



Economic analysis of the DOL's proposed overtime regulation

A REPORT FOR THE NATIONAL RETAIL FEDERATION
BY OXFORD ECONOMICS

NOVEMBER 2023

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EXECUTIVE SUMMARY

The Department of Labor (DOL) has proposed to raise the salary threshold that executive, administrative, and professional (EAP) workers must be paid in order to be exempt from overtime requirements. Specifically, the DOL proposes to raise the threshold from its current value of \$684 per week (\$35,568 annually) to the 35th percentile of full-time salaried wages of workers in the Southern census district, which it estimates will be in the range of \$1,140 to \$1,158 per week when the final regulation is issued in 2024, an increase of up to 69%. The National Retail Federation (NRF) commissioned Oxford Economics to analyze the economic effects the DOL's proposed overtime regulation would have if implemented, both broadly and on the retail and restaurant industries in particular.

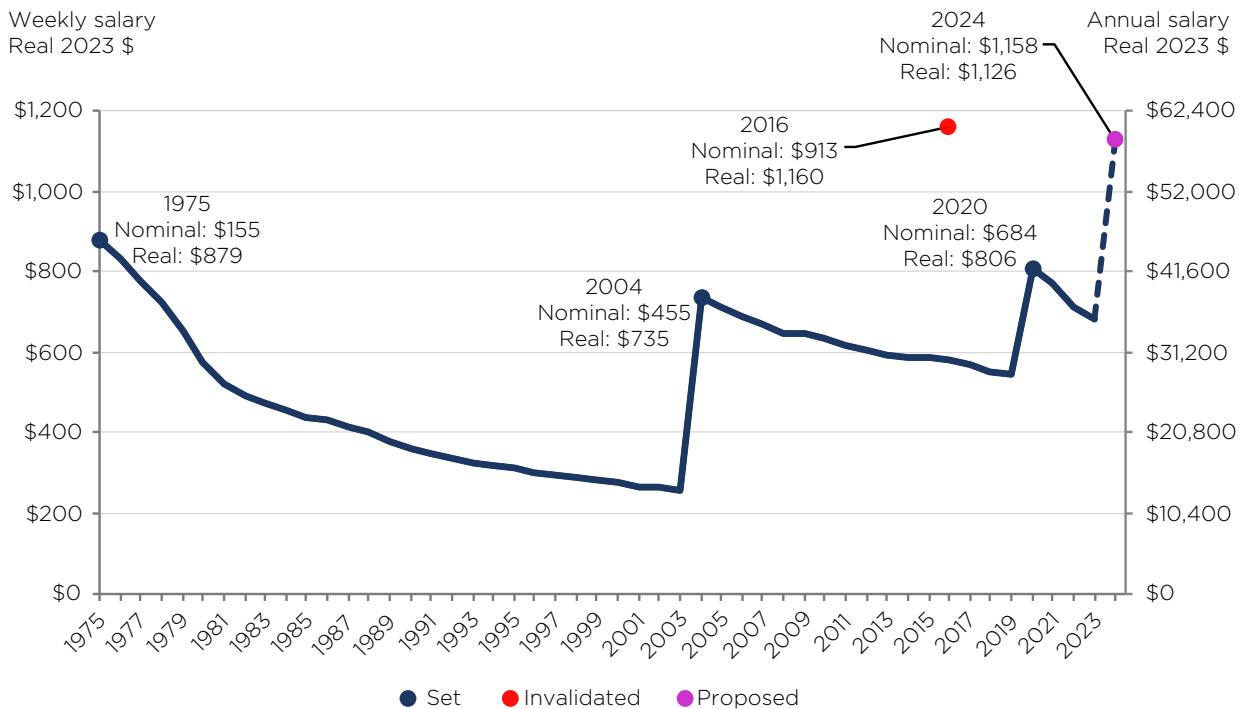
\$1,158

per week for full-time salaried wages from the DOL proposed raise when the final regulation is issued in 2024.

THE EXEMPTION THRESHOLD

The measure the DOL has selected for this increase—a percentile of full-time southern salaries—is fundamentally arbitrary. In real (inflation-adjusted) terms, the proposed threshold is 28% higher than the 1975 “long test” value when it was set, 40% higher than the current threshold when it was set, and only 3% below the level set in the DOL's 2016 overtime regulation, which was invalidated by the courts (Fig. 1).

Fig. 1: Real overtime exemption threshold, 1975-2024



Source: Oxford Economics.

The DOL estimates that 3.4 million workers would be affected by the proposed adjustment to the EAP threshold. However, this estimate is premised on the DOL's poorly grounded assumptions regarding the share of salaried white-collar workers who pass the duties test indicating that they are a bona fide EAP worker. If, as we suspect, the connection between salaried status and EAP exemption status is tighter than the DOL assumes, the number of affected workers could be higher, up to approximately 7.2 million.

7.2 million

of workers could be affected by the exemption status.

COSTS AND CONSEQUENCES

The DOL estimates that the 3.4 million workers affected by the new rule would see their pay rise by \$6 per week on average (0.6%) as a result of the proposed regulation. This represents an annualized economy-wide payroll cost of \$1.3 billion. Additional non-payroll costs such as regulatory familiarization, adjustment, and managerial time bring the DOL's total estimated annualized cost of the regulation to \$2.0 billion. The DOL also identifies six additional unquantified costs of the proposed regulation and three unquantified benefits.

The DOL's estimate of the pecuniary impacts of the rule is low because it assumes that affected workers who never work more than 40 hours per week will see no change at all in their pay as a result of the rule. However, while it is legally permissible for these workers to remain salaried while becoming nonexempt from overtime pay requirements, in practice, many of these workers are likely to lose their salaried status and instead be paid hourly as a result of the proposed regulation.

Indeed, as the regulations make it more difficult and expensive to employ salaried workers below the proposed exemption threshold, firms will shift their management structures to rely on a smaller number of high-paid exempt employees managing the large number of hourly employees. This represents a "hollowing out" of middle-level employees, and a loss of lower-paid salaried positions, which have historically represented important and desired stepping stones in the career progression for younger workers.

AUTOMATIC UPDATES

The DOL proposes to automatically update the EAP exemption threshold every three years following the implementation of the new threshold in 2024, instead of using the regulatory process to adjust the threshold, as it has during the prior 85-year history of the rule. As envisioned, this automatic update process would make

permanent an overtime threshold that is 28% higher in real terms than the 1975 threshold when it was first set.

However, the DOL's proposed method for automatically updating the exemption threshold suffers from the same problem that its analysis of the costs of the proposed rule does: a failure to model newly nonexempt affected workers losing their salaried status. Because the measure that the DOL has selected to adjust the exemption threshold (the 35th percentile of wages for full-time salaried Southern workers) is itself sensitive to which workers are paid salaried and which are paid hourly, this would result in a feedback effect where the exemption threshold is ratcheted ever higher as more workers below the new thresholds lose their salaried status.

OVERTIME AND RETAIL

We find that the proposed regulation would affect approximately 1.7% of retail and restaurant workers. The educational qualifications of affected retail restaurant workers are lower than those in other industries, with affected retail and restaurant workers one and a half times as likely to have less than a bachelor's degree as affected workers in other industries. The proposed regulation, therefore, would be expected to reduce managerial opportunities available to individuals without a bachelor's degree.

Consistent with Oxford Economics' 2015 report on previous proposed DOL overtime regulations,¹ we expect that employers generally and in retail in particular would adjust compensation to ensure they do not absorb additional labor costs through:

- Converting newly nonexempt works to hourly status and lowering hourly pay rates to achieve similar levels of pay; or
- Raising the salaries of workers paid close to the new threshold to keep them exempt, while cutting benefits and bonuses to achieve similar overall compensation.

The reduction in bonuses in particular is expected to have real impacts on the managerial model of the retail industry, which disproportionately relies on merit-based pay.



**higher in real terms than the
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¹ Oxford Economics (May 20, 2015). "Rethinking Overtime." www.oxfordeconomics.com/resource/rethinking-overtime/.

