

Chapter 3

Wages Are Produced By Labor, Not Drawn From Capital

THE IMPORTANCE of defining our terms can be seen at once in this chapter. When people say wages are drawn from capital, they are obviously using wages in the everyday sense, forgetting the economic meaning.

When workers take their reward directly from the product of their labor, their wages clearly are not drawn from capital. If I go out and pick wild berries, the wages for my labor are the berries. Surely no one will argue that wages are drawn from capital in such a case—there is no capital involved!

If I work a piece of leather into a pair of shoes, those shoes are my wages, the result of my labor. They are not drawn from capital, my own or anyone else's. They are brought into existence by my effort, and my capital is not lessened at all—not even for a moment. At the start, my capital consists of leather, thread, and so on. As I work, value is steadily added. When the shoes are finished, I still have my capital, plus the difference in value between the original material and the shoes. This additional value becomes my wages.

Adam Smith recognized that wages are the product of labor in such simple cases. His chapter on wages begins: "The produce of labor constitutes the natural recompense

or wages of labor. In that original state of things which precedes both the appropriation of land and the accumulation of stock, the whole produce of labor belongs to the laborer. He has neither landlord nor master to share with him.”

If Smith had traced this obvious truth through more complicated forms of production—recognizing wages as the product of labor, with landlord and master merely sharers—political economy would be very different today, not a mess of contradictions and absurdities. Instead, he recognized it only momentarily and abandoned it immediately—restarting his inquiry from the point of view of the business owner providing wages from her capital.

Let us pick up the clue where Adam Smith dropped it. Proceeding step by step, we will see whether these relationships, obvious in simple examples, still hold true in the most complex forms of production.

In the “original state of things,” as we have seen, the entire product of labor belongs to the worker. Next in simplicity are cases where wages are paid in kind. That is to say, workers’ wages come from the things produced by their labor, even though they may be working for another or using the capital of another. Clearly, these wages are drawn from the product of the labor, not from capital. Let’s say I hire workers to pick berries or make shoes. I then pay them from the berries or shoes. There can be no question that the source of their wages is the same labor for which they are being paid.

Take the next step where wages are estimated in kind, but paid in an equivalent value of something else. For instance, the custom on American whaling ships is to pay each crew member a proportion of the catch. At the end of a successful cruise, a ship carries the wages of her crew

in her hold, along with the owner's profits and reimbursement for stores used during the voyage. The oil and bone the crew have caught are their wages. Can anything be clearer than that these have not been drawn from capital? They are the product of their labor.

This fact is not changed or obscured in the least when the crew is paid in cash. This is simply a matter of convenience: the value of each share is estimated at market price, instead of dividing the actual oil and bone. Money is just the equivalent of their real wages: the oil and bone. In no way is there any advance of capital in such payment. The obligation to pay the whalers does not accrue until the value of the catch, from which wages are to be paid, is brought into port. When the owner takes money from her capital to pay the crew, she adds the oil and bone to her capital.

So far, there can be no dispute. Let us now take another step: the usual method of employing labor by paying wages. A company hires workers to stay on an island gathering eggs, which are sent to San Francisco every few days to be sold. At the end of the season, the workers are paid a set wage in cash. Now, the owners could pay them a portion of the eggs, as is done in other hatcheries. They probably would, if there were uncertainty about the outcome. But since they know so many eggs will be gathered by so much labor, it is more convenient to pay fixed wages. This cash merely represents the eggs—for the sale of eggs produces the cash to pay the wages. These wages are the product of the labor for which they are paid—just as the eggs would be to workers who gathered them for themselves without the intervention of an employer.

In these cases, we see that wages in money are the

same as wages in kind. Is this not true of all cases in which wages are paid for productive labor? Isn't the fund created by labor really the fund from which wages are paid?

Now, the argument may be made that those working for themselves get nothing if some disaster spoils the work; but those working for an employer get their wages anyhow. This is not a real distinction, however. Generally, any disaster that prevents an employer from benefiting from labor also prevents the employer from paying wages. On the whole, labor done for fixed wages produces more than the amount of the wages. Otherwise, employers could not make any profit.

