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ECONOMIC EFFECTS OF MANDATORY 48-HOUR WEEK

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Manpower Aspects:

It is essential that the 48-hour order be applied flexibly in each locality, if its inflationary potentialities are to be minimized. War Manpower Commission apparently is in agreement on this. Plans call for:

1. Exempting firms with less than 8 employees;
2. Exempting self-employed workers and domestic servants;
3. Allowing for technical production problems involved in balancing departments and maintaining smooth plant operations;
4. Allowing time for reaching a full 48-hour basis gradually;
5. Applying the order immediately only to the 32 labor shortage areas in which the Manpower Commission is prepared to utilize in other jobs workers released by the extension of hours; and
6. Exempting part-time workers.

In each case, the basic tests should be whether increasing hours to 48 will release manpower which can be transferred to good advantage or will increase output of war or essential civilian goods and services. If neither of these things is to be accomplished, hours should not be lengthened since longer hours may drive from the labor force workers (housewives, handicapped or older persons) who cannot work long hours, and premium rates for overtime will raise labor costs unnecessarily, reduce profits, and intensify pressure on price ceilings.

As a practical matter, forced reductions in hours should be made in some lines. Retail stores in some areas, for example, should be prohibited from working more than 30 hours. Such a limitation would force the stores affected to obtain their labor from among the pool of persons who can work part-time but who cannot work full-time. The growing necessity for bringing married women into the labor force in large numbers makes it imperative that opportunities for part-time employment be increased. This is entirely consistent with the requirement that the regular full-time labor force lengthen its hours of work.

The following estimates, obtained for confidential use, show the current pattern of hours worked by all persons engaged in nonagricultural activities (excluding armed forces). Average hours worked in January for all nonfarm persons was 44.8.

HOURS WORKED IN NONAGRICULTURAL ACTIVITIES
January 1943

	Millions of nonfarm workers	Per cent of total nonfarm workers
Total employed	42.3	100.0
Under 30 hours	3.8	9.0
30-34	1.4	3.3
35-39	1.5	3.5
40	8.8	20.8
41-47	5.1	12.1
48	11.5	27.2
49 and over	10.2	24.1

Similar data showing the distribution of hours are not available by industry. However, other figures available provide rough indications of the areas affected by the 48-hour order. Most industries manufacturing durable goods are already operating close to or above 48 hours. The only important exceptions are blast furnaces, steel works, and rolling mills, lumber, and furniture. As a group, industries producing nondurable goods average around 41 hours. Textiles of all kinds, leather goods, canning and preserving, tobacco, and printing and publishing average about 40 or less. Few nondurable industries average above 43 hours.

Several large nonmanufacturing industries work around 40 hours or less. Coal mining recently concluded agreements which will increase hours from 35 to 42. Telephone and telegraph, electric light and power, retail trade, and construction are all around 40 hours or less.

In general, the 48-hour order will affect nonwar industries and those whose products or services enter directly into the cost of living. Hourly wages in these industries are, on the average, somewhat below those in the industries already working overtime.

Reference to the table on page 2 shows that of the 42 million persons engaged in nonagricultural activities, nearly 22 million are already working 48 hours or more. An additional 5 million are working less than 35 hours and are mainly part-time workers who are unable to work full schedules. These two groups total 27 million. This number, at least, will not be affected by the 48-hour order. About 15 million persons are left whose hours might be increased. However, of the 15 million, it is estimated

6 million are exempt because they are self-employed, domestic servants, State and local government employees, or employed in establishments with less than 8 workers.

Therefore, if the order is applied throughout the country to all covered persons in surplus as well as in shortage areas and if no exemptions are made other than those listed above, about 9 million persons will increase their hours of work. On the average the 9 million affected will have to work 7 hours or 16 per cent more than in January to reach 48 hours. If total man hours, and presumably production, are held the same, this increase theoretically would make possible the release of about 1.3 million workers for service in the armed forces.

