the same qualifications as in the classical theory; and we must pause for a moment to consider what this involves.

It means that, with a given organization, equipment, and technique, real wages and the volume of output (and hence of employment) are uniquely correlated, so that, in general, an increase in employment can only occur to the accompaniment of a decline in the rate of real wages. Thus I am not disputing this vital fact which the classical economists have (rightly) asserted as indefeasible. In a given state of organization, equipment and technique, the real wage earned by a unit of labor has a unique (inverse) correlation with the volume of employment. Thus if employment increases, then, in the short period, the reward per unit of labor in terms of wage-goods must, in general, decline and profits increase. This is simply the obverse of the familiar proposition that industry is normally working subject to decreasing returns in the short period during which equipment, etc., is assumed to be constant; so that the marginal product in the wage-good industries (which govern real wages) necessarily diminishes as employment is increased. So long, indeed, as this proposition holds, any means of increasing employment must lead at the same time to a diminution of the marginal product and hence of the rate of wages measured in terms of this product.16

In short, Keynes has made here the same assumptions and subscribed to the same "natural laws" that orthodox theory rests upon. This portion, at least, of Keynesian economics stands or falls with the rest of economic orthodoxy.

Thus Keynes has what might be termed a dual wage theory. Aggregate real-wages depend upon the rate of investment, and the distribution of this aggregate real-wage is effected by applying the marginal productivity theory to money-wages.

Actually Keynes has no satisfactory theory of the rate of investment as Chapter XXIV of The General Theory reveals, but a complete discussion of aggregate production lies outside the scope of this study. However, if the "Law of Diminishing Returns" proves invalid, many aspects of Keynes' rate of investment will be subject to grave doubts.

In an effort to achieve full employment Keynes reasoned:

... that a flexible monetary policy is an alternative to and on both economic and political grounds in preferable to a flexible wage policy. He acknowledges that money-wage cuts may increase employment slightly, but his main contention is that anything which might be accomplished by cutting wages can, as a matter of practical policy, be accomplished better by monetary policy.17

This is a surprising conclusion in the light of many statements made by Keynes. Since the rate of investment and full employment depend so heavily upon "effective demand," which is largely determined by the propensity to consume, it is difficult to understand the ease with which he dismissed the possible favorable effects of wage increases. Of course his assumption of "perfect competition" caused him to visualize a price rise sufficient to nullify the effects of a wage increase, but certainly steps could be taken to prevent this rise. This would offset the deflationary aspect of hoarding and also increase effective demand. Keynes was well aware of the banking system's role in supplying investment funds.

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which should have allowed him to escape from the classical need for private savings. One is almost tempted to conclude that Keynes was unable to recommend a lowering of profits. Surely he could not have said that investment depended more upon the marginal efficiency of capital than upon effective demand.

Space will not allow a complete discussion of Keynesian wage theories, but here the main interest is justifying the contention that the Keynesian analysis is simply a variation of classical economics and completely in the orthodox continuity. Although they were made for The General Theory, as a whole, the seven assumptions made, according to Smithies, by Keynes are relevant in regard to wage theory. They are sufficiently revealing to warrant inclusion here:

(1) Keynes assumes that techniques of production and amount of fixed capital used in production are unchanged throughout the periods with which he is dealing. Thus the analysis is limited to periods sufficiently short for the new investment that takes place during them to have no effect on technique.

(2) However, the analysis usually assumes that the equilibrium positions achieved after the longest periods compatible with the assumption of constant techniques has been reached. While there are many illuminating remarks on the process of moving from one equilibrium to another, no complete explanation is attempted.

(3) Perfect competition is assumed throughout. Thus questions of changing degree of monopoly, or what we call "wage price policy" are largely ignored.

(4) The role of government, either as a taxer or as a spender, is not explicitly recognized in the formal part of The General Theory.

(5) The formal part of the analysis is carried out in terms of a closed economy.
(5) The General Theory deals in aggregates and ignores questions of changes in relative prices and wages.

(7) The General Theory is static and consequently does not take into account the fact that economic events at one point of time are not independent of what went before and will not fail to influence what will occur subsequently.18

Add to these his acceptance of the marginal productivity theory of money-wages and its necessary companion "diminishing returns," and only the impervious could refuse to see that Keynes is a continuation of economic orthodoxy, and that the so-called "Keynesian Revolution," at least, as far as wage theory is concerned, is nothing more than a little "sham skirmish" among friends carried on to perhaps divert attention from the needed real change.

Wage Theory of the Imperfect or Monopolistic Competitionists

Judging by the frequency in which she is quoted, Joan Robinson is one of the major figures among the "imperfect competitionists." Some prefer the extremely contradictory title of "monopolistic competition," and some have claimed a difference exists between the two.19 But it is largely, like most advertising, an attempt to differentiate where no difference exists. Here "monopolistic" and "imperfect" competition

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will be used synonymously. Now, according to Robinson's analysis, a firm operates under what is termed "marginal revenue productivity," or in vague technical language: "the seller is assumed always to equate marginal revenue to marginal cost."\(^{20}\) What the marginal revenue productivity theory means in ordinary language is that an entrepreneur will adjust his production and prices so as to reap the maximum amount of profit taking into consideration the characteristics of the demand for his product.

Curves are drawn to illustrate both increasing and decreasing returns, but overwhelming emphasis is placed on the latter. Consequently, in almost every case, the monopolist increases his revenue by cutting production and raising the prices until he reaches the point of maximum revenue. This means that the entire economy suffers a reduction in output under monopoly as compared to competition, according to this theory. As Robinson conservatively states:

\[\ldots\] it is only when there is a scarce factor for which the full rent is not paid, and at the same time there are economies of large-scale industries, that it is possible that monopoly output may be greater than competitive output. In all other cases we have seen, monopoly output may (on extreme assumptions) be equal to competitive output, but it can never be greater.\(^{21}\)

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\(^{20}\) Joan Robinson, *The Economics of Imperfect Competition*, pp. 51-52.

\(^{21}\) Ibid., p. 154.
The implication is clear that in most cases competitive output is greater than monopolistic output. But another writer is clearer still:

Whether one monopolist maximizes his profits and the other casually makes the best of it, or whether they get together and maximize their joint profits, it seems clear that in all but the exceptional cases, output will be less than under competition, though it may well be greater than under monopoly on one side and pure competition on the other. It seems intuitively obvious that the output which maximizes the joint profits of two groups in society will not usually be the same which maximizes the profits and surpluses of society as a whole (the competitive output).22

In almost every case there appears a nostalgia for the "lost competitive order." In fact by their theory, they have to (1) recommend an effort to increase competition and likewise production; (2) accept the restricted output their curves suggest, or else; (3) abandon their theory entirely. Since their second alternative is popular only with business interests, it can almost be concluded that the "imperfect competitionists" represent only a disorganized last ditch stand in an effort to protect an antiquated economic system.

Furthermore, after endless pages of curve drawing and complicated formulas, they are able to make the astounding conclusion that "prices and production are where they are because monopoly or imperfect competition is what it is." In other words, this theory can never be more than (even assuming

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its assumptions are valid) an analytical tool of use only in telling what has occurred in the past. It has no means of pointing the way to greater productivity except by advocating more competition. Then it is only orthodox economics starting from the appendices and working backward. Monopoly must be condemned as an evil.

What, if it may be asked, does this have to do with wage theory? It simply means that imperfect competition, as it presently exists, must go backward or else it merely represents a very temporary, confused, and transitory stage. There is evidence that the theory has already begun to disintegrate. Reder, for instance, has even contested the basic assumption of the operation of the firm "in such a way as to maximize its profits." 23 In regard to wages, we will shortly see the importance of the preceding general discussion.

The "imperfect competitionists" employ the marginal productivity theory of wages, which, as we have seen, is a competitive theory. Robinson says: "For full equilibrium it is necessary that the marginal net productivity, and the average cost of labor (the wage) should be equal to average net productivity." 24 In the competitive industries this equilibrium is said to occur, but it has been admitted that monopoly is


just as characteristic as competition and more so than perfect competition.

Now if the wage is equal to the average net productivity of labor, the entrepreneur will be receiving his normal reward, and the total value of output will be equal to its total cost of production (including the cost of entrepreneurship). If the wage is less than this, the total value of output will be greater than its cost. The difference between the wage and the average net productivity of labor, multiplied by the number of men employed, will represent a surplus profit over and above the normal cost of the entrepreneur. 25

This supposedly poses no problem for competitive industries for "if the wage is less than average net productivity, surplus profits are earned and new firms are attracted into the industry," 26 but this regulator is absent in the monopolistic industries.

In a chapter on the "Monopolistic Exploitation of Labour," 27 Robinson finds exploitation arising under three conditions which need not detain us here. The significant aspect of the discussion is the fact that under monopoly exploitation does occur and there is, it appears, under this analysis no available means of preventing it. Trade unions may get money-wage increases, but prices will rise and exploitation will simply occur at a higher price level. And if demand is elastic, unemployment will be the result. Regulation is very briefly


27 Ibid., pp. 450-458.
mentioned as an alternative, but it is quickly disregarded for "if profits are kept at the normal level by changes in wages, the mechanism by which resources are directed from one use to another breaks down." Thus again the only way out of the dilemma would be by getting back to competition.

Thus in regard to our original general discussion of imperfect competition, we find it completely incapable of offering a positive contribution in general theory or specifically in the case of wages. Here again they can only tell us that "labor may be exploited under present monopoly conditions, but there seems to be no available solution," or either the remedy is considered worse than the ill.

Certainly we have here no sound wage theory; in fact, it might be argued that this dubious orthodox mutation has no real wage theory. Its contribution to the wage picture, if any at all and this no doubt unintended, was the acknowledgement that exploitation may and frequently does occur in a free enterprise economy.

Thus the conclusion is inescapable that the "imperfect competitionists" in regard to wages represent the extreme confused groping to which orthodox wage theory has evolved. Although something may well grow out of this confusion, there is little evidence that this group will be able to break sufficiently with orthodox thinking to make a real contribution.

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Ibid., p. 291.
The only true order that they are able to visualize is the classical competitive order. Here they are subject to the same pitfalls that beset the rest of orthodox economics.
CHAPTER XIII

A CRITIQUE OF THE ASSUMPTIONS AND "NATURAL LAWS"
WHICH UNDERLIE ORTHODOX WAGE THEORY

At the present time the most widely accepted orthodox wage theory, as we have seen, is the marginal productivity theory. It represented the paragon of orthodox efforts to explain or, perhaps better, to determine wages. It is in one way or another the wage theory of the remaining neo-classical elements, the Keynesians, the imperfect competitionists; and finally it is, as far as they think in terms of theory, the vague explanation of wage payments given by businessmen and a considerable portion of the general public. Of course, as will later be pointed out, businessmen do not utilize the theory in practice to the extent that they are purported to do. This does not, however, alter in the least their faith in the explanation.

The total membership of the marginal theory "fan club" accounts for a very large part of the population. Consequently, its importance in terms of influence can scarcely be over-emphasized. Almost all of the older orthodox wage explanations have been incorporated into or superseded by this purported "scientific law of wages." Thus, there appears the necessity
of analyzing only it in order to determine the efficacy of the orthodox approach in regard to wages.

The validity of the marginal productivity theory of wages, as does the entirety of orthodox thinking, depends upon the validity of (1) the numerous assumptions which form the setting necessary for the successful functioning of the theoretical principle, and (2) the so-called "natural laws" around which the theory is constructed. These two will be appropriately tested in the revealing light of reality.

Assumptions

Clark listed five assumptions necessary for the "static state" in which the marginal theory would attain perfection. These assumed a society "in which population neither increases nor diminishes, in which capital is fixed in amount, in which the method of making goods does not change, in which the mode of organizing industry continues without alteration, and in which the wants of consumers never vary in number, in kind, or in intensity."\(^1\) Even Clark realized these static concepts were contrary to actuality.

