WHY WAGES RISE:

11. PRICING AN HOUR OF WORK

F. A. HARPER

In earlier articles in this series, attention was focused on the fact that the general level of real wages is determined by what is produced; that inflating pay beyond this point raises prices but does not raise the worth of the wage in buying power; that unions, with all their political and other power, cannot veto the iron ceiling that production sets over real wages.

In this article attention will be turned to the problem of pricing one's labors in the market.

THE lone pioneer's desire for some meat, some wheat, or a log cabin is the incentive which drives him to produce. Anticipating his future wants, he produces in advance, like a squirrel which gathers and stores nuts for winter. And in anticipation of years of future use, he makes himself some tools to aid in his labors and in the enjoyment of living.

Then having produced these things, the pioneer is his own sole market. In this situation there is no pricing problem because there is no money and no exchange. Nothing remains unsold as a result of the seller setting his price too high.

Production Creates Own Market

But we are not lone pioneers. We live, instead, in a complex economy. A person usually produces a specialty, selling most of it to many persons and buying his varied needs from many other persons.

Even so, the over-all situation is the same as for the lone pioneer to the extent that no more can be bought than is produced. Despite the fact that some goods and services are exchanged for others, and despite the fact that money may be used to facilitate these exchanges, what is bought still equals what is sold. Just as in one exchange the buying equals the selling because the same item sold by one person is bought by another, so likewise for the total of all trade in a complex economy, all buying equals all selling.

And this leads to the unavoidable conclusion that *production creates its own buying power in a free economy*. Sales equal pur-

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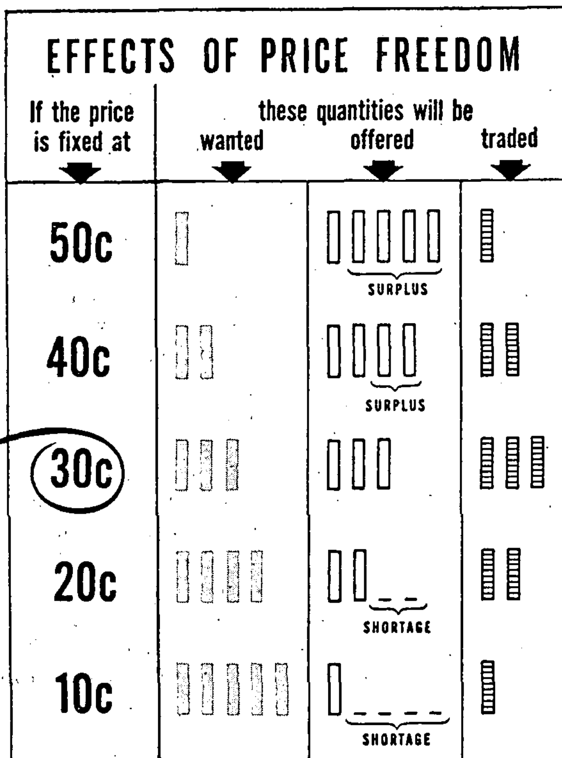
chases and purchases equal sales, in total for all trade as for a single trade. Only if the market is not free, only as freedom to trade is interfered with, is this not true.

The Function of a Free Price

The function of a free price is to accomplish in a complex economy of exchanges what the lone pioneer accomplishes in his separate existence – the production of what is wanted of each thing, and no more, insofar as is possible. The function of price is to discourage production of unwanted items and to encourage production of what is wanted, to the extent that wants can be anticipated and production plans can be carried out.

The lone pioneer has his own troubles in this respect, of course. Perhaps the fishing is not as good as he had expected, or the weather



Free market price

not good for the corn. Perhaps in winter he changes his mind about what he wants, wishing he had provided more venison and less corn. Or perhaps his wife wishes the cabin had been fixed up a little, even if it had meant less hunting. Or perhaps too much food was stored and some of it spoiled. What does he do then? He just blames himself for his lack of foresight and quickly adjusts as promptly as possible so as to go on with production and living.

Adjustments Facilitated

In a complex economy, similar events occur. But one person can blame another more easily for not having foreseen the weather, or for the change in his wife's wants, or something of the sort. But the objective of everyone in a complex society should be the same as if he were a lone pioneer – to adjust as promptly as possible and go on with production and living.

