

LESSON 8 :

INTRODUCTION TO THE THEORY OF WAGES

Learning Objectives

- To further understand the concept of wages
- To understand different Theory of wages
- To know the relation between Labour and Wages

Wages

Wages in the widest sense mean any economic compensation paid by the employer under some contrast to his workers for the services rendered by them. Wages, therefore, include family allowance, relief pay, financial support and other benefits.

But, in the narrower Sense wages are the price paid for the services of labor in the process of production and include only the performance wages or wages proper. They are composed of two parts - the basic wage and other allowances.

The basic wage is the remuneration, by way of basic salary and allowances, which is paid or payable to an employee in terms of his contract of employment for the work done by him.

Allowances, on the other hand, are paid in addition to the basic wage to maintain the value of basic wages over a period of time.

Such allowances include holiday pay, overtime pay, bonus and social security benefits. These are usually not included in the definition of wages.

However, in India, different Acts include different items under wages, though all the Acts include basic wage and dearness allow come under the term wages. For example, under the Workmen's Compensation Act, 1923, Section 2 (m), "wages for leave period, holiday pay, overtime pay, bonus, attendance bonus, and good conduct bonus" form part of wages.

Under the payment of wages act, 1936 section 2 (VI) "any award of settlement and production bonus, if paid, constitutes wages."

But under the Payment of Wages Act, 1948, "retrenchment compensation, payment in lieu of notice and gratuity payable on discharge constitute wages."

The following type of remuneration, if paid, do not amount to wages under any of the Acts:

- (i) Bonus or other payments under a profit-sharing scheme which do not form a part of the contract of employment.
- (ii) Value of any house accommodation, supply of light, water, medical attendance, traveling allowance; or -payment in lieu thereof or any other concession.
- (iii) Any sum paid to defray special expenses entailed by the nature of the employment of a workman.
- (iv) Any contribution to pension, provident fund, or a scheme of social security and social insurance benefits.

- (v) Any other amenity or service excluded from the computation of wages by a general or special order of an appropriate governmental authority.

A wage level is an average of the rates paid for the jobs of an organization, an establishment, a labour market, an industry, a region or a nation. A wage structure is a hierarchy of jobs to which wage rates have been attached.

Labor and Wages

The type of job one does and the financial compensation he or she receives are very important in our society. Job type is linked to status as is wealth. While the type of job one performs is arguably more important status wise than wealth, both are important to Americans.

In the past we used to use other descriptions to classify workers. The terms blue collar or white collar employees were used to describe the type of vocation.

Blue Collar - Manual laborers

White Collar - Officer workers

Pink Collar - Jobs associated with women like nursing, secretarial, etc. This being a rather sexist term, is no longer used.

Today we classify our work roles into three categories called labor grades. The se labor grades are described below:

Skilled Labor

These are workers who have received specialized training to do their jobs. They have developed and honed a special skill and may or may not need to be licensed or certified by the state. Some examples of skilled labor are: carpenters, plumbers, electricians, business executives and managers, artisans, accountants, engineers, police, mechanics, etc. These may be blue or white collar workers.

Unskilled Labor

These are workers who have received no special training and have few specific skills. As our society has grown into an increasingly technological one, the members of this group have developed more and more skills. A mechanic, for example, used to be considered unskilled labor.

Today that is no longer the case. Mechanics require a great deal of skill and training to work with today's modern engines. Examples of unskilled laborers are construction workers, sanitation and custodial workers, painters, factory assembly line workers, etc. These are blue collar workers.

Professionals

Arguably the elite of the labor grades, these are those workers who need an advanced degree to do their jobs. The three primary groups of professional are doctors, lawyers and teachers. These are white collar workers.

These labor grades are often said to be non competing labor grades because workers rarely move from one grade to another and do not compete salary wise with each other. There are reasons why they do not compete with each other.

The cost of education and training may be a significant obstacle. They might lack the opportunity to make such a move and they might also have a lack of initiative.

Theory of wages

There are two key theories that explain why salaries are the way they are in a particular field. These two theories are:

1. Traditional Theory of Wage Determination

In this theory the law of supply and demand dictates salary. These days programmers are in short supply and are in great demand thus they will command a higher salary.

Likewise doctors and lawyers whose specialized skills people need command a high wage. If you looked at the bill my electrician gave me you would know he is in demand!

2. Theory of Negotiated Wages

Those employees who work in unions where the union negotiates salary on behalf of all workers fit into this theory. Since I am a teacher my salary is set by collective bargaining with my union. I may be the best teacher in the world sought after by many students and parents but it wouldn't matter.

However, different methods of wage payment are prevalent in different industries and in various countries. There may be payment by time or payment by results, including payment at piece rates.

Wages are fixed mainly as a result of individual bargaining, collective bargaining or by public or State regulation. How wages are determined has been the subject of several theories of wages. The main elements in these theories may be summed up as follows:

Below is mentioned the theory of Wages:

- (1) Subsistence theory
- (2) Wages fund theory
- (3) The surplus value theory of wages
- (4) Residual claimant theory
- (5) Marginal productivity theory
- (6) The bargaining theory of wages
- (7) Behavioural theories

Now let us discuss the theory of Wages in detail:

(1) Subsistence theory

This theory, also known as 'Iron Law of Wages,' was propounded by David Ricardo (1772-1823). This theory (1817) states that: "The laborers are paid to enable them to subsist and perpetuate the race without increase or diminution."

