A TAX POLICY TO RAISE WAGES

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I

Taxation is commonly thought of as the taking of money away from people. It is thought of as a method of reducing men's incomes - as a way of making them poorer. Can there possibly be a tax policy which would actually raise wages?

Much effort is constantly expended by labor leaders to improve the conditions and the pay of those who toil with their hands or brains. To this end shorter working hours are demanded, vacations with pay are sought, a higher rate of hourly wage is constantly requested and so on. But with all this seeking and striving toward a goal that is of itself commendable, some "basic economic principles" (or laws) may have been lost sight of.

We are all aware that in the physical world results may be tragic when physical laws are ignored. To illustrate, we all know what would happen if a man were to fall from the roof of a high building. Yet on the other hand this law of gravity, if harnessed, can work to man's advantage.

Let's consider a few economic principles which, whether he is aware of it or not, powerfully affect the workingman - and, of course, the workingwoman.

II

Wages are naturally what most people are interested in, so let's begin by talking about them. First, what determines wages? Is it because when Mr. K applies for a job he is able to put his best foot forward and thus impress the employer who is looking for a new man? To many this may appear to be the case. To others the reason may seem to be that the local labor organization has done an efficient job. Still others may think the reason wages at a certain plant or shop are high is because that particular plant or shop is making "good money" and can pay its workers "a good wage." But let's analyze the matter. Certainly we cannot know whether any kind of taxation or tax policy would raise wages, unless we have some understanding of how wages are determined.

We know there are three factors of production. These are land, labor and capital. All are important. One factor alone can accomplish nothing. Production depends upon land and labor and effective production requires the use of capital. So in this discussion, while we are concentrating on the factor <u>labor</u>, it will be necessary to refer to the other two factors. We know that labor without either land or capital can accomplish nothing at all.

Here we shall lump together the worker who toils with his hands and is paid wages and the white-collar worker who toils with his brain and is said to receive a salary. Also, insofar as concerns the income he receives because of the work ("labor") he performs, there will be no attempt here to distinguish "the boss" or the enterpriser who owns the business but <u>also</u> labors with hands and brain, from the worker who merely works. The former in many cases owns land and capital and thus receives not only compensation for his labor but also a return because he owns capital and land. Consequently his income is a combination of wages, interest and land rent, which are the incomes or returns to labor, capital and land. On the other hand, the worker often does not own any capital (the tools and equipment with which he works) nor the land on which the factory is built or on which the crop is produced. The president of General Motors, Harlow H. Curtice, <u>as</u> president, and the lowest paid worker for General Motors, both receive wages although one may call his pay a salary while the other refers to his as wages.

To most of us, it is obvious that in order to receive wages the worker must produce something. The employer cannot be Santa Claus. As we proceed with this analysis we shall consider further this matter of the productivity of the worker. We shall consider what economic policies might be adopted that could increase the worker's productivity, and thus increase his wages. But before we can take up this latter topic it is necessary to present some background.

III

Continuing with our discussion of basic economic principles, we are most of us aware of the law of diminishing returns. In order to discuss this law in connection with the problem of wages we shall use a very simple illustration. Throughout this illustration the reader should keep in mind certain points. First, this explanation must be presented simply, because to bring in all complications would weary and confuse. In order to grasp "principles" one must first set aside details and concentrate on one important principle at a time. The addition of details generally does not change the essentials of the picture at all. In studying geography the student is shown a globe. From this he may gain a general understanding of the world even though he cannot find on it such details as the creek which runs across his father's meadow or the maple tree in front of his father's house. But surely it is an advantage for him to study the globe.

Second, all figures presented in the discussion should be considered as illustrative only. Also, they have been given simply and in such fashion as to avoid unnecessary mathematical complications. They are merely another way of trying to make clear some basic economic principles.

We shall assume, at the start, that two factors of production, land and capital, remain fixed or static. We shall assume that with three men working together 13,000 bushels of (say) wheat can be produced yearly. If a fourth worker is added the output becomes 16,600 bushels. In other words, the fourth man has added, or increased the output by, 3,600 bushels. If a fifth worker is added the total output is 20,000 bushels, or the last worker adds 3,400 bushels. With a sixth worker the output becomes 23,200 bushels, or the sixth worker adds 3,200 bushels. When a seventh worker is added the output is 26,200 or the seventh worker adds 3,000 bushels. With eight workers the output becomes 29,000 or the eighth worker has added 2,800 bushels. Thus we can see the operation of the law of diminishing returns. While each additional worker makes possible a greater total product, the amount added by an extra worker is less when there are many workers employed than when there are fewer. The reason for such "diminishing returns" is that with more workers and no more land and capital for them to use, each worker is less well equipped or provided with these essentials for effective production.

