The Heritage Foundation
Backgrounder
Executive Summary

No. 1457 July 12, 2001

MODERNIZING THE FAIR LABOR STANDARDS ACT FOR THE 21ST CENTURY

D. MARK WILSON

The time has come to modernize the 63-year-old Fair Labor Standards Act (FSLA) to meet the realities of the 21st century workplace. The focus of reform must go beyond conventional deliberations about raising the minimum wage. Policymakers should concentrate on removing outdated and counterproductive statutory and regulatory barriers to innovative workplace compensation plans that benefit both workers and business.

Modernizing the FLSA has the potential to improve the ability of today's working parents to balance their work and family life, increase flexibility in establishing policies that meet the varying needs of different workers and businesses, and meet the challenges of competing in the worldwide marketplace. Substantive reform can be accomplished without issuing a single new federal mandate. Congress can accomplish the critical reform of FLSA simply by freeing employers and workers from the inflexible and confusing requirements of a law that was written for a different era.

THE NEED FOR REFORM

America's economy and labor force have changed significantly since the FLSA was first enacted, yet few provisions of the Act have been updated to reflect those changes. The mix of jobs has shifted away from manufacturing toward services, and technology has changed the duties and responsibilities of nearly every job. The old line between workers and managers has blurred as businesses have reduced management layers and workers have been given the duties and decision-making responsibilities once reserved for supervisors. Outdated FLSA rules have led to confusing and inconsistent classifications of similarly situated workers, and advances in telecommunications have rendered old FLSA rules unfair regarding the treatment of inside and outside sales employees. Perhaps most significantly, in more than 70 percent of two-parent households both parents are employed and face substantial challenges in balancing the demands of the family and the workplace.

Produced by the
Thomas A. Roe Institute for
Economic Policy Studies

Published by
The Heritage Foundation
214 Massachusetts Ave., N.E.
Washington, D.C.
20002–4999
(202) 546-4400
http://www.heritage.org

This paper, in its entirety, can be found at: *www.heritage.org/library/backgrounder/bg1457.html*

POLICIES FOR THE 21ST CENTURY

As the 107th Congress begins its debate over the minimum wage and the FLSA, legislators should consider five important principles to ensure that both workers and employers receive the greatest benefit from modernizing the law. These principles should form the foundation of effective FLSA reform: The Act should allow for a variety of innovative compensation and benefit options; the options should be voluntary, not mandated by government; the options should be flexible and revocable; compliance should be simplified to the greatest extent possible; and the legislation should provide reasonable protections for both workers and employers.

POLICIES FOR REFORM

Flexible Credit Hour (comp-time) Programs. In 1978, Congress recognized the benefit of flexible schedules when it passed the Federal Employees Flexible and Compressed Work Schedules Act that allows federal employees the choice of taking overtime pay either in cash or in the form of paid time off. Policymakers should strongly consider extending to all workers the same opportunity that federal employees have enjoyed for over 20 years.

State Flexibility. Since 1996, Congress has wisely given the states the responsibility and flexibility to bring welfare recipients into the workforce and authority to design and implement their own workforce development programs. To build on those successful approaches, policymakers should also give the states the flexibility they need to adapt their own entry-level wage policies to local economic, demographic, and development needs.

Bonus and Gainsharing Programs. The FLSA limits the use of bonus and gainsharing programs by employers and restricts their benefit to workers. In 2000, Congress removed the FLSA restrictions on the ability of employers to offer stock options to non-exempt workers. Policymakers should take the next step and remove obstacles to performance bonuses and gainsharing plans in the FLSA.

Update the Exemption Tests. The FLSA "white-collar" exemptions are not defined in the Act, but rather in regulations that have remained essentially unchanged since 1954. These antiquated rules often lead to confusing and inconsistent classifications of similarly situated employees. To remedy this problem, policymakers should update and simplify the FLSA salary-basis and duties tests to ensure clarity and practical application.

Treat Sales Workers Fairly. Under the FLSA, outside and inside sales employees are treated differently even though they perform the same type of work in many instances. The only reason these two sales forces are treated differently is that one works face-to-face with customers and the other uses modern technology to communicate. Congress should add an exemption to the FLSA that would allow employers to treat inside and outside sales employees consistently and limit the divisiveness created under current law.

