CHAPTER XII

DISTRIBUTION: WAGES, INTEREST AND PROFITS

1. Labor's Share of Wealth.—The second division of the problem of distribution has to do with the remuneration paid to labor, or wages. As has already been observed, there can be no production without labor. Even collection in its simplest forms involves some expenditure of human energy. In fact, on the lowest level of the collection stage income is exclusively wages, since production consists solely of the expenditure of labor. Since labor is necessary and the laborer must live, it follows that there must be some reward for it. To understand just how this compensation is fixed under existing conditions it is necessary again to imagine a simple example.

Bearing in mind the basic principle that the product belongs to the enterpriser, it follows that wages will actually be paid only when the laborer is not the enterpriser. If the laborer and the enterpriser are the same person, wages must be credited, but it is purely a bookkeeping process, and the amount to be credited can be definitely determined only by comparison with cases where the laborer is not the enterpriser. For practical purposes the study of the laws of wages is a study of the factors that determine how much of the product the enterpriser returns to those who have contributed their labor in the process of production.

Let us imagine an enterpriser who has undertaken to produce cotton stockings. He has rented a piece of land and has acquired the necessary capital, perhaps borrowing it, perhaps putting in some of his own. This capital has been materialized in the form of a factory, including a building, machines and power plant, and a supply of raw materials and fuel. All that is necessary now for the plant to start operation is a working force. What does such an enterpriser actually do in real life? He goes out into the market and buys his labor. He may do this by applying to a trade union or to an employment agency, or he may advertise in the papers, or put up signs. The method is not significant. The important thing is that he lets it be known that he is in the market to purchase labor, and those who have labor to sell come to him to make an agreement.

In essence, therefore, the wage agreement is a bargain, just as the renting of land is a bargain, and resembles the latter in being the purchase of the use of a certain factor of production for a limited time. The significant difference which distinguishes the wage bargain from the rent bargain, and in fact from all other economic agreements, is that the labor factor is actually embodied in the person of its owner. Practically speaking, the laborer sells himself for a limited period of time and under stipulated conditions. This is an analysis of the laws of wages to which any practical enterpriser would subscribe. He knows that he buys his labor in the market just as he buys his raw materials, his fuel, his oil and his electric current.

2. Minimum and Maximum Wage.—So much for the practical side of wages. The theoretical questions have to do with the factors and forces which underlie the wage bargain and determine its terms. Every bargain involves two extremes; one, the lowest sum for which the owner is willing to sell; the other, the highest sum which the purchaser is willing to pay. The sum actually paid, or the price, is a compromise between the two. As previously explained, there must always be an excess in value in the mind of the purchaser as compared with the mind of the seller, or no transfer will take place. The first question, accordingly, is: what is the minimum sum for which laborers are willing to sell their labor? Or, what is the minimum point below which wages cannot fall? The answer is the amount which will enable them as a class to maintain life and economic efficiency, and to raise families large enough at least to maintain the labor force. If wages fall below this point, the supply of labor will begin to diminish and the self-interest of employers will lead them to remedy the situation by paying higher wages.

At one period in the history of economic theory it was believed that this minimum extreme of wages tended to be the actual wage level. It was accordingly asserted that wages tended to be fixed at the minimum of subsistence necessary to maintain the laborer and his family in a fair degree of efficiency. On account of its rigidity and harshness this was called the "iron law of wages," and won for economic science a century ago the pessimistic appellation of the "dismal science." Its fallacy lay in looking at only one side of the bargain and ignoring the fact that the value of labor to the enterpriser must also be considered.

Let us turn then to the consideration of the maximum limit of wages, that is, the sum which enterprisers will, if forced to, be willing to pay. The enterpriser desires to buy labor simply to assist him in production. Our stocking manufacturer buys labor in order to produce stockings. He will not pay so much for his labor that it will leave him without profit from his business. His position as an enterpriser compels him to guarantee in advance a fixed return to those factors of production which he does not himself supply. He undertakes to pay stipulated sums in rent and in interest. He must also agree to pay a stipulated sum for wages. Obviously he will not agree to pay so much that it will leave him less than what he regards as a sufficient incentive to undertake business. How much this will be depends primarily on what he estimates the product of his enterprise will amount to.

Eventually rent, interest and wages, as well as his own profits, must all come out of the product. Generally speaking, the maximum amount which the enterpriser will be willing to pay in wages is represented by the amount left from the product after the deduction of rent and interest (which are here regarded as fixed quantities), and an attractive margin of profit. Since labor is one of the important factors determining the amount of the product, the wages which the enterpriser is willing to pay are determined by his estimate of the productivity of labor, just as the amount of rent which Brown was willing to pay Smith was dependent upon his estimate of the productivity of Smith's land.

3. The Wage Bargain.—There is evidently a close interrelation between the liabilities which the enterpriser assumes for the payment of rent, interest and wages. In practical life no one of these can be fully explained except in relation to the others. There is one important difference between them, which traces back to the fact that labor is embodied in the person of the laborer. This difference is that labor must be paid frequently, and, in practical business, in advance of the completion of production, whereas both rent and interest are paid for only after use for a considerable period, ordinarily three months, six months or a year. Therefore, labor must always accept a somewhat lower return in proportion to its productivity than land or capital to compensate the enterpriser for making these advances.

As already stated, the actual wages paid in any case will be the result of a bargain between the purchaser of labor and the one who has labor to sell. How this bargain works out depends on several factors, including everything which gives either party an advantage or disadvantage in bargaining. One of the principal factors is knowledge concerning the maximum and minimum limits within which the bargain must be concluded. The laborer knows a good deal about the minimum limit, but he probably knows almost nothing about the maximum limit. The employer on the other hand is in a position to be informed about both. Another factor is the urgency of the need which either party feels in the conclusion of the bargain. In this case also the employer has the advantage. While it is true that he must have labor to make his plant productive, it is seldom true that his actual livelihood depends upon the immediate employment of any particular laborer. He can often wait a considerable time for the sake of making a favorable wage bargain. The laborer, however, is seldom in a position to go without employment for any length of time. His very existence and that of his family depend upon his securing a position. Other factors, such as intelligence, personality and education, enter into the wage bargain. These various factors and the whole operation of wage adjustment will be considered in greater detail in a later chapter.

4. Interest.—As has already been stated, capital is an essential of practically all production. It is both fair and necessary that a part of the product should be returned to capital (that is, to the owners of capital) in consideration of its contribution. The return to capital is called "interest." The two principal questions involved in the study of interest are why interest must be paid and how the actual rate of interest is established.

To understand why interest must be paid, it is only necessary to recall the origin of capital and the way in which it is created. As we have seen, there is no sharp distinction in form between capital and consumption goods. The difference lies in the use to which the wealth is to be put. This is particularly evident in the case of the earliest forms of capital, those which are the outcome of primary production. In the illustration used it was pointed out that a savage who has captured a wild kid has the option of eating it immediately and thereby satisfying his hunger or keeping it in captivity for breeding purposes or for its milk. Similarly a man who has collected a fine supply of wild grass seed may use it for food at once or he may carefully hoard it until the next spring so that he may plant it in prepared soil and raise a much larger harvest. These and similar instances show that capital is always the result of subduing immediate desire for the sake of a larger gratification in the future. In other words, it requires self-control, self-denial and foresight.

5. Methods of Accumulating Capital.—The process of accumulating capital is called "saving." Since the present is always more real and influential than the future, saving will not take place unless there is a prospect of greater gratification in the future than from immediate consumption. Furthermore, saving will not