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PUBLIC INTEREST COMMENT

EVALUATING THE DEPARTMENT OF LABOR'S WITHDRAWAL OF THE INDEPENDENT CONTRACTOR RULE

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Independent Contractor Status under the Fair Labor Standards Act; Withdrawal
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The US Department of Labor (DOL) has proposed to withdraw the finalized rule titled "Independent Contractor Status under the Fair Labor Standards Act," which was published to the *Federal Register* on January 7, 2021.[1] We are grateful for the opportunity to submit a comment to the DOL about this proposal to withdraw the rule. The Mercatus Center at George Mason University is dedicated to advancing knowledge about the effects of regulation and policy on society. Accordingly, our comment seeks to aid the DOL as it considers the impact of withdrawing this rule.

EXECUTIVE SUMMARY

Our comment focuses on evaluating the DOL's adopted economic impact analysis, but of equal importance is addressing the DOL's justification that it must comply with legal precedent and previous subregulatory guidance when force-of-law rulemaking overrules both. Courts have a responsibility, established by the Chevron doctrine, to defer to the DOL's force-of-law rulemaking.[2] This deference includes incorporating regulatory changes into future case law, rather than simply relying on precedent developed under prior rules.

1. US Department of Labor, Wage and Hour Division, Independent Contractor Status under the Fair Labor Standards Act, 86 Fed. Reg. 1168 (January 7, 2021); US Department of Labor, Wage and Hour Division, Independent Contractor Status under the Fair Labor Standards Act; Withdrawal, 86 Fed. Reg. 14027 (proposed March 12, 2021) (to be codified at 29 C.F.R. pts. 780, 788, and 795).
2. Valerie C. Brannon and Jared P. Cole, *Chevron Deference: A Primer* (Washington, DC: Congressional Research Service, 2017).

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The DOL's proposed withdrawal of the final rule updating the procedure for determining worker status does not provide a thorough economic impact analysis, including an analysis of the costs of withdrawing the rule. We hope to aid the DOL by providing an evaluation of the costs associated with withdrawing the final rule. This evaluation is based on a limited, back-of-the-envelope cost analysis that is comparable with the external analysis the DOL references in its notice. To summarize, our cost estimates are as follows:

- $836 million dollars in annual employment cost savings for employers
- $521 million dollars in annual expanded compensation (both cash-based and job-quality-related) for workers
- $496 million dollars in annual cost savings owing to increased clarity and reduced litigation, gained mostly by employers[3]

In sum, a partial accounting of the annual cost of withdrawing the final rule is approximately $1.85 billion (based on a limited reassessment of the DOL's sources).[4]

We would also like to register our concern regarding the quality of the notice the DOL issued to withdraw the final rule. The DOL bases its economic impact analysis supporting the withdrawal of the final rule on the October 26, 2020, comment on the initial notice of rulemaking authored by Heidi Shierholz at the Economic Policy Institute.[5] We discuss the analytical shortcomings of Shierholz's comment, and because the DOL incorporates Shierholz's economic impact analysis into its notice, we provide a reanalysis for comparison in the following section. Our analysis is more firmly anchored in academic labor economics research, and we believe it provides a more accurate picture of the likely effects of withdrawing the final rule.

It is worth noting that our usage of Shierholz's analytical framework is not an endorsement—we have reservations about its adequacy. We use it only to allow our estimate to be compared with the one adopted by the DOL and to show the sensitivity of the DOL's adopted framework to its assumptions.

Furthermore, we do not believe that our own reevaluation of Shierholz's analysis includes every relevant cost or benefit. We instead focus on an initial quantification of some important impacts of the final rule, which the DOL should have considered in its notice to withdraw the final rule. We also include the cost savings attributable to reduced litigation and increased clarity, estimated in the final rule, which the DOL does not include in its notice to withdraw.

REEVALUATION OF THE DEPARTMENT'S ECONOMIC IMPACT ASSESSMENT

We base our calculations on two stylized facts from labor economics research and a credible estimate of the pecuniary value of work flexibility:

- *Own-wage elasticity of employment costs.* A meta-analysis of 52 academic empirical research studies finds that the average own-wage elasticity with respect to changes in employment

3. According to the calculations provided within the final rule, withdrawing the final rule before it takes effect would avoid regulatory familiarization costs, equivalent to a one-time benefit of $371 million. This benefit would be shared between workers and employers.
4. In the first year only, this annual cost is reduced to $1.48 billion owing to regulatory familiarization costs.
5. Heidi Shierholz, *EPI Comments on Independent Contractor Status under the Fair Labor Standards Act* (Washington, DC: Economic Policy Institute, 2020).

