

Study Guide to *Human Action* by Robert P. Murphy

Chapter XXI. Work and Wages

Chapter Summary

1. Introversive Labor and Extroversive Labor

A man may overcome the disutility of labor—which is the same thing as saying he will be willing to forego the pleasures of leisure—for various reasons, including the following:

- (1) He works in order to strengthen his body and mind, for example through weightlifting or study of esoteric subjects.
- (2) He endures the disutility of labor out of duty to God. (This is different from category 4 below only if the rewards from such pious service accrue in the afterlife.)
- (3) He works in order to avoid greater mischief. For example, cutting the lawn may take his mind off of a divorce and keep him from drinking.
- (4) He works because he subjectively values the fruits of the labor more than the leisure he must sacrifice in order to obtain them.

Of the above motivations, 1–3 are examples of *introversive* labor, where the disutility of the labor is a necessary ingredient of the experience. (Climbing a mountain doesn't become more satisfactory if one uses a helicopter; that would defeat the whole purpose.) Only category 4 is *extroversive* labor, which is handled separately by economics. Introversive labor is actually treated as consumption in terms of economic theory, even though there are cases where people who are laboring for its own sake end up producing marketable products, which then of course influence market prices.

2. Joy and Tedium of Labor

Even within the category of extroversive labor—where someone seeks the product of the labor, and views the labor itself as irksome—there can be attendant feelings of joy and tedium. There are several sources of the joy of labor:

- (1) The anticipation of the eventual fruit of the labor. This includes feelings of self-respect for being a self-sufficient member of society.
- (2) The worker enjoys the aesthetic appeal of his creations; he takes pride in what he has made.
- (3) After the task is completed the worker feels joy in having endured the unpleasantness that is now finished.

- (4) Certain occupations appeal to idiosyncratic tastes, such as sadists who enjoy being prison guards.

The joy and tedium of labor are psychological experiences that do not affect the disutility of labor, and hence do not alter the quantities of various types of labor offered on the market. However, even though workers will still sell the same number of hours to employers in either case, they are definitely happier if they view themselves as part of a benign division of labor. In contrast, if socialist or union propaganda convinces them that they are toiling cogs at the mercy of greedy capitalists, then they will be miserable.

3. Wages

When someone directly sells his labor to another, the price paid is called *wages*. Although the seller of labor considers its disutility, the buyer evaluates labor purely on the basis of its productivity and usefulness for his own ends. In this sense, labor is treated as a commodity. There is not one general labor market but rather many markets for labor of different attributes. Even so, all labor markets are interconnected because an increase in demand in one branch will draw substitutable workers from related branches, which in turn will reverberate on yet more remote branches until finally all workers have been affected by the new data.

An entrepreneur evaluates labor services just as any other factor of production. He wants to pay as little as possible, but must compete with other entrepreneurs for scarce labor inputs. He is willing to pay up to the increment in revenue he anticipates from being able to sell more goods to his own customers, because of the additional labor he hires. This is what economists mean by saying wage rates are determined by the *marginal productivity* of labor. If a particular employer paid more than this rate, he would lose money and eventually go out of business. If an employer paid less, then his workers would eventually be bid away by rival firms offering more money (though still less than the marginal product of the worker).

A typical objection against capitalism is that employers have an immense bargaining advantage, because the workers will starve and must accept any wage offered. Yet even if it were true that all existing employers colluded to restrict wages, this would offer large profit opportunities for new entrepreneurs to enter the labor market and bid away workers with slightly higher wages. Only institutional barriers to entry (typically provided by governments) can allow employers to systematically underpay workers.

