

# DOL's New OT Rule Will Produce Unbalanced Outcomes

By **Stephen Bronars** (June 5, 2024)

In April, the U.S. Department of Labor issued its final overtime rule, under which the salary level for the white collar Fair Labor Standards Act overtime exemption will be \$1,128 per week, effective January 2025.[1]

This salary level is about 65% higher than the current salary threshold and equals the 35th percentile of the pay distribution of full-time salaried employees in the South region, according to the most recent data from the U.S. Census Bureau's Current Population Survey, or CPS.[2]



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Salaried white collar employees who perform executive, administrative or professional duties, but do not earn enough to be considered bona fide executive, administrative or professional, or EAP, employees by the DOL's rule, are disproportionately employed in smaller cities and towns.[3]

The rule will disproportionately burden businesses in smaller cities and towns, and have much less impact in larger metropolitan areas where wages and salaries are systematically higher.

The new salary level will be the predominant reason why millions of currently exempt white collar workers who perform EAP duties, but live outside the largest metropolitan areas, will no longer be considered bona fide EAP employees by the DOL.

## A Brief History of the Salary Level for EAP Overtime Exemption

The salary level for the EAP overtime exemption has been increased by the DOL many times since the FLSA was passed in 1938. During hearings in the late 1950s, Assistant Administrator Harry Kantor explained that the salary level test "simplifies enforcement" by "screening out the obviously nonexempt employees." [4]

He also said the primary objective of the salary test is to draw a line separating groups of workers, but the line "cannot be drawn with great precision, and can at best be only approximate." [5]

Kantor said that although salary level tests were set for the whole country, there should be "appropriate consideration given to the fact that the same salary cannot operate with equal effect as a test in high-wage and low-wage industries and regions, and in metropolitan and rural areas, in an economy as complex and diversified as that of the United States." [6]

Perhaps because of the substantial pay differences among EAP employees performing the same duties in different areas, Kantor opined that if salary level tests for EAP overtime exemptions were to be used, the salary levels should be set "at points near the lower end of the current range of salaries for each of the categories." [7]

In 2004, the DOL implemented several changes to the policies for the EAP overtime exemption, including a salary level based on the pay distribution from the CPS.

The 2004 rule set the salary level at the 20th percentile of the pay distribution of full-time salaried employees in the South region and/or the retail sector.

The 2004 rule explains why a higher salary level was used than what was proposed in the Kantor report, by stating that "we relied on the lowest 20 percent of salaried employees in the South, rather than the lowest 10 percent, because of the proposed change from the 'short' and 'long' test structure and because the data included nonexempt salaried employees."<sup>[8]</sup>

The new rule sets the salary level equal to the 35th percentile of the pay distribution of full-time salaried employees in the South region in the CPS. This new salary level will affect many more white collar employees than changes in either the 2004 or 2019 rules.

The substantially higher salary level for the EAP overtime exemption raises the same concerns expressed by Kantor in the late 1950s: that a single salary level test to screen out nonexempt employees cannot be effective given the wide pay differences across areas.

### Pay Differences by Region and Metropolitan Area Size

To illustrate the substantial pay differences among full-time salaried employees across areas, Table 1 shows the 35th percentile of weekly earnings of full-time salaried employees by region and area size.

Table 1 is based on the same 2023 CPS data that the DOL used to set the new salary level, but divides each region into metropolitan areas with a population of at least 1 million, metropolitan areas with a population of less than 1 million, and nonmetropolitan areas.<sup>[9]</sup>

The lowest 35th percentile salary is \$943 per week in nonmetropolitan areas in the South region, while the corresponding salary in the larger metropolitan areas in the West region is \$1,430 per week, or 52% higher.

**Table 1: 35th Percentile of Weekly Earnings of Full-Time Salaried Workers in 2023 CPS by Region and Metropolitan Area Size**

Census Region	Metropolitan Area Size		
	Non-metropolitan	Population Below 1 Million	Population of 1 Million or More
[a]	[b]	[c]	[d]
NORTHEAST	\$1,120	\$1,293	\$1,360
MIDWEST	\$1,090	\$1,172	\$1,310
<b>SOUTH</b>	<b>\$943</b>	<b>\$1,045</b>	<b>\$1,193</b>
WEST	\$1,112	\$1,232	\$1,430

*The 35th percentile of weekly earnings are calculated based on the usual weekly earnings of nonhourly full-time workers in the 2023 CPS.*

Table 1 also shows that within each region, salaries in metropolitan areas with at least 1 million residents are substantially higher than salaries in nonmetropolitan areas in the same region.

