



Research

Primer: Overtime Pay Regulation

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EXECUTIVE SUMMARY

American Action Forum (AAF) research finds that expanding overtime pay requirements for salaried workers would impact very few people and minimally affect those in poverty. In March, President Obama directed the Department of Labor to change labor rules and expand the number of people eligible to receive overtime pay. The evidence suggests, however, that expanding overtime pay requirements is a dismal tool to boost earnings among low income workers. AAF finds:

- Expanding overtime pay will only help 0.5 to 6.7 percent of salaried workers.
- Less than 1 percent of all salaried workers will be impacted by expansions in overtime pay and are in poverty.
- 69.0 to 91.2 percent of those affected by expansions in overtime pay have family incomes at least 2 times the poverty line.
- Over 60 percent of those affected by the rule change do not have dependent children.

Intuitively, expanding overtime pay rules would assist so few people in need because most salaried overtime workers are already well compensated. As a result, instead of substantially improving the livelihood of low-income families, these rule changes will impose additional costs on the labor market, which likely will be in the form of layoffs, reduced hiring, and higher prices.

INTRODUCTION

76 years ago federal wage and hours standards were established during the Great Depression in response to reports of inhumane child labor. Two of the most prominent standards enacted were the federal minimum wage and overtime pay, which lawmakers have periodically expanded each over time. Today policymakers are once again calling for expansions in these requirements. While minimum wage proposals at federal, state, and city levels have received the most attention, President Obama in March directed the Department of Labor (DOL) to expand the number of salaried workers covered by federal overtime standards. With efforts to expand overtime pay underway, it is important to understand how the DOL plans to expand coverage, who will be affected by any rule changes, what potential impact it could have on labor markets, and ultimately how successful it will be as a tool to increase incomes and fight poverty.

HOW CAN THE DOL EXPAND OVERTIME PAY COVERAGE?

Under the Fair Labor Standards Act (FLSA), employees who work more than 40 hours per week must be paid

1.5 times their usual pay rate for each overtime hour. However, certain categories of workers, primarily those classified as executive, administrative, or professional employees, are exempt from these requirements and are ineligible to receive overtime pay. This is often referred to as the “white collar” exemption because it generally applies to office jobs that usually pay well. The Secretary of Labor has the authority to “define and delimit” what constitutes the types of employees who are exempt.^[1] So the DOL can change who is required to receive overtime pay by modifying the requirements for the white collar exemption and reducing the number of people who are exempt from FLSA standards.

Today there are three primary requirements to exempt a worker from overtime pay: the worker must be salaried (the salary basis test), the salary must meet a minimum level (the salary level test), and the worker’s duties must align with the definition of an executive, administrator, or professional (the duties test).^[2]

The salary basis test simply requires the worker be paid a “predetermined and fixed salary that is not subject to reductions because of variations in the quality or quantity of work performed.”^[3] As a result, no worker who is paid by the hour can be classified as exempt from FLSA minimum wage and overtime protections.^[4]

The salary level test specifies that the worker’s salary must be at least equal to or above a certain minimum level. Today, the DOL requires that a salaried worker earns at least \$455 per week in order to be exempt from overtime pay. Any pay rate less than that would not be exempt and the worker would be entitled to time and a half pay for any work hours beyond 40 each week.^[5] Raising the minimum salary necessary to exempt a worker from overtime pay historically has been the primary way the DOL expands overtime coverage.

The third requirement is the “duties test,” which requires the worker’s primary responsibilities be related to his or her classification status as either an executive, administrative, or professional employee. The duties test is the most subjective of the three tests and varies by classification. To be classified as an executive employee, the worker must manage a significant portion of the organization, oversee two or more full-time employees, and have significant authority in hiring and firing employees. An administrative exemption only occurs if the employee mainly performs office or non-manual work that directly relates to business operations and he or she must use discretion and individual judgment with important matters. Finally, to be exempt from overtime pay as a professional employee, the worker’s primary responsibilities must be intellectual and require advanced knowledge in his or her field.^[6]

HISTORY OF OVERTIME REGULATIONS AND PERIODIC RULE CHANGES

First introduced by the FLSA, overtime pay was intended to protect factory workers and children from harsh working conditions and low pay. As [AAF previously noted](#), in the 1930s the Labor Department’s Children’s Bureau found that almost 25 percent of children were working at least 60 hours per week, with median weekly earnings of only \$4.^[7] FLSA imposed harsh restrictions on child labor, mandated a minimum wage, and imposed a maximum workweek.

