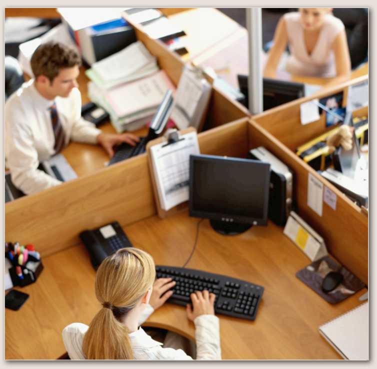
NATIONAL CENTER FOR POLICY ANALYSIS

Redefining Jobs Down: Managers, Salaried Workers and Overtime Pay

Issue Brief No. 181 by Jacob Kohlhepp December 2015

In 2016, millions of professional and salaried American workers will be effectively reclassified as hourly workers and eligible for mandatory overtime pay due to a change in U.S. Department of Labor regulations.



Dallas Headquarters:
14180 Dallas Parkway, Suite 350
Dallas, TX 75254
972.386.6272

www.ncpa.org

Washington Office:
202.830.0177
governmentrelations@ncpa.org

While many welcome this change as a victory for higher wages, upward mobility could be hurt by limiting workplace flexibility and employment options for those trying to climb the income ladder.[1]

New Overtime Pay Regulations

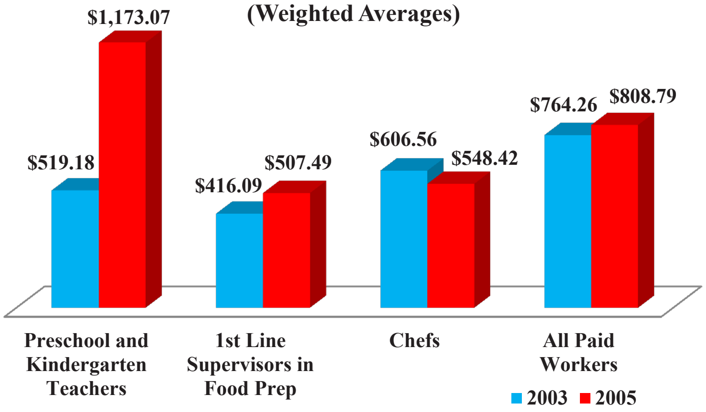
The Fair Labor Standards Act (FLSA) requires employers to pay "nonexempt" workers 1.5 times the employee's hourly rate of pay (or the hourly equivalent if the worker receives a salary) for all hours worked in excess of 40 per week. U.S. Department of Labor regulations under the FLSA define the job duties 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. Labor Department regulations also set the minimum salary level an employee must receive in order to be exempted from overtime pay. The change in federal overtime regulations increases the minimum salary an employee must earn to be exempt from $455 a week in 2015 to $970 a week in 2016.[2]

Effects of the Bush Administration's Reclassification of Workers. Empirical evidence suggests there is a tradeoff between mandatory overtime pay and employee benefits. In 2004, the Bush administration raised the exempt salary level from $155 a week to $455 a week, but instituted a less restrictive duties test.[3] The adjustment of the duties test meant that many preschool teachers, chefs and line supervisors of food preparation workers were exempted, because they were now considered executives, managers or learned professionals.[4] Prior to 2004, many employers were required to pay overtime to individuals in these jobs. After the changes, employers were no longer required to pay them an hourly wage, rather than a set salary, or to pay them overtime for additional hours of work. The Economic Policy Institute and the AFL-CIO decried the move but, after 10 years, it is possible to see whether the loss of mandated overtime pay hurt or helped preschool teachers and chefs.

The best way to evaluate the Bush administration rule change is to examine data on workers in reclassified positions from the March Supplement of the 2004 and 2006 Current Population Survey (CPS) conducted by the U.S. Census Bureau.[5]

Did total weekly earnings change? The evidence is mixed. Pre-school/kindergarten teachers and first-line supervisors of food preparation workers saw a dramatic rise in earnings, while chefs saw a modest decrease.[6] On average, nationwide, hourly workers saw modest increases in weekly income during the same time period [see Table I].