As a practical matter, it is unlikely that as many as 1 million workers will actually be released as a result of the order. Labor market frictions, such as geographic and skill immobilities, ability to transfer workers, etc., will limit materially the number released.

Cost-Price Aspects:

Not all of the 9 million workers whose hours will be increased are entitled by law to premium rates of overtime. However, collective bargaining agreements in some cases and the pressure of competition with firms paying premium rates will probably result in a large proportion of the 9 million receiving overtime rates.

Of the 9 million, it is estimated that about 3 million will increase their work week 9 per cent (4 hours), their average hourly earnings 4 per cent, and their weekly earnings 13 per cent. About 6 million will increase their work week 20 per cent (8 hours), their average hourly earnings 8 1/3 per cent, and their weekly earnings 30 per cent.

On the average, the 9 million will work a 16 per cent (7 hours) longer week, will earn 7 per cent more per hour and 24 per cent per week.

The average cost to the employers affected is a rise in unit labor costs of 7 per cent, if productivity per hour remains unchanged. If employers do not release any workers, their payroll will increase 24 per cent but this will be offset by a 16 per cent increase in output. If employers release an equivalent number of workers, the higher weekly wages paid will apply to a smaller number of workers.

If employers' labor costs represent one-fourth of total costs and other costs remain the same, employers' total costs will rise about 1.7 per cent. Unless costs can be cut, profits will be reduced, prices will have to increase, or direct or indirect subsidies paid to cover the rise in labor costs.

The workers affected constitute a little over one-fifth of all nonfarm workers. An average hourly wage increase of 7 per cent for these workers represents an increase of about 1.5 per cent when it is spread over all nonagricultural wages and salaries. In terms of an $80 billion wage and salary bill, this means a total increase, resulting from the 48-hour order, of around $1.2 billion.

If total production and man hours are increased and all of the 9 million workers receive increases in weekly earnings averaging 24 per cent, the increase will amount to around $4.5 billion. Except for the $1.3 billion caused by payment of overtime rates, however, this amount is not attributable to the 48-hour order but to the fact that more man hours are worked. Except for premium rates it makes no difference whether total man hours are increased by longer hours for some persons or by shorter hours for more people.

On the whole, the net effect of the order is probably deflationary. Given a labor situation which is becoming increasingly tight, the 48-hour order creates more man hours than would have been available otherwise. If no action had been taken, employers would have been faced with hiring more untrained workers. Pressure for higher basic wages, both from employers seeking to hold or attract workers, and from workers, would have been intensified and might well have resulted in substantially higher basic wage rates and costs than those occasioned by this order.

Policies Required:

The rise in unit labor costs will be concentrated in those industries and services the prices of which enter directly into the cost of living. These industries and services are already being faced with higher costs because of sharp curtailment of supplies and equipment available to them. There is real danger that the higher costs will result in higher prices with consequent demands for wage increases. Strong action is required now to prevent the beginning of a new price-wage spiral.

On the income side, the increase in wage and salary income resulting from payment of premium rates for overtime, must not be allowed to increase further the disparity between spendable income and purchasable goods. To neutralize the inflationary effects of longer hours at overtime rates, workers should be required to accept in the form of war saving bonds, which are not redeemable until after the war, that portion of their weekly earnings which is attributable to overtime premiums. It would be unfair to apply this requirement only to those workers who receive premium pay as a result of the 48-hour order. For the most part, wages of workers whose hours are now being lengthened are below the wages of workers who worked long hours before the order. On equity as well as administrative grounds, it is undesirable to discriminate between persons receiving premium pay for overtime before and after the order. Therefore, it will be necessary to require all workers to accept war bonds for the amounts due them as premium wages for overtime.

On the cost side, it is clear that this order imposes higher costs on employers producing civilian goods and services. The extra costs of overtime rates are required because of the national interest in releasing manpower, in maintaining stable labor relations, and in preventing inflationary increases in basic wages. Employers in war industries who were working longer hours before the order have had the opportunity of including extra costs of overtime premiums in their cost-price structures and in their Government contracts. Therefore, employers whose labor costs increase as a result of the 48-hour order should be accorded similar consideration.

