The Doctrine of High Wages

by

J. H. Richardson, M.A., Ph.D.

Research Division, International Labour Office

Wage determination is the most fundamental and difficult problem in industrial relations, involving both the prosperity of industry and the standard of living of the workers. Demands for wage advances are often countered by the argument that they will result in business depression and unemployment. But in many countries the levels of real wages have risen while industrial prosperity has been maintained or even increased. During recent years the rise in real wages in the United States has been so great with continued unparalleled prosperity as to lead to the wide adoption of the doctrine that high wages are essential to economic progress. The purpose of the present article is to examine the basis and implications of this much discussed doctrine, with special reference to post-war developments in the United States.[1]

SINCE "high" is a relative term, standards of comparison are essential in any discussion of high wages; it is also of interest to consider the chief sources from which improvements in wages may be secured. These questions are outlined first. They are followed by surveys of the relation between high wages and labour costs, productive efficiency and purchasing power.

I

Standards of Comparison

There are several standards of comparison by which wages may be judged to be high. The wages of one worker may be higher than those of another. The level of wages in one establishment, industry, district or country may be high in relation to those elsewhere. The wages of a given group of workers may

[1] A recent recognition of the importance of studying this question is that of the International Association for Social Progress which, on the basis of a preliminary report by Dr. Stern, Secretary General of the Czechoslovak Social Institute, decided at its Third General Assembly, Zurich, 19-21 September 1929, to undertake a detailed survey of the problem of high real wages.

be higher than they were last year or a decade ago. Again, wages may be higher in relation to salaries or profits than they were formerly. Any conclusion as to whether wages are high or low depends on the standard of comparison.

The method most commonly adopted in discussions of the doctrine of high wages is to compare present levels of wages with those of a few years ago. Owing to limitations of space the present article is restricted largely to this aspect and, to a lesser extent, to some of the other aspects indicated in the preceding paragraph. It should not be overlooked, however, that, although the amounts which the workers receive may now be greater and represent a higher purchasing power than they did a few years ago, at the same time the total amount received by the workers may form a smaller proportion of the total product of industry. In these circumstances are wages high or low ? Evidently, to give a complete answer, both standards must be applied. Unfortunately in many countries adequate data are not available to show the proportion which the workers receive of the total product of industry, although this aspect of distribution is of fundamental importance.

Some of the methods indicated above may be illustrated by considering wages in the United States. If comparisons are made between present levels and those immediately before the war, it is evident that wages, after allowing for changes in the cost of living, are relatively high. For broad groups of industrial workers, real wages are generally more than 25 per cent. higher than before the war. For many groups the increase has probably been much more than 25 per cent. It is to this remarkable rise, a considerable part of which has occurred in post-war years, that attention is generally directed in discussions of the doctrine of high wages.

In comparison with levels in most other countries, wages in the United States are high, even taking into consideration the relatively small protection afforded the American worker against social risks. After allowing for differences in the cost of living, the wages of many of the chief groups of American workers are probably at least 50 per cent. above the highest European countries, and are more than double those in a considerable number of industrially important countries of Europe. [1]

[1] The International Labour Office comparisons based on food only show even greater differences, but allowance should be made for the higher relative costs in the United States of certain other groups of expenditure, especially housing accommodation.

In one sense, however, American wages do not appear to be high. Total wages do not appear to form a higher proportion of the national income than before the war, although salaried employees have made considerable gains. Also figures may be given to show the relation during recent years between increases in factory wages, manufacturing production, and profits. Between 1922 and 1927 the average earnings of factory workers increased at a rate of 2.4 per cent. a year, while output per man in manufacturing establishments rose at a rate of 3.5 per cent. a year, and the profits of industrial corporations increased, between 1923 and 1927, at an average rate of 9 per cent. a year. [1]

The desirability not merely of securing higher real wages than were paid a few years ago, but also of endeavouring to ensure that the share of national production received by the wage earner shall not decline, has not been ignored by organised labour in the United States. The Modern Wage Policy of the American Federation of Labour emphasises that "higher real wages from a social point of view do not improve the situation of the worker if productivity increases more than real wages. For higher productivity without corresponding increase of real wages means that the additional product has to be bought by others than the wage earner. This means that the social position of the wage earner in relation to other consumers becomes worse, because his standard of living will not advance proportionately with those of other groups." [2] The policy of the Federation is therefore to strive not merely for higher real wages representing an improvement in the economic position of the worker but for higher *social* wages, for wages related to both prices and productivity.