The population of the world increases, and this is one influence which prevents values, wages, and interest from subsiding to perfectly "natural" standards. Capital is increasing and this influence also acts as a disturbing factor. The methods of producing things change, and the changes have a very powerful effect in

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\(^1\)Clark, *Essentials of Economic Theory*, p. 132.
preventing the attainment of a static equilibrium. New modes of organizing different industries are coming into vogue, and this causes a further disturbance of the economic adjustment. The wants of men are by no means fixed; they change, multiply, and act on the economic condition of society in a way that affects the static adjustment. Even physical nature undergoes change.\footnote{Ibid., p. 131.}

Regardless of how much reality deviated from the assumptions, the theory evidently remains completely unharmed. Hamilton aptly describes such reasoning:

An abstraction transcends the series of concretions which call it into being. In its majestic sweep it cannot stop to give place to all the petty things which are not in accord. Accidents, tricks of one kind and another, combinations, frictions, great and small, whatnots that will not fit in, are to be brushed aside; the transitory have no commerce with the eternal.\footnote{Hamilton, The Pattern of Competition, p. 10.}

The single factor of technology has changed so rapidly and so greatly that it alone could almost at any time destroy static equilibrium. When the change of all five factors is totaled, one would expect the deviation from the ideal static state to be almost intolerable. For the "normal" or "natural" state of the whole group is that of constant change. They never stop to satisfy theoretical assumptions. It might be argued that changes in one tend to offset changes in one or all of the others. But strangely enough most change serves, it appears, to increase the disparity between wages and profits. For instance, technological innovations and organizational improvement will increase productivity which
probably will not, despite other assumptions, go equally for profits and wage increments. On the other hand, increased population, according to the theory, will decrease wages.

According to Paul Douglas, "such abstractions are more rigid than necessary, for the theory would have validity under less heroic restrictions." However, while Douglas was loosening the rigid restrictions without, in his way of thinking, harming the essential operation of the theory, he subsequently landed a blow from which marginal productivity doubtless is incapable of recovering. The blow being a group of what he termed "implicit assumptions of the marginal productivity theory." About this he said:

Since the primary purpose of the economic theory should be to explain actual life, it is appropriate to ask how correct these assumptions are as a description of economic forces in the United States and Canada, in Great Britain and in western Europe? If they do not afford a correct picture of reality, by how much are they out of focus and to what degree are the results of the productivity theory thereby invalidated?

He then rather comprehensively analyzed each assumption, after which he arranged them (ten in all) according to their relative validity:

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5Ibid., p. 69. 6Ibid., pp. 71-72.
7Ibid., pp. 72-93.
1. Largely valid but not wholly so

A. Knowledge by business men of relative productiveness of labor and capital.
B. Mobility of capital.
C. (Prior to the passage of the National Recovery Act) Non-interference by the government in terms of the wage contract.

2. Primarily valid but with a strong opposing tendency

A. Competition between employers for laborers.
B. Mobility of labor.
C. Competition between laborers for work.

3. Partially true but on the whole not true

A. All capital is employed.
B. All labor is employed.
C. Laborers know their productivity.
D. The bargaining powers of labor and capital are equal.
E. (Since the passage of the National Industrial Recovery Act) Non-interference by the government in terms of the wage contract. 8

This, as Douglas says, does not exhaust the list of assumptions underlying the marginal productivity theory, but these are the most important. 9 It is probably unlikely that that many of these more insignificant ones are "largely valid but not wholly so." Douglas made this observation:

It will be noted from the above classification that the assumptions which depart most from reality are those which ascribe more power to the workers than they actually possess. The assumptions which serve to increase the bargaining power of the employers, such as the mobility of capital, and the knowledge of relative productiveness, are far more valid than are the similar assumptions which have been made in the case of labor. Moreover, in the

8 Ibid., p. 94. 9 Ibid., p. 69.
case of those assumptions which are less valid, such as the supposed absence of combination between workers and between capitalists, and that of full employment of the factors, the real situation is one which still further weakens labor's bargaining power. Thus employers' combinations are today in America stronger on the whole than combinations of wage-earners, and the unemployment of capital, while probably greater in amount than the unemployment of labor, leads to less severe competition. It can thus be said that up until the summer of 1933 the forces which operated against labor's receiving its marginal product were stronger than those which tend to prevent capital from securing its margin.\(^{10}\)

This last statement is, of course, a very mild way of stating that according to the theory the capitalists are likely to be able to channel a portion of the income labor is entitled to into profits. This, however, apparently troubles no one but the laborer, and he probably will not ever realize he was entitled to it. Here again are a group of assumptions that just happen to benefit capital in their little discrepancies.

Looking at the above list for a moment, it will be noted that "non-interference by the government in terms of the wage contract" appears both in the first and third category. Although the National Recovery Act has been removed from the books, it was replaced by legislation encroaching even more upon laissez-faire, so that letter "C" in the first group might appropriately be dropped. Now, of course, each of these

\(^{10}\text{Ibid.}, p. 94.\)
assumptions is not of equal importance, for Douglas explicitly states, as was noted above, that those operating to labor's disadvantage are strongest, and they are found predominantly toward the bottom in the "on the whole not true group." Even if they were equal, the overall picture appears to favor invalidity. Allow for the moment each assumption to count one tenth of the whole. Thus it will be found: "largely valid but not wholly so"—20 per cent; "primarily valid but with a strong opposing tendency"—30 per cent; and "partially true but on the whole not true"—50 per cent.

Liberally dividing the middle group, which totals 30 per cent, so that the first group gets 20 per cent and the third group gets 10 per cent, it can thus be said that the assumptions are 40 per cent "largely valid" and 60 per cent "on the whole not true." If the proper weights were given each assumption the difference would probably be even greater. Here is, however, the way in which Douglas interprets his work:

Many, who have seen the degree of variance between real life and the assumptions of the productivity school, have in their impatience declared that because of this defective basis, the conclusions which have been drawn from the productivity theory are not worthy of credence and hence should be disregarded. But such an attitude as this ignores the fact that the assumptions do represent real tendencies which in the aggregate are probably more powerful than those of a conflicting nature. Thus, there is a tendency towards competition between laborers and between employers not only when there are no combinations between the members of each group but also when there are. There is a tendency for wage-rates which are lower than marginal productivity to be raised by the competition of the laborers. Such tendencies may
be prevented from working out to their logical conclusion by group pressure and by penalties, but they are not thereby rendered absolutely powerless. Most combinations will, as a matter of fact, take such tendencies into consideration and make some modifications in their policy because of them.

The forces upon which the productivity school built their theories are, therefore, not fictitious, but are instead powerful. To the extent that they are operative, the conclusions which are drawn from them are valid, and the results are modified but not vitiated by the presence of other forces which are at work as well.

The method of the marginal productivity school, as indeed of the entire school of orthodox economists, has described a portion of reality. Within the walls of their assumptions they have tried to trace the results of a change in this factor or in that. This attempt in the field of logic has been precisely similar to the efforts of the physical scientists in their laboratories to eliminate disturbing elements and variables from their experiments and by isolation to secure "controlled" results.

This is a most astonishing conclusion. It appears that he almost repudiates his own findings.

Also in regard to the physical science analogy, Douglas might have pointed out that the physical scientists discard their antiquated ideas instead of refusing to see their invalidity. One can scarcely visualize even the pioneering atomic scientist continuing to tolerate assumptions only 50 per cent valid or less. "What does it matter if atomic mistakes work a hardship on those unfortunate enough to come in contact with invalid portions of the theory, we must not forsake the theory," so says the physical science counterpart of the orthodox economic "scientist."

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11 Ibid., pp. 95-96.
To look further, why should "competition between employers for laborers" be primarily valid when Douglas found that average unemployment from 1897 to 1926, a relatively prosperous period, was 10.5 per cent for the manufacturing, transportation, mining, and the building trade industries.\(^12\) And furthermore, in the summer of 1929 before the depression began, the following percentages of unemployment were reported for the countries listed below:\(^13\)

<table>
<thead>
<tr>
<th>Country</th>
<th>Percentage</th>
</tr>
</thead>
<tbody>
<tr>
<td>Germany</td>
<td>8.6</td>
</tr>
<tr>
<td>Australia</td>
<td>9.3</td>
</tr>
<tr>
<td>Denmark</td>
<td>9.3</td>
</tr>
<tr>
<td>Great Britain</td>
<td>7.9</td>
</tr>
<tr>
<td>Norway</td>
<td>11.3</td>
</tr>
<tr>
<td>New Zealand</td>
<td>9.3</td>
</tr>
<tr>
<td>Sweden</td>
<td>6.5</td>
</tr>
</tbody>
</table>

These figures do not include those who were only partially unemployed, "which in Germany amounted to no less than 6.9 per cent of the total number of workers."\(^14\) Unless one is prepared to believe that these unemployed represent the least productive elements in the labor force (those whose productivity falls below the marginal producer), which is obviously not so, then there is no reason why there should be any real competition at all between employers for workers. They do not have to offer a higher wage to attract an overwhelming percentage of workers. All they have to do in most cases is contact the employment agencies, and if there is any actual competition between workers for jobs, the employers might well get new workers at less rather than more than the

\(^{12}\) Ibid., p. 84.  \(^{13}\) Ibid., pp. 84-8.  \(^{14}\) Ibid., p. 95.
prevailing wage. "Competition between employers for laborers" assumes almost full employment which seldom, if ever, occurs. And just the opposite does occur during severe depressions when workers may sometimes bid wages even below a long-time subsistence level. But under less extreme circumstances, wage competition between workers probably does not appreciably occur. As one writer notes:

An individual unemployed worker willing to offer his services at less than the prevailing rate has almost no opportunity to bid himself into the labor market with his low offer even in a non-union market. In an unorganized market in which the prevailing daily wage rate is, say, ten dollars, individual workers unemployed willing to work for five dollars a day will not gradually displace the ten dollar workers. Most employers do not want to demoralize their employees by discriminatory wage rates. The unemployed and willing five dollar workers will ordinarily affect the prevailing wage rate only through an employer's decision to cut the wage rate for the group of workers as a whole.15

For the marginal productivity theory to operate completely as it is purported to do (that is, give each factor a return just equal to its productivity) perfect competition would be required. Most orthodox theorists only assume perfect competition; probably very few would argue such conditions ever actually exist. But since the general price level exerts an influence equivalent to that of money-wages in determining real wages, all the deviations from the ideal of perfect competition affects wages—usually preventing

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labor to some extent from getting its theoretical share. However, no signs appear to indicate a trend toward a more competitive economy; in fact, practically all evidence points toward just the opposite.

The rise of the "heavy industries," changes in methods of selling, and the widening use of corporate forms of business organization are bringing, if they have not already brought, the era of competitive capitalism to a close. These changes have swept across the industrial scene in America with remarkable speed since the closing years of the nineteenth century. Yet there has been astonishingly little analysis of their significance. Much has been written of the history of individual pools and trusts, and accusing fingers have been pointed at the increasing concentration of control over industry. This literature is founded upon naive conceptions of "competition" and "monopoly" and unreal assumptions concerning the possibility of reviving the competitive market...

Competitive capitalism was given a protracted and thorough trial in the United States after the Civil War. Although legal institutions were framed with a broad and consistent regard for the assumptions of competition, capitalism failed to preserve its competitive quality... exceptions soon began to increase in number; no amount of arguing that certain industries are "affected with a public interest" can conceal a growing doubt concerning the capacity of competition to survive or, where it survives, to produce satisfactory results."16

Or as Robinson indicates, "we see on every side a drift toward monopolization under the names of restriction schemes, quota systems, rationalization, and the growth of giant companies."17


Abundant evidence of the Temporary National Economic Committee gives conservative testimony of the extent to which non-competitive conditions exist in American industry. This is extremely obvious in the case of the very large scale, highly standardized, and highly mechanized industries. And the secular trend is toward a greater predominance of these highly mechanized industries. This would certainly seem to indicate a continued decline in what is vaguely referred to as competition. On this subject Ayres comments:

Competition... is nothing more than a struggle. Each party to the struggle is always trying to put his competitors out of business and to absorb their custom. Thus competition is itself the high road to monopoly. How far the able, more efficient, or more ruthless, competitor can go along this road depends wholly on the mechanical means at his disposal. Wherever in the industrial world large-scale machinery has developed, its appearance has been the preeminent signal for consolidation. The railways, the oil industry, the steel industry, and lately the generation and transmission of electric power—all such industries run true to mechanical type as loci of consolidation. Those areas, such as agriculture, in which small-scale production, or "competition," still prevails are industries not as yet dominated by large-scale machine processes. This has always been the case. In attributing monopoly to "artificial restraints" Adam Smith overlooked the ocean-going ships, in his day and long since the largest single mechanical unit in existence and therefore the inevitable locus of consolidation.