Along with the productivity of labor - what is added by the worker - we must consider the law of demand and supply. To put the matter quite simply, so long as the number of would-be workers exceeds the number of available jobs, there will be a bidding for jobs. This means that unemployed workers will take jobs for a lower wage, thus bidding down wages. On the other hand, when demand for workers at a certain wage, exceeds the supply of workers who are seeking jobs, then establishments must offer more to secure the workers. This tends to bid up the wage which must be paid.

To summarize and restate what has been presented, wages tend to be fixed by demand and supply at the point where the wage paid is equal to the marginal product of labor.

The marginal product in our illustration can be arrived at as follows. We shall assume that there are 675 workers in this community and 100 establishments, each with a given amount of land and capital, which are seeking workers. The wage, as

we have just seen, cannot be fixed at a point which would result in any considerable percent of workers being unemployed, for they would accept work for lower wages (unless some well enforced law forbade hiring workers for less) and so bid down the wages). Neither can the wage be so low that the demand for workers far exceeds the supply of workers. When this occurs the establishments must then offer more to get workers, thus bidding up the wages. If this point of equilibrium (where all workers are employed) is to be reached, many of the 100 establishments must take seven men. Since the seventh man adds 3,000 bushels of wheat (the worker's productivity) this is what will be the worker's wage. To translate it into terms of money, let's assume that the wheat sells for $1.00 per bushel. That would mean that each worker's wage would be $3,000 annually.

But you may still be wondering why the wage in our illustration would be fixed at this point of 3,000 bushels or $3,000 per year. We have found that at this point all workers would be employed. It would be definitely worth-while adding the fourth, the fifth and the sixth worker, and the seventh worker could also be employed, for in each case the worker would add more than or, in any case, as much as it would be necessary to pay him. However, it would not be worth-while to employ the eighth worker for he would only add 2,800 which would be less than the wage he would have to be paid. You may well ask the question: "But what about the seventh man, if he must be paid $3,000 and he only adds $3,000 (or 3,000 bushels)?" Some employers will decide to take the seventh worker (say 75 establishments) while for others (say 25 establishments) it does not seem worth-while to add the seventh. This point of doubt - whether to hire or not to hire - is the margin. And the product added by that worker is the marginal product. (In our illustration this was 3,000 bushels of wheat.) This would mean that those establishments - 75, in our illustration - on which it seemed worth-while hiring seven workers, would pay each worker an annual wage of $3,000. For those establishments on which it did not seem worth-while hiring more than six workers, the wage would still be the same - $3,000 annually. (If it will aid in understanding, the reader may assume that, on 75 of the establishments, the worker adds very slightly more than 3,000 bushels.)

Perhaps you have some objections such as these: Not all workers are equally efficient. Some workers are stronger, or more intelligent, or have been on that particular job much longer (seniority); thus are worth more because they produce more. Why then, should all workers receive the same wage? True, in real life workers are not all alike. Workers who consistently produce more because of one or more of the reasons just noted, generally are aware of this fact and demand a higher wage. Their firms or companies are apt, also, to be aware of their superior efficiency and to realize they must offer higher wages to hold them. Otherwise such workers will go to some other place that will offer them more. This is a different situation than arises when we note that, in our illustration, the fourth man added 3,600 bushels of wheat, 3,400 bushels were added by the fifth man, the sixth man added 3,200 and the seventh added 3,000. If the fourth man, when no better than the others, were to quit, leaving only six men working, the total output would be reduced by only 3,000. That is all he is really worth. Of course in real life we cannot be so precise or know so definitely the exact amount added by each worker. However, all we can do is to use the best judgement we have in such matters. Certainly an employer is unlikely to hire a worker if he feels pretty sure that the amount of product added by that worker is worth less than the wages he must be paid. Wages depend on production, and workers' production is less when the amount of capital and land in proportion to workers is less. How could an employer pay current wages to his workers, if each of them had only a pointed stick to work with and a square foot of earth to work on? It should be obvious that intelligent business executives are guided by such principles as we are here attempting to analyze, even if they have not formulated them in words. But much can be gained in understanding, by reasoning through an illustration, as we are here attempting to do.