CONCLUSION

The FLSA was enacted to protect unskilled, low-pay workers. But today, when both parents have to work and the need for flexibility in work schedules is so great, the rigid provisions of the FLSA hurt American workers more than they help. Modernizing the FLSA will make it possible for employers to create a more family-friendly workplace for American workers and make performance bonus programs more widely available. This will help to increase employee effectiveness and job satisfaction while decreasing turnover rates and absenteeism. New federal mandates are not necessary to achieve this: Congress can accomplish the intended reform of FLSA simply by freeing employers and workers from the inflexible requirements of a law that was written 63 years ago.

—D. Mark Wilson is a Research Fellow in the Thomas A. Roe Institute for Economic Policy Studies at The Heritage Foundation.

The Heritage Foundation
Backgrounder
214 Massachusetts Avenue, N.E. Washington, D.C. 20002-4999 • (202) 546-4400 • http://www.heritage.org

No. 1457 July 12, 2001

MODERNIZING THE FAIR LABOR STANDARDS ACT FOR THE 21ST CENTURY

D. MARK WILSON

As the 107th Congress begins its debate over the minimum wage and the Fair Labor Standards Act (FLSA), policymakers should look beyond increasing the minimum wage in addressing the needs of today's workforce. The FLSA needs to be updated to give workers greater flexibility in ordering their lives, both on and off the job, and to permit employers to reward workers financially for improving productivity and profitability without being burdened with the unpredictable and complex requirements of a Depression-era labor law.

America's economy and labor force have changed significantly since the FLSA was passed in 1938, yet few provisions of the Act have been updated to reflect those changes. The mix of jobs has shifted away from manufacturing toward services, and technology has changed the duties and responsibilities of nearly every job. The old line between workers and managers has blurred as businesses have reduced management layers and workers have been given the duties and decision-making responsibilities once reserved for supervisors. More employees are demanding the opportunity to participate in innovative pay and benefits plans such as stock options and bonus programs. Outdated and confusing rules make compliance with the FLSA difficult, particularly for smaller businesses. FLSA reforms are long overdue.

As the FLSA debate unfolds , policymakers should keep in mind five important principles to ensure that both workers and employers receive the greatest benefit from modernizing the law. The FLSA should allow for a variety of innovative compensation and benefit options; the options should be voluntary, not mandated by government; the options should be flexible and revocable; compliance should be simplified to the greatest extent possible; and the legislation should provide reasonable protections for both workers and employers.

The time has come to modernize the FLSA for the 21st century workplace. The focus should be on removing statutory and regulatory barriers to private-sector initiatives that will improve the ability of working parents to balance their work and family life, increase flexibility, and meet the

Produced by the
Thomas A. Roe Institute for
Economic Policy Studies

Published by
The Heritage Foundation
214 Massachusetts Ave., N.E.
Washington, D.C.
20002–4999
(202) 546-4400
http://www.heritage.org

This paper, in its entirety, can be found at: *www.heritage.org/library/backgrounder/bg1457.html*

evolving challenges of competing in the worldwide marketplace. Specifically, Congress should:

- Enable private-sector employers to offer flexible credit hour or compensatory time (flex-time or comp-time) programs;[1]
- Give states the flexibility to adapt their own entry-level wage policies to their specific economic, demographic, and development needs;
- Remove obstacles that employers face when they attempt to provide performance bonuses and gainsharing plans to workers who are paid by the hour;
- Update the FLSA rules that lead to confusing and inconsistent classifications of similarly situated workers; and
- Equalize the unfair treatment of inside and outside sales employees.[2]

Updating the FLSA will make it possible for employers to create a more family-friendly workplace and make performance bonus programs more widely available. This will help to increase employee effectiveness and job satisfaction while decreasing turnover rates and absenteeism. New federal mandates are not necessary in this process; Congress can modernize the FLSA simply by freeing employers and workers from the inflexible requirements of a law that was written over 60 years ago.

WHY REFORMS ARE NEEDED

America's economy and labor force have changed dramatically since the Fair Labor Standards Act was passed in 1938, yet few provisions of the Act have been updated to reflect those changes. For example:

- The mix of industries and occupations has shifted away from manufacturing toward services, and sophisticated technologies have reshaped the duties and responsibilities of nearly every job.
- Women account for nearly 47 percent of the labor force today, up from 29 percent in 1950.[3]
- In 1999, over 71 percent (18.7 million) of households of married couples with children had both parents working.[4] Nearly 72 percent of single women and 80 percent of single men who headed families with children worked.[5]
- Since 1954, major statutory changes to the FLSA have focused only on extending the law's coverage and increasing the minimum wage.[6]

Concerns over the well-being of the family often force parents to leave jobs that do not fit their families' schedules, or to forgo jobs that better suit their talents but would put additional strain on their families. Such scenarios would be less frequent if more flexible work schedules were allowed by the FLSA in the private sector.

