

ON OVERTIME HOURS LEGISLATION

by

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## ON OVERTIME HOURS LEGISLATION

### INTRODUCTION

In the United States, proposals have been periodically introduced into Congress to amend the provisions of the Fair Labour Standards Act (FLSA) to restrict the use of overtime hours and stimulate employment growth. This report summarizes the research I have conducted since 1970 on the likely effects of these proposed policy changes and my appraisal of their desirability.<sup>1</sup> Although all of the empirical results I discuss pertain to United States data, they suggest the type of empirical analyses that should be undertaken with Canadian data before decisions about policy changes are made here.

I begin in the first main section with a brief history of hours of work legislation in the United States that includes a conceptual framework that I have found useful in analyzing proposed changes in hours legislation. The variety of empirical analyses I have undertaken that pertain to the wisdom of raising the overtime premium are discussed in the second section. My analyses of proposals to require employee consent prior to the working of overtime are discussed in the third section. The paper ends with some brief concluding remarks.

### HOURS OF WORK LEGISLATION IN THE UNITED STATES

The overtime pay premium provisions of the Fair Labour Standards Act (FLSA) currently regulate only two dimensions of the hours of work relationship -- the number of hours after which the overtime premium goes into effect (forty) and the premium level (time and a half). Several European countries and Ontario regulate other dimensions in their legislation: for example, they require either prior governmental approval for overtime or employees to give their consent to working overtime, or both. A bill to amend the FLSA introduced into Congress in 1979 by Representative

Conyers would similarly have prohibited the mandatory assignment of overtime in the United States, as well as raised the overtime premium from time and a half to double time and required premium pay after 35 rather than 40 hours. To introduce the analytic framework that I believe is useful in thinking about such a proposal, or similar ones for Canada, I begin with a brief summary of the history of hours of work legislation in the United States.

The earliest forms of hours of work legislation in the United States were initiated at the state level, applied to women and children, and had the aim of reducing fatigue and exhaustion (Commons and Andrews 1920; Paulsen 1959; Phelps 1939). For example, in 1879 legislation regulating maximum hours of work was introduced in Massachusetts, where its supporters claimed that long workweeks were exhausting and caused women to age prematurely (Cahill 1932, pp. 106-107). The first hours laws covering men in the private sector were also at the state level and covered occupations in which long workweeks adversely affected third parties or employees themselves. For example, legislation in 1890 in Ohio limited the hours of train operators in the hope that this would reduce railroad accidents and protect the travelling public. This law was quickly followed by state laws limiting the workweek of miners, who were subject to unhealthy and unsafe working conditions (Paulsen 1959, p. 114).

In each of these cases a rationale (from the perspective of an analytical labour economist) for the protective labour legislation is found in the fact that the marginal social cost of longer workweeks exceeded the marginal private cost to employers. In the absence of government intervention these divergences persisted for a variety of reasons: low family income levels did not permit many women and children the luxury of turning down jobs with long hours; no good alternatives to the railroads existed for long-range travel and railroad passengers were not always accurately informed about railroad employees workweeks; and the limited

alternative employment opportunities in mining communities often restricted the occupational choice of individuals in those areas. In each case, then, markets failed, in the sense that compensating wage, or price, differentials did not arise to compensate employees, or third parties, for the full risks they incurred because of long hours of work. The case for government intervention was strong; the only real question is why the legislation took the form of outright restrictions on hours rather than the use of tax or penalty schemes to increase employers' marginal private cost of longer hours.

At the federal level, throughout the early 1930s, bills were repeatedly introduced into Congress to limit the length of the workweek. While the goal of protecting existing employees from the ills associated with excessive fatigue remained, a second explicit purpose of such legislation was to increase employment by spreading the available work. Ultimately on June 25, 1938, the Fair Labour Standards Act, with its overtime provisions, was enacted.

Once again, the provisions of the Act can be rationalized in terms of the divergence between private and social costs. Even if employers and their employees in the 1930s were satisfied with long workweeks, their private calculations ignored the social costs borne by the unemployed. The time and a half rate for overtime can be thought of as a tax to make employers bear the full marginal social cost of their hours decisions; it was meant to reduce the use of overtime hours and to stimulate employment, at least to the extent that the increased costs do not substantially reduce total person-hours demanded. Furthermore, if employees were not satisfied with long workweeks during the 1930s but, because of market imperfections, they did not have the freedom to choose employment with employers who offered shorter workweeks, the direct payment of the tax to employees who worked longer

workweeks can be justified as an attempt to remedy this imperfection.

