

DOL Salary Projections May Rest On Inaccurate Assumptions

Law360, New York (June 16, 2016, 11:23 AM ET) --

An important component of the new white collar exemption rule is that the minimum required salary level will be adjusted every three years to the 40th percentile of the full-time nonhourly wage distribution of the lowest wage region (currently the South) in the current population survey (CPS). In the preamble to the final rule, the U.S. Department of Labor estimates that the threshold will increase from \$913 to \$984 per week when the first adjustment occurs on Jan. 1, 2020. The projected increase of 7.8 percent over three years (or approximately 2.6 percent per year) is “based on historical wage growth in the South.”[1]

However, if employees reclassified to non-exempt in response to the new white collar rules are also converted to hourly pay, they will drop out of the full-time nonhourly distribution entirely. Because the new threshold will be set at the 40th percentile of the resulting distribution, removal of employees under the current 40th percentile from the nonhourly distribution would push the 40th percentile of the distribution even higher.

In the preamble to the final rule, the DOL addresses this concern but concludes that it “will have a negligible impact on the salary level” and estimates that, at most, it would inflate the estimates based on historical wage growth by “approximately two and a-half percent” in 2026 (after three updates).[2]

The estimated 2.5 percent increase in the 40th percentile salary threshold over three updates hinges on the DOL’s approximation of workers affected by the rule which may be inaccurate. Their estimate of future salary threshold adjustments also depends on the assumption that no more than 37.3 percent of “affected workers” will be converted to hourly pay.[3] However, this approximation is also based on a number of assumptions that may prove to be inaccurate and unreliable.

The Number of “Affected Workers” is Understated

First, the DOL’s analysis is restricted to “affected workers.”[4] Not all full-time nonhourly workers earning between \$455 and \$913 per week would pass the duties test and therefore qualify for the white collar exemption, but exactly how many of those workers are exempt under the white collar exemption is unknown. In an effort to estimate that number, the DOL applies a 1999 study completed by the Government Accountability Office (GAO) that categorizes the likelihood that employees in a given occupation code perform managerial or professional duties (and therefore would pass the duties test).[5]



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For example, “first-line manager/supervisor of retail sales workers” (retail supervisors) is a category 2 job, meaning that individuals in that job have between a 50 percent and 90 percent chance of passing the duties test. The DOL relies on this study because there is no government survey that records workers' exempt status and whether exempt status is due to the white collar exemption — that information is not readily available. However, it is important to understand the inherent lack of precision in the estimates derived from this 15-year-old study.

Furthermore, the way in which the DOL applies the study likely understates the number of “affected workers.” Returning to our example of retail supervisors, the DOL includes about 70 percent (which is the mid-point of the range from 50 percent to 90 percent) of these retail supervisors in the \$455 to \$913 weekly salary range in its estimate of affected workers.[6]

Application of the approximately 70 percent pass rate to the nonhourly retail supervisors ignores the fact that 49.1 percent of retail supervisors in the CPS are categorized as hourly in the survey. It seems very likely that most of the assumed 30 percent of retail supervisors who do not pass the duties test are the ones already paid on an hourly basis. If that is the case, then the portion of the full-time nonhourly retail supervisors that would pass the duties test is larger than the 70 percent counted as “affected workers” by the DOL. As more of the nonhourly retail supervisors are added to the “affected workers” group, the number of employees likely to be converted to hourly pay increases and the resulting impact on the 40th percentile of the nonhourly distribution becomes larger.

Furthermore, the DOL restricts its definition of “affected workers” to employees who earn between \$455 and \$913 per week; however, in firms where the salary range for a given position includes salaries both above and below \$913 and most of the individuals in that position earn less than \$913, it is possible that everyone in the position will be reclassified to hourly nonexempt. In that case, even workers who are currently earning more than \$913 per week may also become hourly workers in response to the new rule. Any full-time nonhourly employees currently over the \$913 threshold who are converted to hourly pay are not counted as “affected workers” and are not included in the DOL’s estimated change in the nonhourly distribution.

Portion of Reclassified “Affected Workers” is Inaccurate

The DOL’s estimate that, at most, 37.3 percent of affected workers will be converted to hourly pay by the new rule is based on the assumption that employers “will have little incentive to change the pay status of those affected employees who do not work overtime (60.4 percent of affected employees).” [7] However, as we explain below, this calculation is subject to substantial potential error.

Although the DOL believes that employers will choose to classify workers who are not expected to work overtime as salaried nonexempt instead of converting them to hourly, it is quite difficult for the DOL to accurately identify and count these employees. Because most currently exempt employees have not been recording their work hours, without further study, neither the DOL nor the employers themselves can distinguish between employees who work exactly 40 hours or less every week and those who work 41 or 42 hours several weeks per year.[8]

The DOL’s forecast of future possible reclassifications is also questionable because it is unclear whether their assumption that employers will prefer to pay newly nonexempt employees on a salary basis instead of hourly holds. There are few obvious benefits to resisting a conversion to hourly because hours must be recorded for nonexempt employees whether hourly or salaried, and if newly nonexempt workers are paid on a salary basis employers face the additional cost of overtime premiums without the offset of lower payments in weeks with fewer than 40 work hours.

