Regulation Review

“White Collar” Overtime Expansion

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The Department of Labor (DOL) is rolling out a new rulemaking that will extend overtime pay requirements to previously-uncovered groups of employees. Under the Fair Labor Standards Act (FLSA), DOL can exempt “executive, administrative, professional, outside sales, and computer employees” above a certain wage level from FLSA’s overtime requirements. As part of the administration’s ongoing campaign to set further wage standards, this proposal increases that threshold, bringing millions of employees into the fold.

BREAKDOWN

Annualized Costs: $265.8 Million (Direct Costs + Deadweight Loss)

Annual Paperwork Burden: 231,250 Hours

ANALYSIS

One of most curious aspects of this proposal is how difficult it may be to truly discern the effects, and therefore costs. The proposed rule’s analysis says that it will impose roughly $255 million in direct costs to employers each year. However, there is no clear total cost figure.

DOL finds that in the first year, due to a steep familiarization and implementation curve, employers will face $592.7 million in costs. Beyond that first year, the annual costs span a wide, unclear range that varies due to the combination of a progressively lower “learning curve” yet higher pool of covered employees. The “Year 2” level is $188.8 million and the “Year 10” level is $225.3 million. Using the average of those two bookends yields roughly $2.46 billion. Although in the absence of estimates for the intervening years, it is difficult to know the accuracy of this calculation.

Further questions about DOL's cost estimates abound when examining their underlying assumptions. All of DOL's analysis is based on setting the exemption threshold at "$921 per week, or $47,892 annually for a full-year worker, in 2013." However, DOL then acknowledges that, by the time the final rule becomes effective, that threshold will be higher, stating: "Assuming two percent growth between the first quarter of 2015 and the first quarter of 2016, the Department projects that the 40th percentile weekly wage in the final rule would likely be $970, or $50,440 for a full-year worker." The White House echoed this figure in a blog post on the proposal.

Presumably, DOL used the 2013 data because it was the only data available when they began crafting the rule. Yet, there is no attempt to estimate the costs using the $50,440 per year threshold as an underlying baseline. Even though that figure would still be the 40th percentile, relatively speaking, the absolute number of covered employees would still be greater. Since DOL bases its direct employer costs on the number of affected entities and employees, their cost estimates should see a corresponding increase. Given the limited data provided, it is difficult to discern the degree of this difference, but it still points to understated estimates.

Beyond the direct compliance costs that employers will face in adjusting to these new standards, there are important implications for the labor market overall. DOL estimates that, on average, newly covered workers will see an increase in their average hourly wage. Yet, as DOL recognizes in its "Deadweight Loss" (DWL) analysis, this represents an increase in the cost of that labor: "As the cost of labor rises due to the requirement to pay the overtime premium, the demand for overtime hours decreases, which results in fewer hours of overtime worked." DOL finds that the average DWL in monetary terms equals roughly $7.4 million in forgone wages. But how does that translate in terms of hours? DOL finds that the typical worker will lose roughly 0.4 hours per week.

This may seem like a paltry amount. But when expanded to the annual level and multiplied by the approximately one million workers affected by this phenomenon, it cumulatively yields more than 21.2 million hours of forgone labor each year. Using a recent DOL figure for Real GDP per hour worked, this constitutes roughly $1.3 billion in lost productivity. Interestingly, DOL attempts to argue that this rule could result in *increased* productivity due to "increased marginal productivity as fewer hours are worked, reduction in turnover, efficiency wages, and worker health." However, they fail to marshal any quantified estimates of these trends.

This proposed rule represents another significant piece of the administration's campaign to mold labor practices via executive action. Even by the standards of their own estimates, it will have a substantial effect on the economy. However, digging deeper, one finds that those

estimates are (knowingly) built on understated assumptions and incomplete calculations.