#### ON THE WISDOM OF RAISING THE OVERTIME PREMIUM

Although coverage under the overtime pay provisions of the FLSA has increased substantially over the last half century, the premium itself has remained constant at time and a half. Periodically, as in the Conyers bill, proposals have been introduced in Congress to raise the premium to double time. The underlying argument made to support the increase is that while unemployment remains a pressing national problem, the use of overtime hours has increased. Moreover, since the enactment of the FLSA, the deterrent effect of the overtime premium on the use of overtime has been weakened by the growing share of hiring and training costs, fringe benefits, and government-mandated insurance premiums in total compensation. Many of these costs are quasi-fixed or employee-related (e.g., vacation pay, holiday pay, sick leave, hiring costs), rather than hours related, in the sense that they do not vary with overtime hours. An increase in these quasi-fixed costs reduces employers' marginal costs of working their employees overtime, relative to their costs of hiring additional employees. The growth of these costs, it is claimed, has been at least partially responsible for the increase in overtime and therefore an increase in the overtime premium paid by employers is required to offset this adverse effect.

A complete analysis of the desirability of raising the overtime premium requires answers to a number of empirical questions. Would higher overtime pay rates relative to the quasi-fixed costs of employment induce employers to reduce their usage of overtime hours? Would reductions in overtime hours be "converted" to full-time jobs or "lost" to capital substitution or output reductions? Would employers comply with the legislation? Would workers who previously worked overtime, moonlight at second jobs and reduce the employment

opportunities for unemployed individuals? Would the unemployed have the skills necessary to fill any new jobs that might be created? Finally, what would be the income distribution consequences of the proposed policy change? Empirical analyses directed at answering all of these questions, and others, are summarized below.

My own research and that of others has demonstrated that, across establishments in the United States, a strong positive relationship exists between the use of overtime hours and the ratio of weekly nonwage labour costs per employee to the overtime wage rate (Ehrenberg and Schumann 1982a, Ch. 2). This implies that increasing the overtime premium to double time would substantially reduce the average use of overtime hours, perhaps by as much as 20 per cent, on average, if compliance with the legislation did not change and if straight-time wage rates were not affected. Moreover, to the extent that the reduction in hours could be converted into new full-time employment, such a change in the legislation has the potential to increase the employment of workers subject to the overtime provisions by perhaps 1 or 2 per cent. It must be stressed that in the United States less than 60 per cent of the workforce is subject to the overtime pay provisions, due to many industry, occupation, and size class exemptions that exist. So the potential to increase the overall employment level is somewhat less.

Whether such increases in employment would actually occur and whether the new jobs would go to currently nonemployed individuals is another matter. These estimates are predicated on a number of assumptions; if any fail to hold the actual employment gains would be reduced.

First, the maximum employment gain estimates assume that the demand for labour is completely inelastic so that a wage increase does not lead to any reduction in employment. Thus any reduction in overtime hours would be converted into new jobs. An increase in the overtime premium, however, does

raise the average cost per person-hour of labour; this should bring about a shift toward more capital-intensive means of production and, to the extent that the cost increase is passed on to consumers in the form of higher prices, to a reduction in output. Both effects should lead to a decline in the number of person-hours demanded by employers. Simulations we did based on previous estimates of the wage elasticity of demand for labour (see Hamermesh 1986) suggest that this factor should cause the estimate of the number of new jobs created to fall by 0.25 percentage points (Ehrenberg and Schumann 1982a, Ch. 3).

Second, the estimated employment effects assume that all the new jobs created would go to individuals who were unemployed. This ignores the possibility of increased moonlighting by currently employed workers whose overtime is restricted. If this occurred, the actual employment gains would be reduced. Our simulations based on previous studies of moonlighting decisions (Shishko and Rostker 1976) suggest, however, that increased moonlighting would not significantly restrict the number of newly created jobs that would go to the unemployed (Ehrenberg and Schumann (1982a, Ch. 3).

Third, the employment gain estimates assume that indivisibilities in production processes will not prevent any reduction in overtime hours from being converted to new full-time jobs. For example, while large establishments may have the option of substituting one new full-time employee for the overtime hours of twenty employees who each work two overtime hours a week, small establishments with only a few employees working overtime may not enjoy such options. If such constraints existed, one might contemplate exempting small establishments from any increase in the overtime premium; this would reduce the estimated employment gain associated with an increase in the premium. The only study using U.S. data that looked at the issue, however, found no systematic relationship between establishment size and the existence of

a trade-off between overtime hours and employment (Ehrenberg 1971a).