Production is the source of wages. Wages come from the fruits of labor—not the advance of capital. Labor *always* precedes wages. This is true whether wages are received from an employer, or wages are taken directly from the efforts of the workers. Wages paid by an employer imply the previous rendering of labor by the employee for the benefit of the employer. This is true whether paid by the day, week, or month, or even by the piece.

Though it is obvious the way I have explained it, many important deductions are based on the opposite position. How can it be considered plausible that wages are drawn from capital? It begins with the assertion that labor cannot operate unless capital supplies it with maintenance. The unwary reader agrees that labor must have food and clothing in order to work. Having been told that such items are capital, the reader then accepts the conclusion that capital is required before labor can be applied. From this misdirection, it appears to be an obvious deduction that industry is limited by capital. That is to say, that the demand for labor depends on the supply of capital. Hence,

it appears to follow that wages are set by the ratio between the number of laborers looking for employment and the amount of capital available to hire them.

A fallacy exists in this reasoning that has entangled some of the brightest minds in a web of their own spinning. But I think our discussion in the previous chapter will enable us to spot the error. It is the use of the term capital in two different senses.

The primary proposition is that capital is required for labor. Here "capital" is understood as including all food, clothing, shelter, and so on. Whereas in the deductions drawn from it, capital is used in its common and legitimate meaning. That is: wealth devoted to procuring more wealth. This does not include wealth used for the immediate gratification of desire. It means wealth in the hands of employers as distinguished from laborers.

So to say that workers cannot work without food and clothing does not mean that only those who first receive breakfast and clothes from an employer may work. The fact is that laborers generally furnish their own breakfasts and their own clothes. Further, capitalists are never compelled to make advances to labor before work begins (though in exceptional cases they may choose to do so). Of all the unemployed labor in the world today, there is probably not a single one who could not be hired without paying wages in advance. Many would gladly wait until the end of the month to be paid, many more until the end of the week, as most workers usually do. The precise time is immaterial. The essential point is that wages are paid after the performance of labor.

Wages always imply the previous rendering of labor. And what does "rendering of labor" imply? The production

of wealth. If this wealth is to be used in exchange or in production, then it is capital. Therefore, the payment of capital in wages presupposes some production of capital—by the very labor for which those wages are paid.

Since the employer generally makes a profit in this transaction, paying wages is merely returning part of the capital received from labor. The employee gets part of the capital labor has produced.

How can it be said that wages are advanced by capital or drawn from preexisting capital? The value paid in wages is an exchange for value created by labor. And the employer always gets the capital created by labor before paying out capital in wages. At what point, then, is capital lessened, even temporarily?

Note that I refer to labor as producing capital for simplicity's sake. Labor always produces either wealth (which may or may not be capital) or services. Only in an exceptional case of misadventure is nothing produced. Now, sometimes labor is performed simply for the satisfaction of the employer. For example, getting one's shoes shined. Such wages are not paid from capital, but from wealth devoted to consumption. Even if such funds were once considered capital, they no longer are. By the very act, they pass from the category of capital to that of wealth used for gratification. It is the same as when a tobacconist takes cigars from the stock for sale and pockets them for personal use.

Let's test our reasoning against the facts. Consider a manufacturer who produces finished products from raw materials, say cloth from cotton. The company pays its workers weekly, as is the custom. Before work begins on Monday morning, we take an inventory of their capital. It

consists of buildings, machinery, raw materials, money on hand, and finished products in stock. After work has ended for the week and wages paid, we take a new inventory. For the sake of simplicity, we will assume that nothing was bought or sold during that week.

Let us look at their capital now. There will be less money, since some was paid out in wages. There will be less raw material, less coal, and so on. A deduction for wear and tear must be made from the value of the buildings and machinery. But if the business is profitable, as most are, the items of finished products will more than compensate for these costs. There will be a net increase of capital.