Figure I
Weekly Earnings of Preschool and Kindergarten Teachers
(Weighted Averages)



Source: Author's calculations from the March CPS 2004 and 2006.

Did the Bush administration overtime regulations affect other aspects of employment compensation beyond wages? An analysis of employer-provided pensions and medical insurance reported in the CPS suggests there may be a link. From 2003 to 2005 [see Table II]:[7]

- The percent of chefs with an employer-provided pension rose 7.5 percent.
- Preschool teachers saw an increase in pension coverage of 4.3 percent.
- First line supervisors of food preparation workers saw a rise of 4.3 percent as well.

These gains occurred despite a decrease in employer-provided pensions among employees in general.

Among individual workers who were interviewed before and after the 2004 change, there was also a significant increase in the percent of pension coverage [see the Appendix].

Furthermore, the percentage of preschool and kindergarten teachers with health insurance coverage at least partially paid for by the employer increased dramatically.[8] From 2003 to 2005 [see Figure II]:

- The percent of chefs covered by employer-provided health insurance fell 1.5 percentage points.
- However, the percent of preschool and kindergarten teachers covered by employer-provided health insurance rose 3.4 percentage points. Because employment of preschool and kindergarten teachers rose, the total number of these teachers with employer-provided health insurance also increased.
- The percent of first-line supervisors of food preparation workers covered by employer-provided health insurance rose 0.3 percentage points.

These trends ran counter to a general decrease in health insurance coverage among all paid workers of 0.9 percentage points during this period.[9]

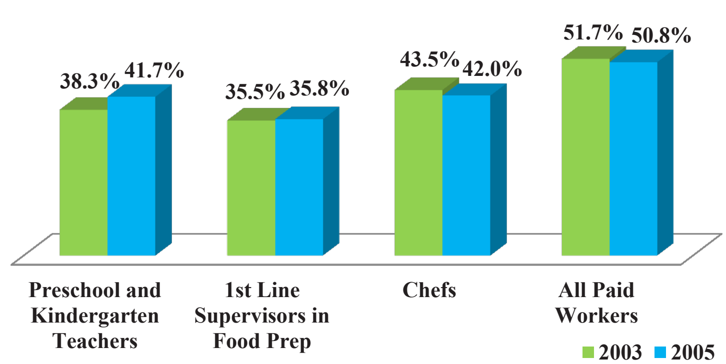
The rise in preschool and kindergarten teacher employer-paid health insurance coverage is especially interesting, because it occurred despite a fall in the percent of preschool and kindergarten teachers with health and pension coverage from 2002 to 2003, the year right before the overtime reform.

Fixed Wages versus Fixed Jobs. Economists generally point to two main models to assess the impact of overtime changes: the *fixed wage model* and the *fixed job model*. In the fixed wage model, hourly wages are fixed. After the implementation of overtime pay, the employer then decides whether to keep using overtime hours, which are now 1.5 times more expensive, or to substitute capital investment or new workers to replace overtime hours.[10] As the Heritage Foundation points out, under this model individuals who still work overtime hours after the regulation is put in place could experience a pay raise. Other individuals, however, could have their hours cut.

The fixed job model, on the other hand, assumes the average number of hours an employee works is factored into the original contract he or she negotiates with a firm. Because overtime regulations only apply to hours worked over 40, the employer could simply decrease the person's base wage in order to keep the total cost of the employee the same. In this model, overtime regulations only raise the total earnings of people working near the minimum wage, since an employer cannot reduce an employee's wage below the federal or state minimum.

Ambiguous Effects on Pay. As discussed previously, total earnings and benefits changed when certain occupations were exempted from overtime mandates. But there appeared to be an ambiguous effect on total earnings. Preschool and kindergarten teachers saw dramatic increases but chefs, who

Figure II
Percent with Employer-Provided Health Insurance
(Weighted Averages)



Source: Author's calculations from the March CPS, 2004 and 2006.

also experienced the policy change, saw slight decreases. The pay increases also do not seem to come from greater hours, meaning it is likely that the changes in earnings are largely unrelated to overtime changes.