Labor–management relations have also changed since the FLSA was passed, and workers are now demanding innovative pay and benefits plans not envisioned by the Act. For example:

- Employees have taken on expanded and more complex roles. Businesses restructuring during the 1980s and 1990s significantly reduced the layers of management at many companies and front-line workers have been given the duties and decisionmaking responsibilities once reserved for managers.

1. The terms flex-time and comp-time are often used interchangeably.
2. This paper, which focuses only on the FLSA, does not attempt to address the complex issue of independent contractors. The Fair Labor Standards Act, the National Labor Relations Act, and the Internal Revenue Code all have different independent contractor tests that result from their different policy goals. Congress should also rationalize the various tests for determining who is an independent contractor.
3. Bureau of Labor Statistics at *http://stats.bls.gov/webapps/legacy/cpsatab1.htm* (June 21, 2001).
4. U.S. Bureau of the Census, "Money Income in the United States: 1999," Report No. P60–209, September 2000, p. 21.
5. Heritage Foundation calculations based on March 2000 Current Population Survey data.
6. U.S. Department of Labor, *Minimum Wage and Maximum Hours Standards Under the Fair Labor Standards Act,* 1988, p. 8.

- Increased competition for employees has engendered innovative reward systems. Businesses have responded to increasing competition by offering bonus and gainsharing programs to salaried employees for meeting performance, quality, productivity, or health and safety goals. The FLSA, however, discourages companies from offering these pay incentives to workers who are paid by the hour.
- Employees have embraced opportunities to share in their companies' profits, but such opportunities have been limited in the past. In 2000, Congress took a step to make these opportunities more available by fixing a problem with the FLSA that restricted the ability of employers to offer popular stock option programs to workers covered by the Act.[7]

Outdated and confusing rules make compliance with the FLSA difficult, particularly for smaller businesses. For example:

- The salary test that employers use to determine which workers are covered by the Act has not been updated since 1975.
- FLSA regulations also have two duties tests: a long test for lower paid workers and a short test for workers paid at least $250 per week. In 1999, the U.S. General Accounting Office found that the tests lead to confusing and inconsistent classifications of similarly situated workers.[8]

A number of federal workplace programs have been reformed over the past ten years, but very little has been done to modernize the FLSA. In 1996, Congress reformed federal welfare programs and gave states greater flexibility to develop innovative ways to move welfare participants into jobs. In 1998, Congress updated federal job training programs and provided states with greater authority to create effective workforce development programs. In 2000, Congress and President Clinton lifted the FLSA restriction on providing stock options for workers who are paid by the hour. Now is the time to move forward with other long overdue FLSA reforms.

KEY PRINCIPLES FOR REFORM

As the 107th Congress begins its debate over the minimum wage and the Fair Labor Standards Act, legislators should consider five important principles to ensure that both workers and employers receive the greatest benefit from modernizing the law. These principles should form the foundation of effective FLSA reform. A reformed FSLA should:

- **Allow a variety of innovative compensation and benefit options.** The 21st century workplace should not be constrained by a wage and hour law passed in a bygone era. Employers should be able to provide a comprehensive set of compensation and work schedule choices that will empower workers to select the option that best meets the specific needs of their families.
- **Ensure the voluntary nature of the options.** Congress should ensure that FLSA reforms are voluntary for both employer and worker. Government should not mandate the available options. Because each workplace is unique, each employer should have the options of offering, or not offering, flexible work schedules and compensation packages. For example, flex-time may work well in some businesses, while compressed workweeks may work better in others. Workers should also be able to choose between continuing in traditional pay programs or switching to new ones.
- **Ensure the flexibility of options.** Congress and the Department of Labor should not attempt to micromanage the FLSA reforms by writing unnecessary legislative or regulatory requirements, which could have different impacts in different workplaces. States and employers are in the best position to design programs that suit their labor market and

7. The Worker Economic Opportunity Act, P.L. 106–533.
8. U.S. General Accounting Office, "Fair Labor Standards Act: White-Collar Exemptions in the Modern Work Place," GAO/HEHA–99–164, September 30, 1999.

workplace needs within broad guidelines. Burdensome regulations will only discourage employers from offering such options as flexible schedules and bonus-sharing programs to their paid-hourly workers.

