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On the Department of Labor's Proposed Rule on Overtime Pay

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Introduction

Mr. Chairman, it is a great privilege to testify before this committee, and I and my colleagues at the Economic Policy Institute (EPI) thank you and your staff for the opportunity to be here.

As the committee is well aware, in March of 2003 the Department of Labor (DOL) proposed major changes to the rules governing the treatment of overtime in the Fair Labor Standards Act (FLSA). Since the proposal was introduced, a rousing debate has ensued regarding the number of workers predicted to lose their current coverage under the FLSA such that they would no longer be compensated at a rate of time-and-a-half for each hour of overtime worked. A correct answer to this question is obviously a critical piece of information, perhaps the most critical piece for those entrusted with the responsibility of evaluating the potential impact of the proposal.

As is well known to those who have followed this debate, the Department of Labor's own analysis finds that only 644,000 workers would lose the right to overtime pay. EPI's analysis, however, finds that this fate would befall eight million employees who benefit from overtime protection under current law.

Clearly, these are very different estimates of the new rule's impact. And neither estimate is benign—all sides agree that some of those who are currently covered will be made exempt and lose current protections. But the difference between the two estimates is large enough to totally change the way one views the proposed changes.

Much of what follows shows that these two estimates are far less different in some ways than they might initially appear. Once we adjust the Department's estimate for a fundamental flaw—that is, its sole focus on those working overtime in the *single survey week examined* instead of the full set of hourly workers who are *covered* by overtime protection—and add in its less-publicized estimate of 1.5 to 2.7 million workers exempted by the new duties tests, then the vast difference between the two impact analyses disappears. As shown in the accompanying chart, when we correct for these omissions, the DOL results reveal that about seven million employees would lose overtime coverage under the new rules, which is quite close to the eight million we predict would lose such protection.

Explaining the Difference Between the Impact Estimates

Thankfully, it is not hard to explain the main source of the different estimates. In trying to determine who would lose overtime protections, the Department of Labor only considered persons who are currently working overtime. While about 90 million hourly workers are currently *covered* by the FLSA's overtime regulations and thus are eligible for time-and-a-half pay when they work overtime, the DOL's widely published number—the number they have set forth in front of this committee—is based only on the 11 to 12 million who were actually paid for overtime *at the time of the survey*.

A moment's reflection should reveal that this is a major oversight, one which results in misleading policy analysis. A fundamental rule of impact analysis is that you must look

at the whole group that is potentially affected by a proposed policy, in this case, the covered workforce. The thrust of our analysis is that if this rule becomes law, the rules that determine overtime protection for each one of these 90 million workers will change. Thus, a serious effort to determine the impact must consider all covered workers, not solely those actively working overtime at a given point in time.

If the rule becomes law, every employer will be faced with a significantly altered set of incentives regarding the cost of overtime, and this fact also underscores the need to look beyond the 14% of hourly workers being paid for overtime at the time the survey was conducted. By paying them 1.5 times their base pay for overtime, these employers are sending a clear market signal that this is a worthwhile expenditure. But if we lower the price of overtime—and that, at its heart, is the impact of this proposed rule change—we gut a critical disincentive built into the FLSA, one that has worked for decades to ensure that employers pay a premium for having covered workers work beyond 40 weekly hours.

Take away that premium—the extra 50% that non-exempt workers must receive for overtime—and some employers will have both opportunity and reason to reclassify covered workers as exempt and assigning them unpaid overtime hours. No credible policy analysis would ignore such a huge change in cost incentives facing employers, but that is precisely what the DOL’s impact analysis does.

Another way to view the difference between the estimates is to note that EPI examines changes in the number of workers *covered* by the FLSA while the DOL examines changes in the number of workers who received overtime pay during the week when the survey was conducted. The EPI approach, which examines the erosion of coverage, is more appropriate because the rule change can lead to significant earnings losses among workers who lose coverage even though they happened not to work any overtime in the survey week. For one, those who did not work overtime when the survey was taken may well do so in some other week. Second, because of the removal of a major disincentive for employer’s to “purchase” more overtime, there will be workers who currently aren’t asked to work overtime but who, once they lose coverage, will be asked to do so without additional pay.

To reiterate, by ignoring the impact of the proposed rule on millions of workers who are currently protected by FLSA overtime regulations (even when they are not currently working overtime), the DOL’s estimate is not credible and provides a misleading view of the impact of the change.

In fact, if we simply extrapolate from their estimate based on this critique, we find that the two estimates are not all that far apart. The ratio of hourly workers with overtime protection to those actively working overtime is about 7.5. This ratio is the factor by which the Department underestimated the affected group that ought to have been considered in their impact study. Multiply this factor by their 644,000—the number of those working overtime who would become exempted—and the result is 4.8 million, close to our estimate of 5.5 million hourly workers who would lose protection under the

new rules. This result is shown in the third bar in the “Hourly” panel of the accompanying chart.

