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WAGES AS A FACTOR OF PRODUCTION

Dr. Jules Backman

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Reviewed by: Tom W. Sills, Colonel, USA

Date: 5 October 1960

INDUSTRIAL COLLEGE OF THE ARMED FORCES

WASHINGTON, D. C.

1960-1961

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13 September 1960

CONTENTS

	Page
INTRODUCTION--Dr. Andrew J. Kress, Member of the Faculty, ICAF	1
SPEAKER--Dr. Jules Backman, Research Professor of Economics, School of Commerce, New York University	2
GENERAL DISCUSSION	28

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Reviewed By: Col Tom W. Sills, USA Date OCT 5 1960

Reporter: Grace R. O'Toole

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Publication No. L61-23

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DR. KRESS: General Mundy, Admiral Patrick, Gentlemen: Yesterday when I was here I expressed something about the factors of production being land, labor, and capital.

Today our speaker, Dr. Jules Backman of the School of Commerce at New York University, will take the role of labor and develop it under the theory of Wages As a Factor of Production.

He has been interested in this field for a long time, particularly in the last 3, 4, or 5 years, and last year brought out the book, Wage Determination, which you will find in the Library, in case you want to refresh your views on that point.

I was speaking to one of his colleagues a few days ago, who knows him well and calls him by his first name, and he said, "Jules won't get enthused about anything these days except wages." So this morning that is what we want him to do.

In February in the Economic Stabilization Unit you will use this book of his (indicating) War and Defense Economics. We have had that a good many years. When I was talking to him a few days ago I said, "We have something like 100 copies of your book." He said, "Do you

want me to buy them back?"

Without further ado, then, Dr. Backman, I am pleased to introduce you to the Class.

DR. BACKMAN: Thank you very much for this very interesting introduction. I can assure you, though, Dr. Kress, that I will be very happy to talk about a lot of other subjects as well as wages. I guess at the University they get confused about some of these matters because we are always talking about wages to the Chairman, meaning our own wages, and hoping to do something about them.

What can you talk about for three quarters of an hour in the field of wages? I might summarize many years of experience in collective bargaining. The answer is that all you can do is give it a lick and a polish. So what I am going to try to do this morning is to cover the areas listed in your curriculum and then trust to your inquisitive minds to probe the other areas during the question period and during the seminar period which follows.

I shall not talk about wage theory, because wage theory has nothing to do with the determination of wages. This is an exercise in which academicians engage, particularly if they have never been exposed to the wage-making process. But all of these fine theories, going back to the iron law of wages and right up to the latest productivity theory, have exactly nothing to do with how wages are determined.

Let's take a look at wages in our economy, and also at some of

the factors that do play a role in wage determination. What do we mean by wages? Everybody knows that wages mean what you pay a worker, an executive, or an Army officer. But is that what we really mean by wages if we are doing the paying? Actually, from the point of view of the employer, labor costs rather than wages are the important thing. Wages merely represent something that is called $500 a month or $1,000 a month, or $80 a week, or $1.20 an hour. But on top of that there are things known as—or what used to be known as—fringes. I don't like that term, because, when something gets so big it is no longer a fringe. I like the term "nonwage benefits," "pensions," "welfare funds," "supplementary unemployment benefits," "vacations," "holidays," "coffee breaks." Did you ever stop to think that a 10-minute coffee break a day is over 80 hours a year, out of a 2,000-hour year? Then there are unimportant things in terms of cost, but they may be important to the individual--like jury duty, leave to attend funerals.

All of these things, in the aggregate, have become so important that today they equal more than 20 percent of the payroll. So, if we say someone is paid $2 an hour and his contract says his wage is $2 an hour, we don't mean that the labor costs are $2 an hour. They may be $2.50 an hour, or some other figure.

So, when we talk about wages, this is sort of shorthand for a package, with a growing proportion of nonwage benefits. And it is the entire package

that we must talk about when we hire somebody or when we pay somebody.

Actually, we may look at wages (and I am using the shorthand) from two points of view. We may look at it from the point of view of the employer, namely, what it costs him. We may look at it from the point of view of the recipient, namely, what he has to spend. So wages represent cost on one side; they represent purchasing power on the other; and both are important.

When you look at collective bargaining you very rarely find management talking about purchasing-power aspects, and you very rarely find labor unions talking about the cost aspect. Each one is like the blind man and the elephant, seeing or feeling that which is exposed to him and which is most important to him.

But, from the point of view of the economy we must consider both the purchasing-power aspects and the cost aspects; purchasing power because this affects what we buy. What we buy affects in so many cases what we produce. We consider the cost aspect because this affects incentive. This encloses profits. This induces us to stay in business or to go into business.

From the cost point of view we may look at wages directly and indirectly. For example, in an industry like steel the direct cost of wages is about 40 cents out of every dollar. In an industry like petroleum it is only 10 cents or 11 cents. And I was in a pottery factory not long ago where one of the executives said, "There walks 70 cents of my

sales dollar," meaning that in this machine operation as much as 70 cents of the dollar went to wages. In a railroad, where as you know there is a tremendous financial problem, wage costs run 55 cents out of every dollar the railroad gets.