In order to make the meaning clearer let's take an example in another field. A beginning student in music spends many hours in practicing scales and studying counterpoint in order to develop dexterity and an understanding of the laws governing music. Another person who plays by ear and has never taken a music lesson may unknowingly be observing some of these laws. Nevertheless, such an individual who undoubtedly has unusual talent might, if given training, go far in the music world, since then intelligent understanding would be combined with native ability.

Now let us return to our point that the fourth, fifth, sixth, etc., worker - assuming these workers to be equal in efficiency - add a progressively decreasing amount to the output, yet each worker will receive the same wage which is determined by the marginal worker (in our illustration the seventh worker). But you may say, "The fourth worker added more than the seventh worker. Why must he receive the same wage? Does not the fourth worker add (or produce) more than the fifth worker." The answer is, "No, as an individual he does not." The crux of the matter is that with additional workers without additional capital and land in like proportion, there are diminishing returns. If enough workers were hired a point could be reached where one more worker would add practically nothing to total output. If the fourth worker feels he is not receiving a just wage, quits his job and goes to another, he may become the seventh worker at this latter establishment. And if he is one of seven on the establishment where he is now working, his quitting would leave six workers and would reduce the total output by only 3,000 bushels. To the employer he is the seventh!

The total product in our example, with seven workers, was $26,200. The wages were $3,000 per worker, making total wages of the seven workers come to $21,000. $5,200 remains, therefore, as income ("interest") for those who have provided the capital used in production and as rent to the owners of land sites and, of course, to cover repairs and depreciation.

Now let's consider what would be the result if, instead of there being 675 workers for 100 establishments, the number (possibly through emigration) is decreased to 568. Using the same line of reasoning in order to determine the point of equilibrium, where the supply of labor and demand for it are in balance, we find the point is determined by the sixth man instead of by the seventh. Since the sixth man added 3,200 bushels or, in terms of money, $3,200, the worker receives a wage of $3,200, instead of $3,000 as in the earlier situation where there were 675 workers.

To further emphasize the point we have just been discussing, let's increase the number of workers from 675 to 740. The point of equilibrium will now be fixed by the eighth worker, thus setting the wage at $2,800 instead of $3,000.

Now let's go back to the original number of workers in our illustration - 675 - and 100 establishments, which resulted in seven men being hired by many establishments and a wage of $3,000 annually. Suppose that a law which cannot be evaded sets the wage which must be paid at $3,400. This would mean that firms could not afford to hire more than five workers each. Only 500 would be employed and 175 would be out of work. If any labor organization should attempt, successfully, to create such a situation, some workers might have a higher wage but many could not earn at all.

IV

A somewhat similar situation arises if a labor group is permitted to limit the number of workers in a given line. Let us suppose, for example, that the number of workers able to learn the printing trade is thus limited. Then those who would go into printing were it not for the limitation which prevented their doing so, must seek employment in other lines. Therefore, there are more bricklayers, workers in factories, workers in coal mines, etc.; and because there are more workers in these

other lines the wages in these lines are forced down.

Wages may be higher in some lines than in others because the number of workers is kept down by the expense and the time required to secure the necessary training. Why is it that a skilled brain surgeon is paid more than a general practitioner or family doctor? We know that not everyone could qualify for entrance to medical school. Nor can all who enter medical school graduate and become practicing physicians. Some find they cannot afford the expense of an education which requires so many years to complete. Others do not have the aptitude, background or native intelligence to start such a course or, if started, to complete it. It is especially difficult to become a thoroughly competent brain surgeon. Thus there is a scarcity of physicians having this skill.

On the other hand, if we contrast the case of the brain surgeon with that of an unskilled laborer, e.g., a ditch digger, we know that no schooling or special training is needed in the latter case, but only the physical strength and willingness to perform the task. This results in a greater supply of ditch diggers than of brain surgeons or even of family doctors. This is the reason why the wage or income from labor is greater in the second and the third case than in the first. If, however, the number possessing the necessary strength - or skill - for ditch digging were scarce in relation to demand, then the wage would be correspondingly high.

Of course, in a free society where each individual has the freedom of choice, any person who is dissatisfied with the pay in one line has a right to seek some job in another line, that pays better, and frequently does so. A farmer's son may decide he wants higher wages than he can get by remaining on his father's farm. So he goes to work in an automobile factory or an airplane factory. A young teacher who has a master's degree becomes dissatisfied with the salary paid him for teaching high school chemistry - or finds that he dislikes teaching - and so takes a job in industry which pays him more. When enough young farmers and young teachers leave these occupations for other lines, the result is fewer workers in agriculture and in teaching. Consequently the wages in these lines tend upward.

