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Tim Worstall Contributor

I have opinions about economics, finance and public policy.

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The Story of Henry Ford's $5 a Day Wages: It's Not What You Think

There's an argument you see around sometimes about Henry Ford's decision to pay his workers those famed $5 a day wages. It was that he realised that he should pay his workers sufficiently large sums to that they could afford the products they were making. In this manner he could expand the market for his products.

It should be obvious that this story doesn't work: Boeing would most certainly be in trouble if they had to pay their workers sufficient to afford a new jetliner. It's also obviously true that you want every other employer to be paying their workers sufficient that they can afford your products: but that's very much not the same as claiming that Ford should pay his workers so that they can afford Fords.

So, if creating that blue collar middle class that could afford the cars wasn't why Ford brought in his $5 a day wages, what was the reason?

Actually, it was the turnover of his staff.

> At the time, workers could count on about $2.25 per day, for which they worked nine-hour shifts. It was pretty good money in those days, but the toll was too much for many to bear. Ford's turnover rate was very high. In 1913, Ford hired more than 52,000 men to keep a workforce of only 14,000. New workers required a costly break-in period, making matters worse for the company. Also, some men simply walked away from the line to quit and look for a job elsewhere. Then the line stopped and production of cars halted. The increased cost and delayed production kept Ford from selling his cars at the low price he wanted. Drastic measures were necessary if he was to keep up this production.

That level of turnover is hugely expensive: not just the downtime of the production line but obviously also the training costs: even the search costs to find them. It can indeed be cheaper to pay workers more but to reduce the turnover of them and those associated training costs. Which is exactly what Ford did. As Paul Krugman points out, the effects are obvious:

> But in any case there is a fundamental flaw in the argument: Surely the benefits of low turnover and high morale in your work force come not from paying a high wage, but from paying a high wage "compared with other companies" — and that is precisely what mandating an increase in the minimum wage for all companies cannot accomplish.

While that's talking about the living wage argument it applies here as well. The point is not so as to be paying a "decent wage" or anything of that sort: it is to be paying a higher wage than other employers. That gets your workforce thinking they've got a good deal (for the clear reason that they have got a good deal) and if the workers think they've got a good deal then they're more likely to turn up on time, sober, and work diligently. They're more likely to turn up at all which was one of the problems Ford was trying to solve.

It's also not true that the offer was of $5 a day in wages. It was all rather more complicated than that:

> The $5-a-day rate was about half pay and half bonus. The bonus came with character requirements and was enforced by the Socialization Organization. This was a committee that would visit the employees' homes to ensure that they were doing things the "American way." They were supposed to avoid social ills such as gambling and drinking. They were to learn English, and many (primarily the recent immigrants) had to attend classes to become "Americanized." Women were not eligible for the bonus unless they were single and supporting the family. Also, men were not eligible if their wives worked outside the home.

Outside of the military it's difficult to think of an American workforce that would be willing to accept such paternalism even if wages were doubled today.

So it wasn't $5 a day and it was done actually to reduce total labour costs by reducing labour turnover. And as a final nail in the coffin of the argument that it was done so that the workers could afford the cars, there's this.

Car production in the year before the pay rise was 170,000, in the year of it 202,000. As we can see above the total labour establishment was only 14,000 anyway. Even if all of his workers bought a car every year it wasn't going to make any but a marginal difference to the sales of the firm.

We can go further too. As we've seen the rise in the daily wage was from $2.25 to $5 (including the bonuses etc). Say 240 working days in the year and 14,000 workers and we get a rise in the pay bill of $9 1/4 million over the year. A Model T cost between $550 and $450 (depends on which year we're talking about). 14,000 cars sold at that price gives us $7 3/4 million to $6 1/4 million in income to the company.

It should be obvious that paying the workforce an extra $9 million so that they can then buy $7 million's worth of company production just isn't a way to increase your profits. It's a great way to increase your losses though.

The reason for the pay rise was not as some of our contemporaries seem to think it was. It was nothing at all to do with creating a workforce that could afford to buy the products. It was to cut the turnover and training time of the labour force: for, yes, in certain circumstances, raising wages can reduce total labour costs.