Competition prevailed in the eighteenth century only in so far as the eighteenth century knew only rudimentary machines. Its prevalence was due not to economic freedom or governmental enlightenment but to the

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state of the industrial arts at the time. But the force of mechanical development was as active then as now. This is the lesson of the industrial revolution. And therefore the growth of industrial consolidation was implicit in the eighteenth century situation quite as much as it is in our own. "Competition"—the rivalry among buyers and sellers was utterly irrelevant to the scale on which business was conducted in the eighteenth century just as it is today. What dominates the scene now as it has always is the machine.10

So far the machine has shown no inclination to even slacken its developmental pace; in fact, this pace seems definitely to be increasing. This would appear to define the problem of the anti-trust officials as the fair size task of curbing the industrial revolution.

There will be no effort here to present a lengthy detailed analysis of the extent in which non-competitive conditions prevail in the American economy today. The next chapter will be concerned partly with this issue, and rough indications may become somewhat apparent at that time. It will also be wise at that time to briefly investigate some of the areas in which competition is said to exist in order to make the analysis more complete.

It may be said in summarizing the discussion of the underlying assumptions of the marginal productivity theory of wages that they are admitted to begin with to fall short of perfection, but the range of imperfection is so great as

10C. C. Ayres, The Problem of Economic Order, p. 70.
to render the theory for all practical purposes useless. For these very assumptions are a large part of what is mystically termed "market forces," which are the forces that are supposed to affect the payment of each factor of production according to its "specific productivity." If these forces do not exist, there is no other reason why distribution should occur according to the theory. Its major purpose appears to be a rationalization of wages after they have been determined in some other manner. But before final evaluation of the productivity theory of wages is undertaken, the discussion must turn to "natural law." With specific reference to the marginal productivity theory, this means mainly a discussion of the "Law of Diminishing Returns."

"The Law of Diminishing Returns"

The role of this extremely dubious concept in the marginal productivity theory has already been shown. To briefly re-capitulate, it will be remembered that this is the "law" that states in the case of labor, for instance, that the productivity of each new worker hired will be less and less until finally the worker at the margin just contributes enough to cover his own wage payment. The employer will not hire another worker beyond this point, for the next worker would not earn his wage. Just why the employer hires the marginal worker is somewhat of a mystery. "This worth to the employer... is determined by the principle of diminishing
productivity, since the product of each unit of a factor diminishes as the number of units is increased, the units of the other factors remaining constant or not increasing to the same extent. 20

The "Law of Diminishing Returns" was originally formulated with special reference to agriculture. Thus stated it meant "all of the world's needed supply of wheat could not be raised on one acre of land." For agriculture, we can see that this is a very important concept. Its importance for the farmer, in this case at least, approaches the importance of the law of gravity when used to discourage the optimistic high jumper from an attempt to soar over the moon. However, it was soon realized that the importance of the "Law of Diminishing Returns" extended far beyond agriculture. It could easily be applied to land in any of its roles as a factor of production. Then eventually Marshall said in the preface to the eighth edition of his Principles of Economics: increasing stress has been laid in successive editions on the "fact that in every branch of production and trade there is a margin, up to which an increased application of any agent will be profitable under given conditions; but beyond which its further application will yield a diminishing return unless there be an increase of demand accompanied by an appropriate increase of

20 Millis and Montgomery, op. cit., p. 175.
other agents of production needed to co-operate with it."21  
It has also been pointed out that Keynes subscribed to the  
"principle" as Marshall has stated it. Douglas as late as  
1948 stated: "In the apportionment of resources within an  
economy, therefore, the principle of diminishing incremental  
productivity is an essential part of economic theory and is  
worthy of consideration."22  And a study of average plant  
production "gives an unmistakable indication of true dimin-  
ishing returns so far as the size of individual plants is  
concerned."23  

Now Marshall seems to have ignored his own statement  
that "knowledge is our most powerful engine of production;  
it enables us to subdue Nature and force her to satisfy our  
wants."24  Certainly it must be admitted that this "most power-  
ful engine of production" has shown no signs of diminishing  
returns. On the other hand, Marshall admitted that increasing  
return industries existed. He gave no indication to what ex-  
tent, but about those that existed he stated:  

... the term "margin of production" has no significance  
for long periods in relation to commodities the cost  
of production of which diminishes with a gradual in-  
crease in output; and a tendency to increasing returns  

22 Douglas, "Are There Laws of Production," The American  
23 Ibid., p. 24.  
does not exist generally for short periods. Therefore, when we are discussing the special conditions of those commodities which conform to that tendency, the term "margin" should be avoided.\textsuperscript{25}

The important fact in regard to increasing return industries is that the supply curve does not swing upward to the right, but rather it moves downward to the right just as the demand curve does. In this case there will be no single point of equilibrium. Consequently, marginal analysis does not apply in the absence of diminishing returns.

Dillard points out that Keynes in \textit{The General Theory} believed "that an increase in employment will be accompanied by a fall in real wage rates, a conclusion which follows from his assumption of diminishing returns in the short-run." But later "when statistical investigations indicated that real wages did not in fact fall as employment rose, Keynes acknowledged he had accepted too readily the classical assumption in regard to falling real wages."\textsuperscript{26}

For the full economic implications of diminishing returns, its companion principle must be considered—the principle of substitution. Marshall states:

\begin{quote}
This principle of substitution is closely connected with, and is indeed partly based on that tendency to a diminishing rate of return from any excessive application of resources or energies in any given direction, which is in accordance with general experience \ldots
\end{quote}

\textsuperscript{25}Ibid., p. 805. \textsuperscript{26}Dillard, \textit{op. cit.}, pp. 218-19.
In the modern world nearly all the means of production pass through the hands of employers and other business men, who specialize themselves in organizing the economic forces of the population. Each of them chooses in every case those factors of production which seem best for his purpose. And the sum of the prices which he pays for those factors which he uses is, as a rule, less than the sum of the prices which he would have to pay for any other set of factors which could be substituted for them; for, whenever it appears that this is not the case, he will, as a rule, set to work to substitute the less expensive arrangement or process...

... there will be a rivalry between hand-power and machine-power similar to those between two different kinds of hand-power or two different kinds of machine-power."

Thus, according to this principle, the price of the various factors will determine the ratio in which these factors are employed by the entrepreneur. For instance, if the price of labor falls it will be profitable for the businessman to hire more workers. In other words, the fall in the price of a factor simply extends the margin of that factor. Consequently, the "Law of Diminishing Returns" may now be stated: if the businessman mistakenly adds an excessive dose of one factor of production, the "Law of Diminishing Returns" quickly signals substitute; whereby satisfactory doses of the other factors are promptly added or the excessive dose is decreased so that a nice equilibrium again prevails. Now, of course, this is not the sole shore of this sweeping, pessimistic principle. But it is the role of diminishing returns theoretically of grave importance to the businessman, and it is the very

essence of the marginal productivity theory of wages. This importance must be somewhat lengthily considered.

Richard A. Lester has been carrying on an attack for some time against the use of marginal analysis for wage-employment problems. He employed a questionnaire technique by which he asked business men pertinent questions relating to marginal analysis. Some of the answers throw a good deal of light on the concept of diminishing returns. On one questionnaire he received fifty-eight useable replies distributed as follows by industry:

17 furniture producers, 13 metal-working firms (foundry, machinery and valve producers), 11 cotton clothing manufacturers (producing work clothes, men's shirts, women's dresses, and cotton underwear), 4 chemical manufacturers, 3 producers of shoes and leather, 3 paint producers, and 3 stove producers. Employment in these 58 firms averaged 600 (range 8 to 8,200).28

These are not industries often referred to as being characterized by increasing returns. Also in some, labor makes up a very large portion of the cost of production. On some questions all 58 firms did not give answers. Part of the results ran as follows:

In the present study, a series of questions was asked regarding unit variable cost and profits at various rates of output. In reply to the question, "At what level of operations are your profits generally greatest under peacetime conditions?" 42 firms answered 100 per cent of plant capacity. The remaining 11 replies ranged from 75 to 95 per cent capacity. Six of the eleven did not answer succeeding questions that would have supplied substantiating data. Some

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of them said these succeeding questions were "too theoretical" or "too technical" or that "data were not available for an exact answer." One simply stated: "Our cost is based on 90 per cent of capacity." Of the five firms that did not offer substantiating material, three gave cost estimates and two gave the following reasons: "Assuming that if we were at 100 per cent we would have to pay considerable overtime wages," and "Theoretical 100 per cent is to produce too many strains" . . .

As further checks on the replies of the executives, they were asked: "Under normal peacetime conditions, is it possible at times to reduce your operating costs per unit of output by lowering your rate of operations?" 0 of 4 replies, 45 were "no" and one was "yes." 29

This seems to illustrate fairly conclusively that increasing returns is far more characteristic of industry than is decreasing returns. This would appear to indicate that, according to Marshall, the use of the term "margin" should be avoided in the case of almost every industry.

From the answers to a hypothetical question in which it was supposed that the north-south wage differential be suddenly abolished, Lester summarized:

Interregional firms, except in rare cases, do not adjust their use of labor and capital equipment to compensate for sectional differences in wage rates. For many manufacturing concerns it is not feasible, or would prove too costly, to shift the proportion of productive factors in response to current changes in wages, in the manner suggested by marginal analysis. 30

Thus, the assumption that the factors of production will be juggled following an increase or decrease in the price of one of the factors appears to be groundless.

29 Ibid., p. 68. 30 Ibid., p. 82.
If it is presumed that the proponents of the "Law of Diminishing Returns" are practical men, then the "Law" must have a meaning short of a fantastic hypothetical case in which so many laborers are employed on one acre of land that their productivity is decreased by their inability to keep out of each other's way. "The entrepreneur is not dealing with the mad dance of one laborer amid a thousand great machines, nor a stampede of a thousand laborers upon one machine."31 No one could argue that productivity would be impaired under such strained physical conditions. But how does such a proposition deserve the status of a "Law?" Reasonableness will generally suffice in the case of the obvious.

But allowing for the moment that the "Law of Diminishing Returns" has a slight meaning short of the fantastically obvious, what is its importance for modern economic purposes, and especially for wage and employment theory? In brief, it appears to have no importance. It is beside the point. In modern industry the entrepreneur does not calculate the productivity of each factor and conclude, for instance, that one factor is employed beyond the profit-making point. Nor does he do this roughly or subconsciously. This chore is taken care of by the machine itself. In the highly industrialized industries it is literally unthinkable to consider whether workers or machines will be employed. The machine process

31 Ayres, op. cit., p. 51.
is so vastly more productive than simple labor power that the choice is obvious. The real point is, however, that the machine generally requires a certain number of workers to keep it operating efficiently. As Lester suggests:

Most industrial plants are designed and equipped for a certain output, requiring a certain work force. Often effective operation of the plant involves a work force of a given size. Certain techniques of production, allowing little variation in the use of labor, may be the only practical means of manufacturing the product. Under such circumstances, management does not and cannot think in terms of adding or subtracting increments of labor except perhaps when it is a question of expanding the plant and equipment, changing the equipment, or redesigning the plant. The flexibility of many plants is, however, extremely limited, especially those designed for early stages of manufacturing, such as the smelting, refining, compounding, and rolling of materials.32

Although his interpretation was entirely different, the extensive statistical research carried on by Douglas appears to uphold also the contention that the machine determines the amount of labor employed. Douglas concluded:

1. That within a given country for the periods studied, there is a substantial and indeed surprising degree of agreement in the value of \( k \) and of \( j \) which we obtain for various years.
2. There is also a surprising degree of agreement between the results for the United States, Australia, and South Africa.33

The symbols \( k \) and \( j \) refer to the increments of production contributed by labor and capital, respectively. To Douglas

32. Lester, op. cit., pp. 72-73.

these conclusions mean that the marginal productivity theory and the principle of substitution are operating as they are purported to do, but the conclusions prove also that the machine wherever it may be operating determines its own labor force. This actually means that Douglas has generalized too early, for true scientific research does not allow two opposing conclusions.

Certainly one cannot visualize the manager of a huge oil refinery pondering whether to add more machinery or more labor. Even in the case of a common machine like the cotton gin, labor could never become so cheap that the entrepreneur would have to waste even a minute deciding whether to add more ginning machinery or employ laborers to hand-pick the cotton from the seed. The area of substitution is so small as to be almost unnoticeable. Surely it is too small to form a good deal of the basis for an extremely comprehensive theory. Thus, it may be said for a very large portion of the economy that the rate of output determines the amount of machinery employed, and this machinery dictates to a very large degree the amount of labor needed. "What dominates the scene now as it has done always is the machine."34 The determination of the "doses" of the factors of production used in modern industry occurs without the services of the "Law of Diminishing Returns."