Fourth, these estimates assume that an increase in the overtime premium will not lead to compensating adjustments in straight-time wages or fringe benefits. Suppose, however, that firms and their employees were initially in an equilibrium situation in which overtime hours were regularly scheduled. One plausible response to a legislated increase in the premium is for them to voluntarily agree to a reduction in the level of straight-time wages, or fringes, or both, leaving total compensation for the initial number of hours unchanged. If this occurred, it may be argued that neither side would have an incentive to reduce the usage of overtime (the legislation would have had no effect on the employer's total costs or on the employee's total compensation for the given number of hours) and the resulting employment gain would be reduced. While I have not obtained any evidence on the probability that such compensating wage or fringe benefit differentials would arise, at least one previous study has found that increases in the minimum wage sometimes lead to compensating reductions in fringe benefits (Wessels 1980). Thus, this possibility should not be dismissed out of hand.

Fifth, these estimates assume either that the skill distributions of those working overtime and those who are unemployed are sufficiently similar that bottlenecks will not arise, or that the elasticity of substitution between the unemployed and those working overtime is very high. Put another way, they assume either that there will always be unemployed workers available to fill the newly created positions or that the occupations that the unemployed are in easily can be substituted for the occupations of those working overtime.

In fact, analyses we have conducted of the distribution of the experienced unemployed by skill class and geographic

area, and the similar distribution for those working overtime, using data from the May 1978 Current Population Survey (CPS), suggest that bottlenecks may well arise (Ehrenberg and Schumann 1982a, Ch. 4). Indeed, the data suggest that at least 8.5 per cent of all the newly created jobs would go unfilled for want of workers with the required skills residing in the same geographic area. This estimate is subject to a number of qualifications, however, and the importance of the skill bottleneck problem will depend on which stage of the business cycle the economy is in. In periods of higher unemployment, when less overtime is worked, skill mismatches would be less of a problem.

Moreover, our previous analyses ignored the question of the substitutability of overtime hours, in occupations in which overtime is worked, for new employment, in occupations in which the experienced unemployed "reside". Hamermesh (1986) provides estimates of substitution across skill categories of labour that should prove useful in this regard and his report in this volume addresses this issue in more detail.

Finally, the maximum employment gain estimates assume both that the overtime pay provisions of the FLSA are fully complied with, and that an increase in the overtime premium would not reduce the compliance rate. In fact, analyses of the May 1978 CPS data and the 1977 Michigan Quality of Employment Survey (QES) data suggest that at least 10 to 20 per cent of the employees working overtime who should legally receive a premium of time and a half for overtime fail to receive it. If the noncompliance rate were to remain constant in response to an increase in the premium to double time and employers continued to pay these employees the same premium, employers usage of overtime hours would not change, and the estimated employment gain estimates would be reduced by 10 to 20 per cent (Ehrenberg and Schumann 1982a, Ch. 5; 1982b).

Taken together, these factors suggest that the employment gain associated with an increase in the overtime premium is likely to be considerably less than the maximum estimates reported above. Furthermore, analysis of the income distributional consequences of the legislation that we conducted suggests that middle-income and upper-income families would gain more from an increase in the overtime premium than would lower income families (Ehrenberg and Schumann (1982a, Ch. 6). More specifically, an analysis of the May 1978 CPS data suggested that overtime earnings per family increase with family income, and that the net effect of an increase in the overtime premium (taking account of the increased premium rate, the decreased overtime hours, and the increased employment) would be to increase average family income more for middle-income and upper-income families than it would for lower-income families. When the inflationary consequences of the legislation are added in, the case for increasing the overtime premium to double time is substantially weakened.<sup>2</sup>

On the basis of the evidence I have summarized above, Schumann and I concluded that raising the overtime premium would not be an effective way of stimulating growth, even though it would lead to a reduction in overtime hours. Moreover, it would not have desirable income distribution consequences (Ehrenberg and Schumann 1982a).

Raising the overtime premium paid by employers might make sense for another reason, however, if the revenue that would accrue from such an increase was not distributed to employees in the form of higher premium pay received by them for overtime. Instead, the revenue from any increase in the tax on overtime would go directly to aid the unemployed; for example it could be contributed to unemployment insurance funds or to employment and training program budgets. Unless it can be demonstrated that market imperfections prevent currently employed workers from freely choosing the length of their workweeks and that the existing overtime premium does

not fully compensate these workers for the disutility associated with long workweeks, then no increase in the premium paid to employees is justified. One can thus logically be in favor of raising the tax paid by employers when they use overtime hours but not in favor of raising the overtime premium paid to employees. In fact, a proponent of such a proposal in the United States historically has been the United Automobile Workers.<sup>3</sup>

#### ON THE WISDOM OF REQUIRING EMPLOYEE CONSENT FOR OVERTIME HOURS

What about the Conyers proposal to legislate the prohibition of mandatory overtime, as is done in several European countries? Presumably such a proposal can be viewed as being based upon the belief that market imperfections persist in the labour market and that the overtime premium does not fully compensate employees for the disutility associated with mandatory overtime. One may question, however, whether markets have failed here. There appear to be a variety of overtime hours provisions offered in the U.S. labour market. For example, only 16 per cent of the respondents in the 1977 Michigan Quality of Employment Survey (QES) who reported working overtime also reported that the overtime hours decision was made unilaterally by their employer and that overtime was mandatory in the sense that employees who refused it suffered a penalty (Quinn and Staines 1979, pp. 90-91). In addition, roughly 20 per cent of employees covered by major collective bargaining agreements in 1976 had explicit provisions in their contracts that gave them the right to refuse overtime (U.S. Bureau of Labour Statistics 1979).