The best way to prevent hardship to employers whose labor costs advance is to allow adjustments in their tax liabilities. In most cases the Government will automatically absorb a sizeable share of premium payments. Net incomes will decline by the amount of increased labor costs and tax liabilities will fall accordingly -- by up to 90 per cent of premium payments in the case of excess profits corporations and by up to 40 per cent in other cases. Procedures should be devised to take care of the remaining portion of premium payments when relief is needed. One way of doing this is to grant additional relief to corporations without excess profits income. These would be allowed to deduct from their normal and surtax liability an amount equal to that part of their premium payments not already reflected in lowered tax liability.

The cost to the Government of granting these tax deductions to all corporations without excess profits that pay overtime is difficult to estimate. Such an estimate depends not only on the aggregate amount of premium payments but also on the way premium payments are distributed between corporations making excess profits and other corporations. In any case, it appears that the resulting reduction in tax receipts would be small relative to the costs of permitting prices to rise or of failing to utilize fully manpower available. The attached memorandum explains in more detail the proposal for tax relief to cover, where needed, the extra costs of overtime payments.

Conclusion:

The 48-hour order has come at a critical point in the battle to prevent inflation. It is important that the order not be allowed to become an instrument for breaking down the economic stabilization program. These suggestions if put into operation will neutralize the effect of premium payments on income, minimize the pressure on costs, and reduce resistance to the extension of hours at premium rates.

Attachment

Attachment

Tax Relief to Offset Premium Wage Payments

The government will have to provide some relief for increased labor costs due to premium payments on overtime. The granting of tax credit is the best way to do it. It is simpler and less inflationary than an upward adjustment of price ceilings would be; it is less cumbersome than cash subsidies and less provocative a precedent for future subsidies. By providing relief through tax reduction, use is made of existing administrative machinery. Moreover, the tax method offers a relatively simple if approximate way of adjusting the amount of relief granted to the need of the corporations receiving it.

There is a clear case for selective and against general relief. To minimize the inflationary force of the relief provision, it should be restricted to those firms which have a real need for it. That is, only those corporations should be given relief whose net income after taxes has been depressed most. Desirable though it may be, it is impossible to handle the problem on an individual firm basis. Some general demarkation line must be drawn and an obvious way to draw it is between corporations with and corporations without excess profits income. The criterion should be established that premiums for overtime should be absorbed in excess profits income if possible, but that they should not be permitted to reduce normal corporate net income after tax. If premium payments result in a reduced normal income after tax the Treasury should assume the burden by way of tax reduction.

The distinction between excess profits corporations and others is admittedly arbitrary. However, it is convenient because it coincides with that drawn in the tax law and it is no more arbitrary than any other demarkation would be. Against applying this distinction here it may be held that the relief thus provided would be too liberal in many cases. Surely, it could not be held that the relief would be insufficient and that excess profits corporations should be given similar credits. Excess profits corporations will be reimbursed automatically and without specific relief provisions for up to 90 per cent of premium payments due to reduced excess profits tax liabilities.

Tax Relief for Corporations

a. A corporation with no excess profits income would be permitted to deduct from its normal and surtax liability such part of premium payments as is not absorbed automatically in a reduced corporate income tax liability. A corporation with net income above $50,000 and a combined normal and surtax rate of 40%, would thus be permitted to offset 60% of its premium payments against its tax liability. Thereby net income after tax would be restored to exactly the amount obtained prior to premium payments (see attached illustration). Clearly, it would be excessive to permit the deduction of the full amount of premium payments, since taxes are automatically reduced by 40 per cent of premium payments (or by a smaller percentage if a lower surtax rate applies) due to a reduction in surtax net income by the amount of premium payments.