Sources of High Wages

The sources from which improvements in wages may be secured are various. A group of organised workers may obtain high wages at the expense of other workers. This occurs, for example, where a trade union deliberately restricts the supply of labour in its trade. The shortage of labour in the trade results

---

[1] *Recent Economic Changes in the United States.* Report of the Committee on Recent Economic Changes of the President's Conference on Unemployment. Vol. II, chapter IX: "Price Movements and Related Industrial Changes", by Frederick C. Mills, pp. 653-654. (Referred to in subsequent notes as *Recent Economic Changes.*)

[2] *Organised Labour's Modern Wage Policy.* Research Series No. 1, published by the American Federation of Labour, 1927.

in wage increase, but the flow of labour attracted to the trade by the high wages is restricted by the trade union regulations. There is therefore a relative surplus of labour available for other trades, and consequently a fall in their wage levels. This is one of the ways by which an unsatisfactory relation may develop between wages in different trades, work of equal skill being paid for at different rates.

Similar consequences follow the imposition of restrictions on the free mobility of labour between countries. Thus the restriction of immigration into the United States is admittedly a factor which has contributed to increasing the level of American wages in relation to those in other countries. Professor Wesley C. Mitchell, in his review of recent economic changes in the United States, concludes that "had there been no reduction in birth rates and no restriction of immigration, the United States would contain several millions more people than it does. As large or a larger fraction of the greater population would be 'engaged in gainful occupations', and, despite more unemployment and a less advanced stage of industrial technique, the workers would probably be producing a greater volume of goods. Thus, the national income would be rising faster than it is ; but *per capita* income would be growing slower than it is. Since birth-rate restriction seems to be voluntary, and since immigration certainly is, we must conclude that Americans are preferring to raise the economic level of average life rather than to maximise national wealth." [1]

Wages may be raised at the expense of other classes of the community. For example, in an industry with a monopoly of an article of inelastic demand the producers may restrict supply and secure monopoly profits. The workers may support this policy and share in the profits by restricting the supply of labour. In such circumstances the high wages and profits are obtained at the expense of the consumer, and also of workers in other industries.

The raising of wages at the expense of other classes of the community is, however, generally a question of wages *versus* profits. This method usually involves conflict. Economists are generally agreed that although this method of raising wages may sometimes be unavoidable and even desirable it is unlikely to lead to considerable improvements. This is partly because if pushed

[1] *Recent Economic Changes*, Vol. II, p. 886.

too far the consequent fall in profits tends to discourage the accumulation of capital, and this ultimately has unfavourable reactions on wages. Also the conflict and bad industrial relations involved have unfavourable reactions on production.

The sources of higher wages already mentioned merely represent changes in the distribution of the national dividend. These may sometimes be necessary where distribution is unsatisfactory. But, as has been indicated, sometimes anti-social action and often conflict are involved in attempts to secure improvements in wages at the expense of other groups of workers or of other classes of the community ; also the possibilities of improvement are small. There is one source, however, from which important improvements in the workers' standard of living may be secured without entailing unfavourable reactions, and that is by increasing production. The increase may be due to the progress of science, the greater application of mechanical appliances, better organisation and methods of work, or improvement in the efficiency of the workers.

