CHAPTER-2
'THE THEORIES OF WAGES'

Theories of wages are nothing but a series of systematic attempts to explain what does determine the level of wage. They portray picture on the diagram of the way in which wages as the price of labour power are connected with other prices and other economic quantities. For almost two countries how they have been developed and have had to be built out of a highly simplified picture of the real world, sketching only the broad out lines of the more obvious features, on the basic of general knowledge or else of interference as to the general shape which things have.

Wage theory has gone through three stages of development since the middle ages, as detailed below: -

**The “Just Wage” of the Middle ages** -

The first was the medieval period of church domination, with the doctrine of the “Just Price” which meant inveality a just wage, whether for the trader on the craftsman; it was that price of his wares which would enable him to maintain himself and his family

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1 Dobb, M.H., Theories of Wages ‘Wage’ 100 (1946)
according to their established position in the community. The just price was concocted by churchmen and given a moral flavour to support the status it is a relic of a static society, from which both intellectual and natural progress were absent, and it might seem to be merely historical interest, nevertheless, there are vestigial remnants of the just wage in some of the more advanced societies of modern time. The allowances and privileges enjoyed by certain royalty and privileged class of families in the society are instances explaining their existence even today.2

I. The classical theories of wage

(a) Adam smith's Theory - In fact, the 'Just Price' of the middle age was a wage concept and it was not until the classical economists that there was anything which could properly be termed a theory of wages. It was with the publication of Adam Smith’s “wealth of Nations” in 17763 that the period of classical economics providing a sense of theories began and came through the 19th century. Smith formulated the labour theory of value of quote him “The full value of any commodity...to the

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2 Phels, O.W.: Introduction to Labour Economic 90 (1950)
3 Smith: Wealth of Nations, P. 30, 66-80, 100-109
person who possesses it, and who means not to use or consume it himself but to exchange it for other commodities, is equal to the quantity of labour which it enables him to purchase or command. Labour, therefore is the real measure of the exchangeable value of all commodities.... labour was the first price, the original purchase money that was paid for all things”. He stated that the real price of everything is “the toil and trouble of acquiring it. What is bought with money or with goods is purchased by labour, as much as what we acquire by the toil of our own body that money of these goods indeed save up his toil". It was his theory of value which formed the central point in the most explosive social doctrine of Karl Marx.

Smith enquires into the question what is not determined the outcome of the bargain over the division of the product “between two parties (masters & workmen) whose interests are by no means the same. The workmen desire to get as much, the masters to give as little as possible. The former are disposed to combine in order to raise the latter in order to lower the wages of labour...
The masters being fewer in number can combine much more easily. In all such disputes the master can hold out much larger..." This would suggest that masters who enjoy better position keep wages own to the minimum possible level. Adam Smith next considers this minimum level and suggest that "in order to bring up a family the labour of the husband and wife together must, even in the lowest species of common labour, be able to earn something more than what is precisely necessary for their own maintenance."

Smith lists five principal circumstances arising from the nature of the employments themselves which bring about differences in the pecuniary gain in same employments and counter balance a great one in others. These are "(i) the wages of labour vary with the ease or hardship the cleanliness or dirtiness, the honourableness or dishourableness of the employment (ii) the wages of labour vary with the easiness and cheapness or the difficulty and expense of learning the business; (iii) the wages of labour in different occupation vary with the constancy or inconstancy of employment (iv) the wages of labour vary according to the small or great trust which

\[\text{Ibid.}\]
must be repose in the workmen and (v) the wages of labour indifferent employments vary according to the probability or improbability of success in them”.

Smith did not explain why these circumstances would move employers to raise the wages of the workman, or improve the latter’s bargaining position. In practice conditions never are such as those assumed by Smith himself, pointed out, all man may not be ‘perfectly free to choose’ their occupations.

(b) **The Subsistence theory of Wages**

This theory is originated from the physiocratic school of the French economists and was commonly accepted during the 19th century. The German economists Lassalle, called it the iron law of wages or the Brozen law of the wages. Kart Marx made it the basis of his theory of exploitation. Ricardo’s name is also associated with this theory although he did not agree entirely with it.

