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POLICY SPOTLIGHT

The Impact of ABC Tests on Labor Markets

Causal analysis shows ABC tests reduce overall employment

LIYA PALAGASHVILI AND REVANA SHARFUDDIN | JULY 2025

The Rise of Independent Work

Freelancing, platform-mediated “gig” work, and other forms of self-employment are at an all-time high in the United States. Over a third of America’s workforce engaged in some type of independent work in 2023. While independent work continues to play a larger and unprecedented role in the economy, efforts have sprung up in recent years to regulate it.¹

What Are ABC Tests?

Stricter worker classification laws, most notably the ABC test, have emerged as the key policy response to potential worker misclassification.

- **Misclassification** occurs when a worker is legally classified as an independent contractor but functions as a full-time W-2 employee.
- **ABC tests** restrict the conditions under which a worker can legally be classified and work as an independent contractor.
- In states like California, ABC tests apply broadly, even in industries and occupations where misclassification is not an issue.

ABC tests have made it more difficult for workers to engage in independent contracting roles, even if they are already properly classified. As a result, legitimate freelancers have found themselves no longer able to work as freelancers.

¹ See Liya Palagashvili and Revana Sharfuddin, “New Study: From Gig to Gone? ABC Tests and the Case of the Missing Workers,” *Labor Market Matters*, January 10, 2025, <https://liyapalagashvili.substack.com/p/new-study-from-gig-to-gone-abc-tests>. Scan the QR code below for the full analysis, including sources.



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Our New Study: Causal Evidence on ABC Test Effects

Despite the growing interest in ABC tests, previous empirical studies did not investigate their causal impact. In 2024, our team at Mercatus published a study on California’s AB5 that found employment and self-employment declined in California for affected occupations post AB5—but without causal estimates.

We now have those causal results. Our new study provides the first causal analysis of state ABC test laws on labor market outcomes. **Our study asked: What is the impact of an ABC test on traditional (W-2) employment, self-employment, and overall employment in states that have adopted these tests?**

In the study, we examined the **nine states** that have ABC tests: New Jersey, Massachusetts, New Mexico, Hawaii, Illinois, New Hampshire, Maine, Nevada, and California. To determine causality, we used a **difference-in-differences approach and an event-study framework** tailored to settings with staggered policy adoption. We also excluded states that passed ABC tests immediately before, during, or after the financial crisis and the pandemic. These methods allowed us to leverage variation in the timing of the ABC test’s implementation across states to identify causal effects without introducing biases from diverse treatment effects or treatment timing. For our data, we constructed a **state-level annual panel dataset** using the Bureau of Labor Statistics and Census Bureau’s Current Population Survey (CPS) monthly data from January 1990 to September 2024. We employed several robustness checks, and results remained consistent.

Key Findings

The full study has not been published yet, but we have previewed our findings. The numbers below represent changes in employment in ABC test states relative to our control states:

- Overall employment declined by 4.79%.
- Self-employment declined by 6.43%.
- W-2 employment declined by 4.73%.
- The occupations hit hardest were ones with high shares of independent contractors.

ABC tests caused significant declines in overall employment, self-employment, and traditional (W-2) employment. While the decline in self-employment aligns with expectations, the reduction in W-2 employment is surprising.

Our findings show that the ABC tests do not lead to more W-2 employment as intended. Instead, they cause significant employment declines across the board for both W-2 and self-employed workers in both the short-run and the long-run (15 years)—particularly in occupations with high shares of independent contractors.