Let's use that as an illustration of indirect wages. Railroads not only pay 50 to 55 cents out of every dollar of revenue for wages but must also buy steel--40 cents in wages out of every dollar--coal--60 to 65 cents out of every dollar for wages, and a host of other products which also involve wage costs.

In fact, for the economy as a whole we generally point out that labor income runs about 70 percent of national income; but, if we add in professional services and farm income, which as you know are predominantly labor types of income, we get up to as high as 85 percent.

So labor as a cost is very important. In fact, when I turn to the concept of wage inflation shortly, we shall see how important it is. Let's look at it the other way. Last year we had an American income of $400 billion, of which $277 billion represented labor compensation—in other words, roughly 70 cents out of every dollar. It used to be 60 or 62; now it's up to 70. Roughly 70 cents out of every dollar went for labor compensation. Of course, you should also know that, included in this overall total called labor compensation are corporate executive salaries, about 3 or 4 percent of the total.

So this is predominantly what we call wages plus nonwage benefits.

When we examine something like retail sales and find that retail sales have a very close correlation with consumer disposal of income after taxes, which is what we get minus the withholding tax and social security taxes, then we see how important wages would be as purchasing power.

From the point of view of the individual, the wages he gets determines his standard of living. Obviously, if I make $100 a week I am going to live better than if I make $80 a week, and not quite so well as if I make $200 or $300 a week. So wages are important, not only as cost but as purchasing power.

One other aspect of wages and we will be past this definitional aspect, and that is the difference between money wages and real wages. Money wages are what we get in our pay envelope. Real wages are what we can buy with it. I don't have to tell you that when the cost of living doubles, unless you get a corresponding increase in your income, you can buy fewer goods and services.

This is one of the problems we must be concerned with, because, if we increase wages more rapidly than we increase goods, we as a nation can only pay more; we can't get more; because what we consume are cups of coffee and eyeglasses and suits and vacations and medical services, and the various other types of goods and services which we buy with our incomes. And if the physical volume of those goods and services is set--and I don't mean that it can't be expanded, because of course it can--merely giving people more money doesn't mean that we

can get more of these things. If that's all there was to it there would be no poor countries in the world, and there would be no low standards of living in the world. They would just have to print some more money over in India, in China, and in South America. We would not have to worry about sending $3 or $4 billion a year over. W'd just let them print their own money. Why, you know in Greece they were so rich after the war they could afford to pay a trillion drachma for a package of cigarettes. But whether they were rich or poor this meant that the currency was worth nothing.

So it is the real goods and services that determine our living standards. If we increase our money income to what we call inflation at a much more rapid rate than we increase goods and services, all we do is pay more. So the distinction between money wages and real wages becomes important.

I was talking a little shop to Dr. Kress on the way over and we got into the question of pensions. Well, this is a subject with which some of you have some concern or will have. It makes quite a difference if you use the pensions you will get in 1939 dollars instead of 1960 dollars or 1970 dollars, or maybe even 1980 dollars--as I look around. It makes quite a difference.

Some of my colleagues who thought they were going to have themselves a rather modest competence when they retired found out when they retired

that what was accumulated in the way of pensions was not worth very much. So real wages versus money wages and real pensions versus money pensions become quite a factor.

Now let me tell you about the relation between wages and prices. Here is an area where the amount of public confusion is about as high as it is any place. As usually is the case, there is a little element of truth in much of what is said as well as a considerable element of exaggeration. Let me turn first to this phrase, "wage inflation," which in effect covers one phase of the relationship between wages, or labor costs, and prices. What is wage inflation? You know, 3-1/2 years ago if you used that term you were considered to be anti-labor. Nobody, but nobody, used it. I used it. That didn't bother me. I remember being before a Congressional committee with Leon Keyserling. If we used a term like wage inflation there were anguished cries that this was anti-labor. It was something that just tore your heart strings. Yet today even respectable people use the phrase. Let me say this to you gentlemen: You can't argue with arithmetic. If you increase your wages by 100 percent and what is being turned out is being increased by 40 or 50 percent, no matter how you look at it, unit costs go up. That's arithmetic. You must have a name for it. Another term? Wage inflation, or maybe we should call it labor-cost inflation, to cover the entire package. That's the one that has developed. It is a term that

is used by one and all today to describe what it describes.

The only trouble is, the term is so new that most of the boys don't know what it really means in terms of its effects. So it is not unusual to see the statement that wage inflation automatically means price inflation. That's nonsense. It doesn't mean that at all. It may mean it. The fact is that when wages go up one of two things or a combination of them can happen. A company may get it back by raising prices. A company may not get it back and take a smaller profit margin. Or a company may try to offset the increase in labor cost by cutting other costs. Since most of our costs are labor, cutting other costs means unemployment.

It may take the form of labor-saving machinery, which means you hire fewer people. Someone else may hire some over time, but you hire fewer individuals to offset the higher labor cost per person.

Each of these three consequences will flow for wage inflation. And here is where the depth of misunderstanding is greatest. It may or may not be price inflation, as I said, that determines what the effects will be. Certainly, in a short run, the state of the economy determines it. For example, if you look at our economy from 1955 to 1957, you will find that wage inflation was accompanied by price rises and by a shading of profit margins. But if you look at it in 1958 you will find that wage inflation was accompanied by no price rises, except in certain service areas, by a sharp cut in profit margins, and by unemployment. In other words,

which of the consequences will develop depends upon something other than the wage inflation. It depends upon the economic environment in which these developments take place. If conditions are conducive for passing on price increases or cost increases in the form of price increases, they are passed on.