Really speaking there is bargain between the capitalist and the workers over the division of product. Interest of these two parties are by no means the same.

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The men desire to get as much and the master to give as little as possible. Both try to combine together to improve the bargain each in his favour. In disputes with their workmen masters must generally have advantage. This would suggest that wages usually tend to be kept down to the minimum possible level. Subsistence theory of wages is linked to the nation of population\(^6\).

According to this theory wages tend to settle at the level just sufficient to maintain the workers and his family at the minimum subsistence level if wages rise above the subsistence level, the workers are encouraged to marry and to have large families. The large supply of labour brings wages down to the subsistence level if wages fell below this level marriages and births are discouraged and under nourishment increases the death rate. Ultimately labour supply is decreased, and the wages again rise to the subsistence level\(^7\).

This theories has been criticized on various grounds namely:

1. In backward countries, wages no doubt are to be

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\(^7\) Supra at Note- 5
found at or near the subsistence level. But the theory does not apply to advanced countries like England & America. The theory evidently is based on the Malthusian theory of population. But it is wrong to say that every increase in wages rate must inevitably be followed by an increase in birth rate. An increase in wages may be followed by a higher standard of living which in turn influences the wage level.

Ricardo, one of the exponents of the theory, stressed the influence of custom and habit in determining what was "necessary" for the workers. But habits and custom were change overtime. Hence, the theory can hold good for only a limited period of time and cannot be true of all times. Especially of a world characterized by fast changing habits, Ricardo, therefore, admitted that wages might rise above the subsistence level "for an indefinite period in an improving society".

2. Secondly the subsistence level is more or less uniform for all working classes with certain exceptions. The theory thus does not explain differences of wages in different employments.
3. Thirdly it may be said that the theory wages only with reference to supply, the demand side is entirely ignored. Moreover the fundamental weakness of the subsistence theory lies in its long-term character. It explain the adjustment of wages over the lifetime of a generation and does not explain wage fluctuations from year to year. As such it has little practical value.

(c) The Standard of Living theory of Wages

Late in the 19th century, a modified form of the subsistence theory was propounded by some writers, which may be called as the standard of living theory of wages according to this theory, the wages are determined not by subsistence level but by the standard of living to which a class of labourers becomes habituated. There is some truth in this modified theory, because the workers generally do not accept wages below their standard of living and high standard of living also increases their efficiency and hence, wages, in many countries workers through their organization, with hold their supply so that wages may not fall below their standard of living, however, the effect of the

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standard of living on wages is only indirect because workers can not get higher wages simply by raising their standard of living, until they also raise their marginal productivity. The theory also does not take the demand side into consideration.

(d) The wage Fund Theory

This theory is associated with the name of J.S. Mill. "Wages" wrote Mill, "depend upon the demand and supply of labour, or as it is often expressed, on the proportion between population and capital. By population is here meant the number only of the laboring classes or rather of those who work for hire, and by capital, only circulating capital and not even the whole of that but the part which is expended on the direct purchase of labour; Mill asserted "wages not depend upon the relative amount of capital and population but cannot under the rule of competition be affected by anything else".

This is what the called wage-fund Mill took it to imply that if a legal minimum wages were to raise wages in one industry the result must be either to cause

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unemployment or lower wages elsewhere, this view that wages were limited by capital was called by Marshall the Vulgar form of the wage fund theory\textsuperscript{11}.

According to this theory, therefore, wages depended upon two quantities, viz, (i) the wage fund or the circulating capital set aside for the purchase of labour and (ii) the number of labourers seeking employment. Hence, the level of wages can be ascertained by means of a simple arithmetical operation, by dividing the wages fund by the number of workers. In other words, wages vary directly as the quantity of capital and inversely as the number of workers\textsuperscript{12}.

Wages, thus, cannot rise unless either the wage fund increases or the number of workers decreases but since the theory takes the wage funds fixed, wages could rise only by a reduction in the number of workers. It would appear, therefore, that according to this theory efforts of trade union to raise wages would prove full. If they succeeded in raising wages in one trade, it can only be at the expense of another, since the wage fund

is fixed and the trade unions have no control over population, accordingly to this theory, therefore, trade unions cannot raise wages for the labour class as a whole. The exponents of this theory explain that wages cannot be generally higher than the normal rate without utilizing same of the funds that are necessary to purchase raw materials and other items of expenditure such a condition tends to drive capital out of an industry and thus, automatically reduces amount available for wages available for wages\(^\text{13}\).