Since the overtime pay requirement was first enforced in 1938, DOL regulators have only raised the salary level test seven times, while adjusting the duties test along with it. Table 1 details the various salary level tests the DOL has enforced.^[8]

Table 1: Weekly Salary Levels for White Collar Exemption (in dollars)				
Year	Executive (long test)	Administrative (long test)	Professional (long test)	Short Test
1938	30	30	None	None
1940	30	50	50	None
1949	55	75	75	100
1958	80	95	95	125
1963	100	100	115	150
1970	125	125	140	200
1975	155	155	170	250
2004	455			

In 1949, the DOL raised the salary threshold for each exemption category and introduced an elevated salary level test that would determine if the employee only had to meet a “short” duties test, which was a less strict version of the original “long” duties test. Starting in 1949, if workers in any of the three exemption categories earned at least \$100 per week, then they would only have to meet the “short” duties test. However, if the workers in an exemption category earned less than the “short” test salary level, but still more than the normal exemption threshold, then they would have to meet the original “long” duties test. For instance, if an executive employee in 1949 earned more than \$55 but less than \$100 per week, then his or her job would have to meet the “long” duties test to be exempt from overtime pay requirements.^[9]

The DOL introduced the “short” test because the “long” test was relatively burdensome to employers. The “long” test placed restrictions on the amount of time an employee could work nonexempt duties, and as a result required employers to closely track moment-to-moment activities. Meanwhile, the “short” test was less of a burden to meet because it related more to the employee’s education and authority within an organization.

After 1949, the DOL raised the salary level test for each exempt category and for the short test every five to ten years. However, after the DOL increased the salary levels in 1975 (\$155 for executive and administrative workers, \$170 for professional workers, and \$250 for the short test), it did not make any more adjustments until

2004.[10]

In 2004, the DOL made several significant changes to these regulations in response to growing evidence that the two-tier duties test was becoming outdated in the modern workplace. The “long” test was particularly rarely used because it was confusing and relative to compensation levels at the time the salary level test was very low. In addition, determining exempt versus nonexempt activities was highly subjective and federal courts frequently denied using time restrictions to limit nonexempt duties in the workplace.[11]

So, instead of having a “long” and a “short” duties test, the DOL enacted a single duties test for each exemption category. In doing so, the DOL terminated most of the time limit requirements that were in the “long” tests and raised the salary level test for each exemption category to \$455 per week. Finally, the DOL introduced a new “highly compensated” test, which is a shorter version of the single duties test that only applies if an employee earns at least \$100,000 per year and \$455 per week.[12]

WHAT SHOULD WE EXPECT FROM THE DOL THIS TIME?

There are two primary levers that the DOL can pull to expand overtime pay coverage. The DOL’s first lever is adjusting the duties tests to be stricter in determining a worker’s exemption status. In particular, the DOL’s elimination of the time requirements in the “long” duties test in 2004 has come under [scrutiny](#). So, the DOL may expand coverage by reinstituting time requirements.

The DOL’s second and more substantial lever is adjusting the salary level test by raising the minimum salary required to exempt an employee from overtime pay. The DOL has yet to announce the new salary level test, but it has been reported that regulators are considering raising it from \$455 per week to anywhere between [\\$550 and \\$1,000 per week](#).

Examining the implications of increasing the salary level test can give a strong sense of how many people will be impacted. The effect that raising the salary level test has on combating poverty and raising incomes is examined below.

OVERTIME PAY REGULATIONS AND COMBATING POVERTY

One of the main arguments for raising the salary level test is that it would be an effective way to fight poverty. However, the rule change would only impact a very specific group of workers who earn a salary, work more than 40 hours per week, and earn above \$455 per week but below the new weekly salary minimum. As a result, raising the salary level test would affect very few people, only a small percentage of whom are in poverty.