34Ayres, op. cit., p. 70.
The discoveries of science and the rapid development of machine technology has been much more important and much more rapid than the proponents of diminishing returns anticipated. These developments have far outstripped the growth of population in the western world. The very great increase in the real wages of an expanded population illustrates conclusively that man is not inevitably bound by the dismal principle of diminishing returns. If "knowledge is the most powerful engine of production," increasing returns will prevail. More facts are continually being compiled. Since technological innovations come about by putting together previously known facts, there is every reason to believe that science and technology will continue to be characterized by increasing returns for at least the practical future.

The rapid expansion of the machine process invalidates the "Law of Diminishing Returns" for the long-run. In the short-run there is sufficient unused plant capacity to employ more workers at a higher real wage. For, as we have seen, a vast majority of industries experience a lower cost of production per unit as they expand production up to 100 per cent. Then even after idle plant capacity is fully utilized, real wages can still rise in the short-run if enough of our energy is channeled into worthwhile scientific research. The so-called "Law of Diminishing Returns" must be in conclusion held invalid as a foundation for the marginal productivity theory of wages, if not for all practical economic purposes.
Bargaining Power and the Law of Supply and Demand

The so-called "Law of Supply and Demand" applies in the case of all orthodox price theory. It determines price. However, its function is most easily appreciated in the case of what is sometimes referred to as the bargaining theory or supply and demand theory of wages, which actually represents the absence of a theory. This notion is a somewhat illegitimate outgrowth of the straight orthodox line. That is, it has been used both as a feeble attempt by the orthodox to give an explanation of wage determination which included and admitted the role of trade unions, and on the other hand it has been used as a justification of the trade union movement. But the bargaining power idea rests squarely upon two orthodox "laws." First, the role of the "Law of Supply and Demand" is obvious; the price of labor is determined by the point at which supply and demand meet. And secondly, the theory also must assume competition. If competition is not assumed, the theory is caught in the same place that the "imperfect competitionists" find themselves. That is, if monopoly exists, there is no satisfactory way of preventing a price rise following a wage increase that will offset any advantages gained by labor. Here the major objective is the "Law of Supply and Demand."

Adam Smith was probably the earliest to suggest a supply and demand or bargaining theory of wages.\[35\] He, of course, 

listed it as one of several possible determinants of wages. The popularity of the theory at present, however, is due in very large part to its compatibility with and justification of the labor movement. But its claim to the title of a theory depends upon the function of supply and demand.

In order to pre-determine the point at which the labor-supply curve intersects the demand curve, labor supply and demand schedules must be computed. It is no child's task to compute supply and demand schedules for any factor of production or for any goods or services, but in the case of labor supply and demand (especially supply) there appear to be almost insuperable obstacles complication such as computation. So many variable factors influence labor supply that the efficacy of modern science is entirely inadequate to handle them. Even Marshall pointed out some of the many factors determining the supply of labor: the growth of population; the physical, mental and moral health and strength of the population; and the education and training of the population.36 Yet he did not say how all these factors were to be handled except that it is difficult. We are not able to handle even the one factor of population growth at the present time. The problem, however, is rather frequently recognized: "at present there exists no satisfactory theory of labor supply for the kind of economy in which we are living. If such a

theory emerges, it will have to take into account the 'institutional' circumstances determining the policies of labor unions. Along, it might be added, with numerous other subjective factors. Hamilton finds difficulty resulting from both blades of the scissors:

"Supply" and "demand" are not simple and ultimate "forces," whence flow "normal" and inevitable rates of wages. On the contrary both of them are broad and complex terms that break apart into simple factors. The demand of labor is a compound of the volume of industrial equipment, the efficiency of technique, the quality of management, the demand of the public for the products of labor, and kindred elements. The supply of labor is a matter of number of laborers, their training, their experiences, their abilities, their organization, and similar qualities.

If supply and demand schedules cannot be computed at present, then no real theory based on the purported "Law of Supply and Demand" exists. The theory cannot say what wage rates will be until they are already determined and obvious to everyone. After wage rates are in existence, they might say that the particular rates are what they are because supply and demand are what they are, which of course tells us nothing. But even without the difficulties of determining labor supply, Ayres has quite successfully exposed the highly tautological nature of this "natural principle," which has

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38 Hamilton and May, op. cit., p. 22.
"all the aphoristic value of the obvious; the way to understand the market is to study the market." 39

But despite the uselessness of the supply and demand "tool," the bargaining power notion is no actual theory of wages. "The limits within which bargaining can take place are a maximum at the top beyond which the employer cannot stay in business and a minimum below which the employee will not work." 40 These are simply the extreme limits of wages in a profit economy. "The theory really begs the question. For, what really determines the limits of the employer's and employee's powers? It might easily be subsistence modified by custom on the one hand and the sum of the claims of rent, interest, and profits on the other." 41 To determine the bargaining power of labor is the rough equivalent of drawing up a labor supply schedule.

In reality the bargaining power or supply and demand "theory" is a laissez-faire or "law of the jungle" idea. It says the parties can have what they are able to get. This is a far cry from a modern scientific approach to the wage question. The "Law of Supply and Demand" is nothing but a truism; consequently, theories founded upon an idea of this sort are likely to tell us little or nothing about actuality.

39 Ayres, op. cit., p. 41.
41 Ibid., p. 78.
Summary

It has now been pointed out that the assumptions on which the marginal productivity theory is based do not even approach complete validity. Even some of those whose sympathies lie with this theory have to a very large extent repudiated many of these assumptions. Perfect competition, the very heart of the theory, is a myth. Frequently assumed, but it is, nevertheless, almost unanimously admitted that such is not the case in reality. Voluminous material gives evidence that competition cannot be called a law. The "Law of Co-operation" applied to businessmen would probably bespeak more truth. Also the "Law of Diminishing Returns" must be dismissed as groundless, which leaves the marginal productivity theory of wages completely undermined. However there is no cause for tears, for the theory is highly tautological anyway. The only actual criterion or measure of the worker's contribution is his wage.

For a time the theory was a very satisfactory rationalization. It told the worker that he was paid exactly what he was worth. However, since the trade union movement attained significance, it has been easy to prove to him that he has not participated equally in the increased productivity of American industry. Also he has found that average real wages can be raised. Marginal productivity theory has been entirely incapable of explaining how trade unions have been able to get
real wage increases for their members. Taken together, these
many shortcomings give strong evidence that the marginal pro-
ductivity theory of wages is not applicable to a modern in-
dustrial economy.

Also the "Law of Supply and Demand" and its cohort--the
bargaining theory of wages--do not warrant the respective
titles of a law and a theory. They are both true by defini-
tions, which leaves both of them worthless as theoretical
tools.
CHAPTER IV

WAGE DETERMINATION IN THE REAL WORLD

In the preceding chapters, it has been pointed out that a very great discrepancy exists between the functioning of orthodox wage theories on paper and in the real world. The national wage structure has not been characterized by long-run stability and near uniformity as the "natural" competitive level implies. In fact, numerous confusing and contradictory wage differentials have been the result of the operation of the mystical "market forces." Instead of stability and uniformity, chaos has been the result.

Yet wage payments have continued despite the invalidity of prevailing orthodox theories. If not by "natural law," how, then, or on what basis have wage payments been determined? The conclusion appears unavoidable that wages have resulted from administration through human decision. Whether that decision is of the obvious and conscious variety brought about through collusive agreements or of the relatively unconscious type where the employer simply pays the "going rate" is of little consequence. In either case the results are the same--wage administration.1

1From here on wage administration will be used to refer to wage determination by man, as opposed to so-called wage determination by "market forces" or "natural law."
Joseph Shister maintains that, since competition and many other necessary orthodox conditions do not prevail, wages are determined in a manner somewhat different from that suggested or predicted by classical theories. There is not a single wage which automatically and of necessity obtains. There is, in fact, a wide range within which wage rates may fall. The lower limit is somewhat indeterminate, but it is in or around a level necessary to prolong the life of the worker. Nor does a hard and fast upper limit exist. Usually, according to Shister, it is roughly fixed by the "profitability" of the firm. But in certain instances this limitation may be exceeded. Just where within this wide range a particular wage rate will fall is determined by three factors: (1) management and its objectives; (2) the presence or absence of a union; (3) governmental activity.²

Thus in order to understand why specific wage rates exist and just how these rates are determined, it is necessary to analyze the functions, interests, and nature of the three groups mentioned. These groups obviously do not operate in a vacuum. There is a definite area of interaction. Here, however, because of time and space limitations, they will only be dealt with separately.

²Joseph Shister, Economics of the Labor Market, pp. 402-403.
Wage Administration by Business Enterprise

The fairly wide range of wage payments both within and between industries often furnish proof, no doubt, of competitive conditions in wage determination, at least for those whose propensity to doubt is low. Yet in their haste to believe, there are indications that important aspects of the wage picture have been overlooked. As has already been indicated, such great discrepancies are not compatible with or justifiable by orthodox theories. Wage administration, however, does not necessarily imply uniform wage rates although undue uniformity may very well suggest administration under present market conditions. In fact, in most unorganized industries actual agreements between business units in reference to wages probably are few or even non-existent. The steel industry is somewhat an exception. It:

... is not characterized by industry-wide bargaining. Nevertheless, one of the principle aims and results of such bargaining--wage uniformity--has been attained through the wage leadership of the United States Steel Corporation and the follow-the-leader policy of most of the industry. Factors of economics, geography, and tradition have long favored uniformity. 3

But this does not indicate that "market forces" are in command in most of the economy, for even "in the non-unionized market, enterprises typically set a wage rate, that is, the terms

upon which they will hire services, if and when wage earners are required." Even Adam Smith was somewhat aware of this tendency.

Masters are always and everywhere in a sort of tacit but constant and uniform combination, not to raise the wages of labor above their actual rate. To violate this combination is everywhere a most unpopular action, and a sort of reproach to a master upon his neighbors and equals. We seldom, indeed, hear of this combination, because it is the usual, and one may say, the natural state of things which nobody ever hears of. Masters, too, sometimes enter into particular combinations to sink the wages of labor even below this rate.5

Unfortunately, Smith never realized the full implication of his contention. A contemporary writer re-emphasized Smith's claim: "One of the cardinal sins of business conduct is to offer a wage rate, or a wage increase, which proves embarrassing to other employers . . . 'getting out of line' becomes as criminal as grand larceny."6

Wages are the price paid for labor. But wages are also a component of the final price of goods and services purchased by the consumer or other business men. The American economy is not one that is characterized by complete, purposeful, and minute control. Areas of the economy may well be organized, but other areas are very imperfectly organized or controlled. In fact, it is a matter of expediency that at least some competitive appearances by maintained if possible. Thus, as in

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6 Ross, op. cit., pp. 50-51.
the cigarette industry, small price differences may be tolerated in order to prevent anti-trust litigation.7

But in general it may be said that it is not necessary for business enterprise to rigidly control or administer wages in order to accomplish desired results. It should almost appear axiomatic to those whose sympathies lie with classical economics that the individual entrepreneur wishes to keep his wage payments as low as possible. At least, that is what one is led to believe by the fervor with which business interests attack legislation that threatens to increase wage payments. And, too, orthodox theory demands that employers fight to keep wages down—that is, in fact, the essence of competition.

But even these expected displays of "self-interest" have their opposing tendencies.