Of course, when you read about the price increase in the newspaper it usually is accompanied by an explanation: "We increased prices because wages went up." Let's look at that just for a minute. You mean, on July 1, when the steel industry increased wages, this is the time they increased prices, because wages went up? Could they have increased prices the day before, the week before, or a month before? You can be darn sure they could have or they couldn't have increased them July 1.

What the wage becomes is the publicly accepted rationale for the price increase. And you increased the price because you could get it. You may say, "But I needed it." Your explanation doesn't stand up. Sure you needed it. I am not challenging that at the moment. I am merely pointing out that you didn't raise your prices because of wages. You raised your prices because you could get a higher price.

I could give you several illustrations. Let me give you one of my favorites. It goes back a few years. In the summer of 1948 the coal industry raised the price of coal by 50 cents a ton because wages went up. That was the time when the railroads began Dieselizing. The railroads

used to use 110 million tons of coal a year out of 500 million and now they use something like 8 or 10 million tons or less. By the end of the year that 50-cent price increase had disappeared, and by the following March prices were 25 or 35 cents lower than they were at the time of the wage increase. Why? Because they couldn't get it.

Steel increases wages on December 1 under this contract of last year, and already the newspapers are beginning to talk about the inability to pass on the wage increase this time, whereas in past periods when a wage increase was coming up, two months before the papers were full of stories by the President of this company and the Vice President of that company to the effect that "We must increase our price to overcome this labor-cost increase." Why is this eloquence silenced today? When you are operating at 50 percent of capacity you don't give much time to price increases regardless of whether you are going to have labor-cost increases. That doesn't mean that they will or won't increase prices when December 1 comes around. But their heart isn't in it today, for obvious reasons.

The railroads increased their rates because of wage increases, and then went right back to the Interstate Commerce Commission and pointed out how they wanted to cut specific rates to meet truck or inland-water-route competition. Why, if all there was to it was an automatic relationship between wages and prices?

Well, I could develop this at great length, but I think you see the point. The fact is that, in the past two decades, unit labor costs have

more than doubled in this country; productivity output per man hour, which John Kennedy could talk to you about, has gone up, depending upon the industry, 40 or 50 percent for the economy as a whole—the average increase is in the neighborhood of 2.5 or 3 percent. John will talk to you, I am sure, about the overall productivity, including capital input, as well as output per man hour.

We know that average wages in manufacturing rose from 64 cents an hour before the war to the current rate of about $2.30. And the quickest sort of calculation will show you that that is almost a quadrupling, an increase of somewhere in the neighborhood of 250 percent to 280 percent. If one goes up 280 and the other goes up 50 or 60, or even 100, it is obvious that the cost per unit must have gone up very significantly.

There is one place where there is a more direct relationship between wages and prices, and that is in services. When you go in to get a haircut you have to pay for it. A haircut involves labor cost; nothing but labor cost. The barber used to live pretty much on tips. We felt we had to tip him liberally because that was his living. Now we are caught in a spiral. The higher wage he gets and the better he can live the more we must tip him because the larger the bill is. So instead of the tip representing something that was his living it now becomes a very nice fringe benefit which gets larger the less he needs it in terms of what the fundamental situation is.

I talked to one group not long ago, a mixed group--labor and management. To make my point I said, "You all know what labor cost involves. You get a dent in your car and you bring it in. The bill is $284. You look at the details and you find that $4 were for materials and $280 for labor." One fellow got up and said, "Dr. Backman, that's the most unfair statement I ever heard. Labor doesn't cost that much." I apologized and I said, "You're right. On my bill it was only $277. I just rounded it out." Another fellow got up and said, "Your reference to the high cost of labor in the building trades is very unfair." I said, "Yes, it's very unfair. When I call a plumber it costs me $11 an hour. Why does it cost me $11 an hour? Because he has to bring somebody to carry his kit to the door. He gets $7 an hour and the other guy gets $4 an hour." I said, "If one of these days you see Backman walking and behind me is a little fellow carrying a brief case, you will know I am acting like a plumber." Eleven dollars an hour; that's what it costs. I have to be sure there are plenty of leaks before I call him. I have to make sure he's got an hour's work.

The fact is--and this is obviously a little exaggerated--although the story about the plumber isn't; that's what it cost, without any exaggeration--that for most services labor is the essence of it. And so we find in our consumer price index that the service component has moved up steadily, surely, almost unavoidably, in the past decade. The cost of goods hasn't moved up so much--a few percent. It is largely the cost of services that

have pushed up this index.

When you go to a hospital you find that the cost is now four times what it was before, and that's a big increase in medical care, incidentally. What's a hospital? It's pretty much a big labor factory. Oh, I know, there is the higher cost for modern equipment and all that, but most of it goes to pay these substandard wages, believe it or not. That's a paradox. It's all, in fact, for labor, and they still can't pay a decent wage.

So, when you get to the consumer price index, this relationship between labor-cost increase and price is much more direct because the service cost determines the state of the index.