1. INTRODUCTION

On September 8, 2023, the Department of Labor (DOL) published a proposed regulation to change the rules governing which US workers are entitled to overtime pay. Among other things, the proposed rule would raise the minimum salary threshold that executive, administrative, and professional workers must be paid in order to be exempt from overtime requirements from its current value of \$684 per week (\$35,568 annually) to a new level to be calculated based on government survey data, which the DOL estimates will be up to \$1,158 per week (\$60,209 annually), an increase of 69%. The proposed regulation also includes a provision to automatically update this exemption threshold every three years going forward using the same formula without issuing new regulations.²

The National Retail Federation (NRF)³ commissioned Oxford Economics to analyze the economic effects the DOL's proposed overtime regulation would have if implemented, both broadly and on the retail and restaurant industries in particular. This work follows a similar analysis we conducted for a previous overtime regulation proposal in 2015.⁴

This report sets out the research and subsequent discussion of the rule's likely economic implications on the retail sector and consequently retail workers as described below:

- **Chapter 2** discusses how the DOL set the level of the proposed new overtime threshold and provides a brief history of the evolution of the overtime rule.
- **Chapter 3** estimates the number of workers who will be affected by the new rules.
- **Chapter 4** explores the likely responses to the proposed rules and reviews the DOL's cost estimates.
- **Chapter 5** considers the DOL's proposed method to automatically update the exemption threshold every three years.
- **Chapter 6** focuses on the effects of the proposed rule on the retail and restaurant industries.
- **Chapter 7** concludes.

² The proposed regulation also includes other provisions that are not the focus of this report. These include amendments to a separate overtime exemption for Highly Compensated Employees, and alternative thresholds for US territories and the motion picture industry.

³ The National Retail Federation is the world's largest retail trade association, representing discount and department stores, home goods and specialty stores, Main Street merchants, grocers, wholesalers, chain restaurants, and internet retailers from the United States (as well as 45 other countries).

⁴ Oxford Economics (May 20, 2015). "Rethinking Overtime." www.oxfordeconomics.com/resource/rethinking-overtime/.

2. THE EXEMPTION THRESHOLD

Under the Fair Labor Standards Act (FLSA) of 1938, most US workers are entitled to time and a half pay for any hours worked in a week beyond 40. However, this rule does not apply to all workers. One of the largest categories of workers who are exempted from overtime rules are those who qualify under the Executive, Administrative, and Professional (EAP) exemption. To qualify for this exemption, a worker must satisfy the following three tests:⁵

- **Salary basis test.** They must be paid a fixed salary that is not dependent on the number of hours they work.
- **Salary level test.** Their salary must be above a fixed threshold, currently \$684 per week.
- **Duties test.** Their job duties must satisfy criteria that have been established by the DOL to demonstrate that they are a bona fide executive, administrative, or professional worker.

While the FLSA (a law passed by Congress) establishes the framework for overtime policy, the specific rules under which workers qualify for the EAP exemption are set by regulations issued by the DOL, which have been amended over time. While the salary basis test is fundamental, the duties test was last adjusted in 2004. The salary level test was also adjusted in 2004 from the prior level of \$155 per week, which had been in effect since 1975, to \$455 per week, and then again in 2019 to its current level of \$684. The DOL also issued a regulation to update the threshold to \$913 per week in 2016; however, this change was ultimately invalidated by the courts.

In its proposed overtime regulations released in September 2023, the DOL proposes to update the EAP exemption threshold to the 35th percentile of wages of full-time (not part-time) salaried (not

hourly) workers in the Southern Census district. This particular measure (full-time Southern salaries) has been the basis for each of the DOL's four 21st century overtime rulemakings (Fig. 2).⁶

Fig. 2: Exemption threshold updates proposed by DOL since 2004

Proposed	Effective	Value (nominal)	Basis
2004	2004 - 2019	\$455	20th percentile wage of full-time salaried workers in the South
2016	Invalidated	\$913	40th percentile wage of full-time salaried workers in the South
2019	2020 - Present	\$684	20th percentile wage of full-time salaried workers in the South
2024	Proposed	\$1,158	35th percentile wage of full-time salaried workers in the South

Source: Oxford Economics

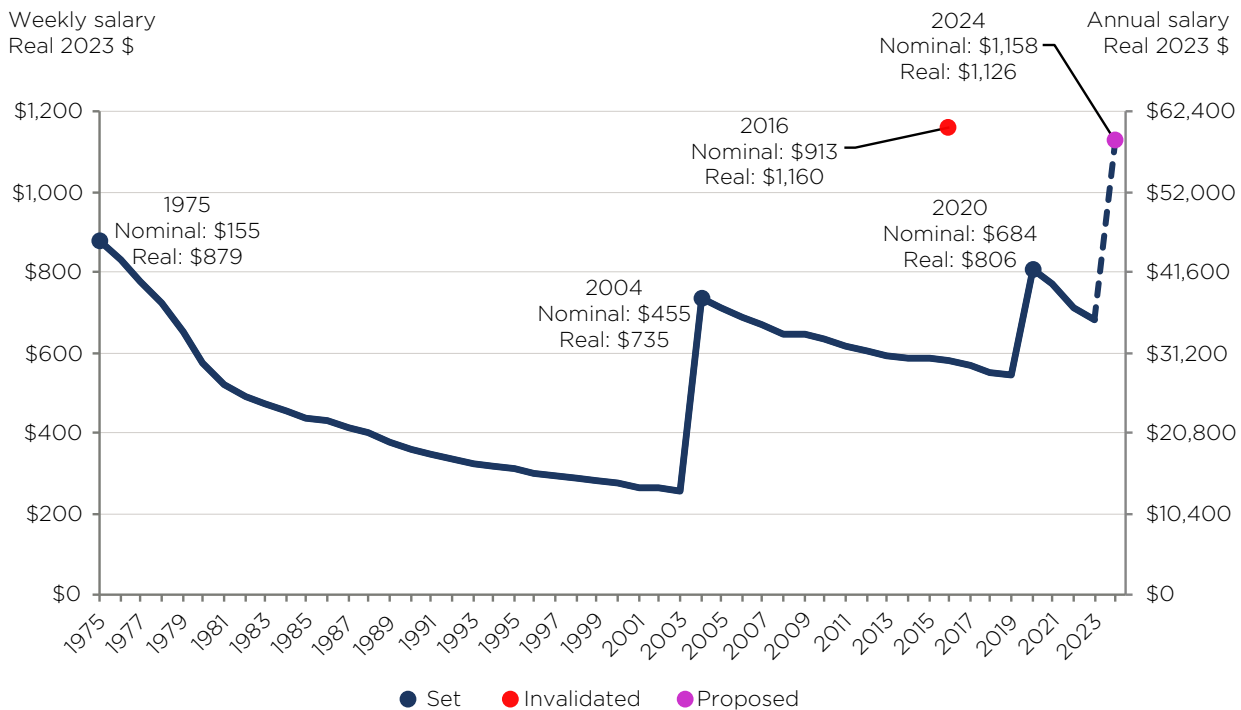
⁵ Teachers, attorneys, and physicians automatically qualify for the exemption without having to demonstrate that they meet the salary level.

⁶ In setting the 2004 salary threshold, the DOL also considered the wages of full-time salaried retail workers along with full-time salaried Southern workers.

In the two successfully enacted rules, in 2004 and 2019, the percentile selected was the 20th; while the invalidated 2016 rules used the 40th percentile. However, while the current proposed regulation opts for the 35th rather than

the 40th percentile, **the DOL's forecast of \$1,158⁷ per week for the threshold in the final 2024 rulemaking is only \$34 per week (3%) lower than that of the vacated 2016 value expressed in inflation-adjusted⁸ 2023 dollars** (Fig. 3).⁹

Fig. 3: Real overtime exemption threshold, 1975-2024¹⁰



Source: Oxford Economics

⁷ This forecast is presented in the NPRM in footnote 3. The \$1,059 value that is referenced more widely in the NPRM represents the calculated value of the 35th percentile full-time Southern wage using 2022 data; however, the DOL proposes to use the latest available data when setting the final threshold, which it forecasts at \$1,158 per week if first quarter 2024 data are then available and at \$1,140 if only 4th quarter 2023 data are. NPRM, Federal Register / Vol. 88, No. 173, at p. 62153.