What is not ambiguous, however, is that the benefits package for all three occupations improved. After these occupations lost mandated overtime pay, they gained pension coverage and paid health insurance coverage. This suggests a tradeoff between overtime pay and benefits. Salaried employees, although not necessarily paid more by the hour, are probably more likely to receive noncash benefits from their employer.

These results support and augment the fixed job theory. The findings are evidence that employee benefits, such as pensions, are part of the contract or payment negotiated for a specific job. Overtime regulations, by driving up the hourly wage, come at the cost of unseen noncash benefits, which, unlike hourly wages, are free to change.

This addition to the fixed job theory has especially important implications when one takes into account the stickiness of wages. Most economists agree that wages are sticky, or that employers tend to avoid decreasing wages because it would hurt morale. Because benefits are less "seen" than wages, it would make sense for employers to decrease benefits as a substitute for reducing wages. In other words, the extension of mandatory overtime pay to an occupation could be more likely to decrease benefits than the removal of overtime pay.

Conclusion

The Obama Administration overtime changes are different than the Bush 2004 changes. But despite the differences, the lessons of the Bush changes could foreshadow bad consequences for the 2015 reforms, such as a loss of employer-paid health insurance. What is certain is that the changes will force millions to be reclassified as hourly employees from salaried employees. This means a loss of flexibility and possibly even a lower chance of promotion.[11] Ultimately, it could mean a net decrease in employee satisfaction.

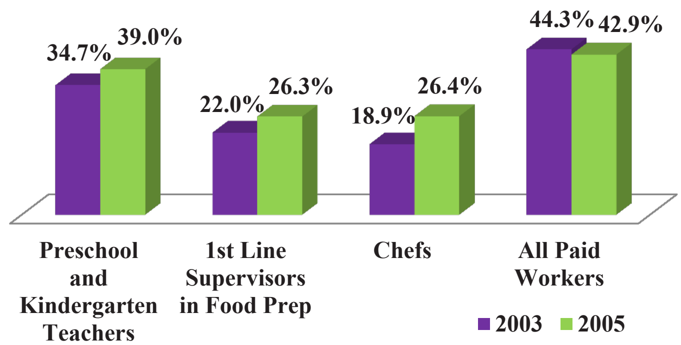
Jacob Kohlhepp is a Koch Fellow with the National Center for Policy Analysis.

Appendix

Methods. In order to even more deeply analyze the effect of the Bush overtime changes, first line supervisors within the retail industry and the food service industry were analyzed before and after the change. The results were inconclusive, and as such are reported in the appendix for those interested.

Data from the Current Population Survey March Supplement were used. By examining unique identifiers, 34 individuals (all first line supervisors) were found who were interviewed in 2004 and in 2006. Some of these individuals were located in states with laws more generous than the federal law. These individuals were used as the control group. The rest of the individuals were located in states that use the federal law to regulate overtime. Because this group of individuals was affected by the overtime change, it was used as the experimental group.

Figure III
Percent with Employer-Sponsored Pensions
(Weighted Averages)



Source: Author's calculations from the March CPS, 2004 and 2006.

Results. Several regressions were run. The first examined whether the policy change (which made many first line supervisors in the states that fully align with federal law) exempt from overtime had any effect on weekly earned income. No statistically significant effects were observed.

The second regression examined whether the policy change had any effect on the number of hours worked. This regression also found no statistically significant effect.

Finally, a regression was run to see if there was any effect on pensions.

Regression 1: Effect of Federal Overtime Changes on Change in Weekly Earnings

R-squared: 0.0062	Affected by the Overtime Change? *Yes=1, No=0; Based on state of residence*	Constant
Coefficient (Standard error)	-88.998 (202.5202)	110.553 (127.111)

Interpretation: This effect means that on average, first line supervisors that became overtime exempt (meaning they no longer had to be paid overtime) saw their earned income grow by $88 less than those who remained eligible. However, this is insignificant given the standard error, so the results are inconclusive. There does not appear to be evidence of any effect in earned weekly income.