Well, we had a phrase used in our economy, "creeping inflation." The late Sumner Schlicter used to feel that this was an inevitable situation. Some of you may have seen a debate in print I had with him a year or so ago in the New York Times magazine section. He took the case for and I took the case against creeping inflation. I think that those who say that we must live with this type of situation are being defeatists. To say that we must throw up our hands and advocate that because unions are so strong they are going to get more than output per man hour is to look at this thing a little backwards. I think the job of the economist is to say, "If you do this, here are the evil consequences, and we must find a way to avoid them. We must find a way to minimize them. We must

find a way to stop it." I don't think you can abdicate your role/by saying merely a group is too hard.

So this area of creeping inflation is closely and intimately related to this thing we call wage inflation.

There is another way in which wages are related to prices. That is through escalator clauses. As you may know, roughly three million workers are covered by contract where increases in prices are accompanied automatically by increases in wages. If the cost of living goes up a half a point the index goes up a half a point, and workers in the automobile industry get a penny increase in wages. If it goes up a point they get two cents. This is the automatic escalator clause.

So that when prices go up there is an automatic impact on wages in these areas. Of course this is an incredible provision. This is a provision which is uniquely indigenous to the United States--the way we carry it out. In most countries of the world, when they have an escalator clause they say the index must go up five points before there is an adjustment, or ten points, or 2-1/2 percent, or they say, "You must wait a year before we see if this adjustment really is warranted, instead of every three months or six months." Or they say, "Let's average three-month periods to make sure it isn't just a casual change."

I was in a program about a year or so ago with a fellow from Toronto. He made what I thought was one of the most profound observations about

the consumer price index I have heard in a long time. It dealt exactly with this point. He said, "The reason why we worry so much about rises in the consumer price index is that we give them all these headlines." He said, "The average family doesn't know when the consumer price index goes up one penny for every $10 it spends. In fact your wife and mine juggles her food budget so that if the price of canned peaches goes up we are suddenly served canned pears or fruit cocktail, or if the prices of canned fruits go up we get more fresh fruits, or if they both go up we get more spinach."

The fact is that there are all sorts of alternatives within which we can juggle. And if we didn't publicize so much what is happening in an index we wouldn't have to worry so much. We can't even measure it exactly as we pretend when we get these headlines: "New high reached. It's up .1 point. New high reached--.1 point." You know that after five months we are up a half a point? That's about .4 of 1 percent. That means that after five months for every $10 another 4 cents may have been added to our living cost in an area where there is plenty of room for juggling.

We are the victims of our own publicity. He made a further observation that people didn't worry much about unemployment when they didn't get all the publicity. I remember when I got out of school I got out in a period of unemployment, in 1927. It was terrible. I got a job. I didn't like it and I quit. It took me three days to find another one. Of

course I didn't know it was a period of unemployment. I didn't find out until I became an economist, later. Of course I found out about it in the early thirties. This was another problem. But 1927 was a period of unemployment. You talk today about unemployment. When you bother to pick up the newspaper as you get around the country, as I do, and see the number of columns of help wanted in the paper, there doesn't seem to be any problem. Oh, I know it is never the job you want; it's never the job for which you are qualified. But there are a lot of jobs around. Sure there's trouble in getting a job.

If a fellow who graduated from school in 1959 didn't have all the corporations sitting on his doorstep that was terrible; he had to go out and look a few places himself. But in 1931, or 1932, or 1933, no matter where you looked there was nothing. That was unemployment.

So the average person doesn't know there is unemployment going around and that we have 3-1/2 or 4 million unemployed. We have 67 million people working. While in some communities it is a serious problem in many communities it's a question of moving around. Incidentally, many of these unemployed are the younger people who are in exactly the same position I was in of trying to find where they belong, and moving from job to job. Basically in our 4 million unemployed the problem of unemployment isn't 4 million; it's a million. Even in the best of times we have 2-1/2 or 3 million unemployed. You might be interested in knowing that even in World War II, when any able-bodied man could get

a job--in fact, when most of the companies had the employment office set on a platform with some steps up to it and anybody who could climb the steps got a job--we still had a half-million unemployed, in the middle of a war. There is a residue, even under the most extreme circumstances, of general unemployment, sometimes, of people who do not want to be employed--and you know wnat I mean.

Included in these figures of 4 million that we toss around are the wives on terminal leave, about to have babies, and getting unemployment insurance between the time they quit and the time the babies come or manage to get fired, as the case may be. It sort of helps to pay expenses. We include all of these types of situations in unemployment figures. So we view unemployment not as 4 million but as a million people who are really part of the active unemployed. I don't mean that all the 4 million didn't have jobs. Don't mistake me. We have seasonal problems. We've got people moving to different parts of the country. We've got people who have finished up something and want to take it easy for a few weeks or a few months. And then we have those people who would like to get a job regardless of what is involved because they need it desperately.

I am not trying to minimize unemployment. Don't mistake me. I am trying to give it some perspective. In 1927 I didn't know there was unemployment because I wasn't following the figures. In 1959 and 1960 I know there is unemployment because I am following the figures. And

yet, if we stop to think, everybody we know is employed. A couple of young fellows are trying to get a job and they manage to get their jobs.