- **Simplify compliance.** Since 1938, the line between professional workers who are exempt from FLSA requirements and workers covered by the Act has become increasingly blurred. The U.S. Department of Labor should modernize and simplify the regulation employers use to determine which workers are covered by the FLSA. Moreover, the Department of Labor should provide employers, particularly small businesses, with easy to understand compliance assistance and the opportunity to correct mistakes before being prosecuted and fined.
- **Provide reasonable protections to both workers and employers.** Employers should be prohibited from coercing workers into flexible work schedules and new compensation programs. Employees should be fully informed about any new program before agreeing to participate in it and they should be able to withdraw from the plan if it does not suit their needs. Finally, employers should be able to discontinue offering flexible schedules at any time if they unduly disrupt the business.

WHAT CONGRESS SHOULD DO

The time has come to modernize the FLSA for the 21st century workplace. The focus should be on removing statutory and regulatory barriers to private sector initiatives that will improve ability of working parents to balance their work and family life, continue to increase flexibility for states, and permit employers to reward workers financially for improving productivity and profitability. Employer and employee protections should be maintained while confusing and inconsistent rules are updated and workers are treated with more equitability.

Flexible Credit Hour (flex-time) Programs

In 1978, Congress recognized the benefit of flexible schedules when it passed the Federal Employees Flexible and Compressed Work Schedules Act. This Act allows federal employees the choice of taking overtime pay either in cash or in the form of paid time off. As a result of this innovation, federal workers are more productive, less absent, and have a greater sense of personal control and autonomy over both their time and money.[9] Policymakers should strongly consider extending to all workers the same opportunity that federal employees have enjoyed for over 20 years.

- Flex-time and compensatory time (comp-time) programs allow workers, at their own request, to work additional hours one week in order to be able to take hours off, with pay, in another week.[10] For example, federal workers can work an extra hour each day during one week and "bank" those five credit hours to use when they want to take paid time off, whether they do so the following week, the following pay period, or the next month.[11]
- Flex-time programs should be voluntary for both employer and worker. Each employer should be able to decide whether or not to implement this option, depending on the needs and nature of their business
- Workers should also be able to choose between continuing to work a standard workweek with overtime pay or accruing paid time off to use in the future. Both employers and workers also should be able to revoke the use of flexible

9. Simcha Ronen, *Flexible Working Hours: An Innovation in the Quality of Work Life* (New York, N.Y.: McGraw-Hill, 1981). Surveys conducted in 17 federal agencies strongly suggest that the effectiveness of the agencies was improved through increases in productivity and decreases in tardiness and absenteeism. Employee attitudes toward their jobs and the work environment also improved, carpooling increased, and commuting time declined.
10. The terms flex-time and comp-time are used interchangeably in this study to refer to programs that allow workers to take paid time off in lieu of overtime pay.
11. D. Mark Wilson, "Flex-Time for Families: What Works for the Government Can Work for the Private Sector," Heritage Foundation *F.Y.I.* No. 132, February 26, 1997.

schedules at any time and cash out accrued leave.

- Flex-time programs should provide reasonable protections to both workers and employers without policymakers' micromanaging flexible schedule options by writing unnecessary legislative or regulatory requirements. Employers should be prohibited from coercing a worker into using flex-time instead of being paid in cash for overtime work and, before agreeing to a flexible plan, employees should be fully informed about how flexible schedules work and the options that are available.

- Employees also should be permitted to use accumulated comp-time hours within a reasonable period of time as long as it does not unduly disrupt the operations of the employer. This is the same standard that federal managers follow.

Representative Judy Biggert (R–IL) has introduced the Working Families Flexibility Act (H.R. 1982) and Senator Judd Gregg (R–NH) has introduced the Workplace Flexibility Act (S. 624), both of which would give employers the option of offering their workers the choice of paid time off or cash wages for overtime hours worked. Both bills would require employers and workers to complete a written agreement in order to participate in a comp-time program. Both bills would also retain all of the employee protections in the FLSA and add new protections to ensure that the choice and use of comp-time is truly voluntary. As is currently the case with overtime pay, comp-time would accrue at a rate of one and one-half hours of comp-time for each hour of overtime worked. Workers would be able to accrue up to 160 hours of comp-time annually and both bills would require employers to pay cash wages for any unused, accrued time at the end of the year. Workers who opted to receive cash wages could continue to receive wages for their overtime.