Regression 2: Effect of Federal Overtime Changes on Change in Hours Usually Worked from 2003 to 2005

R-squared: 0.012	Affected by the Overtime Change? *Yes=1, No=0; Based on state of residence*	Constant
Coefficient (Standard error)	-2.65 (4.32019)	-0.35 (2.712)

Interpretation: This effect means that, on average, first line supervisors that became overtime exempt saw their number of hours worked fall by 2.65 hours more than those who remained eligible for overtime pay. However, this result is also insignificant given the standard error, so the results are also inconclusive. There is no evidence of any effect on hours.

Regression 3: Effect of Federal Overtime Changes on Pensions

R-squared: 0.012	Affected by the Overtime Change? *Yes=1, No=0; Based on state of residence*	Constant
Coefficient (Standard error)	0.7615385*** (0.2163352)	-0.3* (0.1357819)

Interpretation: This effect means that, on average, first line supervisors who became overtime exempt saw their chance of having a pension rise by 76% compared to those who remained nonexempt. Put another way, on average the first line supervisors who became overtime exempt increase their likelihood of having a pension by 46%, while those who remained overtime covered saw their pension likelihood fall by 30%. This effect was statistically significant to the 0.1% level.

Notes

1. Dawn Sweeney, contributor, Steve Caldeira and Katherine Lugar, "New Overtime Rules Close the Door on Hospitality," *Hill*, August 3, 2015. Available at http://thehill.com/blogs/pundits-blog/labor/250087-new-overtime-rules-close-the-door-on-hospitality.

2. Christine Mai-Duc, "Obama's New Overtime Rules: How They Work and who they'd Affect," *Los Angeles Times*, June 30, 2015. Available at http://www.latimes.com/business/la-fi-obama-overtime-rules-explainer-20150630-htmlstory.html.

3. "Revised FLSA Regulations, Effective August 23, 2004, Set New Standards for Overtime Compensation," FindLaw. Available at http://corporate.findlaw.com/human-resources/revised-flsa-regulations-effective-august-23-2004-set-new.html#sthash.EKIzPT56.dpuf. Up until 2004, there were two duties tests: the long test, which limited the amount of nonexempt work that could be performed by an exempt employee, and a short test, which did not limit the amount of nonexempt work for employees who were paid at a higher salary level.

4. Ibid.

5. U.S. Census Bureau, Current Population Survey. Available at https://www.census.gov/mp/www/cat/people_and_households/current_population_survey.html. Funeral directors were excluded from analysis because the 2004 and 2006 March Current Population Survey only interviewed about 30 of them. In contrast, hundreds of chefs and preschool teachers were interviewed.

6. It would have been ideal to only examine preschool teachers, but they are lumped together with kindergarten teachers in a single category in the March CPS. However, there were no significant changes in the earnings of elementary and middle school teachers; thus, there is reason to believe that the changes in the broad category of preschool and kindergarten teachers were driven by preschool teachers, not kindergarten teachers.

7. The overhaul of overtime occurred in mid-2004.

8. It is relevant to look at health insurance coverage by the employer because this overtime change occurred long before the employer mandate of Obamacare.

9. The trends described here and in the figures are similar regardless of whether weighted or unweighted averages are used. Using a "weighted" average, the components are multiplied by a certain factor reflecting their importance.

10. James Sherk, "Salaried Overtime Requirements: Employers Will Offset Them with Lower Pay," Heritage Foundation, July 2, 2015. Available at http://www.heritage.org/research/reports/2015/07/salaried-overtime-requirements-employers-will-offset-them-with-lower-pay.

11. Dedrick Muhammad, "Salary vs. Hourly and Why All Pay Is Not Equal," *Huffington Post*, April 27, 2013. Available at http://www.huffingtonpost.com/dedrick-muhammad/salaried-vs-hourly-work_b_2734218.html, https://sswr.confex.com/sswr/2014/webprogram/Paper21308.html.