To come back to escalator clauses, when the price index goes up you automatically get a wage increase. This is really tying it a little too tightly, I think. I can understand protecting people against the rise in the cost of living, but this business of every time there is a fluctuation of half a point and they try to get protection makes no sense to me.

So-called escalator clauses have their greatest adverse impact, their greatest inflationary impact, during periods of general inflation, monetary or fiscal, because, remember, an escalator clause must be triggered; something must happen before you get the wage increase. That something is a price rise. Now, if the price rise creates the wage increase, and the wage increase then creates pressure for the price increase, under these circumstances we run into the problem of spiraling.

For example, during World War II Canada had a cost-of-living bonus. Every three months they checked the figures and every three months, if the index was up a point, they had to adjust wages. They made an adjustment in July of 1942. There was no adjustment required in October. Then, because the price of beef was going up, it became clear that as of January 1, 1943, there would be a wage increase. But the Chairman of the Wartime Prices of Trade Board discovered very quickly--or was told by his staff—you know the way the top brass find out these things—

that if these wage increases took place there would have to be new price increases, which price increases would trigger new wage increases as of April 1. So it was the first Saturday of December, in the middle of a hockey game--perhaps the best way to reach most of Canada--when the top officials got up and announced that effective Monday they were rolling back--not the price of beef--you can't do much with beef--the prices of coffee, tea, bananas, and milk so that as of January 1 the index would not be up a point, because if it was up a point the wage increase would trigger the next price increase.

Here you have really under a microscope the type of relationship that develops in a tight situation. And here you have the wage-price, price-wage situation moving on.

Let me move on. What about the relationship between wages and profits? First let me note that profits are only one of six factors that determine wages or play a role in wage determination. The cost of living is one; workers' budgets; wage comparisons--that's the most important one; productivity; and the economic environment. These, as well as profits, play a role.

Here are some numbers. From 1950 to 1959 profits before taxes--and that's what you pay your wages out of--very often you'll hear somebody say, "We earned only $10 million last year and if we pay a $10 million wage increase it wipes our profits out"--not at all; Uncle pays half of that because you earned $20 million before taxes if you own $10 million after,

the tax rate being 52 percent, and it really means you now have $10 million of taxable income instead of $20 million; it's true it costs you something but it doesn't cost you $10 million--in 1950 profits before taxes for all corporation were about $41 billion, and it has risen to $48 billion in 1959. Now it's running a little bit lower. Labor compensation during this period rose from $154 billion to $277 billion. What created the pressure on prices from 1950 to 1959? Profit increases, or wage increases, or labor-cost increases, to the extent that either of these played a role. One was up from $7 billion, and the other was up to $122 billion. Profits before taxes ran about 16 percent of national income in 1950. In 1959 it ran 12 percent of national income.

Was it a widening profit margin that caused price increases or was it a widening wage increase margin, which went up, incidentally, from something about 62 percent to about 70 percent? I'm just using round numbers. If prices had not gone up, would the national income have been as high, and would these percentages have been as low as indicated?

Let me illustrate one of the types of propaganda you get in this area. The steel union has a habit of saying that every time the steel industry has a wage increase of $1 they get back $3 in prices. Well, this is a good way to make profits. I have had some involvement in steel negotiations. This happened when the wage-determination book came out, and the press conference, and all that sort of stuff which

the publishers arranged. All of the labor/press fellows, like, Abe Rosson of the Times and the others, were there. Since this was during the steel negotiations, they thought they might get a little inkling as to what was going on by asking the right questions. The press boys are pretty cagey. So one of them said, "What about this business of the companies making this profit--$3 in prices for every $1 in wages?" So, to be funny--and I didn't label it "gag," you see--I said, "Well, I think these companies are a little crazy. If I were running the companies I'd increase wages even more than the union wanted, because look at the tremendous profit I'd be getting--$3 for $1." The American and Metal Market the next day had a front-page feature story: "Jules Backman, sometimes adviser of the steel industry says labor demand isn't enough; the industry could make a bigger profit if they gave a bigger wage increase."

You've just got to be so careful with these. Often when I go to Pittsburgh a press conference is set up, and usually it is off the record. A few years ago when the portal-to-portal discussions were quite important, I was at one of these off-the-record press conferences, and I wanted to emphasize how extreme some of these demands were getting. I said, "The time will come if you keep on in this direction when you'll be paid from the minute you leave the house until the minute you get hime." I couldn't get it across and I thought I ought to make it more dramatic than that. So I said, "The next thing we have to have is demands by the company--coffee to coffee time, toilet to toilet pay." In the Pittsburgh Press

the next day appeared: "Backman advocates toilet to toilet pay." Well, I caught this in the first edition and we had the story killed, or it would have been sent on the wires. Can you imagine going through life being known as Jules T. T. T. Backman? What does T. T. T. mean? Toilet to Toilet Backman. Oh, brother, you've got to be pretty careful. Well, we'll have to clean up the record.

I examined the steel wage stuff--and you can check these figures--and here's what I found. This was done a couple years ago. These are the figures for 1945 to 1955. If prices had risen only enough to cover the wage increase in 1945 to 1955 they would have risen by 37 percent--the actual rise was 120 percent. If they had risen only 37 percent the steel industry, which was making a half-billion dollars before any of this happened, in 1945, would have had a loss of over $2 billion dollars in 1955, despite the enormous increase in volume.