⁸ For the inflation adjustment, we used annual average CPI-U values from the FRED databank to adjust to 2022 dollars. For post-2022 inflation, we use the current Oxford Economics forecast for US CPI inflation of 4.2% for 2022-2023 and 2.8% for 2023-2024.

⁹ That the DOL's forecast for the 35th percentile of full-time Southern salaries in 2023 is so close to the 40th percentile in 2016 is the result of various economic factors, notably including the effects of the Covid-19 pandemic. See, for example, Fig. 5.

¹⁰ The 1975 rules had a higher long test threshold of \$170 per week for professionals; \$155 per week applied to executive and administrative workers.

In its Notice of Proposed Rulemaking (NPRM),¹¹ the DOL argues that the EAP threshold should exceed the value of what it terms the “long test method.” This terminology harkens back to the period from 1949 to 2004 when there were two duties tests for the EAP exemption: a long duties test with a lower earnings threshold and a short duties test with a higher threshold. However, even in the pre-2004 rulemakings, there was never a standardized “long test method” that was consistently applied to multiple rulemakings. Instead, in each of the four rulemakings from 1958 through 1975, the DOL employed variations on what was called the “Kantor method,”¹² named after the DOL administrator who developed it for the 1958 rule.

In its overview of the history of the EAP exemption, the Congressional Research Service (CRS)¹³ concludes that the Kantor method was not so much a consistent procedure as a “principle that

the salary threshold would not disqualify more than 10% of exempt EAP employees (as determined through passing the long duties test) in any of four categories: region, establishment size, city [urban/rural], or industry.”¹⁴ Additionally, the rulemakings based on the Kantor method relied on data from Wage and Hour Division investigations that have not been available since the 1975 rulemaking.¹⁵

The DOL's has produced a “long test method” calculation of \$925 (for 2022) based on the “10th percentile of earnings of likely exempt workers.”¹⁶ However for the reasons discussed above this is a poor stand-in for the historical long test level based on the Kantor method. A more reasonable approach is simply to inflation-adjust the actual 1975 long test threshold, as we have done in Fig. 3, resulting in a value of \$879 per week in 2023 dollars or \$843 per week in 2022 dollars.¹⁷

Moreover, it is at least debatable whether the DOL's contention that the overtime threshold in 2024 should be strictly greater than that which was set a half century ago, and which was inflated away to irrelevance by the early 1980s. Additionally, the DOL is not only proposing to increase the EAP exemption threshold by 69% over its current value and to a level that is 28% higher than the 1975 threshold in real terms, but it also proposes to make this methodology permanent through the adoption of automated update provisions, as discussed in chapter 5.

¹¹ “Defining and Delimiting the Exemptions for Executive, Administrative, Professional, Outside Sales, and Computer Employees.” (November 7, 2023.) 88 FR 62152.

¹² The two terms are deliberately conflated in the NPRM: “[T]his methodology, often referred to as the ‘Kantor’ methodology and generally referenced in this NPRM as the ‘long test’ methodology ...” NPRM, Federal Register / Vol. 88, No. 173, at p. 62161.

¹³ Congressional Research Service (October 31, 2017). “Overtime Exemptions in the Fair Labor Standards Act for Executive, Administrative and Professional Employees,” p. 13.

¹⁴ The Kantor method is also the basis for the strange choice of metric used in the DOL's rulemakings since 2004 shown in Fig. 2, i.e., full-time Southern salaries. Of the four Kantor categories, the regional one alone has survived into the DOL's recent rulemakings.

¹⁵ The CRS also notes two ways in which the Kantor method rulemakings varied. First, the unit of analysis varied between the establishment and the employee. “For example, ... in the 1963 rule, DOL noted that 13% of the establishments in the survey paid one or more of their executive employees less than [the proposed threshold]. Yet, ... in the 1970 rule, DOL noted that 20% of executive employees ... earned less than [the proposed threshold].” Second, in practice, it was difficult to achieve disqualification of no more than 10% in each of the four categories simultaneously. “For example, the 1970 rule ... [proposed] a level which about 11% of all administrative employees’ earnings were below. Yet, 18% of administrative employees in the South, 10% in the small-firm size category (0-9 employees), 16% in nonmetropolitan areas, and 16% in the retail industry earned below the ... threshold.”

¹⁶ NPRM, Federal Register / Vol. 88, No. 173, at p. 62217. This appears to refer to an analysis along the lines of that discussed in chapter 3, that is, using the DOL's 1998 estimates of the share of each occupation likely to pass the duties test. The unreliability of the 1998 analysis, discussed in chapter 3, is thus another reason to discount the \$925 result.

¹⁷ In the units of full-time Southern salaries, this would be the 21st percentile.

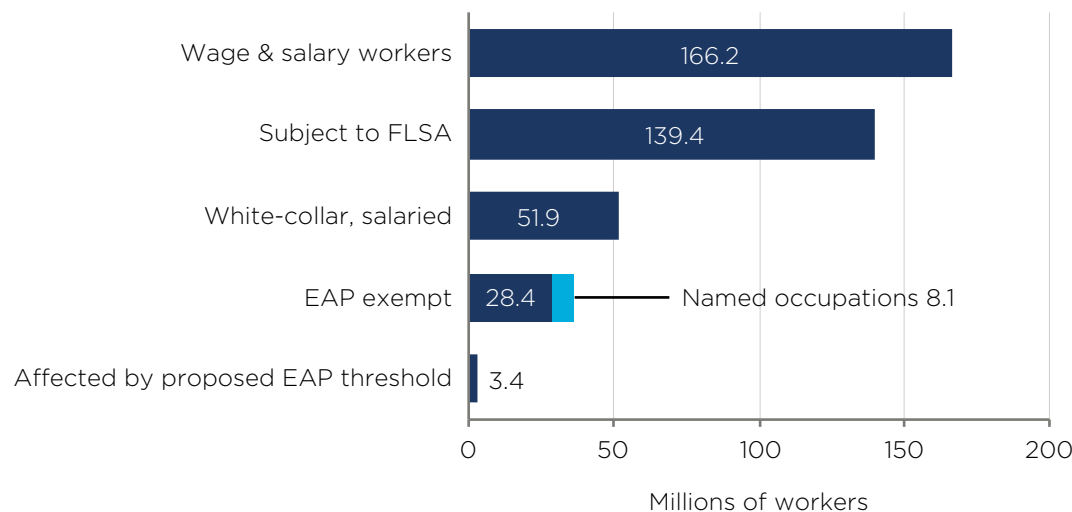
3. AFFECTED WORKERS

The DOL estimates that 3.4 million workers would be affected by the proposed adjustment to the EAP threshold.¹⁸ However, as described below, this estimate is premised on the DOL's poorly grounded assumptions regarding the share of salaried white-collar workers who pass the duties test. If, as we suspect, the connection between salaried status and EAP exemption status is tighter than the DOL assumes, **the number of affected workers could be higher, up to approximately 7.2 million** (Fig. 6).

The DOL estimates that, of the 166 million wage and salary workers in the US, 139 million are subject to the FLSA and its overtime provisions. Of these, the DOL estimates that 51.9 million of these are in white-collar¹⁹ salaried positions and thus are potentially eligible for the EAP exemption. The DOL estimates that 36.4 million workers are currently EAP exempt, of whom about 8.1 million are in named occupations like teachers, attorneys, and physicians; meaning that they qualify for the exemption without regard to salary level. An additional

28.4 million are estimated to be exempt based on passing the three EAP exemption tests described in chapter 2. Of these, the DOL estimates that 3.4 million earn below the proposed new EAP exemption threshold and thus are affected by the proposed regulation.

