Research

The DOL’s Proposed Overtime Rule: Much Ado About Little for Workers, Massive Costs for Businesses

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OVERVIEW

The Department of Labor’s (DOL) proposed overtime pay rule has been advertised as a raise in the wages of millions of U.S. workers. However:

- Since an exemption requires worker duties to be managerial, administrative, or professional in nature and that most workers do not work overtime regularly, the DOL’s proposed overtime rule would only benefit about 1 million of the 4.6 million newly covered workers;
- For all 4.6 million newly covered workers, the average weekly pay increase would be only $5.96, while for those who regularly work overtime the increase would be a mere $19.60; and
- U.S. businesses would face the cost of reclassifying salaried workers as hourly workers, and over 10 years, businesses would face about $2.5 billion in direct costs to comply with the new rule and billions more in lost productivity.

INTRODUCTION

When the White House unveiled important details regarding DOL’s long awaited overtime pay rule, many analysts sought to understand the impact of the rule by attempting to estimate the number of workers affected. The DOL’s proposed overtime rule would raise the minimum weekly pay threshold legally required to exempt salaried workers from overtime pay from $455 per week to the 40th percentile of earnings for full-time salaried workers. According to DOL, the 40th percentile equated to $921 per week in 2013 and will be about $970 when the rule is implemented in 2016. While the White House stated that the proposed rule would impact 5 million workers, the Economic Policy Institute projected that it would affect at least 11 million workers and we estimated that only about 3 million would benefit. According to the text of the proposed rule itself, however, everyone vastly overestimated the rule’s impact on workers. In particular, the DOL estimates that the expansion in overtime pay will only impact about 1 million workers and the actual pay increase for those workers only amounts to about $20 per week. Meanwhile over the next decade, employers would face billions in regulatory compliance costs.

THE NUMBER OF WORKERS THE RULE WOULD IMPACT IS MINIMAL

Under DOL regulations, 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). [1] The major discrepancy between the official DOL figures and everyone else's exists because of the duties requirements. While most analysts have the data to determine the number of workers who would be exempt under the salary basis and salary level tests, only researchers at the DOL have the data and expertise needed to determine who would be exempt under the duties test as well. So in determining the number of workers who the proposed rule would impact, one must identify the number of workers who are currently exempt from overtime pay and would no longer be exempt because of the rule change. Most analysts simply identify the number of workers who are salaried and earn between $455 per week and the 40th percentile of earnings. However, the DOL is able to identify who among the salaried workers in that pay range fulfill the duties test and are actually currently classified as exempt from overtime pay.

When the DOL takes into account the duties requirement, the size of the salaried workforce subject to the rule shrinks substantially. Table 1 compares the total number of salaried workers who earn over $455 per week to the actual number who under current rules the DOL estimates are exempt from overtime pay.

Table 1: Total Salaried Workers vs Exempt Salaried Workers

Worker Category	**Total Salaried[2]**	**Not Exempt because of Duties Requirements[3]**	**Overtime Exempt[4]**
Earn over $455 per week	49.1 million	27.7 million	21.4 million
Earn between $455 and $921 per week	16.0 million	11.4 million	4.6 million
Earn between $455 and $921 per week and works overtime	2.6 million	1.6 million	988,000

AAF estimates that in 2013, 49.1 million salaried workers made over $455 per week. 27.7 million of those workers, however, were not exempt because of the duties requirements. As a result, according to DOL, only 21.4 million workers were actually exempt from overtime pay. Moreover, AAF estimates that in 2013, 16.0 million workers were salaried and made between $455 and $921 per week. But, of those workers 11.4 million were not exempt because of the duties requirements, leaving only 4.6 million workers who were classified as exempt. So under the new rule, the DOL would only expand overtime pay coverage to these 4.6 million workers who were exempt in 2013.

Moreover, the proposed overtime rule would only impact these 4.6 million newly covered workers if they in fact regularly work overtime. AAF estimates that in 2013 only about 2.6 million salaried workers earning between $455 and $921 per week actually worked more than 40 hours per week. 1.6 million of those overtime workers were not exempt because of the duties requirements. This leaves only 988,000 overtime workers who were exempt and under the new rule would receive time-and-a-half pay for their overtime hours. So in reality, the DOL's proposed overtime rule would only benefit about 1 million of the 4.6 million newly covered workers.