4. Catallactic Unemployment

Despite propaganda to the contrary, workers can and do remain unemployed when they perceive the advantages of available working opportunities to be lower than the leisure that could be enjoyed. On a pure, unhampered market, there will always be some workers who are seeking employment but are waiting for better options to present themselves. This voluntary condition is market-generated or *catallactic unemployment*. There are three types of motivations for such a decision:

- (1) The individual expects a remunerative job in his preferred occupation to become available soon enough, so that moving or finding another line of work are less desirable options.
- (2) The individual works in a seasonal industry and is currently living off of the savings from the periods of high demand.
- (3) The individual cannot accept available positions because they violate his religious, ethical, or social views as to what jobs are proper and which are "beneath" him.

The final wage rate in an unhampered market is that at which all job seekers are able to find work, and all employers are able to find workers, at the given wage; it is the price that equates quantity supplied and demanded on the labor market. In this sense, anyone can get a job in an open market, so long as he is willing to accept the prevailing wage. To the extent that there is unemployment, it is voluntary; potential workers do not consider the offered wage high enough to compensate for the disutility of the labor.

Changes in wage rates are the mechanism by which consumer sovereignty guides the labor markets. Workers are free to choose whichever occupation they wish, but there must be some way that consumer desires influence their decisions. When consumers shift their demand from one good to another, this eventually lowers the wages offered in the former sector and raises them in the latter. This encouragement of workers to move between sectors is viewed as "coercion" by socialists, but the only alternative is to have authorities decide how many workers should be allocated to various industries.

5. Gross Wage Rates and Net Wage Rates

The employer ultimately cares about the gross payment he makes to his workers, including all benefits (pension contributions, parking spaces, etc.). Consequently if the government mandates that every employer pay a specific portion of Social Security contributions, this burden falls entirely on the worker's take-home pay. Legislated changes in the length of the work week do not make employers willing to pay more than the marginal product when hiring a worker.

6. Wages and Subsistence

The classical economists, misled by their faulty theory of value, explained wage rates as being determined by the bare subsistence requirements of workers. In other words, population would grow until wages just barely allowed workers to buy enough food and other items to replenish their bodies for another day of labor. Among its other flaws, this "iron law of wages" was obviously false, as the standard of living of the average worker continued to grow under capitalism. Later thinkers, including Marxists, adopted the law such that workers' wages were bid down by ruthless employers until they reached a "socially accepted" minimum level, which could be higher than the bare physiological subsistence. Yet such a historical approach takes wage rates as an external given, and avoids the task of economic theory to explain market prices (including wages) in a complete manner.

A Comparison Between the Historical Explanation of Wage Rates and the Regression Theorem

In a sense, the regression theorem explains the present purchasing power of money with regard to historical facts, namely, the exchange ratios of the money good in the past, when it was either a directly usable commodity itself or (in the case of fiat money) was directly redeemable for a commodity. Even so, the subjectivist theory of money prices still relies on the valuations made today by individuals deciding on their cash balances. In contrast, the Marxist and Prussian Historical Schools explain modern wage rates as *directly* caused by historical precedent; the current valuations of consumers and workers do not enter the explanation. If wage rates are higher in France than in China, this is because they have always been so—not because workers are more productive in France.

7. The Supply of Labor as Affected by the Disutility of Labor

Isolated man obviously works until the point at which the benefits of further work are more than offset by the disutility involved. Yet workers in a large market economy follow the same principle. It is true that any individual worker must generally conform to the standards set down by employers, but these standards are themselves the result of the interplay between employers and workers—just as an individual must conform to the train schedule, but the schedule itself is made in order to accommodate the wishes of travelers.

Under capitalism, the accumulation of capital has proceeded more quickly than the increase in population, so that the marginal product of the worker has risen over time. This increase in real wage rates allows the worker to buy more goods and services for a given amount of his labor. His increased wealth may cause him to "spend" more on leisure, meaning that he stops working after fewer hours than his ancestors would have chosen to do. Government and union-mandated "prolabor" reforms are not the cause of the improvement in workers' lots over the 19th and 20th centuries. These changes either codified changes that would have taken place anyway (such as the elimination of child labor) or they hurt the workers by rendering illegal employment contracts that the workers would have preferred to their restricted options.