All this is not to deny that labor unions have real tasks to perform. A union official can listen to the gripes of the workers and can bring these to the attention of the management. Individual workers may hesitate - even when they may be justified - to do this for fear of being fired. In these and other matters, the background and experience of union leaders may be significantly helpful.

V

Some people think that the introduction of labor-saving devices means that many workers will be thrown out of their jobs. We do not deny that during periods of transition some workers may suffer because of the change. Fewer workers may be needed in a particular line of work and some may need to change to other lines. But certainly workers in general are benefited in the long run if not, indeed, immediately by invention and the introduction of labor-saving devices. Why is this true? Because as we have seen, when workers are better equipped with tools which enable them to produce more, they can be paid higher wages. If a new labor-saving invention reduces the price of a particular product, the consumer has money left over with which to buy other products. He will want to do so, and to satisfy these needs there will be new jobs created which may be filled by the labor no longer needed in the lines where probably fewer laborers are now employed.

In order to illustrate the points brought out in the foregoing paragraph let's put it this way. Let's assume that an inexpensive automobile can be produced for $2,100 (approximately) because of invention and the use of many machines to do a great deal of the work. These machines would mean that fewer workers could produce in a few days many such automobiles. In contrast to this situation, let's imagine the same

situation with the same automobile made largely or mostly by hand. We know that it would take longer to turn out a car and it would have to sell for more. The automobile would have to sell for (say) $4,200, instead of $2,100. This would mean that fewer people could afford automobiles. Now let's assume Mr. T buys an automobile for $4,200. If he could have purchased it for $2,100 and did not then buy a second automobile, he would have $2,100 with which to purchase other things. Most of us have many wants and if we can afford to purchase the things we desire, will do so. Mr. T, if he has $2,100 left over because of being able to buy an automobile at the lower price, will also buy other things. Now let's multiply our Mr. T by (say) several thousand or million individuals and we are in a position to see that there is a potential market for many other commodities, e.g., electric fans, air-conditioners, electric refrigerators and so on.

This is exactly what has happened today. Some of us at least can recall or remember our parents tell about, the days when people did not have the conveniences and luxuries which have today become almost necessities to the common people. One thing which has made this possible is because in the production of almost any commodity which might be mentioned, machines do much of the work formerly done by the worker Taking another example of this, years ago books were made (printed and bound) by hand. They were very costly and only the well-to-do could afford them. Except for a few books with fine leather bindings, today's books are produced almost entirely by machine processes. Thus they have come within the means of the common man.

Today there are fewer workers, in proportion to the total population in the United States, who are engaged in agriculture. Yet these workers, because they have many machines not known one hundred years ago (tractors, combines, milking machines, electrical equipment, etc.), can do work which in the 1850's would have required many more hands and backs. The present-day farmer nets an annual return (recog nizing the difference in price levels of today as compared with the 1850's)which to the farmer of the mid-nineteenth century would have appeared as "fabulous." Why? Because today's farmer, aided by more and better machinery (capital), can produce more. Thus his standard of living is raised. We are not here attempting any discussion of whether the farmer is getting his proportionate share when his income is compared with that of the worker in the city (say, in an automobile factory, etd.).

When we attempt to make a comparison, such as we have been making, of a period of time when some product was made by hand with some period when that product is made more completely by machine, many difficulties arise. It's complicated! Many contributing factors enter into the picture. And to gain a thorough understanding, these should all be considered. But in as simple and brief a presentation as is here attempted, this cannot be done. For instance, in comparing prices of (say) automobiles produced in 1910 with automobiles produced in 1956, it would be necessary to consider price levels, wages and what a dollar can buy. This would take us into a monetary discussion and lead us afield from our subject. It is for this reason that in the above illustration we have assumed prices fairly in line with those of today.