That is the task performed by prices that are free. The accompanying chart on the effects of price freedom shows how this takes place, and how an unfree price prevents adjustments in economic living.

The two simple ideas behind this chart are these:

1. Less of a thing will be wanted at a high price than at a low price, progressively.

2. More of a thing will be produced in anticipation of a high price than of a low price, progressively.

From these two rules it can be seen how the quantities available and the quantities wanted operate like the two ends of a seesaw. A rising price pulls down the "wanted" end and pushes up the "offered" end. A falling price pulls down the "offered" end and pushes up the "wanted" end.

Only when the seesaw is on the level, at the point of the free market price, will there be equality between what is wanted and what is offered. And this is the only sort of equality that should ever be given any economic merit. When individuals are left alone, free to buy and to sell what they wish at the price determined solely by the owner-traders of each item, this equality will operate just as water seeks its own level. No superplan is needed to force prices either up or down to this level. Price will find its own level through the innumerable decisions of individual buyers and sellers.

What any outside force does to prices is to push them either above or below this point of equality. The agent who applies the force is always an outsider to the deals of trade, someone who owns neither what is being sold nor what is being traded for it. He is an economic interloper, with or without official title of some sort.

Forcing the price above the equality point creates surpluses. The higher the price is pushed, the greater the surplus. And forcing the price below this point creates shortages – more and more shortages as the price is pushed down more and more.

Two forces operate to create a surplus as prices are forced above the free market point – consumers want less and producers bring out more. And conversely, these two forces both operate to create a shortage as prices are forced down.

Trade Is Maximized

And finally, as to the function of a free price, it will be noted that trading will be greatest at the equality point, a free price. Either above or below that point trading is lessened, either because things are not wanted at a higher price or because they will not be produced and made available at a lower price.

So if we accept the fact that economic welfare is at its best when willing trading is at its greatest, we must also conclude that economic welfare is greater at the free market price than at any other point. If prices are forced away from the point of the free price in either direction, that destroys economic welfare.

Wages Are a Price

The purpose of discussing the function of price in this detail is because a wage is a price, too. It is the price of doing work, just as the price of a bushel of wheat is the price for that embodiment of economic service. In both instances, the owner – in one case the owner of the wheat and in the other case the owner of his own time and effort – is entering the market with something to sell. And buyers who want either the wheat or the work enter the market to buy and thus satisfy their respective wants.

The laborer as a person is not a commodity in either instance, but the time of one and the product of the labors of the other are items of sale – both in a like sense.

A worker may work for himself producing some product he sells on the market. Or he may sell his productive services to another person who in turn sells the product on the market. Or he may work at some task like that of a household servant.

Since wages are a price, they are subject to all the rules of prices and pricing, the same as anything else. All that has been said about the function of price applies to wages the same as to wheat. There is a point of equality at the free market price where the supply of labor and the demand for labor find a balance.

And there is no other point of wage-price where this is true.

As wages are forced either above or below the free market point, there will be created either a surplus or a shortage of labor. And there will be less employment either above or below the free wage point – less labor traded – to the extent that higher wages discourage those who might want to employ help, whereas lower wages discourage people from wanting available jobs. In one direction from the free price, employers offer fewer and fewer jobs; in the other direction, fewer and fewer persons want jobs.

Bargaining for a Wage

Bargaining over wages should have no other purpose, in terms of economic welfare, than to find the free market price for the labor involved. For that is the only price of labor where there is economic equality. It is the only price of labor where employment will be at a maximum.

How can one know whether the free market price has been found? So far as I can see, this can be judged for sure only after the fact, on the basis of the consequences. Let us first look at the pricing of some other product.

Suppose you are taking your sweet corn to a consumer market to be sold. You guess where the price should be set for it, and start selling at that price. If at the end of the market day you have some corn left unsold, you will know it was priced too high. And if you could have sold more at the price you set, you know that it was priced too low. How else could you know for sure where the right price was? Note that this has nothing whatever to do, precisely, with what your wife – the bookkeeper – said it had cost you to produce the corn – a figure that might be above or below the free market price.