In order to analyze the effectiveness of changes in the salary level test, one must examine the characteristics of the population of workers who currently earn salaries between today’s exemption threshold (\$455 per week) and the new salary test level requirement. For instance, if the DOL were to raise the salary level test to \$650 per week, it would only impact salaried workers who earn between \$455 and \$650 per week. Since the exact details of the new salary test are still unknown, it is helpful to examine a range of possibilities. This paper uses 2013 data from the Survey of Income and Program Participation to examine those who would be impacted if the salary level test were raised from \$455 to \$550, \$650, \$750, \$850, \$950, or \$1,050 per week.

First, let's examine exactly how many salaried workers this rule change would affect.

Table 2: Percent & number of all salary workers who earn between \$455 and new potential exemption threshold and work overtime

Weekly Salary Range (\$)	Percent	Number
455 to 550	0.5%	288,600
455 to 650	1.4%	747,922
455 to 750	2.6%	1,369,835
455 to 850	3.8%	2,040,527
455 to 950	5.0%	2,646,180
455 to 1050	6.7%	3,548,564

Table 2 illustrates the percent and number of all salaried workers who earn between \$455 per week and the new exemption level and work more than 40 hours per week. If the DOL raises the salary level test to \$550 per week, only 0.5 percent of salaried workers could potentially see a raise. At most, the DOL would impact only 3,500,000 or 6.7 percent of salaried workers if it more than doubles the salary level test to \$1,050. It is clear that this policy change will have a minimal impact on raising incomes, especially when one considers that there are 53,000,000 salaried workers in the labor force.

Why would this rule change impact so few people? One reason is that the vast majority of salaried employees who work more than 40 hours per week are already paid well.

Table 3: Pay Distribution of Salaried Overtime Workers

Weekly Salary Range (\$)	Percent
455 and below	7.7%
455 to 550	2.4%
455 to 650	6.3%

Table 3: Pay Distribution of Salaried Overtime Workers

455 to 750	11.5%
455 to 850	17.1%
455 to 950	22.2%
455 to 1050	29.7%
1050 and up	62.5%

Table 3 reveals that the vast majority of overtime salaried workers would be unaffected by a raise in the salary level test. 7.7 percent of salaried overtime workers earn at or below \$455 per week and are already covered by federal overtime standards. A substantial 62.5 percent of salaried overtime workers are unlikely to be affected by an increase in the salary level test because they earn at or above \$1,050 per week, which is likely more than the new minimum weekly salary requirement. Meanwhile, only 2.4 percent of salaried overtime workers earn between \$455 and \$550 per week, 6.3 percent earn between \$455 and \$650, 11.5 percent earn between \$455 and \$750, 17.1 percent earn between \$455 and \$850, 22.2 percent earn between \$455 and \$950, and 29.7 percent earn between \$455 and \$1,050.

Next let's examine the total number of people in poverty that these rule changes will impact.

Table 4: Percent & number of all salaried workers who are impacted by expanded overtime and in poverty

Weekly Salary Range (\$)	Percent	Workers
455 to 550	0.04%	20,324
455 to 650	0.04%	20,324
455 to 750	0.04%	20,324
455 to 850	0.06%	32,518
455 to 950	0.04%	20,324

Table 4: Percent & number of all salaried workers who are impacted by expanded overtime and in poverty

455 to 1050	0.04%	20,324
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Table 4 reveals that only 0.04 to 0.06 percent of salaried employees work overtime, earn between \$455 per week and a potential new salary level test, and are in poverty. As a result, expanding overtime pay would at most assist 20,000 to 30,000 people in poverty.

Why would these rule changes impact so few people in poverty? First, as illustrated in tables 2 and 3, very few salaried workers actually work overtime and earn between \$455 per week and the potential new exemption thresholds. Second, as demonstrated in table 5, of those who work overtime and would be impacted by an increase in the salary level test, very few are actually in poverty.

