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Department of Labor's New Overtime Rule Puts Flexible Work Arrangements and Paths to Success at Risk

Why Congress Should Rein in DOL's Pro-Big Labor Activism

*By Trey Kovacs**

On March 13, 2014, President Obama sent a memorandum to the Secretary of Labor to update and modernize overtime regulations. The President's memo called to increase the amount of workers receiving overtime and said the executive, administrative and professional employees (EAP) exemption needed an update, citing a changing economy as the reason to modernize the rules.[1]

On June 30, 2015, the Department of Labor (DOL) submitted a notice of proposed rulemaking to modify the overtime rules. Most significantly, the proposed rule greatly increases the minimum salary threshold for exempt workers. The current rule, under the Federal Labor Standards Act (FLSA), requires time-and-a-half pay for every hour above 40 that an hourly employee works in week.[2] Salaried employees who perform executive, administrative, professional, and outside sales activities and who make more than $23,660 are exempt from overtime pay requirements. Under the proposed rule, the salary exemption threshold would increase to $50,440, a 113 percent jump.

Currently, the DOL is reviewing nearly 300,000 public comments on the rule and aims to finalize this highly contentious rule by July 2016.[3] Unless Congress acts, the rule will have considerable negative impacts. Workers will find it harder to obtain flexible work arrangements. They will also see reduced benefits and fewer hours. Some workers may face higher tax bills, as employers replace previously untaxed benefits with taxable wages.

Employers will be burdened with increased compliance costs. In addition, a greater amount of employees will be eligible for overtime, which will force employers to make tough choices to control labor costs that could negatively impact workers—including cutting hours, reducing benefits, and hiring fewer people.

How Does It Impact Workers? The overtime rule change is intended to boost the earnings of low income people, but it is a poor means to achieve that goal. The fact is, most salaried workers are already well compensated and most low income individuals already are eligible for overtime.[4] The rule change will have unintended consequences that will negatively affect workers. Current salaried employees on a management track may have their work status degraded to hourly employee. Those former salaried workers may have their hours capped to avoid overtime costs and face new requirements, such as tracking their work hours.

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This acts as a governmental roadblock on aspiration for ambitious employees. For junior managers who are reclassified and have their hours capped, it will greatly restrict their ability to receive flexible schedules, a common perk professional employees value. Another downside is that junior managers who are downgraded to hourly employees are no longer on a management track with a higher career trajectory.

Another detriment of losing salaried status is that it eliminates employees' ability to take time off to pick up a child from school, run errands, or deal with an emergency. As an hourly employee, if you must pick up a sick child you lose getting paid for that time.

The Obama administration's purported goal in changing the overtime is to boost wages, but the approximately 5 million newly eligible employees are unlikely to see a significant pay increase. Secretary of Labor Thomas Perez estimates the overtime pay regulation could add as much as $1.3 billion to approximately 5 million workers' pay in just the first year.[5] On its face that sounds substantial, but spread out throughout the newly eligible overtime employees, it averages out to a wage increase of only $260 a year per worker.

How Does it Impact Employers? Businesses will see increased compliance costs. They will have to track the hours of all salaried employees who earn under the new threshold—which never had to be tracked before. And there will be more of them, as salaried employees above the old threshold and below the new one are shifted to hourly status.

With a large increase in the pool of employees eligible for overtime, employers will have to react in one of several ways to keep labor costs constant. Some of the options employers have may alienate their workforce.

First, employers can reduce base pay to control labor costs when faced with the increase in the salary threshold. U.S Bureau of Labor Statistics economist Anthony Barkume finds that cutting wages would make up for 80 percent of overtime costs.[6]

Second, businesses could hire more part-time and hourly employees, limit workers' hours to under 40 a week, or reduce fringe benefits and cut bonuses in order to raise base salaries above the new threshold of $54,440.[7] That leads to employees paying more in taxes, as tax-exempt benefits are replaced with taxable salary income.

In the end, it is extremely unlikely that employers would keep labor practices constant and simply absorb the DOL's projected $1.3 billion in additional costs. Unlike increases in the minimum wage, the government cannot force employers to pay employees more via the overtime rule, because employers can take steps to keep labor costs at relatively the same level, either by hiring fewer employees, reducing base pay, or cutting back hours.

Policy Recommendations. Congress should challenge the final rule under the Congressional Review Act (CRA), which authorizes Congress to file a joint resolution of disapproval of federal regulations within 60 days of their being finalized. The rule is invalidated if the resolution is passed by the House and Senate and signed by the President.

Congress can override a Presidential veto with two-thirds of both houses voting in favor of the resolution of disapproval.

Another option is to pass legislation to require Congressional approval of any changes to current overtime rule exemptions. Any rule change with such an expansive reach—in this case impacting millions of workers—should be the prerogative of Congress, not unelected bureaucrats.

Conclusion. The Department of Labor's unilateral and sweeping change of the FLSA's overtime rule is a one-size-fits all blunt instrument that will not achieve its intended purpose of increasing workers' wages. Major rule changes that impact workers nationwide should account for the vast differences in cost of living throughout the country. The proposed overtime rule does not. For example, while in New York City the increase in the overtime salary threshold may not have a devastating impact, it could drive a small business owner in rural Alabama to the edge of bankruptcy. It could result in layoffs or management employees being converted to hourly employment.

It is true that many American workers are struggling to make ends meet. However, the proposed overtime rule is no solution. It imposes substantial costs, which businesses have to make up for somewhere. Often, that means reducing wages or hiring fewer workers.

CEI's Wayne Crews estimates federal regulation's total annual burden on the economy at nearly $1.9 trillion.[8] The new overtime rule will only add to that cost. Relieving employers and employees of unnecessary regulatory burdens is more likely to enhance the lot of workers than erecting more barriers to employment.

Notes

[1] "Presidential Memorandum—Updating and Modernizing Overtime Regulations," The White House, March 13, 2014, https://www.whitehouse.gov/the-press-office/2014/03/13/presidential-memorandum-updating-and-modernizing-overtime-regulations.

[2] Defining and Delimiting the Exemptions for Executive, Administrative, Professional, Outside Sales and Computer Employees, 29 CFR Part 541 (2015), http://www.dol.gov/whd/overtime/nprm2015/ot-nprm.pdf.

[3] Ben Penn, "DOL Slates July Release of Final Overtime Rule," Bloomberg BNA, November 23, 2015, http://www.bna.com/dol-slates-july-n57982063833/.

[4] Ben Gitis, "The DOL's Proposed Overtime Rule: Much Ado about Little for Workers, Massive Costs for Businesses," American Action Forum, August 12, 2015, http://americanactionforum.org/research/the-dols-proposed-overtime-rule-much-ado-about-little-for-workers-mass.

[5] Obama's new overtime rules: How they work and who they'd affect," *Los Angeles Times*, June 30, 2015, http://www.latimes.com/business/la-fi-obama-overtime-rules-explainer- 20150630-htmlstory.html.

[6] Anthony Barkume, "The Structure of Labor Costs with Overtime Work in US Jobs," Industrial and Labor Relations Review, Vol. 64, No. 1 (October 2010), http://ilr.sagepub.com/content/64/1/128.abstract.

[7] Oxford Economics, "Rethinking Overtime: How Increasing Overtime Exemption Thresholds Will Affect the Retail and Restaurant Industries," 2015, prepared for the National Retail Federation, https://nrf.com/sites/default/files/Documents/Rethinking_Overtime.pdf.

[8] Wayne Crews, *Ten Thousand Commandments 2015*, Competitive Enterprise Institute, May 8, 2015, https://cei.org/10kc2015.