Suppose they had just broken even in 1955, in other words, had just gotten enough money back to break even--no profit no loss--they would still have required an 86 percent increase in prices. Remember the 37 percent would cover the wages. If they maintained the same profit margin they had just after the war, which was not a tremendous one--about 6 percent--a rise of about 113 percent would have been required. This is not far from the 120 percent rise.

In other words, what I am saying is that no industry has only labor

cost. Industries have many costs. When you get a wage spiral you can be sure that not only will the cost of steel labor go up but the steel mills also own coal mines and coal labor goes up. They own iron ore mines, and iron ore goes up. You can be sure when they go up railroad rates will go up, because they are big users of transportation. And all of these costs come in. Do they come into the steel company on July 1? Of course not. They have been coming in months before from last year's increase and they'll keep coming in months after. And so, when you make that adjustment on July 1, what are you doing? You are reflecting the increases for which you got no price increase in preceding months. You are recognizing then when you give it to the steel workers, the coal miners, the iron ore workers, and the captive railroad workers, and so on, are all going to get it. You don't change steel prices or automobile prices or electrical equipment prices every day. These prices are changed once a year, twice a year, or three times a year, usually as a result of the accumulation of pressures.

The thing to keep in mind on profits is that profits essentially are a permissive factor. If the profit environment is right, then the impact of productivity--which also influences profits and price rises, and wage comparisons--induces less resistance than if you are not operating on a profitable basis. In other words, this is part of an environment which says, "If the things are right you share with us, and if they are not, you don't, or you don't share to the same extent."

I have just one or two other observations. I was asked to make some observations on the relationship between wage pressures and technological changes. There is no question about the fact that higher labor costs induce the pressures toward substitution, or elimination of labor, in some cases.

The substitution of new machines also in turn increases the productivity of those who continue to work. So the higher labor cost causes you to lay off marginal workers and get machines for them, and the use of machines makes possible the earnings to cover the higher labor cost.

What happens to the guy who lost his job? Technological change adds to output per man hour, and hence increases the ability to pay the higher wage which forced the technological change. Technology has many aspects--automation, of course, is the big word today. It's a very important aspect of technology. What is automation? It's merely just a more modern name for what has been going on for a long time. Electric utility plants have been automated for a long time, not completely in the sense that there is no manpower, but in the sense of machines doing most of the job. Also synthetic rubber plants. You can run right through American industry and find different degrees of what is now called automation.

This technology may affect where the jobs are. The flight of jobs from the garment industry of New York is an illustration, as is the attraction to many industries of the South, partly because of large labor

supply and partly because of the wage situation. These illustrate the point.

One last series of observations on the role of organized labor: As you know, there is considerable debate as to how much the increase in wages is due to the pressures of labor. Let's keep one or two things in mind. In the past, in periods of war, in periods of prosperity, wages tended to go up. In World War I we had the so-called silk shade era, even though there were no powerful unions. When you need workers you go out and bid for them. One of the major companies in this country took a 100-day strike in 1950, one of them, in May of 1950. They had a contract under which there would be nothing to be done until July of 1951. Which was the first company to voluntarily raise wages in August of 1950? The same company which had won the strike. In August of 1950 they had the prospect of large-scale war orders as the result of the Korean War. You have to begin making sure you have your skilled workers, so premiums began to be paid for skilled workers. There was no labor union holding a gun at their heads. They had a selfish interest.

And it is a fact that a good part of this involves management wanting to do something. During World War II we had something known as Form 10. What was Form 10? In plain language, it was a conspiracy between labor unions and management to raise wages. You couldn't do it across the board, so you wanted to raise the wage of the office boy

and you called him an assistant chief office boy, when you had two of them. That gave him a title, a different title than office boy, and he could get a raise. The chief office boy had a problem. He was called the office boy, so you called him a junior clerk. Same job.

I was in one arbitration proceeding where the arbitrator couldn't understand how retail wages had gone up as much as they had when the general wage increase was only 20 cents. There was a recess over in the corner. Both parties explained to him the mysteries of Form 10, and how much the increases had been.

It wasn't labor that initiated pensions in World War II; it was management trying to find a way around the steel formula. When you want to get the labor you go out and bid for it.

But there is one area where labor has had a tremendous impact, that is, organized labor. That is on fringe benefits or non-wage benefits. I don't think there is any question about the fact that, if it had not been for the pressure of organized labor, we would not have the degree of liberalization, and we might not even have had some of the things like pensions, welfare plans, S. U. B., and the others.

In the area of non-wage benefits there is no doubt in my mind that a tremendous role has been played by the unions. The role there I think is definite; it's clear; it's unequivocal. The extent to which they have caused a rise in wages is very cloudy, and, as I said, the debate rages as to whether it is anything at all, despite the common sense that it

appears to be something, or whether it is a significant factor.

Gentlemen, I think I'll break off at this point and we'll have our question period.

QUESTION: I would like to know, Doctor, if you advocate wage control legislation.