One major exception to this rule would be necessary. If the sum of premium payments and net income exceeds the excess profits credit, it follows that the corporation would have had net income subject to excess profits tax had no premium been paid. 1/ A part of the premium cost equal to the amount of this potential excess profits income is automatically offset by a reduced excess profits tax liability; no additional relief is required against it. The offset against normal and surtax liability should, therefore, be 60 per cent (or less, if a lower surtax rate applies) of residual premium payments only, i.e., total premiums minus the potential excess profits income thus computed.

In most cases, normal and surtax liability would be sufficiently large to permit the full offset of the premium credit (i.e., that part of overtime payments not automatically reflected in a lower tax liability). Where the tax liability would not suffice, the corporation should be permitted to carry the offset credit forward for a number of years. If it were desired to limit the credit more narrowly, provisions along these lines might be included: (1) Relief might be restricted to an amount which does not raise net income after taxes above last year's figure; (2) Relief might be restricted to an amount which, if added to surtax net income does not raise the total above, say, 80 per cent of the statutory excess profits credit.

b. A corporation with excess profits income would be given no relief beyond that provided automatically through reduction in excess profits liability. Had premium payments not been made, excess profits would have been increased by the amount of premium payments and excess profits tax liability would have exceeded actual liability by up to 90 per cent of this amount. 1/

Tax Relief for Noncorporate Business

The above plan applies to incorporated business only. It might be supplemented by a corresponding credit against personal income tax liability on income arising from business sources. A provision of this kind would be more difficult, however, and perhaps less necessary. If establishments employing less than eight persons are to be exempted from the 48-hour requirement, a relief provision applicable to corporations should cover the large majority of cases. Also, it is likely that many small businesses have been on a 48-hour basis for some time and have therefore had an opportunity to adjust their price-cost structure accordingly.

1/ It is assumed that prices and hence sales receipts would have been the same, notwithstanding the lower labor cost.

If tax relief was to be provided to non-incorporated business the line between needy and other cases would be difficult to draw. No existing statutory distinction between normal and excess income could be referred to. Possibly a tax credit (for premium payments not automatically reflected in a lower personal income tax liability) could be made dependent on and be adjusted to a decline in the ratio of net profits from business to total business receipts below the ratio shown for the preceding (or another base) year. Cases of greatest hardship might be met more simply by permitting partial offset of premium payments against income tax liability if a net loss is shown from business income.

ILLUSTRATION

TAX RELIEF FOR PREMIUM WAGE PAYMENTS

Corporation Income Tax	With 40 hour week	After change to 48 hours 1/	
		Present law	Proposal
1. Gross sales	1,000,000	1,000,000	1,000,000
2. Cost of goods sold			
a. Wage cost (basic rate)	300,000	300,000	300,000
b. Wage cost (premium)	--	25,000	25,000
c. Other cost	300,000	300,000	300,000
d. Total (a+b+c)	600,000	625,000	625,000
3. Gross profit from sale (1 - 2d)	400,000	375,000	375,000
4. Deductions	300,000	300,000	300,000
5. Net income (3 - 4)	100,000	75,000	75,000
6. Partially tax exempt income	5,000	5,000	5,000
7. Adjusted net income (5 - 6)	95,000	70,000	70,000
8. Income subject to excess profits tax 2/	--	--	--
9. Normal tax net income (7 - 8)	95,000	70,000	70,000
10. Surtax net income (5 - 8)	100,000	75,000	75,000
11. Tax:			
a. Normal tax (24% of 9)	22,800	16,800	16,800
b. Surtax (16% of 10)	16,000	12,000	12,000
c. Total tax	38,800	28,800	28,800
12. Net income after tax (5 - 11)	61,200	46,200	46,200
13. Tax credit (60% of 2b)	--	--	15,000
14. Adjusted tax (11 - 13)	--	--	13,800
15. Net income after adjusted tax (5 - 14)	--	--	61,200

1/ Total hours of employment remain unchanged but workers previously employed at 40 hours are shifted to a 48-hour week; the labor force is thus reduced by 1/6. Time-and-a-half is paid for overtime.

2/ It is assumed that the statutory excess profits credit exceeds $100,000 (item 5) plus $15,000 (item 13).