It is increase in *per capita* production which has led to the remarkable rise in wages in the United States during recent years. There is no need here to repeat in detail the well-known data on the results in the United States of applying mass production methods, standardisation, mechanical power, the latest inventions, and other improvements in management. It will suffice to quote that "the increase in *per capita* productivity in manufacturing from 1922 to 1925 was 35 per cent." ; also "the productivity of farm workers has increased at a rate probably never before equalled. And these increases in productivity have been joined to a corresponding increase in the consuming power of the American people." [1]

The workers in various countries recognise the benefits they will derive from increased production. In the United States, organised labour has declared its willingness to co-operate with management in the promotion of efficiency, the elimination of waste, and other means of increasing production. The American Federation has taken the lead in broadcasting this policy. At its Convention in Atlantic City in 1925, a declaration was adopted which included the following passage : "We hold that the best interests of wage earners as well as the whole social group are served, by increasing production in quality as well as quantity,

[1] *Recent Economic Changes,* Vol. I, p. xv.

and by high wage standards which assure sustained purchasing power to the workers. . . ." This co-operative policy for increase of production has been applied with considerable results in a number of industries.[1] Commenting on this policy Professor Wesley C. Mitchell states :

> That organisations of wage earners should grasp the relations between productivity and wages, and that they should take the initiative in pressing constructive plans for increasing efficiency upon employers, is not wholly without precedent ; but the spread of such ideas and the vigour with which they are acted on by large organisations must startle those who have believed that trade unions are brakes upon economic progress.[2]

II

High Wages and Production

High wages may have the effect of increasing the efficiency of the worker or of providing a stimulus to employers to improve the efficiency of their productive organisation and so to reduce labour costs. A rise in wages may result in an improvement in the efficiency of the worker either by increasing his physical capacity for work or by its psychological effects. In industries in which wages are so low as to involve privation and misery for the worker and his family, a rise in wages is likely after a time to pay for itself in the improved physical efficiency of the worker ; also the effect will be cumulative because of the increased welfare of his children. Apart altogether from humanitarian considerations, this is an important economic justification for the establishment of minimum wage-fixing machinery to ensure that unduly low wages shall not be paid.

In the United States the payment of higher wages has probably had comparatively little effect during post-war years in improving mere physical efficiency, except perhaps in the southern States. In European countries, and still more in Asiatic countries, the number of workers living at or below the "poverty line" is relatively large, and there is the possibility of considerable improvements in output if the undermining effects of an unduly low standard of living could be removed.

---

[1] See article on "Recent Developments in Industrial Co-operation in the United States and Canada", in *International Labour Review*, Vol. XX, No. 1, July 1929, pp. 67-83.

[2] *Recent Economic Changes*, Vol. II, p. 864.

The psychological effect on the worker of an increase in wages is often important. The increase may or may not be the result of a change in the method of wage payment. Thus the introduction of piece-work or bonus systems of payment will often provide a stimulus to increased production. This will be especially true if the worker does not fear that this increased output will be followed by unfair cutting of the piece rate. Increases in wages without any change in the methods of payment will also provide a stimulus for a time ; but the stimulus will probably diminish rapidly as the workers become accustomed to the new levels, unless successive increases are possible. In the United States the psychological effect on the worker of wage increases during recent years has doubtless been of considerable importance. In a number of industries there have been successive increases in wage rates ; also there has been a marked tendency to extend piece-work and bonus systems of payment, while there has apparently been less cutting of rates than formerly, and, consequently, better relations between management and workers.

An important aspect of the doctrine of high wages is the stimulus to employers to improve their productive organisation and so reduce labour costs. In the United States a central element of the doctrine is that there is nothing incompatible between high wages and low labour costs. According to the British Committee on Industry and Trade "the characteristic feature of the economy of the great industrial establishments of the United States is not merely the high wages which prevail, but the combination of high wages and low labour costs per unit of output." [1] By introducing labour-saving machinery, improving the organisation of work, providing more horse-power per worker, better personnel administration, including, in the progressive undertakings, a more careful selection and training of workers and promotion by merit, and by other methods of increasing production, management in the United States is continually endeavouring to reduce labour costs, and during recent years has achieved remarkable successes in this field.[2] The extent of labour saving may be indicated by the following statement by Mr. Magnus W. Alexander, President of the National Industrial

---

[1] *Final Report*, pp. 150-151. London, 1929.

[2] It is curious that numbers of American business men who refer to low labour costs in the United States also believe strongly that high tariffs are necessary to protect the standard of living of the American worker.

