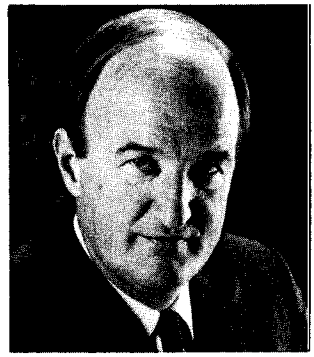


Why Wages Rise

"For low-paying jobs that already exist, public policy must aim at supplementing the income of the working poor. . . . One way would be to raise gradually the minimum wage."

—Wallace C. Peterson, *Silent Depression*[1]

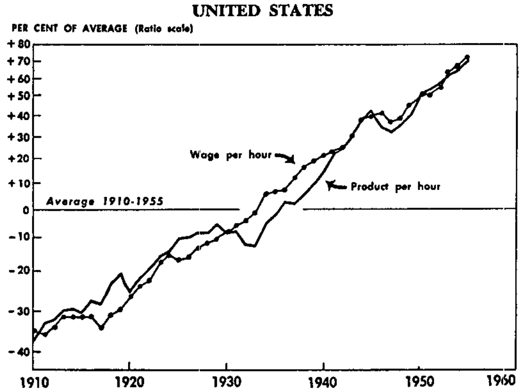
In the recent debate over the minimum wage and the working poor, I was reminded of a little book, *Why Wages Rise*, by F. A. Harper (The Foundation for Economic Education, 1957). In his book, Harper made an important distinction between legitimate ways to raise the average wage and artificial means of raising workers' income.

Genuine Means of Raising Wages

First, let's discuss the genuine ways that wages can rise. Here Harper focused on the critical role of production and worker productivity. "Production comes first," he explains. "Higher wages come from increased output per hour of work." (p. 19) Harper produces a graph (see below) showing a close relationship between wages per hour and output (GDP) per hour, expressed in constant dollars, between 1910 and 1960.

Harper's theory of wages is not new—it is the classical theory of labor taught in college economics. John B. Taylor, economics professor at Stanford, produces graphs that show a similar relationship in his latest textbook (see the next page for a graph showing the rise in hourly compensation since 1955). Even Wallace Peterson, an economist who favors increasing the minimum wage and other forms of government intervention in the labor market, supports the view that, in the long run, "productivity gains are the ultimate source of . . . increases in real living standards."[2]

CHANGES IN PRODUCTIVITY AND WAGE RATES — UNITED STATES



SOURCE: This chart is designed so that a constant percentage increase would appear as a straight line. The values of product and wages are both expressed in dollars of constant buying power. The data for product are for the private sector, and are from the series by John W. Kendrick in his paper, *National Productivity and Its Long-Term Projection* (National Bureau of Economic Research, May 1951), brought up to date by the National Industrial Conference Board. For the data on wage rates, see Chapter 1, p. 11.

Dr. Skousen is an economist at Rollins College, Department of Economics, Winter Park, Florida 32789, and editor of Forecasts & Strategies, *one of the largest investment newsletters in the country. For more information about his newsletter and books, contact Phillips Publishing Inc. at (800) 777-5005.*

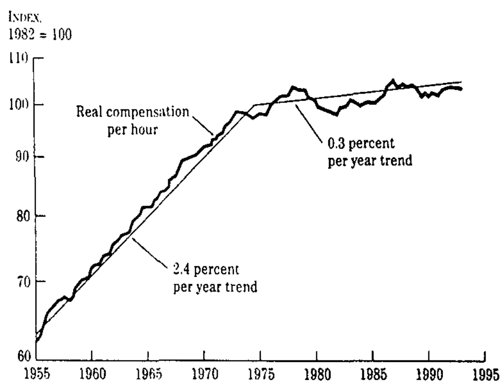


FIGURE 12.2
Growth of Real Hourly Compensation
In the United States, average real hourly compensation (including fringe benefits) grew rapidly from the mid-1950s to the mid-1970s. Starting in the mid-1970s, the growth rate slowed down.
Source: U.S. Department of Commerce.

Two Benefits of Higher Profits

How is it that workers tend to receive higher wages as output increases? The key is profitability. When firms increase their profits, there are dual benefits to workers: (1) more and better products and services are sold to consumers, and (2) more funds are made available from retained earnings to pay workers and to improve tools, equipment, and training. When firms are successful, company officers aren't the only ones who benefit. Workers also receive higher wages and more services, including training, better equipment, and fringe benefits. The advantages of giving higher compensation are: (1) less job turnover, (2) better workers, and (3) higher incentives to work more productively.

The Ford $5-a-Day Story

The Henry Ford $5-a-day story is a classic example. As a result of the huge success of the Model T, in 1913 the Ford Motor Co. doubled its profits from $13.5 million to $27 million. With these profits, Ford decided to share the wealth with his employees and overnight doubled the minimum wage at his Detroit plant from $2.50 to $5 a day. It made Henry Ford an industrial messiah.