Table 5: Poverty Rates of Salaried overtime workers

Weekly Salary Range (\$)	0.5x Poverty Level or less	1x Poverty Level or greater	2x Poverty Level or greater	3x Poverty Level or greater	1 to 3x Poverty Level	3 to 6x Poverty Level
455 to 550	7.0%	69.0%	33.8%	5.6%	59.2%	28.2%
455 to 650	2.7%	74.5%	42.9%	9.8%	54.3%	33.2%
455 to 750	1.5%	82.2%	54.0%	9.8%	44.5%	44.2%
455 to 850	1.6%	85.3%	61.2%	12.4%	37.3%	48.8%
455 to 950	0.8%	88.8%	67.0%	14.1%	32.3%	52.8%
455 to 1050	0.6%	91.2%	72.4%	17.3%	27.0%	55.1%

Table 5 reveals that only 0.6 to 7.0 percent of salaried overtime workers who would be affected by an increase in the salary level test have household incomes at or below the relevant 2013 poverty lines. In addition, the larger the increase in the salary level test, the less precise the rule change is as an antipoverty tool. For instance, while 7.0 percent of those who earn between \$455 and \$550 per week are in poverty, the same is true for only 0.6 percent of those who earn between \$455 and \$1,050. Moreover, 69.0 to 91.2 percent of the impacted workers are at least 2 times the poverty line and 33.8 to 72.4 percent are at least 3 times the poverty line. Clearly, raising the salary level test is not an efficient way to combat poverty and the larger the increase the less target efficient is overtime pay.

FAMILY DYNAMICS OF OVERTIME PAY REGULATION

Why is expanding overtime coverage so inefficient in combating poverty? A family's well-being not only depends on the earnings of a single person, but also on all of the earnings of all family members. Table 6 illustrates the number of workers in families with a salaried overtime worker.

Table 6: Number of Workers in Families of Salaried Overtime Workers					
Weekly Salary Range (\$)	1	2 and up	3 and up	4 and up	5 and up
455 to 550	39.4%	60.6%	22.5%	11.3%	5.6%
455 to 650	33.7%	66.3%	20.6%	6.5%	2.7%
455 to 750	32.3%	67.7%	21.4%	5.0%	1.8%
455 to 850	31.1%	68.9%	19.9%	5.0%	1.4%
455 to 950	30.0%	70.0%	19.4%	5.1%	1.1%
455 to 1050	29.2%	71.4%	18.1%	4.8%	1.4%

In the majority of cases, a salaried overtime worker is the second or third earner in a family. This indicates that most of the time, families do not solely depend on their incomes. Meanwhile, only 29.2 to 39.4 percent of the time a salaried overtime worker is the only worker in a household.

Likewise, many are concerned about the children of low earning overtime workers. In reality, however, most salaried overtime workers do not have dependent children.

Table 7: Number of Kids of Salaried Overtime Workers

Weekly Salary Range (\$)	0	1	2	3	4	5	6
455 to 550	62.0%	14.1%	9.9%	7.0%	7.0%	0.0%	0.0%
455 to 650	64.1%	13.0%	13.6%	6.5%	2.7%	0.0%	0.0%
455 to 750	64.4%	12.5%	13.4%	7.1%	2.4%	0.3%	0.0%

Table 7: Number of Kids of Salaried Overtime Workers

455 to 850	63.3%	14.3%	13.5%	6.2%	2.4%	0.2%	0.0%
455 to 950	61.6%	16.1%	14.4%	5.2%	2.3%	0.2%	0.2%
455 to 1050	62.3%	15.7%	14.5%	5.2%	1.9%	0.1%	0.1%

Table 7 reveals that 61.6 to 64.4 percent of salaried overtime workers who would be impacted by an increase in the salary level test have no children. Meanwhile, only 12.5 to 15.7 percent care for one child, 9.9 to 14.5 percent care for two, and 5.2 to 7.1 percent care for three. This indicates that raising the salary level test will help very few children.

INDUSTRY DISTRIBUTION OF SALARIED OVERTIME WORKERS

Salaried overtime workers are fairly evenly distributed among American industries, with a few exceptions. Table 8 illustrates the industry distribution of salaried overtime workers who earn between \$455 and \$1050 per week.

Table 8: Industry Distribution for all salaried overtime workers earning between \$455 and \$1050 per week

Industries	Percent
Natural Resources, forestry, mining, and agriculture	3.4
Construction	2.9
Manufacturing	6.8
Wholesalers	4.2
Retail	13.2
Transportation	6.3
<i>Truck transportation</i>	4.8

Table 8: Industry Distribution for all salaried overtime workers earning between \$455 and \$1050 per week

Information, technology, and communication	3.3
Finance	4.3
Real Estate	1.4
Rentals	0.7
Business and Professional Services	8.5
Education	18.2
<i>Elementary and Secondary schools</i>	<i>15.2</i>
Health Care	7.6
Leisure and Accommodation	8.1
<i>Restaurants</i>	<i>5.4</i>
Other	5.5
Public Administration	5.6