To the extent that labour markets are competitive and establishments do offer a variety of overtime hours provisions (e.g., employer determines, employee determines, penalty for refusal), compensating wage differentials should arise. That is, to attract labour, establishments that

offered distasteful mandatory overtime provisions would have to pay higher straight-time wages, higher overtime premiums, or higher fringe benefits than establishments in which such provisions did not occur. If fully compensating wage differentials exist, there is no case for legislative prohibitions against mandatory overtime. Evidence on the extent is of importance to policy makers.

In fact, our empirical study of the subject for the United States, using the QES data, found that, on average, such compensating differentials did not exist (Ehrenberg and Schumann 1982<sup>a</sup>, 1984). This finding provides some support in favor of a prohibition of mandatory overtime, although the benefits from such legislation would have to be weighed against the potential costs; the latter include reduced employer flexibility in scheduling production, and thus, increased production costs, which would lead in turn to lower employment levels. The study also found, however, that compensating differentials did exist for union members. That is, unions were able to win for their members through the collective bargaining process what the market on average did not produce.<sup>4</sup> The workers most "in need" of the prohibition on mandatory overtime in the United States appear then to be nonunion workers.

#### CONCLUDING REMARKS

The discussion above summarizes what I believe prior empirical research in the United States has told us about the wisdom of either raising the overtime premium or prohibiting assignment of overtime without employee consent in the United States. While empirical estimates for one country may be useful as a starting point for discussing policy in another country, given differing institutional arrangements or behavioral relationships between countries, they should be used only as a starting point. In a sense, this report may best be viewed as indicating the types of research that should be undertaken using Canadian data.

One proposal that I have not addressed directly is to reduce the standard workweek; Robert Hart discusses European analysis of this issue in his report in this volume. Variations in standard workweeks in U.S. data are very small so no prior analysis of them has been undertaken. However, one can conceptualize such a proposal in a very similar manner to that of raising the overtime premium.

For example, a requirement in, say, the U.S. that employers pay time and a half after the first thirty-five hours per week, would increase the average hourly wage cost of the first forty hours per employee by 6.25 per cent. If the requirement were for double time, the average hourly wage for the first forty hours would increase by 12.5 per cent. In either case, employers would reduce the total person-hours they demand, and this would limit the positive employment effects of the legislated change.

Similarly, converting the hours between thirty-six and forty into overtime hours would increase employers' incentives not to comply with the legislation and lead to possible compensating decreases in straight-time wages and fringes. Both these changes would reduce employers' incentives to substitute increased employment for overtime hours. Finally, one would again have to consider the possibility that skill mismatches between the unemployed and the new jobs that were created would constrain the employment effects of the change in the legislation. Of course, since this amendment would apply to all covered full-time workers, not solely those working more than forty hours, it is less likely that skill mismatches would be a problem in this case. Put another way, the skill mix of all covered full-time workers than it is to the skill mix of those working overtime.

## Notes

1. My research has been reported in Ehrenberg 1971a, 1971b, 1971c and Ehrenberg and Schumann 1981, 1982a, 1982b, 1984. This report draws heavily from that material.
2. In Ehrenberg and Schumann (1982a, Ch. 3), we calculated that an increase in the overtime premium to double time might increase average hourly costs by 0.8 per cent for workers covered by the legislation.
3. A similar proposal was offered in U.S. Department of Labour (1967) by Howard Young who favoured both raising the overtime premium to double time and instituting an additional surtax on overtime that would be paid by the employer directly into a social welfare fund. Young was a special consultant to the president of the UAW at the time. More recently, this position was supported by Kenneth Meyers, a regional director of the UAW in his testimony on the Conyers bill (see U.S. House of Representatives 1980).

If one is concerned that such a proposal will increase employers' costs, one can offer them marginal employment tax credits equal to the amount of their increased costs for expanding employment. This would provide a further incentive to them to increase employment.

4. The finding that unionized workers receive compensating wage differentials for unfavorable job characteristics, while nonunion workers often do not, is not unique to the mandatory overtime issue.

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