Despite the fact that there is little evidence to support it, the DOL's assumption that most full-time nonhourly workers who would pass the duties test, but fail the new salary test, will be converted to salaried nonexempt status is crucial for their analysis of the impact of the new rule. Their conclusion that the salary test will increase at about the historical rate of wage inflation relies on an assumption that there will be little change in the number of managerial, administrative and professional workers who report being paid by the hour. If this assumption is incorrect, several millions of white collar workers earning below \$913 per week could be converted to hourly pay which would substantially increase the 40th percentile of the nonhourly pay distribution.[9]

Finally, it is important to remember the source of the nonhourly pay distribution that is used to determine the salary test level. It is a survey of individuals who are asked the easiest way to report their earnings — hourly, weekly, biweekly, twice monthly, monthly, annually or other. If the person answers "hourly," then he or she is categorized as an hourly employee. If the person answers anything other than "hourly," there is a follow-up question asking if they are paid at an hourly rate at their job. If the person says yes, he or she is categorized as hourly. Everyone else is included in the nonhourly distribution from which the 40th percentile is determined.

Relying on answers to those questions to allocate employees into the hourly or nonhourly distribution is imperfect. In fact, we see in the survey results that jobs where we would expect virtually all individuals to be salaried have a nontrivial group of hourly employees. For example, 24.6 percent of astronomers and physicists, 22.1 percent of mechanical engineers, and 18.9 percent of chemical engineers are categorized as hourly in the CPS, despite the fact that the GAO study finds that individuals in those jobs have a 90 percent or higher chance of passing the duties test. Such puzzling results suggest that the hourly/nonhourly distinction in the CPS is recorded with a substantial margin of error.

The Magnitude of Future Increases is Unknown

There is a great deal of uncertainty regarding how employers will respond to the new white collar exemption rule and how that will be reflected in the CPS. The DOL acknowledges that the salary test will increase faster than inflation, the only question is how much faster. The factors discussed above suggest that the DOL's estimate of an additional 2.5 percent increase in the new salary threshold over three adjustments may not be accurate and is likely to understate its magnitude. A 2.5 percent additional increase should not be viewed as an upper bound on the potential for change in the threshold in 2020.

Employers should be aware of the potential for larger-than-projected increases in the threshold as they make their classification and payment method decisions in advance of the Dec. 1, 2016, effective date. Employees who just pass the salary test in December 2016 may be in a different situation in 2020, because the increase in the salary threshold may well exceed the rate of pay increases for these positions.

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[1] See Final Rule, page 8.

[2] See Final Rule, page 185.

[3] See Final Rule, page 185.

[4] Affected workers include “currently exempt workers who earn at least the current weekly salary level of \$455 but less than the 40th earnings percentile in the South (\$913) [who] would, without some intervening action by their employers, become entitled to minimum wage and overtime protection under the FLSA.” Final Rule, p. 9.

[5] As explained on page 42 of the 1999 GAO study, their estimate of the potentially exempt population is subject to uncertainty because “Rather than counting the number of employees actually classified as exempt by employers, we estimated how many employees are likely to be classified as exempt, based on the occupational classifications and income reported in the CPS sample.”

[6] The DOL assigns different probabilities of passing the duties test to retail supervisors (and all occupations) based on their earnings and the category assigned in the 1999 GAO report. The lowest paid retail supervisors are assigned the smallest probability of passing the duties test within its assigned range (50 percent), and the highest paid retail supervisors are given the best chance of passing the duties test (90 percent). The DOL then adjusts the probabilities for retail supervisors with earnings in the middle of the distribution so that in the aggregate 70 percent (the midpoint of the assigned range) of all retail supervisors would pass the duties test.

[7] See Final Rule, page 185.

[8] The DOL uses two surveys, the CPS and the Survey of Income and Program Participation (SIPP), to measure the number of workers who occasionally work over 40 hours per week. Unfortunately, neither survey asks respondents directly whether or not they occasionally work over 40 hours in a week. In the CPS, the DOL relies on the fact that in addition to usual hours per week, the respondent reports hours worked in the previous week. In the SIPP, the survey respondent is asked to report usual hours each quarter over a panel data set that lasts several years.

[9] The key issue for future adjustments to the salary threshold is how many of the potentially affected white collar workers in the South are reclassified as hourly, because only the nonhourly pay distribution in the lowest paid region will be used to set the new salary threshold.