THE RULE'S IMPACT ON WORKERS' INCOME WOULD BE

NEGLIGIBLE

If one assumes we live in a world where there are no costs to labor mandates, then the impact on worker pay would be significant. The DOL estimates that the proposed rule would lead to 4.6 million additional salaried workers being eligible for time-and-a-half pay for working more than 40 hours per week. Of those workers, only 988,000 regularly work overtime. If those working overtime simply started receiving time-and-a-half pay for all overtime hours, then the potential pay increase for these workers would be quite large. According to the DOL, these 988,000 regular overtime workers averaged 11.1 hours of overtime each week and earned an average weekly salary of $743 in 2013.[5] For a 40 hour workweek, this implies a regular hourly pay rate of $18.58. Under the proposed overtime rule, these workers would earn an average $27.86 per hour ($18.58 x 1.5) for their 11.1 weekly overtime hours. As a result, their weekly pay would increase by almost $310 and those 988,000 workers together would earn an additional $15.9 billion per year.

Unfortunately, the effects of expanding overtime pay coverage are not quite that simple, which the DOL itself recognizes. In particular, using previous research the DOL predicts that the cost of expanding overtime pay would result in reducing the base wages and weekly hours of the roughly 1 million regular overtime workers.

To evaluate the proposed overtime rule's impact on wages and hours, the DOL breaks the 4.6 million newly covered workers into four main types, which are shown in Table 2.

Table 2: The DOL's Worker Types[6]

Category	Number	Percent
Total	4,646,000	100.0%
Type 1	3,478,000	74.9%
Type 2	180,000	3.9%
Type 3	920,000	19.8%
Type 4	67,000	1.4%

Type 1 workers are those who do not work more than 40 hours per week and would thus not be impacted by this rule change. DOL estimates that there are 3.5 million Type 1 workers, representing 74.9 percent of all newly covered workers. Type 2 workers are those who only occasionally work overtime and would be somewhat impacted by the rule. DOL estimates that 180,000 workers fall under this category. Type 3 workers are the 920,000 people who regularly work overtime and would see the largest declines in wages and weekly hours. Finally, Type 4 workers also regularly work overtime, but since their weekly pay is close to the new salary threshold, the DOL predicts employers would increase their weekly pay so that they remain exempt. As a result, their wages would increase and their hours would not change. Only 67,000 workers fall under this category.

Table 3 illustrates the DOL's findings for how expanding overtime pay would impact wages and hours by worker type.

Table 3: Overtime Rule's Impact on Wages and Hours[7]

Category	Wages	Hours
Total	-0.9%	-0.2%
Type 1	0.0%	0.0%
Type 2	-2.3%	-0.2%
Type 3	-5.3%	-0.8%
Type 4	2.0%	0.0%

DOL estimates that on average wages and hours for all 4.6 million workers would decline by 0.9 percent and 0.2 percent respectively. However, since the wage and hour effects would be concentrated on those who either occasionally or regularly work overtime, these figures hide these negative consequences for some workers. For instance, regular wages would fall by 2.3 percent for Type 2 workers (those who occasionally work overtime) and by 5.3 percent for Type 3 workers (those who regularly work overtime). Meanwhile, wages for Type 1 workers (those who do not work overtime) would not change and wages for Type 4 workers (those who's weekly pay will rise) would increase 2.0 percent.

The reduction in wages and hours significantly limits the intended benefits of the overtime rule. For instance, take Type 3 workers, who regularly work overtime. According to DOL, their average hourly wage would fall by $0.78 and their workweek would decline by 0.4 hours. As a result, their weekly base pay would fall by about $45 from about $745 per week to $700 per week. DOL estimates that with the new overtime rule, these workers would still work 10.3 overtime hours.[8] But, since workers are $45 behind, 6.5 of their overtime hours would simply go towards breaking even. This leaves only 3.8 overtime hours that would increase worker pay.

After accounting for changes in hours and wages, DOL finds that the actual net benefit from earning overtime pay would be very small. The average per worker net weekly income change is shown in Table 4.