Conference Board, in his Annual Report, 1928 : "On the average for all manufacturing industries, an output which required . . . one hundred workers in 1914 was produced by only seventy-one workers in 1925, while average working time had declined . . . 9 per cent. from 1914 to 1925."[1] Also, apart from a certain amount of temporary "technological unemployment", the supply of labour released from the manufacturing industries has been readily absorbed into other occupations, the most characteristic of which, reflecting the raised standard of living, are automobile supply and amusement services.

The attitude of business men in the United States to the problems of the efficient organisation of industry is a factor in the increase of productivity which has made higher wages possible. Favourable economic conditions, including the growing demands of an increasing population, have resulted in a spirit of optimism regarding the future. Efficient management has become a creed and business men have been "on their mettle" to eliminate wasteful methods.[2]

Business men in the United States do not, of course, pay high wages in order to provide themselves with a stimulus to improve their own efficiency. Wages are no higher than the circumstances of the country warrant. To quote Professor Perlman, they are "principally the outcome of objective conditions . . . and not the result of deliberate policy on the part of the employers. . . . Although, once these high wages came to be, they entered into so reciprocal a connection with the use of the newer efficiency methods — in which the initiative, of course, was the employers' — that it has become impossible to ascertain which has been cause and which effect."[3]

A main cause of the high level of wages is the relative scarcity of labour, and being scarce, labour is used economically. The relative scarcity of labour is determined by the volume of capital available. In the United States "in consequence of the juxtaposition of rich resources and an inadequate labour supply, there has resulted a progressive development of labour-supplementary

[1] NATIONAL INDUSTRIAL CONFERENCE BOARD : *Twelfth Annual Report of the President* : "Mechanisation of Industry and Economic and Social Progress", p. 4.

[2] Progress towards greater efficiency was stimulated by the publication in 1921 by the Federated American Engineering Societies of a report on *Waste in Industry*, which showed that over a wide field there was serious waste for which management was largely responsible and which management alone could eliminate.

[3] Selig PERLMAN : *A Theory of the Labour Movement*, p. 213. New York, 1928 .

machine equipment, in agriculture, transportation and industry, and also a remarkable utilisation of power."[1] Reference has already been made to the relation between restriction of immigration, scarcity of labour, and high wages in the United States. "Had there been no legal check on immigration in 1922-1927, unemployment would have attained large proportions, and the difficulty of maintaining wage rates would have been greater."[2]

The relatively small development of trade unionism in a number of important manufacturing industries in the United States implies that the levels of wages of these industries are largely determined by managements who have no inducement to pay more than is necessary to attract the kind of labour they require.

Some undertakings in the United States, and also in other countries, pay higher wages than their competitors mainly if not entirely because the higher wages are necessary to ensure an adequate supply of workers willing to adapt themselves to the methods of manufacture and to submit to a high degree of industrial autocracy. The high wage levels have attracted labour of the required degree of efficiency, energy, and adaptability. The workers have accepted without question the methods of production applied and labour disputes have been avoided. In other words, the wage has been paid to ensure an adequate supply of a specially selected class of workers, efficient in relation to the type of work demanded from them. This is one aspect of the "economy" of high wages. Other establishments apply the principle of the economy of high wages in a different manner. For their methods of manufacture they desire to secure considerable numbers of highly skilled workers, and they pay high wages in order to attract these workers. In such establishments an important part is often played by careful methods of selection, training, and promotion. The high wages in both kinds of establishments involve methods of manufacture which result in low labour costs. It is in this sense that high wages are "an index of efficiency".

In view of the endeavour of employers who are faced with high wages to reduce labour costs by improvements in productive organisation, it is sometimes proposed that organised labour should deliberately maintain wages at a level slightly above that

---

[1] *Recent Economic Changes*, Vol. I, p. 4.
[2] *Ibid.*, Vol. II, chapter by Professor Wesley C. Mitchell, p. 886.

which would ensure employment for all workers. This policy is advocated by Mr. Rowe in his recent book, *Wages in Practice and Theory.*[1] He is of opinion that :

> The ordinary stimulus of competition can be, and should be, reinforced by a constant pressure to raise wages, if the utmost is to be got from the present, or indeed any system of industry. Within limits, which are probably in most industries, and at most times, appreciably wide, an increase in wage rates, if it is maintained for a reasonably long period, is more than likely to generate sufficient improvement in the efficiency of production to pay for itself, in the sense that though the first results will be some unemployment, and some reduction of the National Dividend, the ultimate result will be the re-absorption of these unemployed workers, and an increase in the National Dividend.