This theory was criticized on many grounds by Thornton, Jevons and others, and J.S. Mill himself revised it in his second editions. It has been pointed out that it does not place sufficient emphasis on the tendency of entrepreneurs to balance labour costs against other costs. Secondly – It is wrong to think that wage fund is fixed. It is in fact elastic and varies according to business prospects and labour productivity. Thirdly – It is not correct to say that labour supply is fixed. When wages are high, workers appear who would otherwise remain idle. Fourthly- It does not tell us about sources of wage fund and method

\(^{13}\)Ibid,
of its estimation. Lastly, it assumes a degree of antagonism between labour and capital as it points out that wages can increase only at the cost of profits. But it is not necessarily so as during period of boom, both wages and profits can go up\textsuperscript{14}.

(e) Residual Claimant Theory

Another theory of wages has been advanced by the American Economist Walker, which is known as Residual Claimant theory of wages. According to this theory, the labourers are paid what if left after making payments to other factors of production in the form of rent interests and profits. Rents, interest and profits, according to Walker, are determined by definite law but as there is no specific law by which wages are determined, the workers get their what remains after payment of rent interest and profits, therefore, if an account of greater efficiency the national dividend it is increased, the wages may also increase\textsuperscript{15}.

This theory has certain obvious defects. It does not explain how trade unions are able to raise wages. Besides, wages are generally fixed even before

\textsuperscript{14} Ibid,
\textsuperscript{15} Supra at Note 9
production takes place and the residual claimant is not the worker but the entrepreneur then, if rent, interest and profits can be explained by definite laws, as walker says there is no reasons why wages also cannot be similarly explained. Further the theory is criticized on the ground that it ignores influence of supply of labour on wages.

II. New classical Theories of Wages

The modern period wage theories began with the formation of the Austrian School of Economics and its development of the neoclassical doctrine of marginalize.

(a) The marginal productivity theory of wages

It was a direct out growth of this intellectual movement and dominated sound economist though from the theory represents on approach to the problem of wages from demand side. It hold that labour market is in equilibrium when price at which labour is hired is equal, at the margin to its demand price, wages are thus determined in accordance with marginal productivity of labour which varies directly with the tools it has to work with. Marginal productivity is defined as the additional product, resulting from using
an additional unit of labour together with a constant amount of other factors of production. It is held that employers go on employing more and more units of labour as long as the net product of labour is greater than the rate of wages payable. It assume that a point will came when the value of increase on the product due to employment of a given unit of labour is marginal one and its rates of wages will settle wage rate payable to other. To put it in other way marginal productivity provides the basis for a adjustment of wages from time to time. The marginal worker is marginal in the sence that his employment at existing prices and wages completes supply of labour for a given employer as he cannot go beyond this limit of engaging labour in his economic interest. The general level of wages in the long period is as such determined by capital labour ratio. If capital investment is high, relative to the number employed, the wage will be high, if capital investment is low, there will be limited equipment for workers to use productivity will be low and the wage which comes out of product can only be small.
This theory has also been criticised on many grounds. It fails to take account of the influences acting upon the supply side. A wage is not merely a price paid for a factor, it is also the income of a labourer and as such reacts upon his efficiency wages must not only be equal to the marginal product of the labourer, they must also be adequate to enough to support his standard of living. If the wages do not cover the standard of the living of the workers, then either the standard of living will be lowered, and his efficiency will be reduced or the birth rate will decline\textsuperscript{16}.

The supply of labour in such cases will be less and wages would tend to rise. Besides the theory assumes the conditions of perfect competition. In actual life, however, we find that workers also combine together and through trade unions, control the supply and get their wages raised. The theory also assumes that it is possible to very the employment of a single unit, while other factors remain unchanged. But that is also not the case in actual life, because addition to other factors may be necessary if the employment of labour is to be increased by a single unit besides the theory also

assumes that the units of labour are of the same efficiency. If labour is not hemogenous, strictly speaking, it has no marginal product\textsuperscript{17}.