Fig. 4: Number of workers affected by the proposed changes to the EAP exemption according to DOL estimates



Source: DOL NPRM, Oxford Economics

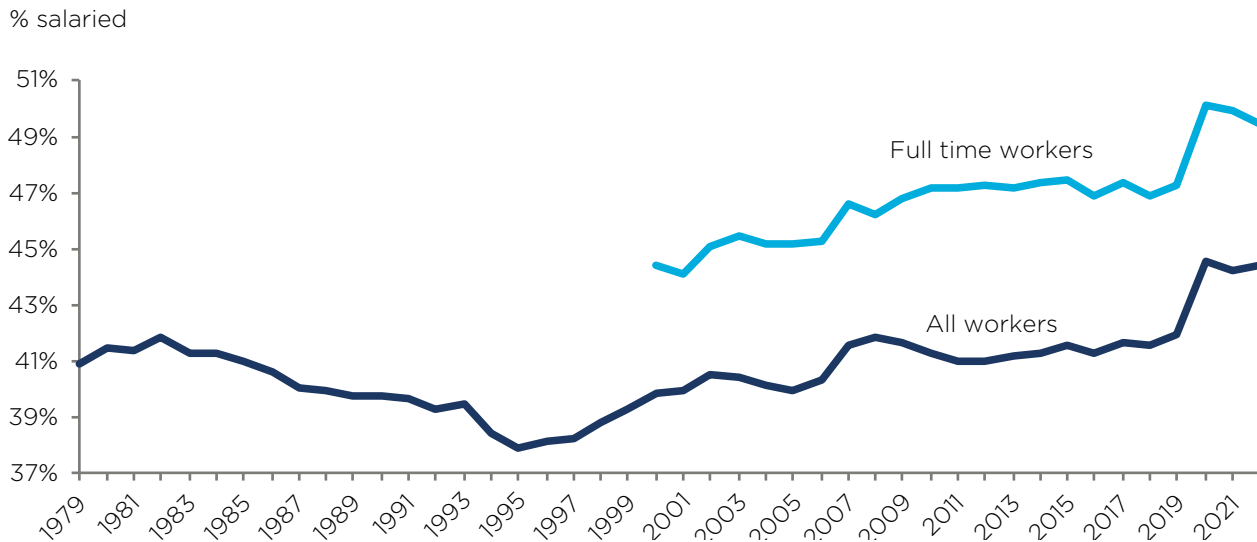
¹⁸ The DOL estimates that an additional 0.2 million workers will be affected by the HCE exemption adjustments in the proposed regulations, making the total number that DOL estimates will be affected by the proposed regulation 3.6 million.

¹⁹ White-collar here refers to occupations the DOL has estimated have a non-zero chance of passing the duties test.

These estimates were made by using data from the Current Population Survey (CPS) to identify which workers are expected to pass each of the three EAP exemption tests. This is relatively straightforward in the case of the salary basis test and the salary level test, each of which corresponds to a question in the CPS. However, there is no question in the CPS (or any other government survey)

that directly addresses which workers pass the duties test. The DOL therefore relies on workers' occupational classification to make this determination, along with estimates of the share of salaried workers in each of the approximately 500 CPS occupations who are expected to pass the duties test.²⁰

Fig. 5: Share of US workers paid on a salaried basis, 1979-2022



Source: BLS CPS, Oxford Economics

²⁰ For example, the DOL estimates that salaried veterinarians have 90% to 100% probability of passing the duties test, while salaried dieticians and nutritionists have a 10% to 50% probability of passing the duties test.

The source for these probability estimates is a 1998 analysis by the DOL's Wage and Hour Division based on institutional knowledge.²¹

There is no independent source to corroborate the reliability of these estimates when they were made in 1998. Nor is there any independent source to test whether the estimates still hold.

Multiple economic factors have potentially altered the relationship between workers' salaried status and EAP exemption status (conditional on occupation) since 1998. These include increases in automation, virtual work, computerized scheduling, and the effects of a global pandemic. Overall, the share of salaried workers in the economy has increased by approximately 6 percentage points since 1998 (Fig. 5).

While it is legally permissible for workers who are nonexempt from overtime pay requirements to be paid on a salaried rather than an hourly basis, such workers are still required to record their work hours and must be paid time and a half pay for any hours worked in a week over 40. This places compliance burdens on employers, as well as generating costs when such employees work overtime. Retail industry experts whom Oxford Economics consulted for this work described such an arrangement as the worst of both worlds, and none of them reported employing any salaried nonexempt workers in their organizations.

In Fig. 6, we have replicated as closely as possible the DOL's CPS-based methodology to estimate the share of salaried white-collar workers within each pay band who are expected to

pass the duties test based on the DOL's 1998 occupational probability estimates.²² Within the pay band affected by the proposed rule (\$684 - \$1,058²³), the DOL estimates that fewer than half (48%) of salaried white-collar workers will pass the duties test. These are the 3.4 million workers that the DOL estimates would be affected by the proposed regulation. However, if the relationship between salaried status and EAP exemption status is tighter than the DOL's 1998 analysis assumes, some of the 3.8 million salaried workers in the affected pay bands whom the DOL estimates do not pass the duties test may in fact do so, in which case the number of affected workers would be higher, up to 7.2 million (= 3.4 million + 3.8 million).

²¹ See www.regulations.gov/document/WHD-2023-0001-0006.

²² These probabilities were calculated by implementing the DOL's described methodology in the NPRM using CPS public use microdata. While we made every effort to match the DOL's work, our numbers do not perfectly match those in the NPRM, owing to the complexity of the method and the use of random numbers to determine which workers pass the duties test. In Fig. 6, a total of 27.8 million (= 3.4 million + 12.8 million + 11.6 million) white-collar salaried workers are estimated to pass the duties test; this corresponds to the DOL's estimate of 28.4 million workers who are currently EAP exempt in non-named occupations (see Fig. 4). Our estimates of the number of EAP exempt workers are thus about 2% lower than the DOL's overall (= (28.4 - 27.8) / 28.4).

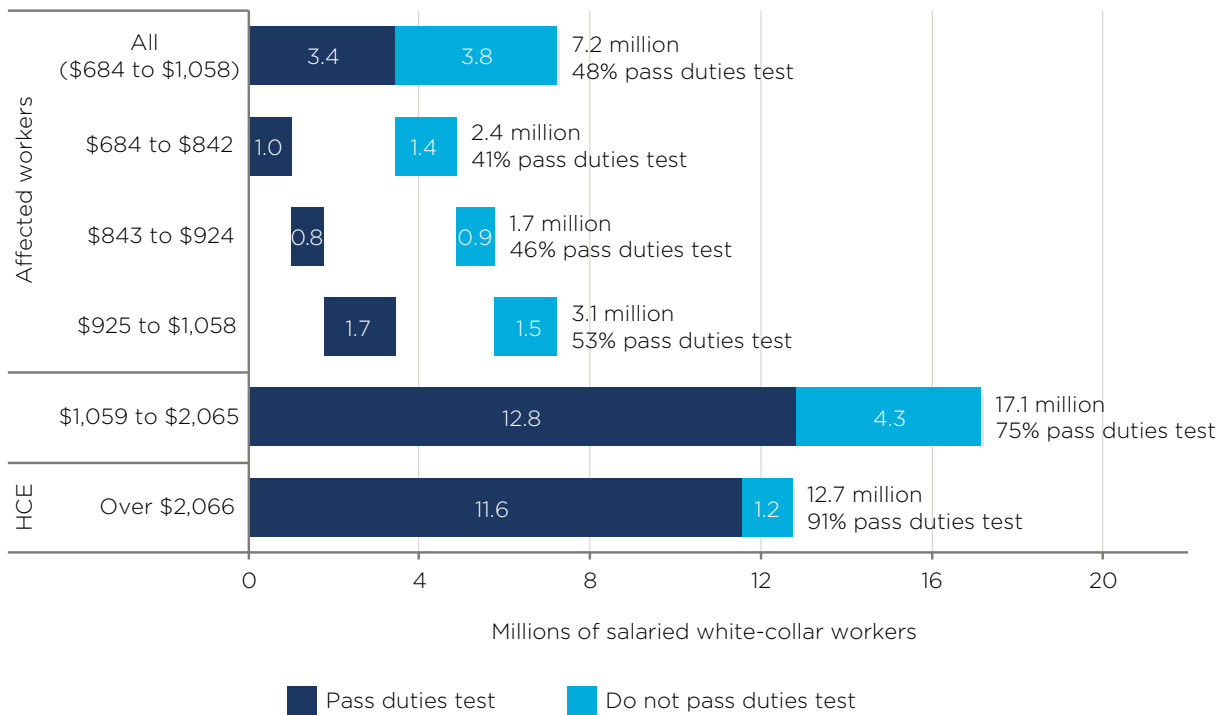
²³ This analysis uses 2022 CPS data, and so the DOL's 2022 threshold estimate of \$1,059 is the appropriate value to use, even though the DOL forecasts the actual value of the threshold when set in 2024 to be \$1,140-\$1,158.