Mr. Rowe recognises the ability of modern trade unionism to control the supply price of labour for periods sufficiently long to produce a direct effect on the technique and organisation of industry, and so on the normal equilibrium level of wages. He therefore suggests that :

> Trade unions ought consciously to try and keep wages not in exact adjustment with, but a trifle above, the current marginal productivity equivalent ; to accept the fact that this is bound to produce a variable, but permanent, margin of unemployment, which is of their own deliberate making and no inherent fault in the capitalist system ; to take all possible steps to increase the mobility and fluidity of labour, in order to facilitate the reorganisation and improvement of technique which must ensue before a fresh advance in wages is possible ; and to mitigate the incidence of unemployment on individuals in every possible way....The idea...is in fact only an extension of a policy which has long been commonly practised in times of trade depression. At such times trade unions deliberately choose to maintain wage rates as far as possible, rather than to alleviate unemployment by accepting a reduction.

Clearly if such a policy is to be successful it must be applied with great care. If excessive pressure is put on employers the result will not merely fail to provide a stimulus to improve productive efficiency but will have the opposite effect. There are many circumstances in which the policy would be unlikely to lead to the result anticipated, for example in industries in which competition for markets is particularly keen, in industries in which demand is declining, or in industries in which the possibilities of improvements in equipment and organisation are inconsiderable. Also the psychological situation created by an artificial raising of wages would be very different from that

---

[1] Pp. 209–212 and 229. London, 1928.

where high wages are in large measure due to a real shortage of labour. Where high wages are the result of a real shortage of labour, employers have no alternative to endeavouring to reduce labour costs by improvements in productive efficiency. If trade unions insist on artificially high wages, a related volume of unemployment is created. The effect of such action on the attitude of employers and of public opinion would be unfavourable and would provoke resistance. There is also the point made by Professor Clay in his review of Mr. Rowe's book, that the action might not result in improvements in efficiency but in the raising of the wages of some groups of workers at the expense of others or at the expense of the consumer, on the lines already indicated.[1]

There are, however, circumstances in which deliberate action to raise or maintain wages in particular industries despite unfavourable conditions may be justified and lead ultimately to increased production and reduced labour costs. Thus the operation of minimum wage-fixing machinery to improve the position of workers in receipt of unduly low wages is often economically sound policy, not only because the efficiency of the workers is improved but because employers improve their methods and are less wasteful in the use of labour. The British Committee appointed to enquire into the working and effects of the Trade Boards Acts gives among its conclusions that "in some instances the enforcement of higher rates of wages has acted as a stimulus to improvement in working methods ; and our attention has been drawn to cases in which improvements in machinery and organisation so brought about have increased production . . . ."[2] Again, the South African Wage Board, in its recent Report to the Minister of Labour, states that during the course of its inspections it discovered many instances of inefficiency in management, and gives figures for certain industries to show that through the pressure of higher wages efficiency has been increased.[3]

Further, the maintenance of relatively high wages may be good policy in industries in which there is evidence that the organisation and methods of manufacture are at a low standard of efficiency and are capable of considerable improvement. If the employers can meet their economic difficulties by wage

---

[1] *Economic Journal*, Sept. 1929, pp. 416-417.

[2] *Report to the Minister of Labour*, p. 23. Cmd. 1645. London, 1922. Cf. also Dorothy Sells : *The British Trade Boards System*, chapter VI. London, 1923.

