

DID HENRY FORD PAY EFFICIENCY WAGES?

Daniel M.G. Raff and Lawrence H. Summers

CONTEXT: HOW DOES THE PAPER RELATE TO THE LECTURE MATERIAL?

- This paper examines how Henry Ford's \$5 a day policy supports the Efficiency Wages Theory.
- The Authors show that explain the ways that paying a higher wages to employees can lead to higher profits by:
 - Attracting better workers
 - Lower turnover rate
 - Higher productivity by workers
- The paper contributes to labor market analysis by exemplifying the benefits of paying workers better wages under the efficiency wage theory

QUESTION: WHAT IS THE RESEARCH QUESTION ADDRESSED BY THE PAPER?

- The paper asks: Does Ford's \$5 a day policy support the Efficiency Wages Theory?
- It also explores:
 - The economic environment of the Industrialization period of the early 20th century
 - How this period was generally noted for long hours and cheap wages
 - Many other firms we're struggling with similar labor issues.
- The goal is to examine Ford's policies and see if they were effective in its increases in productivity and therefore increased profits

ANSWER: WAS THE POLICY CHANGE SUCCESSFUL?

1. Attracting Better Workers: The authors conclude that there was an increase in applicants for the Ford Motor Company. They believe that this would have allowed the company to be more selective in the hiring process and hire better quality workers
2. Reduced Cost of Labor: The authors give the following formula for the cost of labor ->

$$c = w + (i + q)t$$

They conclude that the reduced cost of turnover rate most likely outweighed the increased wages

3. Workers Increase Effort: The authors believe that the policy change gave an incentive for workers to work harder. They cite the decreased Absenteeism as showing more productive workers

GRAPHICAL ILLUSTRATION: TURNOVER RATE BEFORE AND AFTER THE WAGE INCREASE

| Year | 1913 | 1914 | 1915 |
|------------------------|--------|--------|--------|
| Average Force Employed | 13,623 | 12,115 | 18,028 |
| Total Leaving | 50,448 | 6,508 | 2,931 |
| Turnover Rate (%) | 370 | 54 | 16 |
| Resignations | 39,575 | 5,199 | 2,871 |
| Layoffs | 2,383 | 385 | 23 |
| Discharges | 8,490 | 926 | 27 |

Annual Turnover Rates, 1913-1915

CONCLUSION

- This Article suggests that the Ford's \$5 a day policy supports the Efficiency Wage Theory and thereby give credibility to the theory
- This finding suggests that paying higher wages could actually lower firms costs in the long run and thereby increase profits
- Some limitations of the findings are that there could be confounding variables such as technology advancements and the Ford Motor Company already being a successful company