Remarks About the Popular Interpretation of the "Industrial Revolution"

It is commonplace to romanticize the agrarian lifestyle that existed on the eve of the Industrial Revolution. According to this popular myth, farmers happily farmed the land while women tended to their children. Then the greedy capitalists built their unsanitary factories and packed them not only with starving men but also women and children, and worked them to death. Only the "prolabor" reforms of government and unions ended this horrible exploitation, and yielded the much higher standard of living citizens of Western countries enjoy today.

This fable is completely false. Capitalists had no power to compel workers to enter their factories; the workers did so because they viewed doing so as better than begging on the streets or turning to crime or prostitution. The factory system inaugurated by the new capitalist institutions was vastly more efficient than the medieval guild and manorial system, allowing an explosion of population. Millions of people literally owe their lives to modern capitalism. It is true that working conditions in the 1800s were wretched compared to later times, but improvements were possible only because of capital accumulation, which raised the productivity

of labor. The doctrine of exploitation is most clearly exploded by asking *for whom* the factory workers toiled. Mass production creates products for the masses; the landed aristocracy did not buy the entire output of the factories.

8. Wage Rates as Affected by the Vicissitudes of the Market

A worker is born with innate skills and aptitudes that he cannot alter. To the extent the changes in market data influence the wage rates accruing to some skills versus others, the worker either benefits or loses as simple luck, just as the owner of farmland benefits or loses based on the route of a new railroad line over which he has no control.

A worker also can invest in his skills through education, training, and other techniques. In this respect he is a speculator, hoping that the direct monetary expenditures, in addition to forgone leisure and other opportunities during the period of training, are compensated by the higher wages his labor can command because of his enhanced skills.

Generally speaking, unexpected vicissitudes in the market affect the employer's profit margin, not the employee's wages. Of course, once new data become known, they may influence the estimate of a worker's future marginal product and so affect his wages.

9. The Labor Market

Wage rates are always equal to the price of the "full produce of labor," despite Marxist slogans to the contrary. The workers cannot collectively buy the "entire product" because, quite simply, products are made with inputs other than labor.

Although economic theory analyzes the worker as a seller of labor, in the real world a worker is also a consumer. Consequently he may stay in a certain city for "noneconomic" reasons, even though higher wage rates are available elsewhere. In the absence of institutional barriers to migration, wage rates across the world would tend toward the same pay for the "same" labor, but they would not be completely equalized because of this fact. For example, a doctor might be willing to work in Manhattan with a lower standard of living than he could earn in Akron, because he simply enjoys being a New Yorker.

The Work of Animals and of Slaves

People treat animals as means to satisfy their own ends precisely because animals are not capable of engaging in true social cooperation. Yet things are different with humans, because of the higher productivity of the division of labor. Systems of slavery could only survive when propped up with institutional protections, because free labor is so much more productive than slave labor. If a master treats other men as cattle, he cannot expect more than cattlelike performance. It was not moralizing or altruism that ended slavery and serfdom, but the competition from free labor as capitalism swept the Western world.

Why It Matters

In this chapter, Mises explains the supply of and demand for labor, and the principles determining market wage rates. In this respect the analysis is conventional and not idiosyncratically "Austrian." However, in his historical observations, Mises is very unconventional. He credits the Industrial Revolution with improving the lot of the average worker, and explains that unbridled capitalism—in which labor is bought and sold as a commodity—spelled the doom of slavery.