[3] *Report upon the Work of the Board for the Three Years ended 28 February 1929.*

reductions, they will have less incentive to introduce improved methods. The strong resistance of British coal miners during recent years to wage reductions has been based to a considerable extent on the belief that much of the reduction demanded by the colliery companies would be unnecessary if serious endeavours were made to improve the efficiency of the industry. Again, in the recent dispute (July-August 1929) in the cotton textile industry in Lancashire, there was much emphasis by the workers and the public on the need for a reorganisation of the industry. In announcing its terms of settlement of the dispute, the Board of Arbitration found that the employers' case for a reduction of wages was proved. In other words, with the existing methods of production and organisation of the industry the reduction claimed by the employers (12½ per cent.) would be desirable in view of the very depressed condition of the industry. However, the Board was not at all convinced that a reduction in wages was the only remedy. In order to alleviate the immediate situation the Board awarded a wage reduction of half that claimed by the employers. Clearly, however, the Board was of the opinion that the employers, by better organisation and methods, could make a considerable contribution to improving the situation, and that the pressure to do so would be greater if the Board did not accede fully to their demands for wage reduction.

An important element, therefore, in the doctrine of high wages is that in periods of industrial difficulty the principle of "Wages last, not first" should be applied. This principle has the advantage of directing the attention of employers to the possibilities of increasing profits rather by improving productive efficiency than by keeping wages down. In proving the value of this change of psychology and emphasis employers in the United States have made a notable contribution.

III

High Wages and Purchasing Power

A general increase in real wages which is not accompanied by an increase in production may be obtained either at the expense of profits or at the expense of the consumer. If receivers of profit are prepared to take a lower return, the only reactions may be some decline in their demand for commodities and perhaps a reduction in the rate of capital accumulation with the consequences this implies. Usually, however, the attempt is made to pass on the burden to the consumer by increasing prices. As this rise in prices will affect commodities consumed by the workers and their families, the rise in their wages will be absorbed in part by the increase in the cost of living. However, part of the burden of higher prices will fall on other classes, who will reduce their demand for commodities, and unemployment will result with unfavourable influences on wages. The extent of the unemployment will depend mainly on the elasticity of the demand for commodities by these other classes. Clearly the various reactions indicated reduce the possibilities of considerable increases in real wages not based on increased productivity.

An increase in productivity may occur without any increase in real wages. This would imply a fall in the proportion which wages would bear to other elements in the national dividend. The additional goods produced might be disposed of in various ways. If distributed in the form of profits they would be likely to result in an increase in the demand for luxury goods, and the increased productive capacity of industry would be directed to the satisfaction of this demand. Alternatively, the increased productive capacity of industry might be absorbed by an increase in saving. This could be effected either by individual savings or by the decision of business undertakings to reinvest profits in their own or other industries. It could also be effected by exporting goods and investing the proceeds abroad. The consequence of these various methods of saving would mostly be to direct the increased productive capacity of industry into the construction of capital equipment, and ultimately an increase in the capacity to produce consumers' goods would result.

Usually, however, any important increase in the productive capacity of industry results in an immediate increase in the purchasing power of the workers. This may come about either by an increase in money wages or by a fall in prices or both. In modern industrial communities the spectacular increases in productivity are in the mass production of foodstuffs, clothing, furniture, household utensils, and other commodities consumed by the whole community. This has been especially true in the United States in recent years. In fact, the securing of the economies of large-scale production depends on ability to market a large product. To secure an adequate market for consumers' goods produced in great quantities, the price must be within the purchasing power of a large proportion of the workers. The genius of Mr. Henry Ford has lain mainly in his recognition of the tremendous increase in the market for cars which would result if the price were within the reach of the lower middle class and the manual worker, and in his ability to organise production so that the price could be lowered to that level.

With a commodity like motor cars, which had hitherto been within the reach only of the wealthy classes, it was essential that prices should be greatly reduced if a mass demand was to be created. No practicable increase in money wages would have been effective. With many other commodities, however, increased production may be absorbed either by a lowering of prices or by a raising of money wages. Either method implies an increase in real wages. For the raising of money wages to be effective it must be widespread. An increase in the production of, say, photographic apparatus would not be absorbed by raising the money wages only of workers engaged in its manufacture. These workers constitute only a small part of the market for these commodities. In order to secure adequate markets, the employers in this or in any other single branch of industry would tend to reduce prices rather than to increase wages. If, however, there is increased production in a large number of industries and the general body of employers tacitly agree upon a policy of wage increase, markets will be found to absorb the increased production without any great lowering of the general level of prices.