When arguing for expanded overtime pay protections, advocates often paint a picture of struggling [retail and fast food managers](#) who work long hours without receiving any overtime pay due to their exemption status. In reality, however, this group represents a minority of salaried overtime workers. Only a little over 5 percent of those who could be impacted by a raise in the salary level test actually work in the restaurant industry and only 13 percent work in retail. Meanwhile, surprisingly at 18.2 percent, education employees represent the largest group of workers who could be impacted by a rule change. However, education workers may be a larger than expected proportion of this sample because the reference period of this particular SIPP data set was April, May, June, and July 2013. As a result, half of the reference period took place during summer months when school is not in session, potentially skewing the number of salaried overtime workers in education who could be affected by a rule change.

GENDER DYNAMICS OF OVERTIME PAY REGULATION

Another concern shared by Americans today is ensuring gender pay equity in the workplace. The evidence suggests, however, that expanding overtime pay by raising the salary level test would mostly benefit men.

Table 9: Gender Breakdown of Salary overtime workers, by exemption level

Weekly Salary Range (\$)	Female	Male
455 to 550	35.2%	64.8%
455 to 650	42.4%	57.6%
455 to 750	43.0%	57.0%
455 to 850	43.0%	57.0%
455 to 950	43.2%	56.8%
455 to 1050	41.8%	58.2%

Table 9 reveals that only between 35.2 and 43.2 percent of the potentially impacted overtime salaried workers are female, while 56.8 to 64.8 percent are male. Women would not benefit much from a raise in the salary level test because less than half of salaried workers (46.9 percent) are female. In addition, of those who are salaried and work overtime, only 33.3 percent are female. To address pay equity in this country, lawmakers would have to consider policies that encourage and enable more women to pursue higher paying careers. A popular approach seems to involve encouraging more women to enter science, technology, engineering, and mathematics (STEM) fields, for example, which are very high paying and [mostly occupied by men](#).

THE COST OF EXPANDING OVERTIME PAY REGULATIONS

The discussion in this paper so far has focused on the ineffective nature of the rule change and ignored its negative consequences. Indeed, all the figures above assume that there are no costs to expanding overtime pay and therefore provide an optimistic picture of the number of people that the rule change will help.

In reality, however, just like raising the minimum wage, money does not come out of thin air to expand overtime pay. Specifically, the cost of expanding overtime pay has to come from somewhere and will likely be in the form of layoffs, less hiring, and higher prices for the services provided. It will certainly hurt an already ailing labor market. Past research suggests that expanding FLSA overtime coverage has led to employers substituting part-time work for full-time work. In particular, [Trejo \(2003\)](#) found that in the past expanded FLSA coverage increased the proportion of part-time work by 3.7 percentage points, while reducing the proportion of

full-time and overtime work by 1.2 and 2.5 percentage points respectively. Rather than trying to force policies on employers that would further hurt the labor market, federal policymakers should acknowledge that the root cause of stagnant wages is weak economic growth in the past five years.

CONCLUSION

The rule changes coming soon from the DOL are complex in nature and aimed at helping those in need. The DOL will specifically try to help these workers by raising the salary level test, which is the minimum weekly salary necessary to exempt a worker from overtime pay. A close examination of those who will be impacted by the changes, however, reveals that very few people will benefit at all and only a very small percentage of those who are affected are actually in poverty. That is because most salaried employees who work more than 40 hours each week actually earn more than any feasible new salary level test. Moreover, expanding overtime pay coverage will help very few children and mainly benefit working men. With the additional cost to employers and in turn workers created by the overtime pay regulation, it is clear that expanding overtime pay coverage is not an effective way to help those in need. Instead, policymakers need to address the root causes for stagnant wages: lackluster economic growth and a struggling labor market. Neither are addressed by expansions in overtime pay.

[1] Whittaker, William G. “The Fair Labor Standards Act: A Historical Sketch of Overtime Pay Requirements of Section 13(a)(1),” Congressional Research Service, May 2005, retrieved from Cornell University ILR School, available at

http://digitalcommons.ilr.cornell.edu/cgi/viewcontent.cgi?article=1240&context=key_workplace