The theory was based on the assumption that if the workers were paid more than subsistence wage, their numbers would increase as they would procreate more; and this would bring down the rate of wages.

If the wages fall below the subsistence level, the number of workers would decrease - as many would die of hunger, malnutrition, disease, cold, etc. and many would not marry, when that happened the wage rates would go up.

In economics, the subsistence theory of wages states that wages in the long run will tend to the minimum value needed to keep workers alive. The justification for the theory is that when wages are higher, more workers will be produced, and when wages are lower, some workers will die, in each case bringing supply back to a subsistence-level equilibrium.

The subsistence theory of wages is generally attributed to David Ricardo, and plays a large role in Marxist economics. Most modern economists dismiss the theory, arguing instead that wages in a market economy are determined by marginal productivity

2. Wages fund Theory

This theory was developed by Adam Smith (1723-1790). His basic assumption was that wages are paid out of a pre-determined fund of wealth which lay surplus with wealthy persons - as a result of savings.

This fund could be utilized for employing laborers for work. If the fund was large, wages would be high; if it was small, wages would be reduced to the subsistence level. The demand for labour and the wages that could be paid them were determined by the size of the fund.

3. The Surplus value theory of Wages

This theory owes its development to Karl Marx (1818-1883). According to this theory, the labour was an article of commerce, which could be purchased on payment of 'subsistence. price.'

The price of any product was determined by the labour time needed for producing it. The labourer was not paid in proportion to the time spent on work, but much less, and the surplus went over, to be utilized for paying other expenses.

Marx himself considered his theory of surplus-value his most important contribution to the progress of economic analysis (Marx, letter to Engels of 24 August 1867).

It is through this theory that the wide scope of his sociological and historical thought enables him simultaneously to place the capitalist mode of production in his historical context, and to find the root of its inner economic contradictions and its laws of motion in the specific relations of production on which it is based.

4. Residual claimant Theory

Francis A. Walker (1840-1897) propounded this theory. According to him, there were four factors of production/ business activity, viz., land, labour, capital and entrepreneurship.

Wages represent the amount of value created in the production, which remains after payment has been made for all these factors of production. In other words, labour is the residual claimant.

5. Marginal productivity Theory

This theory was developed by Phillips Henry Wicksteed (England) and John Bates Clark (USA). According to this theory, wages are based upon an entrepreneur's estimate of the value that will probably be produced by the last or marginal

worker. In other words, it assumes that wages depend upon the demand for, and supply of, labour.

Consequently, workers are paid what they are economically worth. The result is that the employer has a larger share in profit as has not to pay to the non-marginal workers. As long as each additional worker contributes more to the total value than the cost in wages, it pays the employer to continue hiring; where this becomes uneconomic, the employer may resort to superior technology.

6. The bargaining theory of wages

John Davidson propounded this theory. Under this theory, wages are determined by the relative bargaining power of workers or trade unions and of employers. When a trade union is involved, basic wages, fringe benefits, job differentials and individual differences tend to be determined by the relative strength of the organization and the trade union.

7. Behavioural theories

Many behavioral scientists - notably industrial psychologists and sociologists like Marsh and Simon, Robert Dubin, Eliot Jacques have presented their views on wages and salaries, on the basis of research studies and action programmes conducted by them. Briefly such theories are:

The Employee's Acceptance of a Wage Level

This type of thinking takes into consideration the factors, which may induce an employee to stay on with a company. The size and prestige of the company, the power of the union, the wages and benefits that the employee receives in proportion to the contribution made by him - all have their impact.

The Internal Wage Structure

Social norms, traditions, customs prevalent in the organization and psychological pressures on the management, the prestige attached to certain jobs in terms of social status, the need to maintain internal consistency in wages at the higher levels, the ratio of the maximum and minimum wage differentials, and the norms of span of control, and demand for specialized labour all affect the internal wage structure of an organization.

Wage and Salaries and Motivators

Money often is looked upon as means of fulfilling the most basic needs of man. Food, clothing, shelter, transportation, insurance, pension plans, education and other physical maintenance and security factors are made available through the purchasing power provided by monetary income - wages and salaries.

Merit increases, bonuses based on performance, and other forms of monetary recognition for achievement are genuine motivators. However, basic pay, cost of living increases, and other wage increases unrelated to an individual's own productivity typically may fall into maintenance category.

Assignments

1. Explain the importance of the theory of wages.
2. State the difference between blue collar, white collar and pink-collar employees.
3. What are the different types of theory of wages? Explain in detail.

Case Study

Breaking The Bargaining Pattern

Gilson steel is a local fabricating and supply firm. Situated in open country, far from the large steel making centers. The firm has been in business many years.

About the third of employees have worked in the organization for more than ten years. Top management would like to get away from the current practice in which negotiations on wage matters and fringes follow the pattern.

The firm's president feels that industry-wide bargaining tends to divorce employees from the firm. He thinks they feel that their employer is a combination of U.S. steel and Bethlehem steel instead of Gilson. He argues that the local firm which has prospered, can do better by employees than is possible in national pattern. He says that the local conditions should be taken into account. His basic objection to current practice, however, is his conviction that it tends to divorce its employees from local employer. The labour relations manager has been urged to try negotiating terms at variance with the national pattern.

Answer the following questions:

- What theory and policy do you read into the president's suggestion?
- How will his ideas fit into the existing pattern of public union policy?
- Can you suggest a promising innovative approach?