

Has Capitalism Created a Wasteful Excess of Managers?

Have you noticed there seem to be a lot of managers nowadays? It's not just you. Professors at the [Harvard Business Review](#) estimate there is one manager for every 4.7 employees and claim this excessive amount of paper-pushers leads to a total loss of \$3 trillion dollars per year in the US.

This amount of waste is staggering, but, as an economist, I'm quite skeptical of this. Business owners have a goal of making money. Although it's possible there are other motivations in the market, the self-interest of pursuing higher profits is the most basic motivation for business. So why would business owners waste trillions of dollars a year on superfluous managers?

Some may argue they are incompetent, but this also seems unlikely. If it were the case that businesses were wasting so much money, anyone who realized this would be able to dominate an industry by cutting back on management. Waste is incompatible with success in a free market.

Instead, a recent [paper](#) out of the National Bureau of Economic Research by Lauren Cohen, Umit Gurun & N. Bugra Ozel provides a more plausible explanation. The staggering number of managers in our economy is not evidence of private sector waste. Rather, it's a response to public sector interference in the labor market.

Nine to Five... Or Else

The argument of the paper revolves around the Federal Labor Standards Act (FLSA) which is a Federal Law that regulates multiple parts of the labor market, including overtime law. If you've ever worked a basic nine to five job, you've probably

had to do some overtime before.

For those who haven't, getting paid overtime involves getting paid for working more than 40 scheduled hours a week. According to the FSLA, employers must pay workers a minimum of 50 percent more for every hour over 40. In other words, employees are rewarded "time and a half" for all time worked.

So, if your normal wage is \$20/hour, and you work one hour of overtime, you get paid a full one hour of pay (\$20) *and an extra half hour* (\$10) of pay for that one hour of overtime.

However, there's an obvious problem with FSLA. It just doesn't make sense for some jobs. The amount of work a person needs to get done in a week is not exactly the same every week. Some jobs might require 50 hours of work one week and 30 hours of work the next, for example.

Extremely volatile jobs with widely variable hours would be difficult for businesses to plan for. A one-size-fits-all regulation is simply too blunt to be workable. Regulators, recognizing this, allowed for some exceptions to this requirement. Among the exceptions exists the salaried manager.

Specifically, so long as workers are paid \$455 per week and have a managerial title, they can be paid a salary which is exempt from this overtime rule.

Multiple Margins of Adjustment

Any time government regulators make blunt regulations on business that utilize arbitrary measures, it incentivizes businesses to make slight changes to avoid the regulations.

Economists would call these slight changes different *margins of adjustment*.

When politicians pass overtime laws, they expect employers will make one of two changes. They will either not ask workers

to work more than 40 hours or they will pay them time and a half for doing so. But employers can comply with the FLSA in unintended ways.

Imagine you work as a grocer making \$11/hour. In a 40 hour week you make \$440. You have duties at the checkout counter and on cleanup. Now imagine that Friday nights in the store are always busy, and you consistently get out one hour late.

Without FLSA laws, imagine you'd be willing to work the extra hour for \$12. So you'd be paid \$452 for the week. Alternatively, if you are paid time and a half for the hour of overtime due to FLSA, you'll receive \$440+\$16.50 ($\$11 \times 1.5$) for a total of \$456.50.

But this isn't the only option. The store could change your title from grocer to "grocery manager" and pay you a salary of \$455 a week. This saves them the extra \$1.50 or potentially more when you take on more than an hour of overtime.

This is exactly what the NBER paper finds. The authors state:

We document widespread and systematic evidence of firms exploiting the provision of the FLSA that allows them to be exempt from having to pay overtime wages if an employee has a 'managerial title' and is paid a salary above a bright-line threshold. We document a sharp spike in firms' use of managerial titles (especially suspect titles) just above this threshold.

So has capitalism created a bloated manager class which wastes trillions of dollars per year? It's doubtful. Instead it appears the burgeoning use of empty titles is, at least in part, a response to clumsily written regulations.

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