Flexible work schedules benefit families in a way the family and medical leave provision does not—with paid time off. Working a few extra hours one week in order to take paid time off later provides families with the time they need when they need it, without crimping their budgets. Currently, most workers can take advantage of short-term unpaid leave for family responsibilities, but at a cost—their lost pay. Flexible work schedules would increase a family's sense of control over both their time and their money.

Now that more families have both parents in the workforce, American workers need flexible schedules and compensation packages. The Fair Labor Standards Act, however, does not allow employers to offer such flexibility. Providing choices such as the options of receiving overtime pay as cash or as paid time off will enable workers to more effectively balance the demands of the workplace with the needs of their families. Congress can make this happen by giving private-sector workers and employers the same flexibility that is currently enjoyed by federal workers and agencies.

State Flexibility

In 1996, Congress wisely gave the states the responsibility of bringing welfare recipients into the workforce and flexibility regarding the means they use to accomplish this.[12] In 1998, Washington provided states with the flexibility to design and implement their own workforce development programs.[13] To build on those successful approaches, policymakers should also give the states the flexibility they need to adapt their own entry-level wage policies to local economic, demographic, and development needs.

Under the state flexibility (state-flex) approach to setting entry-level wages, each state would have five options when the federal minimum wage is raised:[14]

12. Temporary Assistance for Needy Families, P.L. 104–193.

13. Workforce Investment Act, P.L. 105–220.

14. "State Flexibility: The Minimum Wage and Welfare Reform," Employment Policies Institute, March 2001.

- Raise the state wage at the same pace as the federal minimum wage rises above $5.15 per hour (this would happen automatically if states take no action);
- Keep the state rate constant at its current level to reflect state and local labor market conditions;
- Establish regional rates to address local economic, demographic, and development needs in the state;
- Raise the state rate, but more slowly than the federal rate hike or to a wage that may be lower than the new federal minimum wage, while above $5.15 per hour; or
- Raise the state rate higher and/or more quickly than the federal rate hike.

States already have the authority to implement an entry-level wage rate that is higher than the federal rate. This FLSA reform would simply give the states the flexibility to set their own schedule and rate structure at or above the current federal minimum wage of $5.15 per hour.

Representative Jim DeMint (R–SC) has introduced the Minimum Wage State Flexibility Act of 2001 (H.R.1441) that would allow states that set their minimum wage to at least $5.15 per hour the flexibility to adapt their minimum wage to local economic and labor market conditions.

State-flex would enable each state to tailor its entry-level wage to its unique demographic and labor market challenges. Economic conditions vary widely among the states. For example, in October 2000, when the national unemployment rate fell to a 30-year low of 3.9 percent, Connecticut had the lowest unemployment rate (1.8 percent), while New Mexico and West Virginia had the highest rates (5.5 percent) in the lower 48 states.[15] Moreover, employment growth from April 2000 to April 2001 was strongest in Vermont (5.1 percent), while West Virginia had the largest employment loss (-1.7 percent).[16]

A one-size-fits-all federal minimum wage undermines state efforts to move Americans from welfare to work. If there is a minimum wage, it should at least reflect the significant differences in the cost-of-living and general wage levels that exist among the states and even in different regions of the same state. Currently, federal policy recognizes the wide economic variations across the country and leaves it up to the states to set benefit levels for both welfare and unemployment insurance. In January 2000, welfare benefits for a family of three (1 adult, 2 children) ranged from $164 per month in Alabama to $923 per month in Alaska.[17] Minimum weekly unemployment benefits range from $5 in Hawaii to $94 in Washington, while the maximum weekly benefit ranges from $190 in Mississippi to $646 in Massachusetts.[18]

The federal government officially recognizes state labor market differences when paying its own employees. Beginning in January 2001, the basic hourly wage rate for entry-level federal positions varies from $7.35 in Orlando, Florida, to $7.98 in San Francisco, California.[19] A national minimum wage makes as much sense as requiring Washington to pay federal workers the same wage for an entry-level job in New York City as it does in Fargo, North Dakota, where the cost of living is much lower.