As discussed in chapter 2, the DOL estimates a value of \$925 for the equivalence of the 1975 “long test” threshold, while we argue that a more appropriate estimate would be \$843 (in 2022 dollars).

- Using the DOL’s estimate of \$925 per week, 1.7 million to 3.1 million workers who would have qualified for EAP exemption under the 1975 test would be affected by the proposed rule.
- Using our estimate of \$843 per week, 2.4 million to 4.8 million²⁴ workers who would have qualified for EAP exemption under the 1975 test would be affected by the proposed rule (see Fig. 6).

In both cases, the lower estimates (1.7 and 2.4 million) represent those salaried white-collar workers in the affected pay (excluding those in named occupations) who are expected to pass the duties test using the DOL’s 1998 probability assumptions, while the higher estimates (3.1 and 4.8 million) represent the total number of such salaried workers.

Fig. 6: Full-time salaried white-collar workers in non-named occupations who are expected to pass duties test under DOL methodology by salary band



Source: Oxford Economics based on DOL methodology

²⁴ These are the sums of the rows labeled “\$843 to \$924” and “\$925 to \$1,058” in Fig. 6. The lower estimate, 2.4 million, represents those workers estimated to pass the duties test by the DOL’s methodology (0.8 million + 1.7 million), while 4.8 million is the total of all white-collar salaried workers not in named occupations in these pay bands (1.7 million + 3.1 million).

4. COSTS AND CONSEQUENCES

The DOL estimates **that the 3.4 million workers affected by the new rule would see their pay rise by \$6 per week on average (0.6%)** as a result of the proposed regulation. This represents an annualized²⁵ economy-wide payroll cost of \$1.3 billion.²⁶ Additionally, the DOL quantifies \$664 million in non-payroll costs associated with the proposed regulation (Fig. 7). To the extent that the payroll costs, which are transfers to employees from employers (and ultimately from customers), represent the goal of the regulation, it is worth noting that the non-payroll costs to achieve each dollar of transfer is 51¢ based on the DOL's own estimates.²⁷

In addition to the \$2 billion in quantified costs, the DOL identifies six additional unquantified costs of the proposed regulation, which are listed in Fig. 8. While the DOL does not quantify any benefits of the proposed regulation, it does identify three unquantified benefits.

Fig. 7: NPRM's quantified costs of the proposed regulation

Cost category	Annualized cost (\$ millions)
Payroll costs	\$1,294
Non-payroll costs	\$664
Regulatory familiarization	\$75
Adjustment	\$40
Managerial	\$549
Total costs	\$1,958

Source: DOL NPRM, Oxford Economics

Fig. 8: NPRM's unquantified costs and benefits of the proposed regulation

Costs	Benefits
Reduced scheduling flexibility	Strengthen overtime protection for some already nonexempt workers
Preference for salaried status	"Potentially lead to" increased worker productivity
Increased prices	Increased personal time for some workers
Reduced profits	
Hiring costs	
Hours-related worker effects	

Source: DOL NPRM, Oxford Economics

²⁵ Figures reported here are the DOL's estimates of annualized 10-year costs using its preferred 7% discount rate.

²⁶ This represents the full cost of the proposed overtime regulation, including provisions for the Highly Compensated Employees exemption. The payroll cost of the EAP adjustment are over three-quarters of this, or \$1.0 billion per year (= 3.4 million workers * \$6 per week * 52 weeks per year).

²⁷ = \$664 million / \$1,294 million.

The DOL's estimate of the pecuniary impacts of the rule is so low (\$6 per affected worker) in part because it assumes that affected workers who never work more than 40 hours per week (which the DOL estimates is 69% of them²⁸) will see no change at all in their pay as a result of the rule (at least on average). Although not stated, the assumption behind this seems to be that these workers would continue to be paid on a salaried basis despite becoming nonexempt as a result of the proposed regulation. However, as we discussed in chapter 3, the shift from overtime exempt to nonexempt status would likely result in many of these workers losing their salaried status and being paid on an hourly basis instead. Even for workers who never work more than 40 hours per week, this is likely to lead to some change in their earnings.

The DOL's difficulty in forecasting how workers' hours and pay would be affected by changes in overtime rules is a result of genuine uncertainty in the economics literature around the effects of overtime rules. The predictions of theoretical

models of overtime pay are ambiguous, while empirical studies are hampered by the relatively small number of observed changes in overtime rules in recent years.

The DOL focuses primarily on two papers, by Trejo (1991)²⁹ and Barkume (2010),³⁰ in its analysis of the literature on overtime regulations. While these papers use detailed data to assess the impact of overtime regulation, they ultimately rely on observing correlations between wages and overtime hours at single points in time and so cannot make causal claims. Findings from both are similar, with suggestive evidence that wages fall to mitigate the costs associated with expanded overtime coverage, but not enough to completely offset these costs.

Although discounted in the DOL's analysis,³¹ a third paper by Quach (2022)³² does make causal estimates of the employment and income effects of US overtime rules. Quach finds evidence that overtime coverage decreases employment and increases earnings polarization. Quach's

results imply an employment elasticity of -3.36, with firms shedding lower-paid workers to offset the wage increases of maintaining the exemption status of salaried workers who would be made nonexempt by the changed salary line.

Quach also finds strong evidence of employee reclassifications from salaried to hourly status, with 10 workers reclassified from salaried to hourly status for every 100 directly affected by the invalidated 2016 overtime regulation. Given that the 2016 regulation never went into effect, this likely represents a lower-bound estimate of the number of workers who would have lost salaried status under the rule.

²⁸ The NPRM sources this to the 69% of non-hourly workers who reported working no overtime hours in a year in the 2021 Survey of Income and Program Participants. SIPP respondents are likely a poor stand-in for the population of EAP exempt workers in the affected pay bands. See NPRM, Federal Register / Vol. 88, No. 173, at p. 62205.

²⁹ Stephen J Trejo, "The effects of overtime pay regulation on worker compensation." *The American Economic Review* (1991): 719-740.

³⁰ Anthony Barkume, "The structure of labor costs with overtime work in US jobs." *Industrial and Labor Relations Review* 64, no. 1 (2010): 128-142.

³¹ According to the DOL, as "[t]he paper has not been published in a peer-reviewed journal and has significant limitations...[t]he Department has not adjusted its methodology in response to this paper ... but remains interested in further peer-reviewed research that may provide relevant findings." NPRM, Federal Register / Vol. 88, No. 173 at 62211. However, the DOL cites and relies on discussion and working papers in numerous other places. For example, it bases labor demand elasticity estimates on its analysis of an IZA discussion paper from 2014. See NPRM, Federal Register / Vol. 88, No. 173, at footnote 370. The DOL also cites working papers at footnotes 364, 365, 368, 376, 377, 407, and 408.

³² Simon Quach, "The Labor Market Effects of expanding Overtime Coverage," Working Paper (2022). Available at <https://sites.google.com/view/simonquach/home>, accessed October 2023.

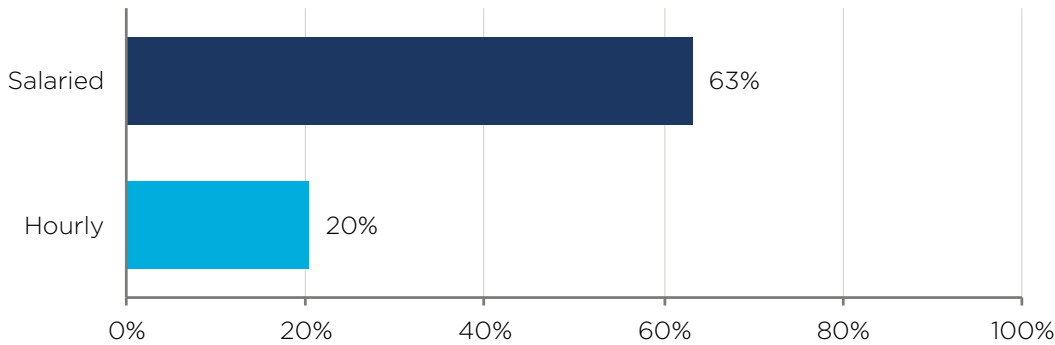
Although the NPRM makes no estimate of the share of affected workers who would lose salaried status under the proposed regulation, the “preference for salaried status” is one of the DOL's six unquantified costs that are listed in Fig. 8. As this section of the NPRM states:

“Some of the workers who would become nonexempt as a result of the proposed rule could have their pay changed from salaried to hourly status despite preferring to remain salaried. Research has shown that salaried workers are more likely than hourly workers to receive benefits such as paid vacation time and health insurance and are more satisfied with their benefits. Additionally, when employer demand for labor decreases, hourly workers tend to see their hours cut before salaried workers, making earnings for hourly workers less predictable.”³³

In addition to these effects, an increasingly sought after characteristic of salaried positions, especially in the wake of the Covid-19 pandemic, is the ability to work remotely. According to 2022 data from the General Social Survey, 63% of salaried workers earning between \$35,000 and \$60,000 per year work from home at least some of the time, while only 20% of hourly employees in these pay bands do so (Fig. 9).