Obviously, then, wages were not drawn from capital. They came from the value created by labor itself. There was no more an advance of capital than if someone hired workers to dig clams and paid them with the clams they dug. Their wages were truly the product of their labor. The same as, in Adam Smith's words, "before the appropriation of land and the accumulation of stock."

This situation is similar to that of bank depositors: After they have put money in, they can take money out. By withdrawing what they have previously put in, the bank depositors do not lessen the capital of the bank. Likewise, by receiving wages, the worker does not lessen, even temporarily, the capital of the employer. Nor does the worker lessen the total capital of the community.

It is true workers generally are not paid in the same kind of wealth they have created. Likewise, banks do not give depositors the same bills or coins they deposited—instead, they receive it in an equivalent form. We rightly say the bank gives depositors the money they paid in. So

we are justified in saying workers receive in wages the wealth they created with their labor.

This universal truth is often obscured because we confuse wealth with money, due to our habit of estimating capital in terms of money. Money is a general medium of exchange, the common flow through which wealth is transformed from one form to another.

Difficulties in exchanging wealth generally show up on the side of reducing wealth to money. Money may easily be exchanged for any other form of wealth. Yet sometimes it is more difficult to exchange a particular form of wealth for money. The reason is simple: there are more who want to make *some* exchange of wealth than there are those who want to make a particular exchange.

Employers who pay wages in money sometimes find it difficult to turn their products back into money quickly. They are spoken of as “having exhausted” or “advanced” their capital in wages. Yet the money paid out in wages has, in fact, been exchanged for an increase in the value of their products. (Only in exceptional cases is the value created by the labor less than wages paid.)

The capital they had before in money, they now have in goods. It has been changed in form—but not lessened.

Now, in some cases production may require months or years, during which no return is received. Meanwhile, wages must be paid. Such cases—where wages are paid before the desired results are completed—are always given as examples of wages advanced from capital. Well, let us see.

In agriculture, for instance, harvesting must be preceded by several months of plowing and sowing. Similarly, in the construction of buildings, ships, railroads, and so on, owners cannot expect an immediate return. They must wait,

sometimes for many years. In these cases, it is easy to jump to the conclusion that wages are advanced by capital—if fundamental principles are forgotten. But if I have made myself clear, the reader will not be fooled. A simple analysis will show that such instances are no exception to the rule. The fundamental principle is clear whether the product is finished before or after wages are paid.

Let's say I go to a broker to exchange silver for gold. As I give them my silver, they hand me the equivalent in gold (minus commission). Does the broker advance any capital? Certainly not! What they had before in gold, they now have in silver (plus profit!). Since they received the silver before paying out the gold, they did not—even for an instant—advance any capital.

The operation of the broker is exactly analogous to the cases we are considering. Labor is rendered and value is created before wages are paid. Creating value does not depend on finishing the product—it takes place at every stage of the process. It is the immediate result of the application of labor. No matter how long the process, labor always adds capital before it takes it in wages. The owner merely exchanges one form of capital for another.

Consider a blacksmith hired to make simple pickaxes. Clearly, the smith adds picks to the employer's capital before taking money from that capital in wages. But what about a boilermaker working on a great ship? One may be completed in a few minutes, the other not for years. Yet both are items of wealth, articles of production. Each day's work produces wealth and adds capital. In the steamship as in the pick, it is not the last blow (any more than the first) that creates the value of the finished product. Value is created continuously—it is the immediate result of the

exertion of labor.

We see this quite clearly when different parts of the process are carried out by different producers. Here we customarily estimate the value of labor in various preparatory stages. A moment's reflection will show this to be the case in the vast majority of products. Take a building, a book, or a loaf of bread. The finished products were not produced in one operation or by one set of producers. In clearly defined steps, we can easily distinguish the different stages of creation and the value of materials. At each step, we habitually estimate the creation of value and the addition to capital.