Table 4: Overtime Rule’s Net Impact on Weekly Pay[9]	
Category	**Change In Weekly Pay**
Total	$5.96

Table 4: Overtime Rule’s Net Impact on Weekly Pay[9]	
Type 1	$0.00
Type 2	$45.97
Type 3	$19.60
Type 4	$20.47

According to DOL, for all 4.6 million newly covered workers, the average weekly pay increase would be only $5.96. While average weekly earnings would not change for Type 1 workers, they would only increase by $19.60 for Type 3 workers, the largest group of overtime workers. Meanwhile, weekly earnings would rise by $45.97 for Type 2 workers and by $20.47 for Type 4 workers.

Since per worker weekly earnings would only rise by a small amount, the DOL’s estimated aggregate income gain for these workers is only less than a tenth of the $15.9 billion resulting from our simple calculation above. In fact, DOL estimates that the proposed overtime rule would increase annual income for these workers by only $1.4 billion annually.[10] While the majority of the increase in income would benefit the workers who regularly work overtime, none of it would benefit the 75 percent of newly eligible overtime workers who do not actually work more than 40 hours per week.

Finally, it is important to note that in evaluating the impact of the proposed overtime rule, the DOL ignores highly relevant labor market research on this topic. In particular, the DOL analyzes how expanding overtime pay would impact the hours of people who continue work overtime. However, the DOL does not take into account how expanding overtime pay would impact the number of people who work overtime. Trejo (2003) examined this issue and found that expanding overtime pay coverage not only reduced the number of overtime workers, but it also reduced the number of full-time workers. Specifically, the proportion of overtime and full-time work falls by 2.5 and 1.2 percentage points respectively. Part-time work simultaneously rises 3.7 percentage points.[11] Taking into account the negative employment consequences for full-time and overtime workers would surely further dampen the DOL’s already minimal income estimates.

BUSINESS AND THE ECONOMY FACE MAJOR COSTS

While this proposed rule’s actual benefits for workers would be minimal, businesses would face significant compliance costs and the economy would suffer from lost productivity. These burdens include the costs of reclassifying workers from salaried to hourly, tracking worker hours and keeping time sheets, and rearranging work schedules. According to a previous AAF analysis, the proposed overtime rule would impose about $255 million in direct employer costs each year. Over 10 years, businesses would face about $2.5 billion in direct costs to comply with the new rule.[12]

Moreover, the overtime rule’s impact on hours will result in a significant reduction in productivity. According to the DOL, the proposed rule would cause the weekly hours of employees who regularly work overtime to fall by 0.4 hours per week or 0.8 percent. This may seem small. But, AAF previously found that when expanded to the nearly 1 million workers who would lose hours, it adds up to over 20 million labor hours lost annually. As a result, the economy would lose about $1.3 billion every year in productivity.[13] So, nearly all of the $1.4 billion in additional worker pay would be entirely offset by the $1.3 billion lost from less productivity and the over $200 million in direct compliance costs every year.

CONCLUSION

The DOL's new overtime rules have been celebrated as a way to increase incomes for hardworking low- and middle-income families. Unfortunately, lack of proper data and expertise has led to a lot of misinformation regarding the rule's reach into the labor force, as most analysts vastly overestimated the number of workers who the proposed rule would impact. A careful reading of the rule itself, however, reveals the proposed rule is much ado about very little for workers and the DOL itself expects that only about 1 million workers would actually benefit with an increase in weekly pay. Furthermore, the DOL projects that most of those 1 million workers would only receive an additional $20 per week, not a raise most would call a saving grace. Meanwhile, the rule would impose billions in compliance costs and burden the economy with fewer hours and productivity. Since 2009, the Obama Administration has issued over $700 billion worth of regulations that include 475 million paperwork burden hours. AAF has shown over and over again that these regulations cumulatively reduce employment and pay. Instead of issuing yet another costly regulation, perhaps the best way to promote employment and wage growth is to slow down the rising cost of regulatory burdens.

[1] 29 CFR Part 541, "Defining and Delimiting the Exemptions for Executive, Administrative, Professional, Outside Sales and Computer Employees; Final Rule," Preamble, Federal Registrar, Department of Labor, Wage and Hour Division, 2004, available athttp://www.dol.gov/whd/overtime/preamble.pdf