Thus, various objections have been raised to this theory of marginal productivity, but many of them seem to be hypothetical only, and the main criticism of the theory is that it does not take the supply side and the standard of living of the workers into account in the determination of wages, and it assumes conditions of perfect competition which do not always prevail\textsuperscript{18}.

(b) Cost of Production Theory

Ricardo is often quoted as an exponent of subsistence theory in its rigid form. He says that natural price of labour depends upon the price of the food, necessaries convenience, required for the support of labourer and his family. With a rise in the price of the food and necessaries, the natural price of labour will rise, with the fall in their price the natural price of labour will fall this is because the power of labourer to support himself, and the family which may be necessary to keep up the number of labourers, does not depend

\textsuperscript{17} Supra at Note 16
\textsuperscript{18} Ibid 416
upon the quantity of money which he receive for wages but quantity of food necessaries, and conveniences which become essential to him from habit which that money will purchage thus we have a cost of production theory of labour\textsuperscript{19}.

This theory has been criticized by saying that so for as habits are concerned different habits of living are to be found in the same climatic conditions in the same country. However, natural price of labour vary from place to place, Ricardo observes that the natural price of labour estimated even in the food and necessaries is not absolutely fixed and constant. It varies at different times in the same country and very materially differs in different countries it essentially depends on the habits, and customs of the people. Ricardo emphasizes that the market price of labour is determined by the proportion of the supply to the demand\textsuperscript{20}.

(c) Kalecki's Theory of Wages

The polish economist, Dr. M. Kalecki, carttended just before the second war that it was the sum of the expenditures of the capitalist class (both investment as

\textsuperscript{19} Supra at Note-11
\textsuperscript{20} Ibid,
well as private consumption expenditures) that determined the size of capitalists income (Profits and interest): wages then appeared as a residual the level of real wages depending on what was left out of the total product after capitalist class had its cut. The theory, and in so far as it made wages depend on what was left over after profit and interest had exacted their share, it was nothing but reminiscent of a Adam Smith's deduction theory. His other theory of determination of relation between profit and wages (distribution of net product) explains the share of wages in the total product as varying inversely with the degree of monopoly, which is virtually defined as the ration of value of out put to the wage cost of that out put. It implies that a growth of such institutions as carotels will tend to increase the share of profits and decrease the share of wages in the national product and that the share of wages is likely to be smaller other things being equal in an age of monopoly capitalism than it was when completion was fairly wide spread\(^2\).

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\(^2\) Part I: Kalkecki: Essays in the theory of economic fluctuation
(d) Wage theory of Keynes

There are three essential ideas in the Keynesian wage policy, viz (i) a national wage policy (ii) a stable (rigid) money wage level in the short run, and (iii) a rising money wage level in the long run. According to Keynes a national wage policy might originate in either of two ways: supervision or cooperation, supervision would mean an administered wage policy and the agency to administer it is the central government. A national wage policy may also be evolved through employer-employee cooperation. While the former is feasible only in peacetime the latter is possible but as Dunlop says at the risk of jeopardizing the stability of the wages in the short run. Even with an administered programme, the problem of stable wage level in the short run has been regarded with apprehension. The Keynesian wage analysis is in fact, part of a general programme for preservation of continues full employment.

(e) Supply and demand theory of wages

The modern theory of wages applies to labour the fundamental principle of determination of value of good and maintains that wages depends on the relation
between demand for and supply of labour, subject to certain reservation necessitated by the peculiarities of labour the demand for labour like other factor of production is a derived one. The demand price of labour as in case marginal productivity theory, is determined by its marginal productivity which depend not only its one productivity but also on productivity relative to that of land and capital. In fact, it is not the demand for labour that matters but the elasticity of demand for labour which depend on the elasticity of demand for its product, the more elastic is the demand for the product, the more elastic is the demand for the labour which makes the products the elasticity of demand for labour in the percentage increase in the number of workers employed as the wage rate falls by 1% this elasticity demand, among other factor on the degree of substitution between labour and other factor services.