With such wide differences in employment opportunities, governors and state legislators are in a better position than are policymakers in Washington, D.C., to determine the appropriate

15. Bureau of Labor Statistics, "Regional and State Employment and Unemployment: April 2001," May 18, 2001.
16. Six other states have also lost employment over the past year: Connecticut, Illinois, Michigan, Mississippi, Montana, and Oregon.
17. U.S. Department of Health and Human Services, *Temporary Assistance for Needy Families Program: Third Annual Report to Congress*, August 2000, p. 247.
18. *2000 Green Book,* Committee on Ways and Means, U.S. House of Representatives, 106th Cong., 2nd Sess., October 6, 2000, p. 293.
19. U.S. Office of Personnel Management, Locality Pay Schedule, available at: *http://www.opm.gov/oca/01tables/GShrly/gshrpdf/01salhr.pdf*.

entry-level wage levels for their own areas. State legislators understand the living and working conditions in their districts and how a minimum wage rate change would affect economic conditions, job opportunities, and welfare reform for their constituents. The experience of the states in successfully moving people from welfare to work thus far will augment this knowledge and help them to make appropriate decisions—if the federal government does not continue to tie their hands.

Bonus and Gainsharing Programs

The Fair Labor Standards Act makes two stipulations concerning bonus and gainsharing programs that limit their use by employers and restrict their benefit to workers.[20] First, bonuses paid to covered or non-exempt employees may have to be treated as part of the employee's regular rate of pay for the purpose of calculating overtime pay.[21] This adds to the complexity and cost of the programs and discourages their use. Second, the FLSA requires non-discretionary bonuses that reward employees (either individually, as a team, or as a workplace) for meeting performance measures such as quality, productivity, or health and safety goals, be included as part of the regular rate of pay for the purposes of computing overtime pay.[22] Although intended to prevent evasion of needed worker protections, this deters companies from developing innovative compensation programs that fully motivate and reward all their workers.

Adding to the confusion is the different treatment profit-sharing and gainsharing programs have under the FLSA. Payments made to workers under profit-sharing plans do not run afoul of the FLSA provisions, while payments to employees based on other performance measures are subject to FLSA restrictions.[23]

In 2000, Congress fixed a similar problem with the FLSA that restricted the ability of employers to offer stock options to non-exempt workers.[24] That effort shows that the 63-year-old FLSA can be modernized for the 21st century workplace. Policymakers should take the next step and remove obstacles to performance bonuses and gainsharing plans in the FLSA. Specifically, Congress should:

- Provide that an employee's regular pay rate, for purposes of calculating overtime compensation, will not be affected by additional payments that reward an employee or group of employees for meeting or exceeding productivity, quality, efficiency, or sales goals under a gainsharing, incentive bonus, commission, or performance contingent bonus plan.
- Enable a wide variety of bonus and gainsharing programs. For example, employees should be able to be paid bonuses on a per-capita basis (where each employee receives the same amount if a certain goal is reached or exceeded), or, alternatively, bonuses could vary according to individual or group performance. Employers should also be able to end the

20. Gainsharing programs link employee bonuses to measurable improvements in productivity. Employees are given individual or group productivity goals and the savings achieved from such improvements, or the gains, are then shared between the company and the employees. The payouts are based directly on factors under an employee's control, such as productivity or costs, rather than on the company's profits.
21. Bonuses paid to professional, managerial, and administrative (exempt) employees require no particular recordkeeping or compensation treatment.
22. If a bonus is paid for meeting performance measures, the employer must compute the bonus as part of the employee's regular rate of pay for the entire period of work on which the level of performance has been achieved. The employer must then divide the bonus by all of the hours worked by the employee and retroactively include that amount in the hourly rate used to determine overtime pay. Bonuses for which the employer has the sole discretion as to their payment and amount are not required to be included as part of the employee's regular rate of pay.
23. The FLSA excludes from the calculation of the regular rate of pay any payments that are made pursuant to a bona fide profit-sharing plan, trust, or bona fide thrift or savings plan to the extent the amounts paid to an employee are determined without regard to hours of work, production, or efficiency.
24. The Worker Economic Opportunity Act, P.L. 106–533.

programs, following a reasonable notice and the payment of all bonuses earned.