Technical Notes

- (1) As with his discussion of the creative genius (pp. 138–140), Mises here steps outside a more conventional theory of labor markets in his discussion of the joy and tedium of labor (pp. 585–589). In particular, his discussion of the "joy of class 4" (p. 589) is liable to confusion. It is certainly possible that the number of people working as garbage collectors is lower because of the feelings of disgust that most have for this occupation. It is true that this revulsion drives up wages, and that the higher wages counteract the effect of the dirtiness of the job. Yet there is no reason that the higher wage *completely* offsets the unattractiveness of the job; there are probably fewer people working as garbage collectors than would be the case if (say) people didn't have noses. In the Misesian framework, then, this aspect of the distaste would be classified as part of the disutility of the work rather than its tedium.
- (2) Economists often characterize the equilibrium (or final) market wage rate as that which allows everyone who wants a job (at that wage) to get one (e.g., p. 597). Does this mean that, say, the salary of a professional basketball player is too high, because clearly there are millions of young men who would gladly enter this field and cannot? Obviously not. The answer is that the buyer of the various units of labor (i.e., the employer) must view them as interchangeable, according to his subjective valuations. If someone tried to sell a bushel of rotten apples at the market price, he would find no buyer, because his "apples" weren't really units of the same good to which the price referred. His frustration wouldn't indicate a surplus of apples on the market.
- (3) Mises says that if workers are "indifferent with regard to their dwelling and working places, there prevails...a tendency toward an equalization of wage rates for the same type of work all over the earth" (p. 623). The reader should not misunderstand the claim. Mises is *not* saying that the marginal-productivity theory of wage rates is only approximately true. Suppose autoworkers of the same skill make more in Detroit than in Orlando, because the high crime rate of Detroit deters people from living in the area. Even so, the owner of the factory in Detroit hires workers in accordance with their contribution to his bottom line. If wage rates are higher than they otherwise would be, it is because the smaller supply of available workers has increased their *marginal* product in Detroit factories.

Study Questions

1. Introversive Labor and Extroversive Labor

- What is meant by "introversive" labor and "extroversive" labor?

2. Joy and Tedium of Labor

- Why does catallactics only examine extroversive labor?

Comment: "Modern capitalism is essentially mass production for the needs of the masses."

- Why can't ideology affect the disutility of labor?

Explain: "[N]either the joy nor the tedium of labor can influence the amount of labor offered on the market."

3. Wages

- What do labor and commodities have in common?
- How is the height of wage rates determined? How does this differ from market prices for commodities?
- Why can't the tacit combination among the employers to which Adam Smith referred lower the wage rates below the competitive market rate on an unhampered market?
- Why is it important to stress the fact that the scarcity of labor exceeds the scarcity of most of the primary, nature-given material factors of production?
- Why do wage rates tend toward the marginal product of the kind of labor in question?

4. Catallactic Unemployment

- What is the definition of catallactic unemployment?

Comment: "Unemployment in the unhampered market is always voluntary."

5. Gross Wage Rates and Net Wage Rates

- What is meant by gross wage rates? In what way are they important for the employer?

6. Wages and Subsistence

- Why is the concept of the "iron law of wages" futile for catallactic reasoning?
- What is the reproach of Mises vis-à-vis the analysis of the Prussian Historical School?

- Why are the claims of the labor unions with regard to "take-home wage rates" fallacious?
- What ultimately determines wage rates?

7. The Supply of Labor as Affected by the Disutility of Labor

- Give a short overview of the facts that affect the supply of labor.
- Besides the employer, who can exert social pressure on a worker?
- What is institutional unemployment? What causes it?
- How did capitalism shorten the working hours of workers? How did the proportion between leisure time and working time change?
- Why does a social security tax always burden the employee and not the employer?
- Why were the laissez-faire economists the pioneers of the unprecedented technological achievements of the last two hundred years, according to Mises?

8. Wage Rates as Affected by the Vicissitudes of the Market

- What is the relation between innate talents and wage rates?
- In what ways does the uncertainty of the future affect the employee?

9. The Labor Market

- What is the definition of market wage rates?
- Why would workers tend to move from comparatively overpopulated areas to comparatively underpopulated areas?
- Why did servile labor disappear?
- Why is the worker subject to the supremacy of the consumers?
- Does the hired man owe his employer gratitude?