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OPINION | COMMENTARY

Working Overtime to Avoid the Truth

The Labor Department isn't being straight about the likely effect of adding people to the overtime rolls.

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Many salaried workers in the U.S. may soon be obliged to punch a time clock, thanks to the Labor Department's proposed regulation raising the income level for workers to qualify for overtime. More overtime pay sounds great. But what Labor fails to mention—and its economists surely understand—is instead of paying more workers overtime, many companies will simply cut back their hours or lower their salaries. That's not a story Labor is comfortable telling. So it doesn't.

Currently, most salaried employees in the U.S. making more than $23,660 annually are exempt from the requirement that employers pay workers time-and-a-half for every hour over 40 hours weekly. But the Obama administration wants to raise the threshold for being exempt from government-mandated overtime pay to $50,440. This means that about five million more salaried workers will need to have their weekly work hours counted and documented—a requirement that can be practically fulfilled only if these workers "punch" time clocks. The Labor Department is expected to roll out the final version of this regulation in July.

Among the perks of a salaried job are greater job security, a consistent paycheck, work flexibility, and, increasingly, the ability to telecommute. Yet if these new regulations transform five million salaried workers into hourly workers, will there be any new benefits to offset the loss of these perks?

The Labor Department's official objectives are "to spread employment by incentivizing employers to hire more employees" and "to reduce overwork and its detrimental effect on the health and well-being of workers." The story is that employers would allegedly hire new workers rather than pay overtime to the old ones.

But these claims are contradicted by the story the department is spinning for the public. Instead, the for-the-media policy objective is to raise the pay of current workers. Labor Secretary Thomas Perez told reporters last June that the new rules would "put more money in people's pockets," as much as $1.3 billion nationwide, according to Mr. Perez. In other words, employers will pay overtime wages to once-salaried workers.

So will the regulations spread employment, or will they instead increase worker income by raising the amounts that employers pay in overtime wages? It's possible, of course, to have some combination of these two outcomes: In some cases employers will hire more employees (spreading employment) and in other cases employers will pay overtime wages to current workers (increasing worker pay).

In a new Mercatus Center research paper, we analyze the likelihood that the new overtime-pay rule will promote any of the stated objectives. We find that the Labor Department overlooks the most likely response by employers—namely, to cut employees' base salaries, when feasible, in reaction to the overtime regulation. Empirical studies reveal little evidence that overtime-pay regulations result in greater pay or more employment.

Economist Stephen Trejo of the University of Texas studied changes in overtime-pay regulations from 1974-78 and 1970-89 and found in a study published in 1991 that downward pay adjustments occurred to offset the increased overtime pay. Importantly, in a 2003 study Mr. Trejo also found that such regulations do not reduce average work hours. Research by the Bureau of Labor Statistics economist Anthony J. Barkume revealed similar findings.

The effect isn't unique to the U.S. In a 2012 study of overtime regulations in Japan, Sachiko Kuroda of Waseda University and Isamu Yamamoto of Keio University examined "name-only managers," who do work that is virtually the same as regular hourly employees but who are exempt from overtime pay because of their classification as managers. They found no significant differences in pay between the two groups. According to these researchers, "exempt employees are paid higher base salaries in order to compensate for their loss of overtime pay, keeping their effective hourly wages as high as those of other employees."

Anecdotal evidence tells the same story. After settling a class-action lawsuit in 2006, IBM voluntarily reclassified 7,000 of its once-salaried workers as hourly workers. The salaried workers were earning an average of $77,000 annually. After transitioning them to hourly pay, IBM cut their base pay by 15% in anticipation of potential overtime-pay costs. When a major lawsuit was filed in 2007 against McDonald's in Japan regarding the reclassification of managers to earn overtime pay, McDonald's responded by reducing managers' base pay.

It is irresponsible and unethical of the Labor Department to emphasize only the potentially positive consequences of government-mandated overtime pay. Employees should be aware that while it's possible that this regulation will increase their pay or reduce their work hours, the more likely outcome is that their base pay will fall, and they'll lose many of the perks that come with not having to punch a time clock.

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