- Maintain worker protections. For example, programs should not be utilized on an ad hoc basis and bonuses should be over and above an employee's regular base pay. The programs should be in writing, clearly specifying the formula by which performance bonuses are paid and when they are paid, and this information should be made available to employees.

The goal of FLSA modernization should be to provide protections against abuse while allowing flexibility for employers and employees to structure plans for rewards and payments in ways that best meet their needs. Currently, the law tries to balance these two factors but does so in a way that discourages employers from providing bonus and gainsharing programs to their non-exempt hourly employees. These sensible reforms would encourage the greater use of performance bonuses while maintaining protections against abuse.

Representative Cass Ballenger (R–NC) has introduced the Rewarding Performance in Compensation Act (H.R.1602) that would allow employers to make payments to employees for meeting or exceeding productivity, quality, efficiency, or sales goals under a gainsharing, incentive bonus, commission, or performance contingent bonus plan. This would give hourly, non-exempt employees the same access to bonuses and gainsharing programs that exempt employees receive.

Bonus and gainsharing programs have real benefits for workers. They enable employees to have more control over their jobs and more involvement in workplace decision-making, which raises productivity and increases compensation—both wages and bonuses.

A number of studies have shown that gainsharing programs improve productivity and increase pay for workers.[25] One study found that gainsharing programs improved productivity by an average of 23 percent in the first two years they were implemented and that workers earned average bonuses equal to 17 percent of gross pay during that two-year period.[26] Another study of all firms known to have gainsharing plans found that the median firm experienced a 5 percent to 15 percent increase in productivity while the median bonus received by workers was equal to 6 percent of wages and salaries.[27] Not only do bonus and gainsharing programs help achieve more productive businesses and higher pay for employees, but they also are an important part of meaningful employee involvement, allowing employees to have a greater share in their company's success.

Despite the benefits of performance bonus and gainsharing plans for employees, the FLSA currently discourages employers from offering such plans to their non-exempt employees. The problem stems from the fact that the U.S. Department of Labor is applying a 63-year-old labor law to a workplace that was not envisioned when it was enacted. At the same time, employers are confronted with the challenge of understanding and complying with regulations implementing a law that makes little sense in the current reality of work, the workplace, and workers of today. Unless the FLSA is reformed, many firms will remain reluctant to implement bonus and gainsharing programs, despite their obvious advantages. This will restrain productivity and economic growth. Moreover, it will impede an important means of improving real wage growth and providing a higher standard of living for American workers.

Updating the Exemption Tests

The Fair Labor Standards Act exempts workers who are employed in an executive, administrative, or professional capacity from the Act's wage and hour requirements. However these "white-collar" exemptions are not defined in the FLSA, but are

25. Testimony of Anita U. Hattiangadi before the Subcommittee on Workforce Protections, Committee on Education and the Workforce, U.S. House of Representatives, 105th Cong., 2nd Sess., July 16, 1998, available at: *http://www.epf.org/commentary/testimony/1998/t980716.asp*.

26. Ibid.

27. Ibid.

instead left to the Secretary of Labor to define by regulation. Problems arise because the regulations have remained essentially unchanged since 1954, while the American labor force and the responsibilities placed on workers have changed dramatically. The old line between white-collar and blue-collar workers has blurred as companies have shed layers of management and empowered front-line workers with decision-making responsibilities.

The FLSA regulations establish two tests to determine which workers are exempt from the Act's wage and hour requirements—a salary requirement and a duties requirement. The salary-basis test requires workers be paid a salary (not on an hourly basis) and that the level of the salary must indicate managerial or professional status. The duties test requires that employees' job duties and responsibilities include managerial or professional skills. For workers to be exempt, they must meet both criteria.

In 1999, the U.S. General Accounting Office reviewed the antiquated FLSA regulations. It found that uncertainties and difficulties with the two criteria lead to confusing and inconsistent classifications of similarly situated employees; that the tests do not take into account the effect of modern technology on employment; that inflation has eroded the salary exemption levels since they were last updated in 1975; and that lower-pay supervisory employees may have inadequate protection.[28] The U.S. Department of Labor also notes in its May 2001 Semiannual Regulatory Agenda that the "salary level tests are outdated and offer little practical guidance in applying the exemption."[29] It goes on to say that "clear, comprehensive, and up-to-date regulations would provide for central, uniform control over the application of these regulations and ameliorate many concerns."