DR. BACKMAN: Absolutely not. I don't want to be in an unequivocal position. May I say that even in wartime we never had complete wage control. We had something called wage stabilization. One of the most elementary rules in connection with price fixing is the basic principle that you can't control an item that you can't identify or that you can't fix or that you can't make uniform. Despite my current relationship to wages, I started out in the field of price fixing. I studied every experiment in the history of the world. Dr. Kress didn't want to have a broken arm, so he brought up two books. One of the first ones is Government Price Fixing which was in 1938, before World War II. I was pretty closely connected with what went on.

There is only one thing that you can identify or make uniform, and that is the quality of a wage, the quality factor. But apart from that I am opposed to all those types of controls in peacetime.

QUESTION: Doctor, we hear a lot these days about our pricing ourselves out of world markets. Would you comment on that?

DR. BACKMAN: First let's look at the facts. We priced ourselves

out of world markets to the point where it looks as if in 1960 we'll have the largest volume of exports we have ever had. That's an interesting fact. I am reminded of a study published a few years ago in the electrical equipment industry where they pointed out that foreign trade imports into this country had become so enormous that they had increased 14 fold since before World War II. This was terrible. Somebody then asked the right question: "How important are imports?" They had risen from 1/4 of 1 percent to 1/2 of 1 percent. That was in the total electrical equipment production.

I had the occasion a couple weeks ago when I was out on the West Coast to look into the electrical equipment industry. We all know how much Japan is selling to us in the way of electrical equipment, mainly transistor radios--about $75 million a year. It's terrible. You may not have known that we sell $70 million worth of electrical equipment to Japan every year. Actually the net import is about $5 million.

I think the answer is that in some areas the combination of modern equipment which gives them an approach to our productivity and a wage scale that runs sometimes as high as a third of our wages, more often more, has given many foreign countries an advantage.

But, before we get all exercised about this, may I remind you that it was not so long ago when the cotton textile industry moved from New England to the South because wages were lower, and, while a few people were concerned about the depressed area in New England, I didn't notice

any demands for legislation to stop the movement down South. In fact most of it was taking place in the twenties and early thirties when people didn't think in those terms.

If we can buy things more cheaply abroad we should by them abroad. There are those who will say this will cost Americans jobs. That's about as silly a statement as one could make. The only way Japan can sell to us is if they or someone else buys from us. Otherwise, all they are getting are pieces of paper which they can't use. Some of us don't mind having some of these pieces of paper, called dollar bills, and waving them around. We like to say we have so much instead of so much less. But the fact is we want dollars for what they can buy, and so do foreign countries.

If Japan sells us textiles, pottery, electrical equipment, or machinery of one type or another, the only way they can be paid is if they buy something from us. When they buy something from us that makes jobs. If I buy a Japanese transistor radio and save $10 and then use the $10 to buy some bow ties, that makes jobs.

The trouble, gentlemen, is this. We see the jobs which are lost when an industry is affected by foreign competition, because here are 25,000 workers in the textile area who lost their jobs. But we don't see the 100, and the 50, and the 72, and the 27 jobs made as we spend our money now released because we have more to spend on other things, and when foreign countries spend their money.

Many years ago Dauchat, a French economist, developed something which Hanry Hazlett publicized later on, called the broken-window fallacy. It went something like this. Two kids were having a catch and one missed, and it went through the window. The storekeeper came out fit to be tied. The kid was a philosopher and said, "Now, wait a minute, mister, let's look at this broadly. Let's recognize the favorable impact on the economy." (He was an economist, you see.) "Do you realize this is going to make a job for a glazier." Of course the fellow, not being an advanced student in economics, said, "Thanks, son. I'm glad I am doing my part."

But the fact remains that he could have spent that money and made the job himself. It's in that area that you run into the problem of what happens in foreign areas.

Take steel. You've read about how steel has been priced out of the market and how foreign imports are coming in, and it's a terrible situation. We can produce only 150 million tons of steel. You know, with all of the extra steel brought in because of strikes, we imported about 4-1/2 or 5 million tons of steel. While we import steel from Dusseldorf we sell them heavy plate. The same areas from which we import are areas to which we export.

Well, Howard Piquet will be here in a little while and Howard will be able to tell you more about it.

QUESTION: The sins of the wage inflation spiral must be as apparent to labor leadership as they are to us. Do you see any evidence of labor leaders accepting a cut in that 20 percent of the payroll?

DR. BACKMAN: Let me use that as the occasion for a speech. The job of a labor leader is to get as much as he can for his workers. Now look, fellows, let's understand the facts of life. These men are paid to do a job. When we criticize them because they do a good job for their men we are in the wrong ball park. We are talking about the wrong sort of things.

Mr. Reuther is paid to do as much as he can for his auto workers. While you and I may not like some of the things he does, if he does that job well, we have no right to criticize him for doing the job well. We might want to criticize the environment, or the laws, or the favorable attitudes of one group or another that makes them possible.

But let's start off by not making John L. Lewis a whipping boy, or Reuther, or Petrillo, or anybody else who may have been in the public eyes a whipping boy because he did his job. Let's get that clearly off the table, because I think it's important.

Now, as to whether they recognize the problem: I don't think Walter Reuther is a fool. He's a very smart guy. I am sure he recognizes it. But it's not his job to do something about it. It's management's job to do something about it. So the real question is: Does management

recognize it? I think that in the last year we are beginning to get signs that management is recognizing it. Why do I say that? I say it because of the drive on so-called make-work rules and featherbedding. You may say, "We all know that failed." You don't know anything of the kind. You may know it because you are not informed about it. I don't know it. In fact it was very successful.