It is not exactly news that American businessmen, by and large, do not work for money alone. A dozen non-profit motives lie behind their labors: love of power or prestige, altruism, pugnacity, patriotism, the hope of being remembered through a product or institution, etc. American business leaders in general have offered few pure specimens of economic man. Which of the non-pecuniary motives has been strongest in American business? It is hard to say and, until recently, it was bootless to ask. What gives the question pertinence now is the fact that the corporation, which the businessmen control, is going through a profound change in role in American society. It is graduating from a merely economic institution

to one that consciously accepts wide social and human purposes and responsibilities as well. 8

In short, this represents the emergence or development of the "corporate soul." Where does this leave the necessitated "profits and loss" calculus of orthodox theory? According to Shister such behavior explodes the theory for it assumes selfish interest. "Management may often be willing to sacrifice a certain amount of profit for the sake of gaining, for example, recognition and respect. Under such circumstances, management will pay more than the necessary minimum for the purpose of, say, gaining prestige." 9 But lest we applaud too loudly corporate generosity, it is well to remember that such firms as the General Motors Corporation can easily afford the public approval sought by its administrative elite. This "socially responsible" business giant out-distanced the entire field in its quest for profits in 1949. And in the first quarter of 1950, despite its "benevolence beyond the call of duty," its profits have increased almost 50 per cent over the same period in 1949. 10

Does the emergence of the "corporate soul" account for the fact "that workers in the plants of big companies have

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9Shister, *op. cit.*., p. 403.

higher earnings than those in small companies," and that higher wages are found "in industries in which concentration of ownership centers control of a large share of the industry in a few companies." Obviously such is not the case. Such differentials would more nearly be caused by the monopolistic and monopsonistic exploitation of the "poorer organized" areas of the economy—the "competitive areas." And also, if profits are very high it may be advantageous to pay rather high wages. For instance, better than average treatment of employees might well ameliorate somewhat society's contempt for monopoly. Actually such differences in wage rates may simply be a reflection of laxity caused by the great deal of leaveway that high-profit business organizations encounter in regard to wage determination. Now does this suggest or imply competition? For if competition existed in the first place, this leaveway brought about by very high profits would not exist. The crux of the matter is, however, that after an agreeable price for the product has been established, wages, generally speaking, may be administered at a level suitable to the individual entrepreneur. The differences may well exist through the greater productivity and efficiency of larger plants and firms, but this is by no means necessarily the cause, nor are

11 Jacob Perlman, Hourly Earnings of Employees in Large and Small Enterprises, Monograph No. 14 (Temporary National Economic Committee, 1941), p. xi.
such conditions always characteristic of bigness and monopoly. In other words, the procedure somewhat resembles the fixed fight in which it is left up to the fighter to decide in which round he will take a "dive." Obviously he would usher in the end of the fight in an early round. And somewhat likewise, wages will likely be administered at the lowest possible level taking into consideration worker efficiency, labor turnover, etc.

Now the validity of this analysis depends on the contention that price administration occurs in significant areas of the economy. Competition has already been dealt with in part, but here it is necessary to give at least some indication of the extent to which conscious price administration prevails in the American economy.

In 1936 Burns listed the following industries as being characterized by price leadership: steel, anthracite coal, agricultural implements, petroleum, newsprint, corn products industries, cement, glass, can manufacturing, and others of less importance.\(^{12}\) Also tobacco, aluminum, nickel, sewing machines, bananas, milk, shoe machinery, rayon, and many industries of less national significance were characterized by monopoly or duopoly.\(^ {13}\) "Non-price competition" prevailed in

\(^{12}\) Burns, \textit{op. cit.}, pp. 204-214.

\(^{13}\) \textit{Ibid.}, pp. 225-233.
the sale of automobiles, beverages, candy and gum, electrical products, and others.\textsuperscript{14} Add to these the practice of market sharing and pooling, and one has a formidable list of industries in which price administration occurs. A very recent work, \textit{The Structure of American Industry}, points out substantially the same non-competitive conditions prevailing in most of the American economy. For instance, with reference to the chemical industry, the following observation was made:

In view of its closely woven texture and pronounced cohesive tendencies, thus, and in spite of the enormous number of its products and markets, the chemical industry may be considered a great oligopoly, dominated by these few, diversified producers. In the circumstances, it is only prudent for each company, large or small, to take into account all possible effects on the market and on other companies of its contemplated action, whether it concerns output, prices, investment, or entering some related field. Every such decision becomes a matter of diplomacy, subject to veto or modification in the interest of orderly markets and friendly relations . . . . In these circumstances, it is not surprising that chemical companies typically shun price competition.\textsuperscript{15}

Further indication of price administration may be obtained from a brief account of the prominence and functions of the trade associations. These associations are, according to Burns,

\begin{flushright}
potential instruments for the administration of new price and production policies. Yet in the United
\end{flushright}

\textsuperscript{14}Ibid., p. 413.

States trade associations increased in number and extended their activities in a period of alleged devotion to laissez-faire. The state first ignored them, and under the National Industrial Recovery Act, virtually adopted them as its chosen instruments for the control of industry.\textsuperscript{16}

But to illustrate the importance of trade associations, the Temporary National Economic Committee reports may be consulted. In 1939 approximately 1,500 regional and national trade associations existed. Many of these were small and relatively insignificant from the standpoint of the entire economy. Many, however, were extremely significant. Of 1,175 associations reporting through questionnaires, 63 per cent indicated a major degree of activity in "trade practices" which, as defined, meant or pertained to price stabilization or control.\textsuperscript{17} These associations were also asked the following question: "If there were no legal limitations or areas of doubt, what additional activity or activities would you endeavor to develop with the expectation that they would significantly benefit your membership?"\textsuperscript{18} To this question 647 useable answers were received. Of these 202 associations indicated

\ldots that they would engage in one or more additional activities if there were no legal limitations or areas

\textsuperscript{16}Burns, \textit{op. cit.}, p. 43.

\textsuperscript{17}Charles A. Pearce, \textit{Trade Association Survey}, Monograph No. 18 (Temporary National Economic Committee, 1941), p. 64.

\textsuperscript{18}\textit{Ibid.}, pp. 64-65.
of doubt, 13 merely indicated that they would take steps to combat "unfair" competition or "unfair" trade practices. Nearly all remaining associations expressed a desire for price or production control, in connection with which the participation or supervision of Federal agencies was not infrequently urged or invited.19

Furthermore, based on the overall interpretation of the answers by all the trade associations to various questionnaires, the TNMC stated:

Trade associations typically disavow price-fixing and espouse price stability. That distinction they carefully draw. Such a distinction exists, but it is essentially a difference between a method of action and an objective of action. A number of lines of approach to the achievement of price stability may be taken by trade associations, of which agreements to fix prices, restrict production, allocate markets or customers represent only one—that which encounters definite legal obstacles. Other approaches are surrounded by areas of legal doubt, while still others seem to be quite free of legal obstacles or hazards. These lines vary in the directness of their approach to the objective, although the most direct approach may not always be the surest. More fundamental than the manner of approach is the recognition by the members of the industry of the principle of self-restraint in the market.20

Burns has summed up very well the trend in the functions of these business organizations:

... trade associations claimed that their function was to contribute the knowledge and rationality that were essential to competition yet lacking in so many industries. But the associations found that fuller information concerning methods of cost accounting, actual cost, prices, production, shipments, and the like did not meet their needs. They were impelled to devise methods of replacing individual decisions concerning price and production policy (no matter how

19 Ibid., pp. 65-66. 20 Ibid., p. 52.
broad their factual basis) by cooperative control. The provision of information bred a desire to secure unanimity in the interpretation of that information. Information concerning the best bookkeeping forms for calculating cost passed over into suggestions concerning policy in the matter of distributing costs over production at different times and over different types of product. Suggestions concerning amounts to be added for contingencies and profits developed this policy into one of suggested prices. The use of average instead of individual costs suggested a uniform price for the whole industry. Statistics of production were accompanied by suggestions concerning future production policy; output was compared with current sales and it was suggested that production and not prices, called for adjustment when production exceeded sales. Statistics of production were used as a tentative basis for the sharing of the market. Statistics of inventories and unfilled orders supplemented these efforts. Direct statistics of prices developed the desire to induce uniformity of prices and thus restrict price competition; price cutters were sought out and cajoled or threatened. Occasionally these aims found their final expression in direct attempts to control output and, therefore, reduce the pressure to cut prices.21

In addition to the foregoing, a study of alleged violations of the Sherman Antitrust Act and the Federal Trade Commission Act found ninety-two cases implicating trade associations in only four years between 1935 and 1939, and thirty-three additional cases involved collusion where no formal organization existed.22 Considering the slowness and deliberateness with which these Acts are enforced, and the violations that passed unnoticed, these figures appear to indicate widespread co-operation among theoretically competing units. Referring to such violations and evasions, Homan commented:

In business circles, the pressure for the continuation of this situation is very strong, and there has come into existence a more or less reasoned argument for the protection of what may almost be called a vested interest in violations and evasions of the law. Of the situation as it existed in pre-New Deal Administrations, a promoter and supervisor of trade associations has publicly said with astonishing candor, "Practically, under the Harding, Coolidge, and Hoover Administrations industry enjoyed, to all intents and purposes, a moratorium from the Sherman Act, and, through the more or less effective trade associations which were developed in most of our industries, competition was, to a very considerable extent, controlled. The Department of Justice acted with great restraint and intelligence and only enforced the Sherman Act against those industries who violated the laws in a flagrant and unreasonable manner. Naturally, the efforts which were made to control prices during this period had to be carried on with the utmost caution, and great care had to be taken not to violate the provisions of the anti-trust acts in a flagrant way."23

But with the advent of the New Deal price administration and monopoly suddenly became legal, and the destructiveness of competition was very much frowned upon. The technique or method of administration has been appropriately described by Dreher:

The NRA was the specific measure by which the New Deal tried to socialize industrial production under business auspices. Its origins and organizing ideas were, as we now know, varied and contradictory. Yet, merely because one of its foster fathers was the Chamber of Commerce of the United States, it would be a mistake to regard it as no more than a big-business conspiracy to raise prices and milk the public. Big business already had that privilege. The NRA was rather an attempt to extend the monopoly-capitalist method of price "stabilization" to all business . . . . Thus, out of

many conflicting hopes and pressure, the NRA took shape as "self-government" of business by trade associations, but under Government auspices and in the national interest, with suspension of the antitrust laws, elimination of "cutthroat competition," the right of labor to organize, a floor under wages and a ceiling over hours...24

During World War II, of course, the economy was subjected to governmental regulation, but since the war there is no indication, despite federal government lip-service to the desirability of competition and appropriate appeasement of the small-business, that the trend toward increased private control has slackened. Galbraith, in 1946, for instance, commenting on the unexpected success of wartime price administration, stated:

The core of the explanation is to be found, without much doubt, in market structures which readily permit of informal controls by the seller. Monopolistically competitive or imperfect markets lend themselves readily to these informal controls, and price control was effective because these markets are rather more common than conventionally assumed before the war...Withal, one of the suspected wartime virtues of monopoly or oligopoly has been its special vulnerability to price control...I am tempted to enunciate a rule that is all too self-evident in this discussion: it is relatively easy to fix prices that are already fixed.25

But price administration was not such a simple task in the relatively unorganized or "competitive" markets.26 Entrepreneurs there were somewhat inexperienced in the art of price maintenance.


26 Ibid., p. 479.
The preceding rather lengthy digression should suffice to illustrate that a major portion of the economy has been and is at present characterized by a growing degree of business price control. This being the case, business enterprise is in a position to administer to an appreciable extent the wage rates of its employees. This wage administration may very well be on an individual basis, but it must of necessity occur. It is theoretically the fluctuation of prices in response to varying conditions of "supply" and "demand" that is responsible for the proper determination of the amount and worth of the labor that will be employed. In other words, if the final price of business goods and services is administered or fixed, this, then, is tantamount to fixing the entire system for control has been wrested from the "market forces."

**Wage Administration by Labor Unions**

"That unionism is a source of wage advantage would seem clear from commonsense observation, but authoritative economic opinion has held differently for many years.\(^ {27}\) Douglas, for instance, after admitting that unions may gain substantial increases during the organizational period, is doubtful of their long-run effect.