Turning to the impact of the rule change on salaried workers, EPI’s and DOL’s approaches were similar (as were their findings). In this part of the DOL’s impact analysis, it examines the impact of changes in the duties tests on how salaried employees are classified, which is very much akin to our own approach, and is historically the way this work has been undertaken. The following statement appears on page 15580 of the preamble to the rule:

The PRIA [the DOL’s impact analysis] indicates an additional 1.5 million to 2.7 million employees will be more readily identified as exempt from the overtime requirements of the FLSA because the updated duties tests will replace the current duties tests in determining their exemption.

The preamble states that, based on their current duties, these workers are unlikely to pass the existing exemption tests and are thus covered by current overtime rules. However, due to the very changes in the proposed rule that we examined in our analysis, the Department concludes that these workers would pass the new tests, and would be classified as exempt from overtime protection. Note that EPI found that 2.5 million salaried workers would become exempt as a result of the change in the duties test, slightly below DOL’s higher estimate (see the “Salaried” panel of the accompanying chart). It is unclear why an estimate of this magnitude—that approximately two million workers could lose overtime protection from the new rule—was given such little attention by the DOL in its presentation of its findings. Instead, the DOL chose to focus on the exemption of 644,000 hourly workers.

Will 1.3 Million Employees Really Gain Coverage?

Thus far we have focused solely on those who will lose coverage under the proposed rule. The Department of Labor also claims that their rule would cover an additional 1.3 million who are not currently eligible for overtime pay. The agency argues that because the proposed rule raises the coverage threshold from \$155 to \$425 per week (or \$22,100 per year), 1.3 million salaried workers will gain overtime protection that they currently lack. But here again the DOL’s analysis is flawed, leading in this case to an *overestimate* of the number who would gain coverage under the new rules.

The DOL made two critical mistakes in this estimate. First, its 1.3 million estimate includes 600,000 workers who are already covered under current law. These workers are not in white-collar occupations and thus cannot be exempted on the basis of their duties (their occupations are farming, forestry and fishing, transportation and material moving, handlers, equipment cleaners, helpers, laborers, machine operators, assemblers and inspectors, none of which could be exempted as executive, administrative, or professional employees).

The Department mistakenly assumed that, since these 600,000 workers have earnings above the current minimum salary test of \$155/week, they would gain protection under the new rule that lifts that minimum. But, in fact, the DOL is counting them as becoming newly covered when they already are covered under current rules.

This leaves 700,000 legitimate salaried, low-income, white-collar workers earning less than \$22,100 per year (these include executive, administrative, managerial, and professional employees, as well as technicians and related support workers, sales, administrative support, and clerical employees). Here the Department made a second error. Some of these workers could, indeed, be helped by the new rule, but since DOL admittedly failed to examine their duties, we have no way of knowing their coverage status under current law. Surely, it is a mistake to assume that all of them, including clerical workers, are currently and legitimately classified as bona fide executive, administrative, managerial, and professional employees. But that is precisely the assumption that DOL makes.

In fact, according to Acting Solicitor of Labor Howard Radzely, the Department of Labor “concluded that information regarding duties is not relevant” because these workers would all be guaranteed overtime under the proposed rule. But again, this represents a fundamental analytic flaw: by ignoring their current duties, the DOL fails to make a determination of how many of these low-income, white-collar workers are currently covered, and thus it cannot determine how many are *gaining* overtime protection under the new higher salary test.

Conclusion: Aligning the DOL and EPI Estimates

A good deal of confusion has been generated by the difference between EPI’s and DOL’s claims as to how many workers stand to lose overtime protection from the new rule, with our estimate at eight million and theirs at 644,000. In fact, once we appropriately adjust the Department of Labor’s estimate of hourly workers to account for the fact that the Department only looked at a small subset of the affected group, and we include their own estimate of 1.5 to 2.7 million salaried workers who would be newly exempted due to their changes in the duties tests, both the DOL and EPI arrive at similar numbers of affected employees. **As shown in the accompanying chart, when these factors are taken into account, the Administration’s own results reveal that about seven million employees would lose overtime coverage under the new rules, an estimate that is quite similar to the EPI estimate of eight million workers losing such protection.**

By examining only those employees working overtime at a given point in time, and ignoring the far larger group of hourly workers who are not now overtime workers but could easily be so in the future, the Department of Labor generated a misleading undercount of who would be hurt by the new rule. This is especially the case when we consider that the proposed rule change has the potential to eliminate the cost disincentive currently in place to discourage employers from using and abusing overtime. Such a change is likely to lead to the reclassification of millions of workers from their current nonexempt status to exempt from overtime protection. At that point, they will no longer be compensated for overtime, violating the word and spirit of the FLSA.

Reconciling EPI and the Department of Labor's Estimates of the Number of Workers Who Would Lose Overtime Protection Under the Proposed Rule