The effect of the instant pay raise was dramatic: a tremendous surge in output and skyrocketing morale among Ford workers. Thousands of potential employees moved to Detroit in hopes of getting a job. Ford argued that the higher wage had two great benefits, increased efficiency at the automobile plant, and increased buying power of his workers. Importantly, the $5 wage permitted Ford workers to buy their own cars for the first time. Indeed, sales of Model T's continued to soar as wages went up and prices declined. By 1916, over half a million cars were sold.[3]

Ludwig von Mises adds the following point to Harper's original argument: it is *marginal* productivity, not just total productivity, that has raised average wages over the past hundred years. He points out that many jobs have not changed over the years (barbers, butlers, etc.), yet they benefit from higher wages due to labor competition. "It is not any merit on the part of the butler that causes this rise in his wages, but the fact that the increase in capital invested surpasses the increase in the number of hands." Mises concludes, "there is only one means to raise wage rates permanently . . . namely, to accelerate the increase in capital available as against population."[4]

Do's and Don'ts

Harper, Mises, and other free-market economists warn politicians not to seek artificial ways to increase income, such as:

—minimum-wage legislation,
—welfare programs,
—labor union power, and
—anti-immigration laws.

All of these measures either cause unemployment or economic inefficiency.

On the other hand, there are a few policies the government can undertake to encourage productivity and higher wages, such as tax cuts on business and investment. Reducing corporate income taxes will increase net income and thereby increase the capability to pay workers more and provide greater benefits. Cutting capital gains taxes will encourage private savings, reduce interest rates, and stimulate capital formation.

Minimum-Wage Millionaires

But the most dramatic improvement in the lives of the working poor could be achieved by converting Social Security into a genuine private pension system. Privatizing Social Security would increase the nation's saving rate and, most importantly, provide a high retirement income for all American workers. Even minimum-wage earners could have over $1 million in pension assets under a privately funded Social Security at retirement.[5]

These measures are far superior to raising the minimum wage and other counterfeit proposals to help the working poor. ☐

1. Wallace C. Peterson, *Silent Depression: Twenty-five Years of Wage Squeeze and Middle-Class Decline* (New York: Norton, 1994), p. 232.
2. *Ibid.*, p. 232.
3. For a retelling of the $5-a-day story, see Jonathan Hughes, *The Vital Few* (New York: Oxford, 1986), pp. 301–304.
4. Ludwig von Mises, *The Anti-Capitalistic Mentality* (South Holland, Ill.: Libertarian Press, 1972), pp. 88–89.
5. Sam Beard calculates that Social Security contributions of minimum-wage earners ($1,240 a year) would make them millionaires in 45 years if their Social Security contributions earned 8 percent a year. See his book *Restoring Hope in America* (ICS Press, 1996). Also, see my column "$4,000 A Month From Social Security?", *The Freeman*, June, 1994.

BOOKS

Deregulating Freight Transportation

by Paul Teske, Samuel Best, and Michael Mintrom

The AEI Press • 1995 • 236 pages • $39.95

Reviewed by Burton W. Folsom, Jr.

Deregulating Freight Transportation is a thoughtful and timely book written by Paul Teske, Samuel Best, and Michael Mintrom. The authors describe how the movement to deregulate transportation finally succeeded and how it is saving the U.S. economy billions of dollars each year.

Much of this book is the story of the ICC (Interstate Commerce Commission) and the CAB (Civil Aeronautics Board) and why railroads, trucking, and the airlines were so inefficient during much of this century. The authors describe the origin of state and federal regulation. The ICC was empowered in the early 1900s because some shippers complained loudly about rebates and rate discrimination. Railroads gave rebates to large shippers who did volume business; railroads also gave discounts to shippers who did business along the well-traveled routes. To the railroad owners, this behavior simply followed good cost-benefit analysis. The fixed costs in railroading meant that shippers with small loads and shippers who lived in remote areas were expensive to service—therefore, they should pay more.

What small shippers lacked in economic clout they offset with their political muscle. They lobbied state legislatures and later Congress to get laws passed that fixed rates and regulated the railroad industry. The regulating of the trucking industry followed in the 1920s and 1930s, and the CAB in airlines followed the ICC model in the 1930s.

According to Teske, Best, and Mintrom, federal regulation meant fewer transportation options, higher prices, and industries governed by the politics of lobbying, not the economics of competition. Much of this was exposed in the 1970s. Intrastate rates, which were not always subject to regulation, were often discovered to be remarkably low. Southwest Airlines in Texas and Pacific Southwest in California became models of low costs and excellent service. Senate hearings in 1975 exposed the inefficiency of the regulated airlines. The resulting clamor led the airlines to "experiment" with competition and free markets. Consequently, passenger fares dropped 30 percent from 1976 to 1990.

The presence of frequent fliers and busy travel agents led to demands that trucking and railroads follow suit. The ICC was under fire and could barely justify its existence to critics. During the 1980s and early 1990s, Teske, Best, and Mintrom describe the initial dismantling of the ICC and how shippers have profited. The authors, in fact, recommend the abolition of the ICC and also an improved single base-state system to meet varying state standards for loads and vehicles.

The authors conclude that "reliance on the market as a regulator will be the main American policy toward freight transportation in the next century." At a time when free-market thinkers grieve over failed federal programs in medical care, Social Security, and welfare it's nice to read a success story—and that's what Teske, Best, and Mintrom have given us. □

Dr. Folsom is senior fellow in economic education with the Mackinac Center for Public Policy in Midland, Michigan.

Roads in a Market Economy

by Gabriel Roth

Ashgate Publishing • 1995 • 272 pages • $76.95

Reviewed by John Semmens

No one has labored longer than Gabriel Roth has in the pursuit of a more efficient transportation system. For over 40 years he has been analyzing problems and suggesting solutions. Most of this work has been in the form of shorter policy studies,