This appears to have been the situation during recent years in the United States. The manufacturers have recognised that, with the great increase in production, they could find markets only by general increases in money wages or a general lowering of prices or both. In fact they have adopted both methods; they have, however, shown preference for the former, and this policy has fitted in well with the Federal Reserve authorities' desire to maintain a fairly stable level of commodity prices.

The general wage and price changes in the United States during the years 1922 to 1927, when the increase in productivity was most marked, may be illustrated by the following figures.[1] They show the average *annual* rates of change.

---

[1] *Recent Economic Changes*, Vol. II, chapter IX : "Price Movements and Related Industrial Changes", by Frederick C. MILLS.

Item	Percentage annual change
Per capita earnings of factory workers	2.4 increase
Wholesale prices :	
All commodities	0.1 decrease
Farm prices	1.1 increase
Non-agricultural products	1.8 decrease
Cost of living	0.7 increase

The relation between increases in money wages and the increase in productivity is expressed in many articles and speeches by American business men. It is indicated, for example, by Mr. Sam A. Lewisohn in an article in the *Management Review* for September 1926. He emphasised "how much our quantity-production enterprises depend for their success upon the great buying power of the American worker that has resulted from his high wage-scale and the high standard of living that he has attained, with its accompanying interest in new comforts and devices as they are developed and brought before the public."

Mr. Henry S. Dennison, in his chapter on "Management", published in *Recent Economic Changes* [1], states that an economic doctrine quite different from that prevailing among business managers some years ago has gained a foothold :

> Instead of believing that every cent paid as increased wages must come from the investor's return or else from ultimate consumers, it is now widely believed that, where an appropriate increase in productivity can go along with an increase in wages, the consequent increase in purchasing power results not only in higher standards of living and better states of health, but also in increases in the quantities and varieties of goods which can be sold. These increasing quantities, by helping to carry overhead and by making specialised operations possible, tend further to reduce cost and so again to increase wealth.

Mr. Dennison hesitates to express an opinion as to the effect on the doctrine of a long depression.

The following passage from the *Monthly Letter* for November 1925 of the National City Bank of New York may also be quoted :

> The idea of connecting up the working man's advance with increasing production is all to the good. It is not only true that his real gains must come through industrial progress, but that industrial progress will utterly fail of results and actually choke down for want of an expanding market unless there is the widest possible distribution of benefits. All plans for increasing production necessarily contemplate a corresponding increase of consumption, and the only

[1] Vol. II, p. 523.

way that consumption can be obtained is through the constant increase in the buying power of the masses. Broadly speaking, everything produced in all the industries must be sold back to the people engaged in the industries, for there is no other way of disposing of the output.

The preference of American manufacturers for increases in money wages instead of considerable general reductions in prices is not difficult to understand. A steadily declining price level, even when due to increases in production, tends to exercise a depressing effect on business activity. One reason for this is that the demand for commodities is delayed as long as possible in the expectation of satisfaction later on at a lower price. Also the real burden of debts is increased and profits are reduced through the fall in the value of materials during the process of manufacture and of stocks of manufactured articles. On the other hand, the granting of increases in money wages has, at least temporarily, a stimulating effect on the workers, and often tends to an improvement in industrial relations and to a diminution of resistance to changes in the organisation and methods of work. Also increased money resources act as an immediate stimulus to the workers' demand for commodities. An increase in real wages through a decline in prices would not be accompanied by these advantages or would be attended by them in a lesser degree.

To sum up, the position is that increasing productivity must be accompanied either by increasing money wages or decreasing prices or both. In the United States during recent years manufacturers have adopted both courses, but the rise in money wages has been predominant.[1] Because of the advantages indicated in the preceding paragraph of increasing money wages instead of reducing considerably the general level of prices, the application of the doctrine of high wages may be regarded as a contributory factor in the continuation of prosperity in the United States.

This conclusion is reached by the United States Committee on Recent Economic Changes.[2] They are of the opinion that :

The widening gap between wages and the cost of living—wages increasing while the cost of living was stationary—may be assumed

---

[1] The maintenance of a fairly stable general price level by Federal Reserve action must have been a factor in determining the adoption of a policy of increasing money wages.