VI

It was noted in earlier paragraphs that wages are determined by the workers's productivity. It was also seen that this productivity of the worker diminishes with each additional worker ("diminishing returns") when the available amount of capital and of land does not increase. Now let's consider what can be done to increas the worker's productivity and, consequently, his wages. When we were considering the effect of invention, machinery, etc., on the worker, it was emphasized that workers who are better equipped with tools can produce more. We might elaborate this statement by adding the words: "newer and more up-to-date tools." Machinery and tools are

of course, classed as capital. In short, more and better capital increases the worker's productivity and is a most important force in increasing wages.[1]

Presumably a farmer can produce more wheat if he has a farm of 200 acres than if he has a farm of 50 acres. So we can see that more good land can also have an influence on what the worker (not alone the farm worker, but it is easier to see the influence there) can produce and on the worker's wages.

VII

Let us consider what can be done in our tax policy that will result for the workers in more and better tools and more good land. The tax system in the United States to which we are accustomed today, goes unnecessarily far in taking away from those who save and invest, the natural reward (in extra productivity of industry) of their saving. It does not do as much to promote saving and investing in capital as the best tax system could do. If our tax system draws too heavily on what capital yields, we may drift into socialism and compulsory saving as necessary in order to provide the capital equipment on which labor must depend.[2]

Neither does our present system accomplish as much as the best system could do to force into use more good land. Our present system does nothing to penalize the speculative holding of good land out of use. In the United States this is a very real problem when we consider that about a third or more of the land in American cities is held out of use. If instead of taxing capital as heavily as we do today, land (bare-land value not including any improvements or other capital) were to bear most of the burden of taxation, the results would be far different than are secured by the system with which we are familiar. A system which taxes land is a means of securing public revenue that does not lessen the incentive to save and invest in capital and does not burden the poor.

Is such a system anywhere in use? Yes, there is such a system which has been in use for years in various cities and rural districts in Australia and is spreading gradually to others. Throughout Queensland and New South Wales and in some of the districts in other Australian states, land has been more heavily taxed locally and capital not taxed, for decades. In those districts and states, the land or site, which no man has made and which owes its value to past geological forces and to community growth and development, is taxed instead of the capital that results from man's work, saving and investment. Buildings, machinery, planted trees, crops, drainage ditches, the fertility put into the land by the owner or user of the land - these are not taxed.

Statistical studies show that in the parts of Australia where this tax system is in force, there is more capital constructed, including more dwellings; and there is much less land held out of use for speculation.

Here are other findings of this study. In areas which adopted the system of taxing land more heavily and capital less heavily, there was a greater increase in the value of plant and machinery in factories, indicating that the workers there were better equipped with tools and machinery. Wages paid to factory workers and other workers in these areas were higher and more people migrated to these areas. It appears, therefore, that the adoption of such a system could go a long way to im-

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1-- For a brief discussion of this subject see CAPITAL, AMERICA vs RUSSIA: AN ANSWER TO COMMUNISM, by Harry Gunnison Brown (St. Louis, Missouri., Public Revenue Education Council) 1956.

2-- Op. cit., Sect. V, pp. 6-8.

prove the condition of even propertyless workers in the United States. Their labor would product more, and therefore they would get higher wages.

Today our newspapers and magazines constantly refer to the threat of communism. Many workers (perhaps some labor leaders) are especially vulnerable to communistic doctrines. Perhaps many such workers and their leaders are well-meaning and have the best interests of the American workingman at heart. What these workers and labor leaders do not understand or recognize is that the most effective way to work for the betterment of the American worker would be to seek the adoption of a system of taxation which would result in a stronger free private enterprise system.

Such a system would be more favorable to capitalist incentive than any other system of taxation whatsoever. It would mean more effective use of our natural resources and our valuable city sites, so often held wastefully out of use. It could - and would - conduce to higher wages for workers. And this no other tax system would do or could possibly do. No system of labor organization and no policy of labor unions can possibly - without creating substantial unemployment - raise wages of workers to a higher level than the productivity of workers. Do our labor leaders - to whom the workers look for guidance - want to do the best possible for the rank and file workers who are their constituents? If so they must cooperate - better still, lead - in securing the adoption of a tax system which will raise wages by increasing workers' productive power. To be able to do this effectively, they must gain an understanding of the cause and effect relations explained herein.

When labor leaders, and workers as well, do gain a clear understanding of these relations, it is hardly likely that they will prefer a continuance of the present heavy taxes on capital and its income to an increase of taxes on land values. The latter is the kind of tax system that can make wages higher. And in working for the adoption of this reform, these workers and labor leaders will not only be improving the lot of the American workingman, but will at the same time be strengthening the system of free private enterprise as contrasted with the socialistic regimentation of the communist-dominated states.

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