It is the same with selling your labor. If other employers want you at the price you are getting, or perhaps more, your price on your services is too low. If, on the other hand, nobody wants you at the price you ask, your price is too high. And here as with the price of sweet corn, this figure of a free-price wage for yourself has nothing to do with the cost of producing you; it doesn't even have anything to do with your cost of living, which you adjust to your income rather than vice versa.

Unemployment

When wheat is priced above the free market level, the accumulation that is unsaleable at that price is called a *surplus*.

When the comparable situation arises among the working force of a nation, we call it *unemployment*. This refers to the labor – perfectly good labor – which is going unsold at the wage-price.

I would define unemployment as *involuntary leisure of a person who is willing to work at the free market price.*

The only way there can ever really be a surplus of labor, unwanted at the price, is by some sort of force being used on wages to keep them above the free market price. It couldn't happen otherwise. For it seems fair to say that if I don't want to work at the best price the highest bidder for my services is willing to offer me, I am merely preferring idleness to work. And if I thus prefer idleness to work, I am not really an unemployed person. My situation is best described by saying that employment is just not an object of my yearning, sufficient for me to merit the use of the label "unemployed."

To illustrate differing ideas about this problem of unemployment, let me cite one incident. The French scholar, Bertrand de Jouvenel, once told me of his coming to the United States for the first time in the early thirties. He had heard of the tremendous unemployment here, and was greatly concerned about his future; for when he landed in New York, he had only eleven cents in his pocket. Yet he quickly found work, in a land where about one-third of the "gainfully employed" of this country were at that time "unemployed." He took a job washing dishes in a restaurant at the wage being offered. He considered the United States in the early thirties to be a land of opportunity.

Jouvenel would probably say, with some justification, that if I were to decline to work at the free market level of wages – whether under the pressure of my government, as in the thirties, or under the pressure of the labor union – I should more accurately be described as suffering from power-enforced leisure rather than unemployment. For voluntary lack of work is not involuntary leisure – not unemployment as I have defined it.

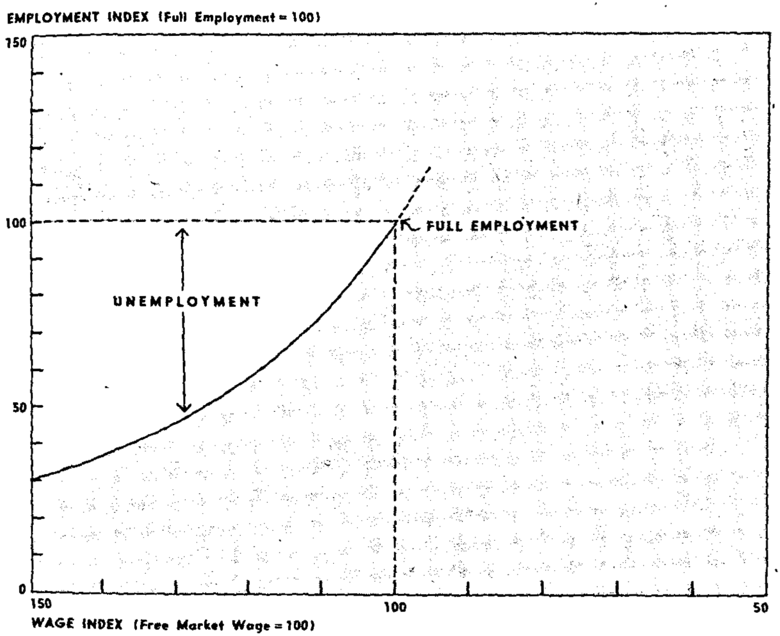
Despite this, however, we shall be using the term unemployment hereafter in the conventional sense, to refer to persons among the normal labor force who are not, at the time, working.

The Demand for Labor

The demand for labor is not a fixed thing. There is not an unchanging number of persons wanted for work. The number demanded depends on the wage. I do not, for instance, happen to employ even one person around my residential property. The price of labor available there is too high for my need of work to be done. But at a

WAGE LEVEL AND UNEMPLOYMENT

Demand Elasticity of 3



lower price for doing work, I would hire one person – at a still lower price, perhaps two persons; then three; and so forth.

Some commodities have a type of demand which we call "unity," where one per cent more of the commodity is wanted after the price is lowered by one per cent. And vice versa.