The supply of labour means the number of workers that would offer themselves for employment at each possible wage rate. The relationship between wage and the quantity of labour is a direct one and hence the supply curve of labour slopes upwards from left to right.
This labour supply however, depends on a number of factors like the rather of population growth, the age and sex of distribution of population, the working hours, the normal period of education and training, labour laws regarding employment of women and child labour, the attitude of society towards employment of women and child labour, the attitude of labour in general towards work and leisure, and labour mobility.

The supply of labour at any given time is more or less, given and depends both on its quantity and quality. It is the standard of living that effects labour supply, thus, there are two limits within which wages in practice obtain, Viz, upper limit as determined by marginal productivity of labour to employer and lower limit as determined by the standard of living of a worker. This two forces of supply and demands act and react upon each other to come to equilibrium. Interaction of the force determines wages. In the long run, level of wages tend of that point at which marginal productivity is equal to supply price of the worker at as determined by his standard of life wage at any

movement on the other hand, are determined by marginal productivity of labour to employer\textsuperscript{23}.

The wages rather in an industry will be determined at a point where the demand for labour equals its supply. While a wage rate above equilibrium rate will induce more workers to offer themselves for employment and the firm would be induced to cut down employment a fall in the wage level below equilibrium would lead to exodus of workers from the industry and the firm in a bid to stop this would offer higher wages and the equilibrium level of wages would restored. The equilibrium point for the firm is where marginal revenue productivity curve cuts the horizontal supply curve of labour\textsuperscript{24}.

The theories regarding wages may have some value in certain specified condition. They are in adequate as a general theory applicable in a circumstances. These the criterion determining wage structure may vary from circumstances to circumstances. All the theories indicated above represent half truth. As a matter of fact, the wages are determined after various

\textsuperscript{23} Ibid,
\textsuperscript{24} Ibid,
consideration, viz; efficiency of labour, qualification training, technological knowledge, availability of labour in the market, competition among the employers and workers, collective bargaining and the policy of state, price level of necessaries, etc. In the present day times with the advent of social welfare state, the last factor is more important so far as the minimum wages are concerned. The capitalist are in a better position than the workers. If capitalists are organized they are exploiting the labour as far as possible, by lowering down the wage level. In such circumstances, the state intervention is always need in order to provide social security to the bread winners who are in worst possible condition in under developed countries. It may not be out of place to say that minimum wages Act was passed for the improvement of the economic conditions of the working people in industries in our country.

**III. Role Of The Theories In Determination Of Wages**

We have pointed out the above theories of wages in brief, in order to emphasise that there is no complete and concrete theory of wages and hence the determination of wages policy in any country is not an
easy task. With the coming of socialistic ideas and the concept of welfare state, the determination of wages is now looked upon from an entirely different angle than thought of earlier writers. The workers are no longer regarded as a mere factor of production, the price of which has to be determined by the forces of demand and supply. The contract of employment is now changing into a contract of partnership. The productivity of labour, the bargaining capacity of the workers, the Government legislations and intervention, the role of economic development, national income, cost of living, the capacity of industry to pay, the requirements of social justice, the employer's consumption and investment and his degree of monopoly, etc, now influence the policy in most of the countries and in a developing economy of a country like India, the determination of a sound and correct wage policy has been a serious problem. The tribunals and wage boards have generally followed the principles laid down in the fair wages committee's report in fixing wages in India, and 'norms' have been evolved in fixing minimum wages25.

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On the basis of the foregoing description of various theories of wages, it is clear that there is no complete universally acceptable and correct theory of wages and hence, the determination of wage policy in any country is not an easy ask. Before state regulation of wages, there was neither bargaining nor collective bargaining and the wage rates were determined by the employers and the workers had to work on those wages if they linked. The wage problem has been tackled in different countries on different basis, depending upon varying economic, social and political circumstances^{26}.

Keeping in view the theories briefly discussed above, it may be pointed out that wages are share of labour out of the total production in lieu of contribution of labour to the process of production. All the theories indicated above represent half truth. As a matter of fact, the wages are determined after various consideration, viz, efficiency of labour, qualification, training, technological knowledge, availability of labour in the market competition among the employees and workers, collective bargaining and policy of state, price level of necessaries, etc. In the present day times with
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27 Ibid,