

How the New Overtime Pay Rule Will Hurt the Middle Class

Brief Analysis No. 828

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June 14, 2016

The U.S. Department of Labor has updated Fair Labor Standards Act (FLSA) overtime regulations, raising the threshold at which salaried employees are exempt from overtime pay, effective December 1, 2016. Salaried employees making up to \$913 per week (\$47,476 annually) will qualify for overtime compensation at one-and-a-half times their normal pay. This is a significant increase from the previous exemption level of \$455 per week (\$23,660 annually). The FLSA also defines the job duties of employees who are exempt from overtime pay. The "duties test" exempts employees who are executive, professional or administrative and also work independently, exercising their own judgment without close supervision. This remained unchanged.



The administration predicts the new rule will put \$12 billion in the pockets of 4.2 million newly eligible employees over 10 years, but it will cost the restaurant and retail industries alone over \$2 billion annually. [See Figure I.] It is inevitable that businesses will make changes to their compensation model to offset these costs.

An Oxford Economics case study of the restaurant and retail industry outlined three possible ways employers may offset increased costs: lowering hourly wages, cutting benefits and bonuses, and reducing workers' hours.

Reclassification of Employees. Employers may begin paying more employees hourly wages, as opposed to salaries, or decrease their hourly wages to compensate for their overtime pay. The College and University Professional Association for Human Resources says the rule will force colleges to reclassify salaried workers as hourly employees.

Reduction of Hours. Employers are also likely to cut employees' hours to less than 40 hours per week, making them ineligible for overtime

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Figure I
Annual Cost to the Retail and Restaurant Industry of Extending the Overtime Exemption Threshold (in billions of dollars)



Source: Oxford Economics, "Updated impacts of raising the overtime exemption threshold," July 17, 2015.

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compensation. They will then replace those hours by hiring additional part-time, entry-level workers. For instance, Oxford Economics predicted that if the exemption threshold were raised to \$808 (significantly less than the new rule), 175,000 retail and restaurant employees would be reduced to 38 hours per week. Employers would then hire an additional 76,000 part-time workers. [See Figure II.]

Benefit Cuts and Reduced Workplace Flexibility.

Additionally, employers are likely to cut employee benefits, such as health insurance. Some may add the value of benefits to base pay to push salaries beyond the exemption threshold. Others may cut benefits for employees working overtime, to offset their added pay.

According to an NCPA analysis, when the overtime threshold was previously raised under the Bush Administration, first-line supervisors in food preparation who received overtime compensation were less likely to receive pension benefits than their overtime exempt counterparts. Among employees who became overtime-exempt, the likelihood of having a pension increased by 46 percent, as opposed to a 30 percent decline in pension likelihood among those who remained covered by overtime regulations. This suggests a clear tradeoff between overtime pay and benefits. Currently, more than 40 percent of full-time private-sector employees do not have access to employer-provided retirement plans, such as 401(k) plans or pensions.

Furthermore, if employers are forced to pay more in salaries, they are likely to reduce the plethora of other nonmonetary benefits they provide workers, such as relaxed work demands, workplace ambiance, schedule flexibility, job security, hours of work and fringe benefits. A recent analysis from the Mercatus Center predicts negative impacts for jobs poorly suited for hourly compensation, including technology start-up and telecommuting jobs.

The Intended Beneficiaries of Overtime Pay.

The White House has framed the changes in overtime pay within the context of increasing wages for middle-earners and building a stronger middle class. Given that 60 percent of the affected employees don't work more than 40 hours per week, giving additional overtime compensation does little to address these issues. But this should come as no surprise. Overtime pay was never intended to increase wages nor grow the middle class. When the FLSA was passed in

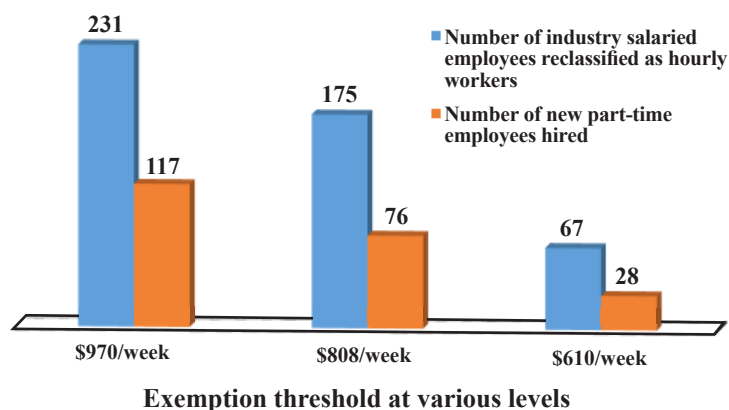
1938, President Roosevelt aimed to create jobs and protect laborers in a market rampant with child labor and abusive working conditions. Time-and-a-half overtime pay was intended to push employers to hire more employees as opposed to overworking their staff. Prior to the act, a regular work day might be 10 hours and the work week six days. The FLSA enshrined the 40-hour work week in law. In other words, overtime pay was never intended to be a solution for low wages and a shrinking middle class.

Effects on Nonprofits. Businesses will not be left to suffer the effects of the new rule alone. For instance, Operation Smile, a nonprofit international charity that provides free surgeries for children with facial deformities, claimed in congressional testimony that the new regulation would cost the organization \$1 million annually. Thus, they would be able to perform 4,200 fewer surgeries per year. Additionally, the American Council on Education has outlined the detrimental effects the new rule on colleges throughout the country, including tuition increases, service decreases and layoffs. This will not only affect numerous employees at higher educational facilities, but also the quality of education for students.

Conclusion. Businesses and nonprofits alike will not simply absorb the dramatic increase in employment costs mandated by the new overtime legislation. They will likely restructure their employment model and reclassify workers, reduce hours and cut benefits.

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Figure II
Impact on the Retail and Restaurant Industry of Extending the Overtime Threshold (thousands of employees)



Source: "Rethinking Overtime: How increasing overtime exemption thresholds will affect the retail and restaurant industries," Oxford Economics.