³³ NPRM, Federal Register / Vol. 88, No. 173, at p. 62201.

Fig. 9: Share of workers earning \$35,000 - \$60,000 per year who ever worked remotely in 2022



Source: General Social Survey, Oxford Economics

In general, the NPRM's analysis of the proposed regulation's costs suffers from the same problem that runs through much of its analysis: a tendency to assume that which workers are paid on a salaried basis is determined by an exogenous occupational structure and to ignore the role that the DOL's overtime regulations themselves play in determining this. Importantly, the effects of the proposed regulation are not all to be felt immediately upon the rule's implementation. Over time, as the regulations make

it more difficult and expensive to employ salaried workers below the proposed exemption threshold, firms will shift their management structures to rely on a smaller number of high-paid exempt employees managing the large number of hourly employees. This represents a hollowing out of middle-level employees, and a loss of lower-paid salaried positions, which have historically represented important, highly desired stepping stones in the career progression for younger workers.

5. AUTOMATIC UPDATES

The DOL proposes to automatically update the EAP exemption threshold every three years following the implementation of the new threshold in 2024. While a similar provision was included in the invalidated 2016 overtime rule, this would be the first time that automatic updates would go into effect.

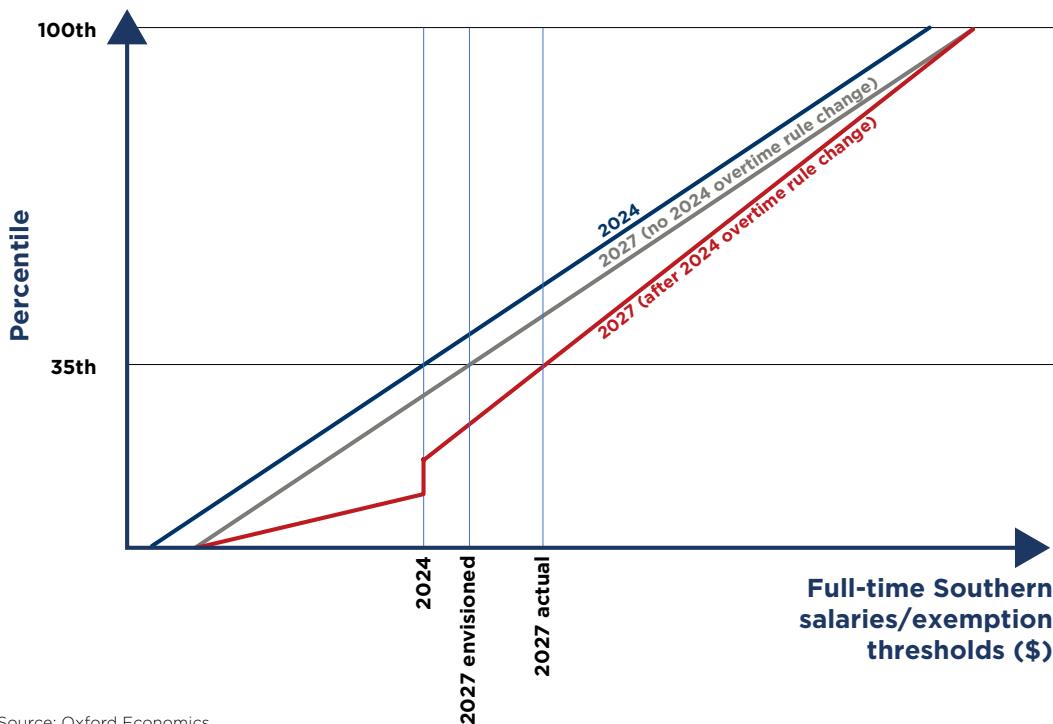
As discussed in chapter 2, the DOL proposes to increase the EAP exemption threshold from its current value of \$684 per week to the 35th percentile of full-time Southern salaries, which it estimates will be

up to \$1,158 when the final regulation is issued in 2024 (a 69% increase). In real terms, this is only 3% below the value of the invalidated 2016 rule and 28% higher than the value of the 1975 long test threshold when it was set (see Fig. 3). As envisioned, the automatic update process would effectively make this higher EAP exemption level permanent by re-setting it every three years.

However, there is strong reason to think that this provision for automatic updates would not work as envisioned. The DOL's proposed method for

automatically updating the exemption threshold suffers from the same technical flaw as its NPRM analysis of the effects of the proposed regulation suffers from: the failure to model newly nonexempt affected workers losing salaried status. This is because the metric that the DOL has selected upon which to base its updates—the 35th percentile wage of full-time salaried workers in the South—is itself sensitive to which workers in the (Southern) economy are paid on a salary basis and which are paid hourly.

Fig. 10: Effects of the raised salary threshold on the automatic update mechanism, 2027



Source: Oxford Economics

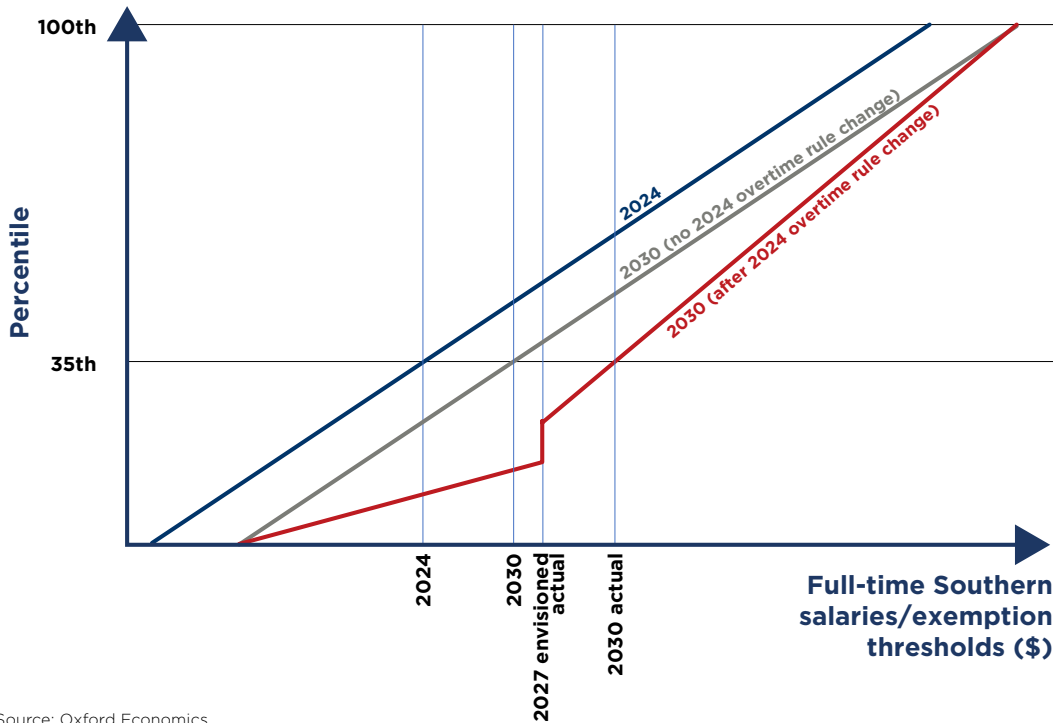
Fig. 10 demonstrates this. The blue line represents the distribution of salaried wages in the South in 2024, and the grey line the distribution that would prevail in 2027 if the proposed regulation does not take effect. The red line represents the distribution that would prevail in 2027 if proposed regulation does take effect and the overtime threshold is increased to the value represented by the vertical line labelled "2024." In this case, a share of the workers who earn below this threshold would lose their salaried status, causing the red line to be lower than the gray line. Because

some affected workers will have their salary increased to exactly the new threshold, the red line has a vertical segment at this threshold.