The bread from the baker's oven has a certain value. But this is composed, in part, of the value of the flour from which the dough was made. This, again, is composed of the value of the wheat and the value given by milling. And so on.

Production is not complete until the finished product is in the hands of the consumer. Not, for example, when a crop of cotton is gathered; nor when it is ginned; nor made into yarn; nor even into cloth. The process is finished only when the consumer receives the finished coat or shirt or dress. Yet at each step, it is clear there is the creation of value—an addition to capital.

It may take years to build a ship—but value is created day by day, hour by hour, from the very start. The value of the finished ship is the sum of these increments. No capital is advanced in paying wages during the building, because labor produces more capital than is paid back. Clearly, if someone asked to buy a partially completed ship, the owner would expect to make a profit at any stage of construction. Likewise, a company's stock does not

lose value as capital in one form (wages paid) is gradually changed into capital in another form (the ship). On the contrary, on average its value probably increases as work progresses.

This is obvious in agriculture also. Value is not created all at once, but step by step during the whole process. A plowed field will bring more than an unplowed one; a sown field more than one merely plowed. The harvest is merely the conclusion. Orchards and vineyards bring prices proportionate to their age, even though too new to bear fruit. Likewise, horses and cattle increase in value as they mature. We do not always discern this increase in value, except at the usual points of exchange. Yet it most definitely takes place every time labor is exerted.

Hence, whenever labor is rendered before wages are paid, the advance of capital is really made by the worker—not the owner. The advance is from the worker to the employer—not from the employer to the employed.

Yet, you may protest, "Surely in the cases we have considered, capital is required!" Certainly. I do not dispute that. But it is not needed to make advances to labor. It is required for quite another purpose, as we shall see.

Suppose I hire workers to cut wood. If I pay in kind, with a portion of the wood, it is clear no capital is required to pay wages. But it is often easier and more profitable to sell one large pile than several smaller ones. So for mutual convenience, I pay wages in cash instead of wood. If I can exchange the wood for money before wages are due, I still do not need any capital.

It is only when I must wait to accumulate a particular quantity of wood that any capital is required. Such quantity might be needed before I can make any exchange; or merely

before I can get the terms I want. Even then, I will not need capital if I can make a partial or tentative exchange by borrowing against the wood.

I will need capital only if I cannot—or choose to not—sell the wood or borrow against it. In other words, I will need capital only if I insist on accumulating a large stock of wood. Clearly, I need this capital only to accumulate a stock of product—not for paying wages.

Consider something more complicated, like cutting a tunnel. If the workmen could be paid in pieces of tunnel, no capital for wages would be required. Indeed, this could be done easily by paying them in stock of the company. It is only when the backers wish to accumulate capital in the form of a completed tunnel that they need capital.

Let's return to our initial example of a metals broker. Surely they cannot carry on their business without capital. But they do not need it to make any advance of capital to me when they take my silver and hand me back gold. They need it because the nature of their business requires keeping a certain amount of capital on hand, so they are prepared to make the type of exchange the customer desires.

We shall find it the same in every type of production. Capital is required only when production is stored up. Producers never need capital to employ labor. When they need capital, it is as merchants or speculators in the products of labor. That is, in order to accumulate such products.

To recapitulate: People who work for themselves get their wages in the things they produce, as they produce them. They exchange this value into other forms whenever they sell these products.

The people who work for another and are paid in money, work under a contract of exchange. They, too, cre-

ate their wages as they render their labor. But they only collect them at stated times, in stated amounts, and in a different form. In performing the labor, they are advancing on this exchange. When they get their wages, the exchange is completed. During the time they are earning wages, the workers are advancing capital to their employer. At no time (unless wages are paid before work is started) is the employer advancing capital to them.

Whether the employer chooses to exchange the output immediately or to keep it for awhile in no way alters the character of the transaction. It matters no more than the final disposition of the product by the ultimate consumer, who may be somewhere on another continent at the end of a long series, perhaps hundreds, of exchanges.