\(^ {27}\)Ross, *op. cit.*, p. 13.
Since 1914 the wages in the non-union manufacturing industries have risen at least as rapidly as have those in the union manufacturing trades. The evidence seems to indicate that when labor organization becomes effective, it yields very appreciable results in its early stages, but that thereafter the rate of gain enjoyed by its members tends to slow down to a speed which does not appreciably exceed that of the non-union industries.\textsuperscript{28}

Also Millis and Montgomery are in doubt as to the influence of trade unionism "in bringing about the rise in real earnings."\textsuperscript{29} Thus, before undertaking to demonstrate the role of unions in the wage administration picture, it appears necessary to first supply evidence that they are able to affect wages in any way. In view of such skepticism, the inclusion of the following figures seems justifiable:

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\begin{center}
Estimated Straight-Time Hourly Earnings, January, 1945, in Sixty-Five Manufacturing and Extractive Industries, Classified According to Percentage of Workers Covered by Union Agreements in 1945
\end{center}

\begin{center}
\textbf{Group I: 80-100 Per Cent Under Agreement}
\end{center}

\begin{center}
\begin{tabular}{lll}
Newspaper printing & \$1.243 & Nonferrous metals & \$0.992 \\
Shipbuilding & 1.243 & Beet sugar & .997 \\
Automobiles & 1.225 & Metal mining & .963 \\
Anthracite coal & 1.131 & Glass and glassware & .922 \\
Bituminous coal & 1.125 & Leather tanning & .898 \\
Basic steel & 1.102 & Cement & .874 \\
Aircraft & 1.097 & Wool carpets and rugs & .870 \\
Breweries & 1.062 & Men's clothing & .850 \\
Rubber products & 1.057 & Meat packing & .829 \\
Agricultural equipment & 1.147 & Cane sugar & .785 \\
Women's clothing & 1.040 & & \\
\end{tabular}
\end{center}

Weighted average, \$1.069

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\textsuperscript{28}Douglas, \textit{Real Wages in the United States (1890-1926)}, p. 562.

\textsuperscript{29}Millis and Montgomery, \textit{op. cit.}, p. 213.
**Group II: 60-80 Per Cent Under Agreement**

<table>
<thead>
<tr>
<th>Industry</th>
<th>Percentage</th>
<th>Weighted Average</th>
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<tbody>
<tr>
<td>Locomotives</td>
<td>$1.237</td>
<td>$0.777</td>
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<tr>
<td>Petroleum refining</td>
<td>1.176</td>
<td>978</td>
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<tr>
<td>Railroad cars</td>
<td>1.109</td>
<td>975</td>
</tr>
<tr>
<td>Machine tools</td>
<td>1.044</td>
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<tr>
<td>Felt hats</td>
<td>1.042</td>
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<td>.991</td>
<td>Tobacco products</td>
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<tr>
<td>Electrical machinery</td>
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**Weighted average, $0.969**

**Group III: 40-60 Per Cent Under Agreement**

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<th>Industry</th>
<th>Percentage</th>
<th>Weighted Average</th>
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<tbody>
<tr>
<td>Silverware and plated ware</td>
<td>.946</td>
<td>$0.774</td>
</tr>
<tr>
<td>Jewelry</td>
<td>.914</td>
<td>768</td>
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<td>Cereal preparations</td>
<td>.886</td>
<td>763</td>
</tr>
<tr>
<td>Stone &amp; clay products</td>
<td>.842</td>
<td>Knitted wear and</td>
</tr>
<tr>
<td>Furniture</td>
<td>.814</td>
<td>Gloves</td>
</tr>
<tr>
<td>Baking</td>
<td>.790</td>
<td>Lumber and timber</td>
</tr>
<tr>
<td>Boot and shoe cut stock and findings</td>
<td>.784</td>
<td>Dyeing and finishing</td>
</tr>
<tr>
<td>Leather gloves and mittens</td>
<td>.783</td>
<td>Knitted cloths</td>
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<tr>
<td>Flour</td>
<td>.780</td>
<td>Knitted underwear</td>
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<tr>
<td>Leather luggage</td>
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**Weighted average, $0.866**

**Group IV: 0-40 Per Cent Under Agreement**

<table>
<thead>
<tr>
<th>Industry</th>
<th>Percentage</th>
<th>Weighted Average</th>
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<tr>
<td>Crude petroleum &amp; natural gas</td>
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<td>$0.723</td>
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<tr>
<td>Chemicals</td>
<td>.905</td>
<td>Silk and Rayon</td>
</tr>
<tr>
<td>Nonmetallic mining and quarrying</td>
<td>.812</td>
<td>Condensed and</td>
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<tr>
<td>Paper products</td>
<td>.990</td>
<td>Evaporated milk</td>
</tr>
<tr>
<td>Nonalcoholic beverages</td>
<td>.766</td>
<td>Butter</td>
</tr>
<tr>
<td>Ice cream</td>
<td>.761</td>
<td>Cotton manufacturers</td>
</tr>
</tbody>
</table>

**Weighted average, $0.74930**

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30 Ross, op. cit., pp. 116-117.
The above figures do not by any means prove conclusively that unions are responsible for the wage differentials. Other factors may very well be influential. But after further consideration and statistical analysis, it was concluded by Ross that "real earnings in the highly organized industries have increased to a greater extent than have those in the less organized industries." The differences would have been greater had not the War Labor Board followed a policy advantageous to the non-unionized industries. The Board attempted to decrease the great disparities between wage rates by allowing the lowest rates to rise most rapidly. But even a superficial comparison between recent real wage increases in the Bituminous Coal Industry and other industries should illustrate sufficiently that labor unions may be greatly influential in causing real wage to rise. Also, as will be illustrated later, unions may act somewhat as a "spearhead" with non-unionized areas following the lead for various reasons. Such actions certainly will decrease the differential between unionized and non-unionized plants and industries, but it makes the union even more significant than ever.

Another popular argument concerning labor unions relates to monopoly. Are labor unions monopolistic? Of course, legally speaking, they are not considered monopolistic. But neither are they competitive. One of the most criticized

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31 Ibid., p. 117.
aspects of the labor movement has been the jurisdictional
strikes carried on by competing unions. Also, if two dif-
ferent unions are found in one plant, they will not neces-
sarily agree, and the plant may very well be subject to per-
petual industrial warfare.

But labor is not a commodity according to the courts;
consequently, labor unions cannot be monopolies unless they
collaborate with management to control a commodity. This in-
terpretation may be satisfactory to keep a group of anti-union
courts from killing the labor movement through the use of the
anti-trust laws, but for economic interpretation, it does not
appear adequate. It is unquestionable that a strong industry-
wide union such as the United Mine Workers may not only con-
trol wages but may actually control the price and production
policies of the entire industry. From the standpoint of
economic theory, it is sheer non-sense to shun reality by in-
sisting that a difference exists between a man and a sack of
potatoes. If commodity monopoly represents market imperfec-
tion and price administration, control of the labor supply
accomplishes the same results.

One writer prefers a different approach:

While enterprise monopoly is not all of one pattern,
it usually operates through control over supply . . .
Union monopoly, on the other hand, does not re-
quire and cannot ordinarily establish such control over

the supply of labor through a comparable restriction of entry into the occupation. A group of workers cannot destroy competing workers as a firm can destroy competing firms. It cannot ordinarily enlist government support to make the work of the competitors illegal nor can it restrain every potential worker from entering its labor market.

But it can coerce the employer into submitting to the union. Union monopoly regulates the wage rate, therefore, not by sustained control of supply but by control of the buyer, who is the employer. The technique used to establish this control is, of course, the strike, but its importance is wholly misunderstood unless it is seen as a method of controlling the buyer.33

Actually a combination both of control over supply and the employer would more nearly characterize the union's power, but if the end result is considered (control over wages), it is not necessary to quibble as to how this occurs. Monopolistic control usually denotes the power of fixation by the controlling element.

The difficulty that orthodox thinkers have encountered in their effort to include the labor movement in or explain it by orthodox theory has already been pointed out. The marginal productivity tool was, of course, found to be practically useless in the case of unionized workers. Unions are opposed to the basic assumptions of the marginal productivity theory. Of course, Robertson has tried to wiggle out of the predicament in which all marginalists are caught by objecting to the "misapprehension that the orthodox theory asserts that wages are determined by marginal productivity. It does

33 Lindblom, op. cit., pp. 57-58.
not—it asserts that they measure it, and that there is therefore a functional relation between the rate of wages paid and the number of persons employed. This obviously represents a partly different interpretation of the marginal productivity theory. But even the new interpretation is probably futile. Lester has illustrated that employers generally will not dismiss a portion of their labor force as a result of increased wages. As a matter of fact, he found they would more likely increase the number employed along with greater sales effort in order to take advantage of decreased unit cost brought about by a larger volume of production. This leaves the marginalists without a leg on which to stand.

The strategic withdrawal from the marginal analysis to the bargaining theory in an effort to include unionism was also alluded to, but here we may delve somewhat deeper into the union wage policy.

The American trade union, being essentially pragmatic and having no well-defined role in society as yet, is peculiarly subject to pressures. The task of the union leader is to reconcile these pressures in such a manner as to serve the paramount objective of "building the union".

The central proposition, then, is that a trade union is a political agency operating in an economic environment. The relationship between the

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leaders and the rank and file is a complicated one, as each exerts a reciprocal influence on the other; but in general it is the leaders who make the specific decisions, regardless of the formal procedures employed. This conclusion should not be taken as signifying uncritical acceptance of Michels' "iron law of oligarchy" as characteristic of the union in all its phases. Many aspects of union life are truly democratic, but wage bargaining is poorly adapted to rank-and-file control. It is similar to the foreign policy of a nation, which is never a matter for popular determination. 36

Now in a political arrangement in which the leaders are separated from the rank and file, the actual wage decisions generally are made by the union leaders. These men (the union leaders) are fighting a battle of their own with the union itself often merely the means or method for personal victory.

In the arena of power, the labor leaders are newly risen men; no matter how much bluster some of them may employ, they feel the social gap. They reveal their feelings in their general tendency to imitate the standard middle-class, business-like mode of living, and by the resentment they show when they talk about business' lack of respect for labor. This craving for status and respect is often a strong undercurrent of their lives. 37

Of course the rank and file must be appeased sufficiently to keep the organization healthy and growing. They exercise a considerable influence, but many of them have conflicting interests and desires. Could such an institution conceivably be expected to act inevitably in an "economic" manner? Obviously it would be impossible to compute a supply schedule for such an organization. Ross appears correct in calling

36 Ross, op. cit., p. 6.

the trade union "a political institution which participates in the establishment of wage rates." 38

Dunlop, for instance, analyzed many economic concepts of union behavior before he finally concluded that "the most suitable generalized model of the trade union for analytical purposes is probably that which depicts the maximization of the wage bill for the total membership." 39 But even this very broad contention is subject to numerous exceptions. The union leader will, for example, often exchange a possible good-size wage increase for a closed shop. But Dunlop differentiates between what he refers to as the "pecuniary and non-pecuniary" aspects of the sales stipulation between the union and the employer.

Labor organizations have always been vitally concerned with "industrial jurisprudence," that is, with the non-pecuniary aspects of the labor bargain. Some indications of the complexities in the terms of sale of labor services can be conveyed by a brief examination of a relatively simple and well-known trade-union agreement, that between the General Motors Corporation and the International Union United Automobile Workers of America---CIO---which was signed on June 24, 1940. The agreement contains 16 main subdivisions and almost 150 separately numbered paragraphs. The clauses of the contract readily identifiable as directly determining the wage-rate structure are those covering: overtime rates by day and week, Sunday and holiday rates, night-shift rates, basic wage adjustment, vacations with pay, and minimum hours of work possible in a day if a wage earner is required to report for work. The nonpecuniary structure of the agreement is composed of clauses specifying: the form and character of union recognition, the grievance

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38 Ross, op. cit., p. 43. 39 Dunlop, op. cit., p. 44.
procedure, the seniority of union representatives and committeemen, seniority status of the rest of the workers, discharge and layoffs, working hours, bulletin boards, leaves of absence, strikes and stoppages, and the duration of the agreement.40

Such a contract is not adequately described as a "maximization of the wage bill for the total membership." Nor can one conceive of "supply and demand" being the impetus behind such an extensive agreement affected by so many subjective, nonpecuniary factors. One could just as easily and correctly apply the "Law of Supply and Demand" to a piece of controversial legislation coming out of an evenly divided congress. But in order to get a clear and unmistakable view of wage administration by labor unions, the effect of unionization must be considered from the standpoint of the entire economy.

The locus of union power may be at the local level, the regional level, the national level, and even the international level (United States and Canada). One union may represent the workers of an entire industry as in coal, or a union may be an independent local. In the case of industry-wide bargaining, the administered wage is the obvious result. In fact, unless the demand for the product produced is very elastic, there is a wide range within which wages may fluctuate. It would appear to make little difference to the individual employer how much the wage payments are, if they are the same

40 Ibid., pp. 17-18.
throughout the industry or even throughout his region. There
could even appear to be advantages deriving from a stabilized
and equal wage scale for the entire industry. It would, in
fact, decrease the struggle in many cases. But such industry-
wide collaboration is not without its disadvantages from the
employer's point of view.