When a new threshold is set again in 2027, instead of the "2027 envisioned" value, which accounts only for the usual effects of inflation and increases in real wages, the new threshold will be set at the "2027 actual" value, which accounts for changes in the wage distribution as a result of the 2024 rule. Importantly, these effects compound rather than diminish over time, as shown in Fig. 11.

The mechanism selected by DOL thus suffers from a positive feedback between the policy itself and the mechanism by which the policy is to be automatically updated triennially. This would result in the exemption threshold being ratcheted ever higher than the envisioned value.

Fig. 11: Effects of the raised salary threshold on the automatic update mechanism, 2030



Source: Oxford Economics

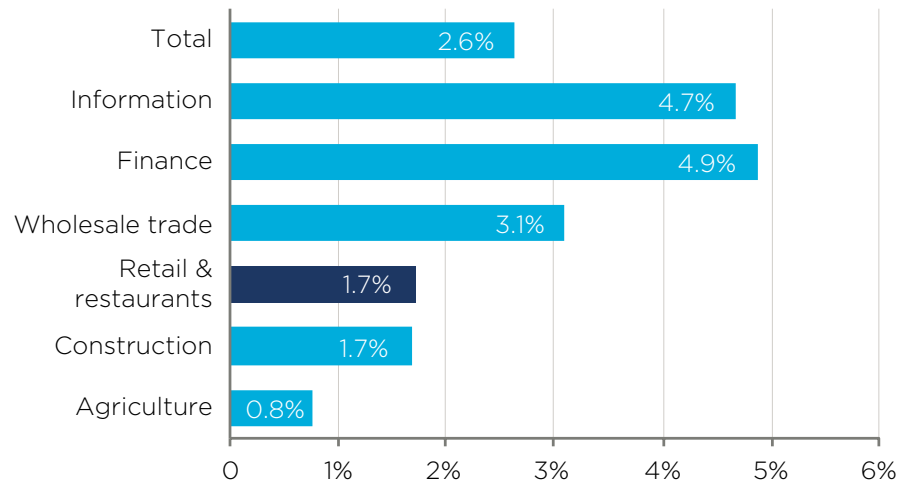
6. OVERTIME AND RETAIL

This section focuses on the impacts of the proposed regulation on the retail and restaurant industries in comparison with other industries.

Using the same CPS-based methodology as the DOL in its analysis in the NPRM, we find that the proposed regulation would affect approximately 1.7% of retail and restaurant workers. This is slightly lower than the 2.6% average across all industries (Fig. 12).

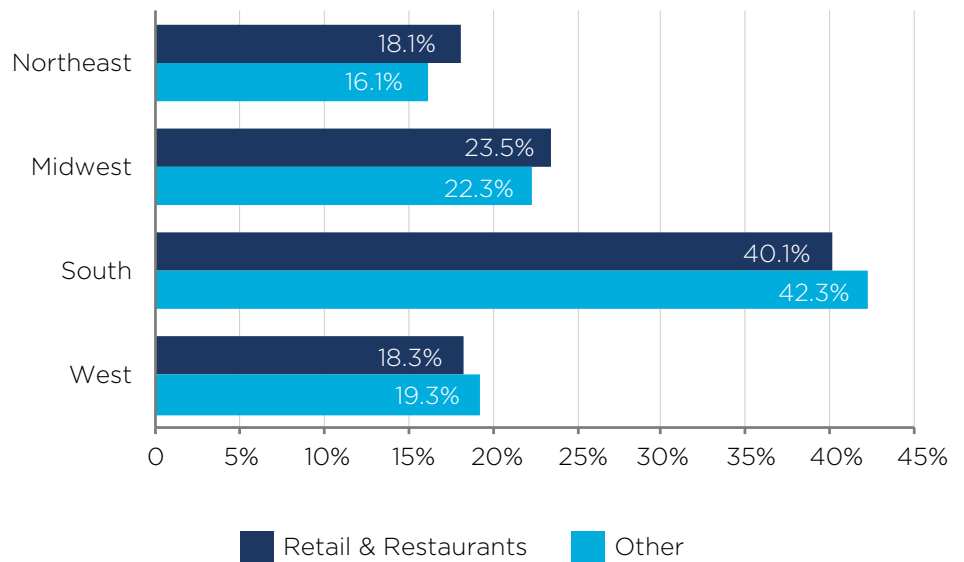
Geographically, the highest share of affected workers is in the South. This is true across all industries as well as in retail and restaurants as wages are lower in the Southern census region (Fig. 13).

Fig. 12: Share of workers affected by proposed overtime regulation by industry



Source: Oxford Economics, CPS

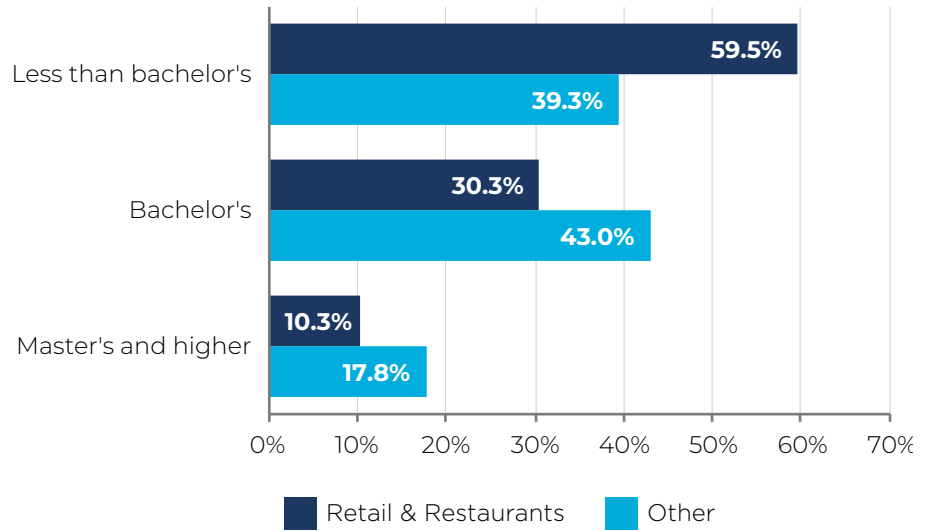
Fig. 13: Affected workers by region, retail & restaurants vs. other industries



Source: Oxford Economics, CPS

The educational qualifications of affected retail and restaurant workers are lower than those in other industries. Affected workers in retail and restaurants are one and a half times as likely to have less than a bachelor's degree as are affected workers in other industries: 59.5% vs. 39.3% (Fig. 14). To the extent that affected positions are likely to be reduced in the retail and restaurant industries in particular, therefore, the proposed regulation would be expected to reduce managerial opportunities available to individuals without a bachelor's degree.