Apparently the demand for labor is not of this one-to-one ratio. Two noted students of this subject who have studied it carefully – Douglas in the United States and Pigou in Britain – both arrived at similar results.[1] A consensus of their conclusions puts the demand for labor at something like three or four to one. That is, a decline of one per

[1]Douglas, Paul H. *The Theory of Wages.* New York: Macmillan, 1934. p. 501.
Pigou, A. C. *Theory of Unemployment.* New York: Macmillan, 1933. p. 97.

cent in wages would uncover new jobs for three or four per cent more work. And vice versa.

This idea is of tremendous importance to economic welfare, especially under conditions which threaten a depression. I do not know for sure that this three or four per cent is the correct figure. But whatever the exact figure, it works in the same way. The difference is only in the rate of response, in new jobs available at differing wages.

Let us take these Douglas-Pigou figures, leaning a bit on the conservative side of their conclusions. Let us say that the figure is three per cent. What would this mean when applied to real life?

Three to One

The accompanying chart of the wage level and unemployment shows how unemployment and the wage level are related on this three-to-one basis.

At the free market wage of 100 (base scale) there is full employment – no unemployment. Everyone who really wants to work has a job.

Now assume that wages are to be forced above the free market level (moving leftward from 100, on the base scale). Employment declines – unemployment increases – at a rapid rate, according to the factor of three. Starting from whatever level one wants to consider, a one per cent rise in wages will reduce employment by three per cent.

Wages about ten per cent above the free market price would mean unemployment of about one-fourth of the working force.

If wages were to go up about twenty-six per cent, it would unemploy about half the working force.

How can we tell whether the price of work at a given time is too high? All we have to do is to look at the unemployment figures, assuming the figures to be accurate. Or one might ask people who are not working whether they have turned down jobs at the price offered, or whether they are out of work because they couldn't find any jobs at any price.

Moving in the opposite direction of wages below the free market price (rightward from 100, on the base scale) results in the opposite tendency. More and more people are wanted for work. But since there is full employment at the free market wage, reductions in wages from that point can cause "negative unemployment" only under special conditions. New persons not normally in the working force may be pulled into jobs at a wage below the free market point if they can be induced to do so under the urgency of war, or something like that.

Overfull employment seldom

happens except in wartime, for two reasons. One reason is that wages tend quickly to bounce upward to the free market point, there being no potent and effective force in the nation to hold them below that point for long. This is because wage earners are voters, and they do not form unions to keep wages below the free market point.

The other reason why "negative unemployment" does not last long is that the labor statisticians soon conclude that their count of the working force must have been wrong before. So they revise their figures in such a way that full employment is not exceeded, according to the newly revised statistics.

Such is the problem of pricing work in the market for labor. Such is the function of freedom in wages. • • •

In the next and final article in this series, these principles of pricing work will be tested in real life experiences. They will be tested against some historical experience, including the so-called business cycle. They will be appraised from the standpoint of the welfare of those in the labor force, of the nation as a whole.

How Poor the Farmer?

HERBERT L. SCHALLER

AGRICULTURAL income may be down – but it is not on the verge of disaster. Farmers may be feeling the pinch – but they are not on the edge of bankruptcy.

Some farmers have gone broke; others will. But can you name any industry where people go into business for themselves that some of them don't fall by the wayside?

Amid all this din and noise over the farm problem by those who would act the role of savior, one pitiful fact remains: It is a sad commentary on our intelligence and our great agricultural industry that we have allowed the farmer to become a mere political pawn in a game played primarily by those who have a selfish interest in the outcome.

First of all, who is the farmer? Primarily, he is a businessman. He is not much different from his friends and neighbors who run the local grocery, furniture, clothing, or other community store.

Let's compare them for a moment.

Perhaps one basic difference is the fact that these other businessmen compete directly with others in their field on a product basis. They buy and sell essentially the same items in many instances, and make their profit by better merchandising, greater efficiency, and volume.

The farmer, on the other hand, competes almost entirely in his field on an efficiency basis. He stakes his profit on the fact that he can produce better than others at a lower cost per unit, and thereby profit at the market.

The end result is that both must rely on efficiency of operation to give them the profit they need.

But what happens in farming? In this business every effort is made to keep the inefficient producer still operating. And whom do we penalize? The good, efficient, progressive farmer.

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