Employers who sign master agreements, such as those
in England and Sweden and in various small-scale Amer-
ican industries, have seen fit to pay the price. Em-
ployers who oppose the development, such as those in the
great mass-production industries of the United States,
 demonstrate once again that political stakes are para-
mount over economic stakes in collective bargaining;
that power is worth money and often more than money.41

But in many instances, industries may find it expedient
or even necessary to encourage industry-wide bargaining—
coal and certain textiles.

Employers often do not wish to resist at all;
what is more, they often find it profitable to en-
courage wage increases on an industry-wide basis.
Any appraisal of the effectiveness of employer re-
sistance to union wage policy which assumes that
employers wish to act as guardians of competitive
rates is certain to go wide of the mark.42

At the present time, however, only a few rather small indus-
tries—full fashioned hosiery, elevator installation and re-
pair, installation of automatic sprinklers, pottery and related
products, stove making and wall papering—and one large-scale
industry—coal, are characterized by industry-wide bargaining.43

41 Ross, op. cit., p. 72. 42 Lindblom, op. cit., p. 120.

43 Collective Bargaining with Associations and Groups of
Employers, Department of Labor, Bulletin No. 897, House
Ross says:

... the drift is unmistakable. Moreover, it is only part of a more general tendency toward centralization and consolidation in the wage-bargaining process. Multi-employer, multiunion and multiarea agreements are evidence of formal integration of bargaining structure... In this way, as in so many other ways, developments in union policy are only a reflection of corresponding changes in almost every sphere of economic activity. 44

What are some of the causes making for wage uniformity? According to classical theory, the competitive haggling between workers and between employers would in the long-run establish a more or less uniform "natural wage rate." But this assumes competition between all factors and above all individual bargaining. As Ross states: "Where a single price does emerge, there is established a prima facie case against the operation of market forces." 45 In the "atomistic" markets, there is very likely to be no discernible wage structure of a more or less permanent nature. Certainly few would argue that any permanency or any decent wage level is likely to come out of two of the occupations more nearly characteristic of "perfect competition"—agriculture and domestic service. There must be man-made causes, then, behind this tendency toward uniformity.

It has been pointed out that unions are political institutions. They are run by a group of status hungry individuals, who must appease a heterogeneous mass of often

disgruntled workers whose desires and wishes are also often in conflict. One of the stronger propensities in the western culture is that of invidious comparison. When applied to the labor movement, this tendency appears in the form: "Did our union get as much as the others?" It may be well to boast "the best contract in the industry," but it is an absolute necessity to get as much as the rest. Probably the quickest way in which a labor leader would likely be ousted would result from his consistent failure to keep up with the rest of the industry. A ten cent raise would lose all its attractiveness if the rest of the industry got twenty cents. It is partly through political expediency that wage rates tend toward uniformity.

But even without widespread industry-wide agreements, a very considerable amount of uniformity appears to result from collective bargaining. Especially is this true of the so-called post-war "rounds" of wage increases. It is frequently believed that certain "key bargains" set the pattern for the entire economy.

When the key bargain has been set, the change in rates in a number of other related cases tends to be fixed. A sequence of wage changes develops between these wage leaders and other bargains which tend to follow. When the wage structure as a whole is considered, there are a limited number of these key wage bargains which tend to be inter-related.46

Many factors may influence the way in which these "rounds" of increases spread through the economy. Such things, for instance, as price leadership, or even the desire to maintain a non-union shop may demand that the employer meet or even exceed union patterns.

Probably the key bargain which has the largest impact is that between the steel producing subsidiaries of the U.S. Steel Corporation and the United Steelworkers of America, CIO. Outside the basic steel industry there are a number of other key bargains which are closely tied to this settlement and serve, with minor modifications, to influence wage patterns in their industries. These bargains might be included in the steel pattern in its broadest sense, but each is a key bargain in its own right. This designation would include the two large flat glass producers, the major electrical equipment producers, the major automobile producers, aluminum, shipbuilding, the major agricultural implement producers, shoe machinery, and a large part of the steel fabricating industries. The big four contracts in meat packing and rubber might be included as a part of this "family," for there are important ties in wage setting; but on balance they should be regarded as distinct key bargains...

This is not the place to attempt a list of the wage bargains to be classified as pivotal. Judgments will undoubtedly differ. A list of twenty-five to fifty, however, would no doubt effectively condition such a large number of wage rates, at least within narrow limits, that it could be said the wage structure of the country was fairly definitely fixed.47

Harbison distinguishes further and finds three general categories or types of agreements: "generating types which have a direct influence on other types, satellite types which are dependent to some extent on generating types, and semi-isolated types which are more or less self-contained."48

47 Ibid., pp. 157-158.

In the absence of a workable wage theory, custom and habit must be relied upon. This accounts in large part for the spread of wage increases after "key bargains" have been established. It sets a pattern which eventually comes to be accepted by employers and demanded by the unions. This can be no better illustrated than by the 1946 railroad strike. The eighteen and one-half cent increase had become fashionable in a large number of previous settlements. Ross describes the incident thusly:

The two-day strike of the Locomotive Engineers and the Railway Trainmen throughout the nation's railroad system in 1946 resulted from mismanagement on the part of the government officials involved as much as from arrogance on the part of the union leaders. Considerable dissatisfaction had developed among the railroad workers over the deterioration of their relative earning status. Once they were "the aristocrats of labor," By 1945, their annual earnings were surpassed by those in the automobile, shipbuilding, machinery, rubber, and petroleum industries. Leaders of the railway unions had chafed under wage stabilization policies during the war. The CIO had chartered a rival railway union, and District 50 of the United Mine Workers had been raiding the Brotherhoods. Government boards and agencies had already awarded 13.5 cents per hour to a large number of labor organizations which had neither the venerable history nor the political problems of the Brotherhoods. Sixteen railway unions had agreed to arbitrate and were bound to accept the decision of the arbitration board. The Locomotive Engineers and the Railway Trainmen, however, had not participated in the arbitration; and when the Emergency Board made an identical recommendation, they were free to repudiate it. Under the circumstances, it is difficult to understand how the two boards could feel that a wage increase of 15 cents per hour would be satisfactory. The President, attempting to mediate the difficulty, made a "compromise proposal" providing that the wage increases be advanced to 13.5 cents on the condition that the seven rule changes also recommended by the Emergency Board be withdrawn. This was too clearly a restatement of the original
recommendation to permit acceptance without loss of face, although it probably would have been acceptable if it had been proposed in the first instance. The Locomotive Engineers and the Railway Trainmen finally accepted the proposal, but only after a disheartening debacle which might have been avoided if the two boards had recognized the necessity for an 18.5 cents award in view of the prior involvement of the government in a large number of settlements at that level.49

The role of custom and the status implications are unmistakable. The nonpecuniary, status aspects of the wage are vastly more important than the actual size or pecuniary aspects in many cases such as this. Uniform wage administration obviously will tend to result from such a context. In fact, the trade union idea of the "standard rate" is predicted upon the concept of taking wages out of competition.

It is becoming somewhat more customary to submit wage disputes to an arbitration board. Here the "Law of Supply and Demand" performs its magic through the spiritualistic medium of the impartial board. When disputes are arbitrated, a conscious man-made wage is an indisputable fact. It might be argued that the board through some spiritual means arrives at the "natural" rate, but this probably requires more faith than even the orthodox can muster. But arbitrators have no means of determining a scientific objective wage.

We do not yet know enough about economics in general, or about how wages are or should be fixed, to set up hard-and-fast rules in the matter. Society is substantially agreed that murder is a crime, but society

49 Ross, op. cit., pp. 61-62.
is not substantially agreed as to under what circumstances, and how much, wages should be raised.\textsuperscript{50}

Arbitrators are faced with the same dilemma and problems that confront business enterprise and labor unions. The only criterion for judgment is: "What have other workers gotten, and what have other employers granted under similar circumstances?" Such considerations lead inevitably to wage uniformity. Also if decisions are not customary and satisfactory to both sides, it becomes difficult to find "impartial" boards that are acceptable. Ross, who has served as a labor dispute arbitrator, describes the technique as follows:

The "going rate" and the "prevailing pattern of adjustment" are probably the most compelling criteria of wage determination. Anyone familiar with the realities of arbitration realizes to what extent the other standard criteria are subordinated to these and are employed as supporting rationalizations . . . .

The ready-made settlement supplies an answer, a solution, a formula. It is mutually face saving. The employer can believe that he has not given away too much, and the union leader that he has achieved enough. It is the one settlement which permits both parties to believe they have done a proper job, and the one settlement which has the best chance of being "sold" to the company's board of directors and the union's rank and file. One can understand why wage negotiations are often stalled until an applicable "pattern" develops, and why the employer is then reluctant to grant anything more and the union to accept anything less.\textsuperscript{51}

In order to get an idea of the growth of total union membership the following figures show union strength for selected years for the past three decades:\textsuperscript{52}

\textsuperscript{50}George Soule, \textit{Wage Arbitration}, p. 4.

\textsuperscript{51}Ross, \textit{op. cit.}, pp. 51-52.

\textsuperscript{52}Carol F. Daugherty, \textit{Labor Problems in American Industry} p. 405.
The 1949 estimates boast 15,694,000 combined membership.\(^{53}\)

This represents a fairly rapid growth. There has been, how-

ever, a noticeable decline in the rate of growth since the

war, but unions have at least been able to maintain the gains

made in the past, whereas membership fell appreciably in the

face of the anti-union campaign in the 1920's. It appears

safe to conclude that unions have become a fairly well en-
trenched and influential part of the American economy. If

membership continues to grow and union jurisdiction is further

spread through the economy, it is likely that the union role

in the administration of wages will increase. The rumored

peace treaty between the CIO and the AFL might well furnish

the impetus for another spurt in the spread of unionism.

Wage Administration by the Government

Since the United States came into being during an ex-
treme laissez-faire period, direct legal control over wages

has been the historical exception until fairly recently.

Regulation of maximum hours occurred during the nineteenth cen-
tury, first for specific elements of the labor force, and

later for everyone on a designated occupational basis. The

\(^{53}\)Statistical Abstract of the United States, Bureau of
limitation of working hours affects wages to an extent, but here we are interested more in their direct regulation. It should not be necessary to prove or even illustrate that governmental wage regulation results in man-made wage rates. Consequently, the following is simply a discussion of certain aspects of governmental wage administration.

A movement for minimum wage legislation to cover women and children gained momentum around the turn of the past century. Soon certain states began to pass such legislation, but the movement was brought to an abrupt halt through the extremely reactionary Supreme Court of the 1920's. But the delight of the laissez-faire addicts was short lived, for the depression and the New Deal were lurking around the corner.

In 1933 Congress, in desperation, passed the National Industrial Recovery Act, which was supposedly directed toward helping the economy pull itself out of the recession by its own boot straps. But a portion of the act represented the first attempt on the part of the Federal Government to directly regulate wages. That is, the effort was direct in the sense that NRA codes were considered administrative law. The minimum wage for the various codes ranged from thirty to forty cents. Wage differences between various races and regions and between the sexes were generally recognized. Also it was customary to stipulate "that members of the industry shall endeavor to increase the pay of all employees in excess of the minimum wages, as set forth in the codes, by an equitable
adjustment of all pay schedules.\textsuperscript{54} But the NRA was short-lived; it died in the hands of the Supreme Court in 1935 just two years after its inception.

In order to further combat the depression and unemployment, the Federal Government passed a number of relief acts, which disbursed payments all the way from the "dole" to the Public Works Administration. But these various policies warrant mentioning for they were an attempt to outright administer the incomes of a very large portion of society.