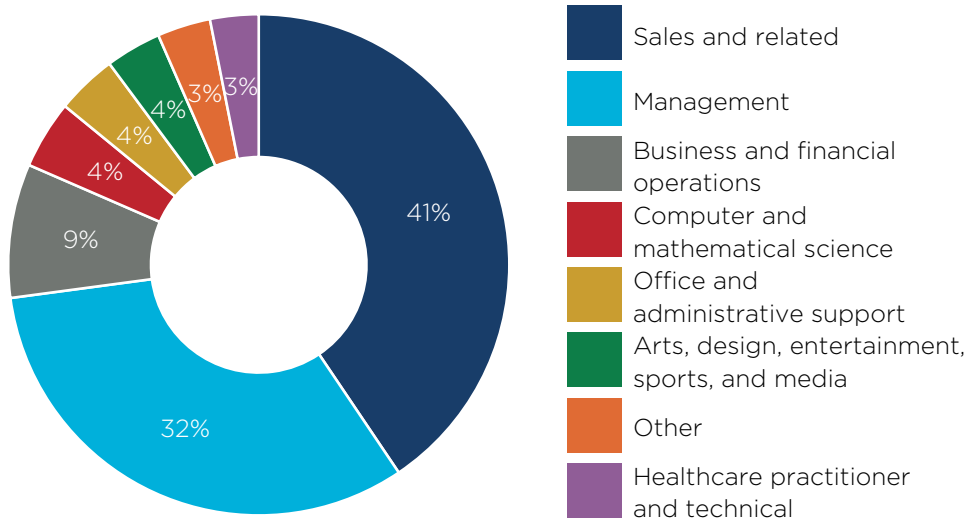
Fig. 14: Affected workers by education, retail & restaurants vs. other industries



Source: Oxford Economics, CPS

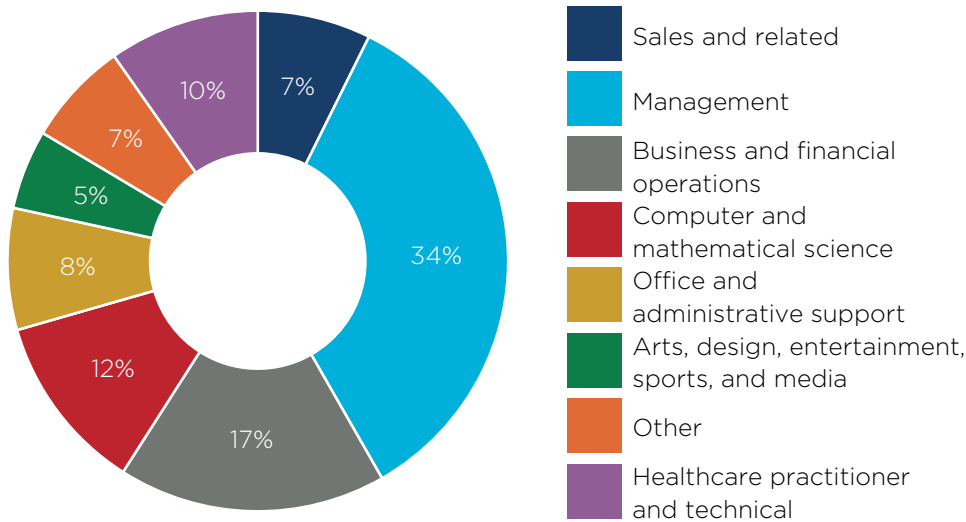
Of the affected workers in the retail and restaurant industries, 41% work in sales and related occupations (Fig. 15). Other affected occupations include management (32%) and business and financial operations (9%). In other industries (Fig. 16), most of the affected workers are employed in management (34%) and business and financial operations (16%). Sales and related occupations constitute only about 7% of the affected workers in other industries.

Fig. 15: Affected workers by occupation, retail & restaurant industries



Source: Oxford Economics, CPS

Fig. 16: Affected workers by occupational, non-retail & restaurant industries



Source: Oxford Economics, CPS

Oxford Economics' 2015 report focused on potential consequences of a large increase in the overtime rule on retail employers.³⁴ Our review of the academic research at that time, as well as our interviews with retail and restaurant employers, suggested that employers would adjust compensation to ensure they did not absorb additional labor costs through: lowering hourly pay rates of hourly workers; cutting incentive bonuses and benefits to raise salaried workers base salaries above the salary line threshold; and finally reducing workers' hours and headcounts. This, we argued, would include steps such as increasing automation where possible. In sum, we argued that the effect of steep increases in the salary line would be:

*"an accelerated 'hollowing out' of low-level professional and administrative functions, as firms centralize their management structures to rely on a smaller number of genuine managers and professionals. Workplaces would become more hierarchical, and inequality would increase. Lower-level employees, currently covered by overtime law, would find it harder to rise into the professional ranks as the number of midlevel salaried positions contract. Companies would encounter difficulties developing talent and promoting internally because of a narrower pipeline of talent."*³⁵

In our 2015 report, we noted the important role of bonus pay in the retail industry, with retail managers often receiving a large portion

of their pay in the form of incentive compensation. These compensation arrangements reflect competitive pressures to manage stores most productively. In order to meet the higher salary requirements of the proposed regulation, some of these workers are likely to see their base pay increased, with the difference taken out of their expected bonus.³⁶ As we noted in our 2015 report, "supervisors receiving more overtime and less incentivized bonus pay may prove less effective than more senior managers still motivated by large-incentive bonus pools."³⁷

³⁴ Oxford Economics, 2015, "Rethinking Overtime," <https://www.oxfordeconomics.com/resource/rethinking-overtime/>.

³⁵ Oxford Economics, 2015, "Rethinking Overtime," <https://www.oxfordeconomics.com/resource/rethinking-overtime/> at p. 4-5.

³⁶ Technically, up to 10% of the value of the EAP threshold can be accounted for by "non-discretionary bonuses." See <https://www.dol.gov/agencies/whd/overtime/whdfs17u>.

³⁷ Oxford Economics, 2015, "Rethinking Overtime," <https://www.oxfordeconomics.com/resource/rethinking-overtime/> at p. 4.

7. CONCLUSION

In its proposed rule, the DOL proposes to raise the EAP exemption threshold to the 35th percentile of Southern salaries, which it estimates will be up to \$1,158 when the regulation is finalized in 2024. As we discuss in chapter 2, this threshold is fundamentally arbitrary, and is significantly higher in real terms than the three successful regulations since 1975, and only about 3% lower than the invalidated 2016 regulation.

The DOL estimates that 3.4 million workers would be affected by its proposed EAP threshold. However, in chapter 4, we find that this could be as many as 7.2 million workers depending on the (continued) validity of the DOL's 1998 analysis of the share of salaried workers in each white-collar occupation who are expected to pass the duties test.

The assumption that workers' salaried (vs. hourly) pay status is a fixed characteristic of their jobs is a recurring defect in the DOL's analysis. It is behind the DOL's very low estimate—\$6 per affected worker—of the payroll costs of the proposed regulation. While the DOL acknowledges loss of salaried status as an unquantified cost, it does not attempt to estimate that share of workers likely to lose salaried status, or to quantify how this loss of salaried status will affect them.

As the regulations make it more difficult and expensive to employ salaried workers below the proposed exemption threshold, this will likely lead to a hollowing out of middle-level employees, and a loss of lower-paid salaried positions as employers will shift their management structures to rely on a smaller number of high-paid exempt employees using increasingly sophisticated tools to manage a large number of hourly employees.

A report we published in 2015 suggested employers would adjust compensation to ensure they did not absorb additional labor costs through changes such as lowering hourly pay rates of hourly workers and reducing workers' hours and headcounts. There is every reason to assume similar consequences would flow from a decision to go ahead with the proposed 2023 change in exemption thresholds.

While this static view of workers' salaried status has limited real-world impacts in the context of an NPRM analysis, it is likely to upset the automatic updating provisions that the DOL has proposed. This is because the measure the DOL has selected—the 35th percentile of southern salaries—is itself sensitive to which workers are paid on a salaried basis.

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November 2023

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To discuss the report further please contact:

Oxford Economics

5 Hanover Sq, 8th Floor
New York, NY 10004
USA

Tel: +1 646-786-1879

www.oxfordeconomics.com

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www.nrf.com



Global headquarters

Oxford Economics Ltd
Abbey House
121 St Aldates
Oxford, OX1 1HB
UK
Tel: +44 (0)1865 268900

London

4 Millbank,
Westminster,
London,
SW1P 3JA
Tel: +44 (0)203 910 8000

Frankfurt

Marienstr. 15
60329 Frankfurt am Main
Germany
Tel: +49 69 96 758 658

New York

5 Hanover Square, 8th Floor
New York, NY 10004
USA
Tel: +1 (646) 786 1879

Singapore

6 Battery Road
#38-05
Singapore 049909
Tel: +65 6850 0110

**Europe, Middle East
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Mexico City

Asia Pacific

Singapore
Hong Kong
Tokyo
Sydney

Email:

mailbox@oxfordeconomics.com

Website:

www.oxfordeconomics.com

Further contact details:

www.oxfordeconomics.com/
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