For example, in every region, the 35th percentile salary in the largest metropolitan areas is at least 20% higher than the corresponding salary in nonmetropolitan areas in the same region. Weekly earnings below the new \$1,128 salary threshold are shaded, with the degree of shading determined by the difference from the threshold.

In nonmetropolitan areas in all regions, and in metropolitan areas in the South with less than 1 million residents, the 35th percentile of the pay distribution is below the \$1,128 salary level in the rule.

There are many possible reasons for salary differences across areas, including cost-of-living differences or differences in local income tax rates. The DOL presents no evidence that there are fewer bona fide EAP workers within a white collar occupation in areas with lower salaries, on average.

However, a nationwide salary level of \$1,128 per week for the EAP overtime exemption implicitly assumes there are relatively fewer bona fide EAP employees in nonmetropolitan areas and smaller metropolitan areas, simply because salaries are lower in those areas.

### **Occupation Groups Based on Probability of Passing the EAP Standard Duties Test**

The DOL defines white collar employees affected by the rule as salaried employees in occupations covered by the FLSA, who will pass the EAP standard duties test and the current salary level test, but will fail the new salary level test. Affected employees will be reclassified as nonexempt solely because of the new salary level.

Although the DOL does not know precisely which employees will pass the EAP standard duties test, the rule describes a methodology to estimate the number of affected employees based on their occupation.

The methodology relies on a 1999 U.S. General Accounting Office study that provides a rough approximation of the probability that employees will pass the EAP standard duties test based on their occupation, and places occupations into groups based on these probabilities.

According to the DOL, most employees affected by the rule are in two occupation groups:

- 69.8% of affected employees are in occupation group 1 with a 90% to 100% probability of passing the EAP duties test, and
- 21.5% of affected employees are in occupation group 2 with a 50% to 90% probability of passing the EAP standard duties test, according to the 1999 GAO study.

The DOL's methods imply that 4.2% of all salaried employees in group 1 will fail the duties test and 27.5% of all salaried employees in group 2 will fail the duties test.[10]

The most common group 1 occupations are managers and software developers, and the

most common group 2 occupations are first-line supervisors of retail sales workers and computer occupations.

### **Area Differences in White Collar Employees Affected by the Higher Salary Level Test**

In this section I use a version of the DOL's methodology to estimate the share of salaried white collar employees in occupation groups 1 and 2, who will fail the new salary level test despite passing the EAP standard duties test and the current salary level test. I calculate this share for each occupation group by the region and size of the city or town in which the employee lives.[11]

Table 2 presents salaried employees in each occupation group who will fail the new salary level test as a percentage of the currently exempt employees in each group — who pass the current salary level test of \$684 per week and will pass the EAP standard duties test — for the same 12 geographic areas as in Table 1.

For example, 20.3% of currently exempt EAP employees in group 1 occupations in nonmetropolitan areas in the South will fail the new salary level test.

A much greater percentage of employees in this occupation group are denied exempt status because of their salary than the 4.2% those who fail the EAP standard duties test.

In fact, the new salary level test will be the predominant reason why group 1 employees, who have at least a 90% chance of passing the duties test, are classified as nonexempt in nonmetropolitan areas in every region, and in metropolitan areas in the South and Midwest with less than 1 million residents.

At the other extreme, only 2.4% and 6.2% of currently exempt EAP employees in group 1 occupations in the largest metropolitan areas in the West and Northeast, respectively, will fail the new salary level.[12]

Table 2 shows that the new higher salary level test disproportionately changes the exempt status of managers and professionals in group 1 occupations who work in smaller cities and towns, especially in the South and Midwest.

### ***Table 2: Affected Workers as a Percentage of Exempt White Collar Workers not in Named Occupations***

Probability Code [a]	Census Region [b]	Metropolitan Area Size		
		Non- metropolitan [c]	Population Below 1 Million [d]	Population of 1 Million or More [e]
1 (90%-100% passing the standard duties test)	NORTHEAST	10.7%	9.1%	6.2%
	MIDWEST	16.8%	15.2%	11.6%
	<b>SOUTH</b>	<b>20.3%</b>	<b>19.6%</b>	<b>14.7%</b>
	WEST	14.6%	8.8%	2.4%
2 (50%-90% passing the standard duties test)	NORTHEAST	17.8%	15.1%	6.2%
	MIDWEST	23.3%	21.0%	13.7%
	<b>SOUTH</b>	<b>26.8%</b>	<b>23.6%</b>	<b>13.9%</b>
	WEST	18.6%	14.7%	4.1%

Table 2 also presents similar estimated percentages for the group 2 occupations with a 50% to 90% probability of passing the EAP standard duties test.