In 1933 when it became evident that the then existing programs of the Emergency Relief and Conservation Act were not enough to cope with the situation, the Federal Emergency Relief Administration and the Civil Works Administration were set-up. Wages under these were paid on a basis of need or "budgetary deficiency," or in the case of actual worthwhile projects, the prevailing wage of the locality was usually paid. Millis and Montgomery describe the unfortunate experience of the Federal Government in its effort to make payments on the basis of need:

The administration of relief on a case-work basis to such a large portion of the population required far more social workers than were available. Complaints of mistakes, of delays in obtaining relief, or autocratic decisions, and of prying into personal affairs, combined with the growing recognition of the evils of forcing able bodied persons to remain idle or to accept

\textsuperscript{54} Michael F. Gallagher, Government Rules Industry, pp. 40-41.
spasmodic relief work, led the Federal Government to withdraw from financing and administering relief.\textsuperscript{55}

Consequently, by 1935 both the FEWA and the CWA had been abolished and the Works Progress Administration was established. Under the WPA, the attempt to administer incomes on the basis of need was dropped, and wages were paid on a monthly earning basis. In 1936 the procedure was slightly modified and the program was required to "pay the prevailing hourly wage with a designated monthly wage schedule."\textsuperscript{56} By 1939 the prevailing wage policy of paying workers was done away with and a monthly schedule of earnings was established which ":(a) would not affect substantially the 'current national average cost per person on the WPA,' (b) geographical variation in earning schedule for workers of the same type of work shall be only that which may be 'justified by cost of living.'"\textsuperscript{57}

Of course, the Public Works Administration was established in 1933, but it differed somewhat from the other programs. It employed skilled and semi-skilled workers in the construction of worthwhile and generally needed public works. The FWA was also legally required to pay the "prevailing wage" that existed in the particular area. Collective

\textsuperscript{55} Millis and Montgomery, \textit{Labor's Risks and Social Insurance}, p. 102.

\textsuperscript{56} Viola Wyckoff, \textit{The Public Works Wage Rate and Some of Its Economic Aspects}, p. 279.

\textsuperscript{57} \textit{Ibid.}, p. 100.
bargaining agreements were usually respected. The Walsh-Healy Act had been passed in an effort to salvage at least a part of the NRA, and it was the purpose of this Act to state minimum standards (wages and hours) that must be met in order to qualify for public contracts. As usual, the "prevailing wages" were required. The depression and wartime public contracts were covered by this act, which gave the government control over a considerable portion of the economy during those periods. And there does not appear to be a noticeable trend toward a lessening of governmental public contracts in the post-war period.

The actual effects of governmental standards on the rest of the economy is difficult to ascertain. Generally it was believed that no governmental policy should be allowed to interfere with the private sector of the economy. No wage policy should, for instance, attract workers into public works where they might have otherwise gone into private employment. This was a major cause of the "prevailing wage" policy. Wyckoff points out, for instance, that one of the chief causes for the very short life of the Civil Works Administration was probably the general belief that it was paying higher than prevailing wages, and thus attracting workers from private enterprise.58

58 Wyckoff, op. cit., p. 279.
The Fair Labor Standards Act of 1938 was the first direct wage legislation that was aimed at the entire economy to remain on the books. This Act affected wage rates in three ways: minimum wage stipulations, maximum hours, and finally, child labor restrictions, which is an indirect method to protect wage rates from the cheap labor of children. The Act, of course, applied only to those engaged in interstate commerce. The minimum wage requirement was twenty-five cents an hour for the first year, thirty cents an hour for the next six years, and forty cents an hour beginning in 1945. For male adult workers, the maximum hours per week was set at forty-four; the next year it was to be dropped to forty-two; and in 1940 it was to be set at forty hours per week. But workers could be worked beyond the maximum providing time and one-half was paid for every hour exceeding the weekly maximum.50

Industry committees were established to study and make recommendations concerning their respective industries. These committees could recommend minimum differentials so long as such differential did not give any group of employers a competitive advantage. Also it was specifically stipulated that no wage rate should be set that would "substantially curtail employment" in an industry. This demonstrates clearly the orthodox orientation of government economics.

50Daugherty, op. cit., pp. 337-840.
Beginning January, 1950, the minimum wage was raised to seventy-five cents by an amendment to the Fair Labor Standards Act. However, this did not represent a true real gain since the cost of living had risen enough to offset practically all the increase. For instance, the forty cent minimum in 1949 was equivalent to only twenty-three cents in 1938, which actually represented a loss of ground from that year since the first minimum was placed at twenty-five cents.60

In the early part of 1942 the National War Labor Board was created. The major purpose of the Board was to stabilize wages as a part of the effort to prevent a serious inflationary spiral which had shown indications of becoming a real threat. The Board had a predecessor in the National Defense Mediation Board, which was established in March, 1941. The NDMB only possessed conciliatory power which did not prevent wage increases and serious industrial disputes. However, these weaknesses did not exist under the War Labor Board. Strikes were prohibited, and all disputes were to be settled by peaceful means. A tripartite board representing industry, labor, and the public was appointed, and it was the duty and responsibility of this Board to settle wage issues according to the dictates of congress and the President.61

60 Commerce Clearing House, Incorporated, New Wage-Hour Law, pp. 5-18.
Since prices had risen somewhat faster than wages since the base year of 1939, the WLB ruled in July, 1942, in the "Little Steel" case that wage increases of 15 per cent would be allowed in order to offset the rise in the price index. These increases were gradually granted in the ensuing months. In September of 1942, it was stipulated by the President that in addition to the increases under the Little Steel formula wage increases could only be granted in cases necessary to correct maladjustments, or inequalities, to eliminate substandard wages, to correct gross inequities, or to aid the effective prosecution of the war.\(^{62}\)

The WLB was rather ambitious in its attempt to decrease inequalities. This as a rule was in the form of granting increases in many instances in which wages were extremely low, or in the case of interplant and intraplant inequities, and in some instances in which an industry had paid such low pre-war wages that it was having difficulty in maintaining its labor force. By April, 1943, however, a "hold-the-line" order was issued. The Board was urged to be extremely hesitant in allowing wage increases that would necessitate price increases.\(^{63}\)

The Board was very active in its attempt to gather industry-wide wage information and develop what was called

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\(^{62}\)Seymour E. Harris, Price and Related Controls in the United States, pp. 333-335.

\(^{63}\)Ibid., pp. 336-339.
"industry wage brackets." These brackets indicated the span or range of wage rates within a particular industry for specific jobs. In this way the very low paid areas and plants could be brought up to a desirable minimum level.

The WLB was very effective in its stabilization policy. This, of course, was the main purpose of the Board. Generally it recognized and respected the "going rates" that had existed at the beginning of the war. And although the Board did not decrease to a certain extent some of the unjustifiable differentials that had existed at the start of the war, such decreases were not large. "From October, 1942 (the date that the stabilization policy went into effect) until October, 1944, for example, wage rates were allowed to increase by only 3.2 per cent."64 Such a small increase could not have changed the difference greatly, and, too, a portion of this increase went for Little Steel adjustments for all workers.

Of course, it might be argued that war-time experiences are of little consequence for peace-time purposes, but such a contention is much too extreme.

Contrary to the view expressed by some, events since V-J Day do not indicate a return to the pre-war structure of wage differentials. It is true that the war-time tendency for wages to increase relatively more for low wage than for high wage industries no longer seem to prevail. However, no reverse tendency has become apparent.65

64 Shister, op. cit., p. 300.
The following statement by a high aircraft corporate official about certain aspects of the war wage policy is rather interesting: "If we only retain that part that is good, and build that into our permanent setup, then we will have derived some benefit from this indirect attempt on the part of the government, while aiming at stabilization and warding off inflation, to bring some order out of chaos in the rate structure of the companies in this country."66

The WLB was terminated December 31, 1945, and in its place was established the National Wage Stabilization Board. This Board was almost an exact replica of the WLB, and almost all of the powers of the WLB were transferred to it. The very strict controls were relaxed slightly, allowing in some cases voluntary wage increases by employers. Arbitration facilities were established, and all disputes were required to be submitted to the Wage Stabilization Board for arbitration. Increases were allowed, but the approval of the WSB was necessary before they could serve as a basis for price adjustment under the OPA.67

The Wage Stabilization Board had two main criteria on which it allowed wage increases: "(a) the 'general pattern' already established within industries and (b) the elimination of 'gross inequities' as between 'related industries.'"68

66Shister, op. cit., p. 301.
68Ross, op. cit., p. 59.
The "general pattern" policy obviously led to a considerable amount of uniformity in the "first round" of post-war wage increases. In February, 1946, a key wage bargain was made between the Steelworkers' Union and the basic steel producers. This bargain called for an eighteen and one-half cent raise. This figure became popular, and the Board approved increases of that size in all branches of the steel industry, among the "Big Four" in the rubber industry, General Electric, the automobile industry, and nonferrous metal industry. These similar increases were justified on the grounds that a similarity existed between these industries. But "it declined to recognize an asserted relationship between dairy workers and automobile workers in Detroit." In almost every group of related industries a pattern developed, and the Stabilization Board happily followed the pattern. Finally, on February 24, 1947, the Wage Stabilization Board was officially abolished, and the rather obvious tendency toward uniformity was not so prevalent in the subsequent "rounds" of wage increases.

It should by now be clear that the Federal Government's wage policy respects the "going" or "prevailing rate" established in the private sector of the economy. True, the government does usually attempt to bring wages up to a desirable minimum, but otherwise it tends to go along with the

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69 Ross, op. cit., p. 60. 70 Ibid., p. 57.
"customary" wage rate. Of course, there is a definite tendency toward uniformity whenever the government enters the picture.

When the government participates actively in the determination of wages, the pressure for uniform treatment is almost irresistible. It is a cardinal tenet of democracy that the government must exercise its powers evenhandedly and dispense justice impartially. To discriminate among unions and among employers is virtually impossible from a political standpoint, even if it were desirable.71

Also Wyckoff is inclined to believe that the governmental public works and public contracts wage policy may have a tendency to slightly push wages up in the private sector of the economy because somewhat liberal judgments of the "prevailing" local wage are sometimes made.72

71 Ibid., pp. 53-62. 72 Wyckoff, op. cit., p. 283.
CHAPTER V

CONCLUSIONS

Orthodox wage theory contends that certain "natural economic laws" operating in a free market will cause wage rates in the long-run to seek a somewhat uniform, "natural level." This "natural level" is purported to be a fair and just reward for services rendered. In reality, however, the wage rates that have resulted are unintelligible and unjustifiable from the standpoint of orthodox theory. Why do regional wage differentials exist? Why are women and certain racial groups paid less than white men for identical work? The answers to such questions cannot be found in orthodox theory. The so-called "natural laws" and "market forces" have been found to be inadequate explanations of the existing wage structure.

Wages have not been found to be products of "natural laws" or "market forces," but rather they have, in fact, been found to result from the more or less arbitrary administrative efforts of business enterprise, labor unions, and government. This leaves, then, the most prevalent theoretical guide, orthodox theory, completely useless in practical application. In fact, it has so frequently and consistently, through its
frictions and malfunctions, operated to capital's advantage and to labor's disadvantage that one is tempted to brand it as a mere rationalization.

But what is the Basis of wage administration? The evidence strongly suggests a tendency toward an administered income distribution--administration that will solidify and perpetuate the present status system. Note, for instance, the recent General Motors sliding-scale contract with its employees. Greater business concentration and co-operation leads almost inevitably to the same outcome. Witness the war period in which the government, through its very extensive control, was in a position to modify income distribution to almost any extent that it saw fit; yet no significant modifications resulted. At the present time business and its agents in the journalistic field substantially agree that price control legislation should be passed--but, wages must be controlled also.

The labor movement might be considered a menace to an administered status arrangement. Unions, however, follow many divergent policies with so little co-ordination that they do not pose a constant threat to the status quo. In fact, the behavior of the American labor leader strongly indicates that his interest is not in wrecking the status system, but rather he is primarily concerned with improving his own position in the social scale. Even the rank and file
have not indicated extreme contempt for "The American Way."
Dissatisfaction with the status arrangement does not appear to be a great menace in the American culture.

If a serious threat to the existing status system arises, it will more likely be of an external nature. For instance, the business cycle might be mentioned as one of several such external forces. Many business cycle theorists are inclined to believe that our present income distribution is incompatible with the continued stability and growth of the economy. Recurring business recessions might well breed trouble. Proof of such contentions lies, however, outside the scope of the present study, but they are suggested implications.

One other tendency warrants brief mention—the trend toward increased wage uniformity. Larger business contraction and increasing collaboration accentuates this trend. So also does the ever growing influence of the Federal Government. Then, of course, another cause is the growth and extended influence of labor unions. Especially is this true in the case of industry-wide bargaining. Uniformity in wage rates is not, however, characteristic of competitive conditions, but rather it is an indication of just the opposite. Such a trend is simply a part of a seemingly general tendency toward a more purposefully organized economy.

At present the wage structure of the American economy is not wholly and logically consistent. The picture is often
clouded by confusion and incongruity. But when order does emerge, it does not take the form of the classical "natural order." The administered wage of the American economy is, at present, understandable, in the main, only if viewed as a "status order."
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