Let me give you some illustrations. Let's take steel. You say, "The steel industry obviously failed." Failed in what? They never even spelled out what they wanted. They merely said they were going to make some changes. Whoever made that a collective bargaining effective device?

Then you remember the illustration of the two men in a cab, the only one they were able to come up with ultimately? The story about the two men in a cab? There is no such story. A number of years ago when we had one of these fellows in the cab over the furnaces, he was spelled by a second man. Then they airconditioned the cab and the crane and they said, "We want one man." The International Union said, "Fine." The Americans said, "No, no, a thousand times, no." So they went to arbitration, and about eight months or a year before collective bargaining started the company won it hands down. There was not a chance of losing.

This was the well publicized illustration. Do you know what has happened since the negotiation, very quietly, without any public fanfare?

At the local basis, which is the only place where it could take place, there have been all sorts of changes effected. One of the interesting paradoxes is that one of my friends in one of these companies says, "You know, we have made a lot of progress. We have a Southern plant and for the first time they heard about the airconditioning in the crane, and now they want airconditioning and two men." Interestingly enough, the company that now has this problem, it was one of their people who at a press conference when he could think of nothing else used that as an illustration.

I could take you to Pittsburgh Plate Glass where they made demands for 37 changes in work rules. The company turned it over to a neutral group and got 23 of them in full and 7 partially.

I could take you to the electricians in New York. This is a gang where you don't get very much. They recently made a contract cutting out some of the waste time.

I could take you to the plumbers in Chicago where recently they made a contract for the first time permitting prethreading, and stuff like that.

I could take you to the longshoremen on both Coasts, where they are permitting prepackaging.

Why did management make the drive in this area? Because it was socially conscious? Forget it. In 1958 they discovered what was an obvious thing, that when volume goes down they get a terrific profit

squeeze and they found that on the way back profits weren't moving as rapidly as they thought they should. So they began looking for places to cut. And some of these things that seem so obvious they began to hit upon.

Not because labor has become statesmanlike, not because management has become statesmanlike, and not because labor leaders have abdicated what is their job, but because management has begun for the first time in the postwar period to find out that they can't pass it on in price increases--economic environment, you see--wage inflation is not automatically price inflation; they are trying to cut down the labor cost increase.

If any of you are interested in a number of other illustrations of this, in the June issue of Nation's Business there is an article outlining a number of the changes that took place last year. It is a very interesting write-up on the facts involved, and an interesting story of progress made up to this point.

QUESTION: Dr. Backman, it seems to me that in the negotiating processes our laws have placed management at a disadvantage because we have made laws on monopolistic policies of industries so that they can't band together. However, the CIO is allowed to have an industry-wide union. So therefore the whole steel union can pick out one company to work on, to try to get the things they want. Will you comment on this?

DR. BACKMAN: I can hit it only very briefly. This is a very long

subject. It goes back to the origins in terms of no unions or very ineffective unions, a complete lack of balance of power, with large companies being able to clamp down on individual workers, and the almost inevitable swing in the other direction when you do these things publicly. There is a sort of pendulum-like effect in all these things. You go from one extreme to the other and in time you sort of narrow it until you hit some happy medium.

There is no question about the enormous power which the labor unions have. I personally am opposed to industry-wide bargaining on that basis. I like to see plant-wide bargaining. But I don't see how you can stop people from communicating with each other and getting sort of an unwritten understanding if it isn't written.

I think the real problem is that the union is industry-wide and must bargain industry-wide—in other words, must meet the threat in that area. It doesn't mean that merely meeting it in that area is going to solve the problem. But at least it equates the forces of power.

I'd rather see both forces of power cut down, but the other alternative is to meet it. I think, too, that there is a public attitude involved. So long as the public thought of labor as the underdog many of these things could happen.

One more point--there are many, but these are just a few things that can be said about it. The relative importance of organized labor is declining, for two reasons: First, they are making no progress in

additional organization, in expanding the labor force, so it will surely go down. Secondly, and more important, the relevant importance of manufacturing to the economy--manufacturing and mining, which, of course, is the stronghold--is declining. A third fact is that, within companies, the relative importance of production workers is going down because of automation, because of new developments. And we find that the service workers, the nonproduction workers—I am speaking of service workers now as the white collar workers--in contrast to the blue collar--have gone up in manufacturing from 13 percent of the total to something like 22 percent in the last 10 years. This trend is moving in that direction.

That is cutting down the relative size of the base. That is what some of the screaming is about. You get some of these battles. Take the featherbedding battle in the railroads. Everyone knows that the fireman only goes along for the ride. There is nothing else for him to do. They began getting rid of the firemen on the Canadian Railroads and there has been no increase in accidents. The fireman has nothing to do. But the firemen's union is involved. So the firemen will fight to the death of the last union officer.

DR. KRESS: There are other questions as you can see, but our time in this auditorium has expired. We are asking you to go to some of the discussion groups, and perhaps some of you can ask your questions there. Dr. Backman, on behalf of all of us, thank you for a very interesting morning.