For example, 26.8% of currently exempt employees in this group in nonmetropolitan areas in the South will fail the new salary test and be classified as nonexempt.

In nonmetropolitan areas and metropolitan areas in the South and Midwest with less than 1 million residents, 21% or more of employees in group 2 occupations who pass the duties test will fail the new salary test.

In contrast, only 4.1% of employees in group 2 occupations, in the largest metropolitan areas in the West and only 6.2% in the largest metropolitan areas in the Northeast, will be classified as nonexempt due to the new salary level test.

## Conclusion

Although the rule sets the same salary level test for white collar employees in all locations, the impact of the rule on businesses, employees and customers will be very different in smaller cities and towns than in larger cities.

While the DOL presents no evidence that the duties of managers, supervisors, or software and computer workers differ significantly based on region or the size of the city or town in which the job is located, the rule will cause many employees in white collar jobs to be classified as nonexempt because they work in a city or town with a lower cost of living, and not because of the duties they perform on the job.

The problem of applying a single salary level test to an economy with wide cost-of-living differences across areas was recognized by the DOL in the 1950s. This is a much less important problem if the salary level is set to a low percentile of the pay distribution of exempt EAP employees.

The relatively high salary level in the rule will cause the salary level test to be the

predominant factor in determining which employees are classified as exempt in many nonmetropolitan areas and in smaller cities.

The rule will cause many bona fide EAP employees in smaller cities and towns to be classified as nonexempt, despite passing the standard duties test, simply because they live in an area with a low cost of living.[13]

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[1] "Defining and Delimiting the Exemptions for Executive, Administrative, Professional, Outside Sales, and Computer Employees," Federal Register, Vol. 89, No. 82, April 26, 2024, pp. 32842-32973.

[2] This article, for ease of exposition, will refer to employees who report that they are not paid by the hour in the CPS as salaried employees.

[3] Section 13(a)(1) of the FLSA, which was passed in 1938, exempts from the overtime pay requirements "any employee employed in a bona fide executive, administrative, or professional capacity," the Rule p. 32842.

[4] "The Fair Labor Standards Act: A Historical Sketch of the Overtime Pay Requirements of Section 13(a)(1)," Congressional Research Service, August 28, 2007, pp. 12-13.

[5] Ibid, p. 13.

[6] Ibid, p. 13.

[7] Mr. Kantor refers to different categories because prior to 2004 there were separate salary levels for executive, administrative, and professional employees. Ibid, p. 13.

[8] "Defining and Delimiting the Exemptions for Executive, Administrative, Professional, Outside Sales and Computer Employees," Federal Register, Vol. 69, No. 79, April 23, 2004, p. 22167.

[9] The size of the metropolitan area in which an employee lives is indicated by a variable in the CPS with seven possible categorical outcomes based on the area's population.

[10] The DOL assumes that 10% of the lowest paid employees in group 1 fail the duties test and none of the highest paid employees fail the duties test, with an average failure probability of 4.2% based on technical assumptions.

[11] The estimate of affected employees used here assumes that employees earning between \$684 and \$1,128 per week in California, New York, and Washington will not be affected by the new salary level because state laws in these states, effective January 2025, will already have higher state-specific thresholds for overtime exemptions.

[12] Based on exempt salary thresholds in California, Washington, and New York effective on January 1st, 2024, white collar workers earning below \$1,200 in New York City, Nassau, Suffolk, and Westchester counties, white collar workers earning below \$1,124.2 in the rest of the areas in the state of New York, white collar workers earning below \$1,280 in the state of California, and white collar workers earning below \$1,302.4 in the state of Washington are considered non-exempt.

[13] Because many businesses operate in towns and cities of different sizes, the impact of the Rule in smaller cities and towns may spill over to larger cities. Bona fide EAP employees in larger cities may be reclassified as nonexempt because co-workers in the same job who are employed in lower cost-of-living areas fail the salary level test.