[2] *Recent Economic Changes*, Vol. I, p. XIV.

to have contributed definitely to the degree of prosperity which has characterised the period as a whole (1922-1929). . . . In the early post-war period much of the Press and many employers demanded a "liquidation" of labour. It was freely declared that business could not settle down until wages were brought back to pre-war levels. . . . This might have precipitated a period of serious strife, had it not been that leaders of industrial thought . . . were quick to grasp the significance of the power of the consumer with money to spend to create an accelerated cycle of productivity. They began consciously to propound the principle of high wages and low costs as a policy of enlightened industrial practice. This principle has since attracted the attention of economists all over the world, and while it is in no sense new, its application on a broad scale is so novel as to impress the Committee as being a fundamental development.

It should not, however, be assumed that the principle could be applied with equal success in other countries. The United States has the advantages of abundant raw materials and an enormous domestic market, without the handicap of barriers of tariffs or of language. Also the foreign market is small relative to the home market. Countries which depend more on foreign markets are in a different position. A country which increases its production of the goods it exports in large quantities can find markets chiefly by a lowering of prices. There would therefore be greater difficulty in applying a policy of raising money wages instead of lowering prices unless the countries with which it trades were doing the same, and this is most improbable.

This section may be concluded by a quotation from the Final Report of the British Committee on Industry and Trade, which emphasises the differences between the situation in the United States and Great Britain.[1] After discussing the reaction of the customary standard of living on real wages, the Committee refer to—

the theory which in recent years has obtained a certain amount of favour, that high wages by leading to high purchasing power tend automatically to stabilise themselves in virtue of the increased demand thus generated for industrial products, and the consequent enhanced capacity of industry to sustain a high rate of wages. This assumption is mainly based on recent experiences in the United States, where a very large proportion of industrial production is destined for home consumption, and the home market is surrounded by the ring fence of an enormously high customs tariff. In such circumstances there is no doubt that the increased purchasing power resulting from the high wages policy which prevails in certain industries has a certain tendency to keep up wages, as also in those other industries which

[1] *Final Report*, p. 150.

supply articles of consumption for the wage earners. It would be rash to infer that a similar result could be expected to follow in anything like the same degree in Great Britain where so large a proportion of articles of consumption are imported.

IV

Conclusions

A high general level of real wages is mainly the consequence and not the cause of a high rate of production. But there are important reactions between production and wages. The rate of production is dependent largely on the volume of capital available to provide the workers with mechanical power and equipment. Where capital and also natural resources are large and labour relatively scarce, real wages are high, and this provides a stimulus to management to introduce more labour-saving devices and thus further to reduce labour costs. This in turn increases output per worker, and the increased volume of commodities facilitates the payment of still higher real wages. Increases in real wages may also, by their physical and psychological effects, result in greater efficiency of the workers.

Where there is an abundant supply of labour and intense competition for markets, an artificial forcing up of the level of real wages, which would be accompanied by a considerable volume of unemployment, would provide a stimulus to employers to improve productive efficiency only if industry is badly organised and there are large possibilities of improving productive efficiency; otherwise, such a policy would provoke the resistance of employers and the hostility of public opinion. It follows that in industries where there is evidence of inefficient management and out-of-date equipment the determination to maintain wages may be advantageous as a means of compelling progress in rationalisation. Also for industries in which wages are unduly low there is justification on economic as well as on humanitarian grounds for deliberate action for the raising of wages.

From the point of view of purchasing power, an increase in productivity generally necessitates a rise in money wages or a fall in prices or both, in order that the additional supply of commodities may be sold. In the United States, with a large home market and a relatively small foreign market, the method of raising wages is practicable, and has the advantages of providing a greater stimulus to business prosperity, and a greater incentive to the workers to increase output, than would a reduction in the general level of prices. In Great Britain and other European countries where foreign markets and foreign competition are more important, the method of raising money wages could only be applied to a much smaller extent ; increase in productivity would result in higher real wages mainly by a lowering of prices.