To remedy this problem, policymakers should:

- Update and simplify the FLSA salary-basis and duties tests to ensure clarity and practical application. Any new test for exemption should also be flexible enough to recognize existing industry practices, the nature of the work performed, and the possibility of future changes in the workplace.
- Allow employers to retroactively correct a worker's pay if he or she has mistakenly been classified as exempt.
- Allow pay deductions for part-day absences and raise the salary levels for the salary-basis test.
- Treat additional highly skilled, well-paid workers as exempt because their specialized knowledge is equivalent to that of exempt professionals in many instances. For example, in 1992, Congress exempted certain computer professionals who earn over 6.5 times the minimum wage even though they are paid by the hour.[30]

The economic changes that have occurred over the past 63 years since the passage of the FLSA make it increasingly important to readjust its implementing regulations to meet the needs of the modern workplace. Updating the rules, however, will require carefully balancing the employers' need for clear and unambiguous regulatory standards with the employees' demand for fair treatment in the workplace.

Treating Sales Workers Fairly

Under the Fair Labor Standards Act outside and inside sales employees are treated differently even though they perform the same type of work in many instances. Specifically, sales employees who travel out of the office to a customer's place of business are treated as professional salaried employees. However, employees who conduct sales from inside a company are subject to the FLSA wage and hour requirements.

In many companies, there is no meaningful difference between the type of work that inside and outside sales employees perform. The only reason

28. U.S. General Accounting Office, "Fair Labor Standards Act: White-Collar Exemptions in the Modern Work Place."

29. *Federal Register*, Vol. 66, No. 93 (May 14, 2001), p. 25687.

30. P.L. 101–583, Section 2.

these two sales forces are treated differently by the FLSA is that one works face-to-face with customers and the other uses modern technology to communicate. The FLSA and its implementing regulations are outdated and few substantive changes have been made to the Act that recognize the realities of the modern workplace and the impact of the Internet.

Congress should add an exemption to the FLSA that mirrors the outside sales exemption but is tailored to the duties performed by inside sales employees. This would allow employers to treat inside and outside sales employees consistently and limit the divisiveness created under current law while providing for the maximum flexibility for employers.

Representative Patrick Tiberi (R–OH) has introduced the Sales Incentive Compensation Act (H.R. 2070) that would provide for a narrower exemption of certain inside sales workers who meet certain duties and compensation tests. Specifically, the bill provides an exemption from the FLSA's wage and hour requirements for certain inside sales employees who use the telephone, fax, and computer. It also includes protections to ensure that inside sales employees who meet specific duty tests will receive a base salary, guaranteed commissions, and continuing incentives. The duties test, for example, would require that the employee has a thorough understanding of the client's needs or specialized or technical knowledge about the employer's products or services.

Unlike telemarketers, inside sales employees are highly trained and usually have detailed technical knowledge about the products and services that they are selling. They often develop close working relationships with customers and perform the same activities as outside sales employees who work away from the office and travel to a customer's place of business. However, though inside sales employees have a compensation structure similar to outside sales employees, because they are subject to the FLSA overtime requirements, employers limit the amount of time they may work and thus the number of sales they can make, curbing incentive pay. The result is a two-tiered class of sales employees. Exempt outside sales employees have the freedom to work as needed for additional incentive pay, while non-exempt inside sales employees are relegated to a 40-hour workweek and occasional overtime, if they are lucky. Congress should modernize the FLSA to treat inside and outside sales employees fairly.

CONCLUSION

The Fair Labor Standards Act was enacted to protect unskilled, low-pay workers. But today, when both parents of more and more families have to work and the need for flexibility in work schedules is so great, the rigid provisions of the FLSA hurt American workers more than they help. The FLSA's outdated provisions also deny many workers the ability to participate in bonus and gainsharing programs that would increase their take-home pay.

Updating the FLSA will make it possible for employers to create a more family-friendly workplace for American workers and make performance bonus programs more widely available. This will help to increase employee effectiveness and job satisfaction while decreasing turnover rates and absenteeism. New federal mandates are not necessary for this to be achieved: Congress can accomplish the intended reform of FLSA simply by freeing employers and workers from the inflexible requirements of a law that was written 63 years ago.

—D. Mark Wilson is a Research Fellow in the Thomas A. Roe Institute for Economic Policy Studies at The Heritage Foundation.