costs is −0.66.[6] This finding suggests that workers capture 66 percent of the value of labor cost decreases associated with worker classification changes, whereas employers capture the remaining 34 percent.[7]
    - Employers experience a reduction in the cost of labor when shifting their production model from using employees to using independent contractors because of reduced tax and regulatory costs of hiring independent contractors relative to employees. This occurs because (a) the cost of payroll taxes shifts from the employer to the independent contractor, (b) social insurance program costs (unemployment insurance, workers compensation, etc.) decrease for every worker who is an independent contractor because independent contractors are ineligible for these programs, and (c) mandated employer-provided fringe benefits must be provided to employees, but they need not be provided to independent contractors.
- *Own-wage elasticity of labor demand.* A meta-analysis of 105 academic empirical research studies estimates that the long-run own-wage elasticity of labor demand is around −0.25.[8] This finding suggests that employment expands as employers use their portion of labor cost savings to create new jobs and hire new workers as contractors.
- *Average willingness to pay for fully flexible work.* A recent National Bureau of Economic Research study finds that the average worker is willing to accept a salary that is 10.4 percent lower for a flexible job.[9]

With this empirical grounding for our assumptions, we provide a reassessment of the DOL's adopted economic impact assessment of withdrawing the rule. We use the same analytical framework as Schierholz but arrive at the opposite conclusion: withdrawing the final rule would cause a net negative economic impact on the workers and employers affected by the rule.

On the basis of the previously cited research, workers capture 66 percent of the total decrease in labor cost, or $4,082 per worker, via increases to cash-based compensation.[10]

- We calculate the sum value of each worker's lost supplemental income, lost employment fringe benefits (paid leave, health insurance, and retirement benefits), and net change in

6. Ángel Melguizo and José Manuel González-Páramo, "Who Bears Labour Taxes and Social Contributions? A Meta-Analysis Approach," *SERIEs* 4, no. 3 (2012): 247–71.
7. Indeed, in established academic journals, the lowest estimate we have seen is 50 percent—that is, workers take 50 percent of either an increase or decrease of labor cost. On the high end, economic papers show that workers can take close to 100 percent of the increase or decrease in labor costs. In particular, in one of the most highly cited papers on this question, economist Jonathan Gruber finds that a decrease in labor costs went almost entirely to workers in the form of a higher wage. Jonathan Gruber, "The Incidence of Payroll Taxation: Evidence from Chile," *Journal of Labor Economics* 15, no. 3 (1997): S72–S101.
8. Andreas Lichter, Andreas Peichl, and Sebastian Siegloch, "The Own-Wage Elasticity of Labor Demand: A Meta-Regression Analysis," *European Economic Review* 80 (2015): 94–119.
9. This estimate is consistent with those found in other studies, although some research has found much higher willingness to pay for work flexibility among a subset of workers. Haoran He, David Neumark, and Qian Weng, "Do Workers Value Flexible Jobs? A Field Experiment" (NBER Working Paper No. 25423, National Bureau of Economic Research, Cambridge, MA, July 2020), 26; Nicole Maestas et al., "The Value of Working Conditions in the United States and Implications for the Structure of Wages" (NBER Working Paper No. 25204, National Bureau of Economic Research, Cambridge, MA, October 2018). M. Keith Chen et al., "The Value of Flexible Work: Evidence from Uber Drivers," *Journal of Political Economy* 127, no. 6 (December 2019): 2735–94.
10. 0.66 × $6,185 = $4,082 per worker.

FICA (Federal Insurance Contributions Act) tax liability to produce the net loss in wages and fringe benefits: $6,185.[11]

- We then estimate each worker's average valuation of work flexibility: $2,517.[12]
- Each worker thus sees a net annual benefit of $414.[13]

On the basis of the previously cited research, we estimate that employers capture 34 percent of the total decrease in labor cost, or $2,103 per worker.[14]

- The long-run own-wage elasticity of labor demand (−0.25) indicates that, on average, $525 of the reduced labor cost captured by the employer will be directed to hire new workers.[15]
- The other 75 percent of labor cost savings captured by the employer ($1,577 per worker) will be redirected to other capital investments (by the employer or the firm's stockholders) or to consumption (by the employer or the firm's stockholders). Either use would contribute to additional economic activity and job growth, but the magnitude of the associated employment effect is uncertain.[16]

To summarize, we estimate that when an employee is reclassified as an independent contractor in the given scenario,

- workers gain an average annual benefit worth $414 per worker (including cash losses and the assumed cash value of worker's gained flexibility) and
- employers gain an average annual benefit worth $1,577 per worker.

In order to provide a comparable aggregate estimate of the final rule's economic impact, we follow Shierholz's assumption that 530,000 current employees would be reclassified as independent contractors. We estimate the following annual national-level effects of the final rule:

- Workers' total annual compensation would increase by $521 million.[17] (This increase includes a permanent employment expansion of 9,800 workers.[18])
- Employers will receive $836 million in annual benefits through labor cost savings.[19]

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11. Worker reclassification from employee to independent contractor losses: $648 (supplemental pay) + $1,357 (paid leave) + $2,771 (health insurance and retirement benefits) + ($3,310 − $1,901) (net change in FICA liability) = −$6,185. See table 2 in Shierholz's comment. Note, we make one minor change to the numbers provided by Shierholz by excluding the $777 "paperwork costs" she assumes independent contractors have to pay. These costs are required only for business expense deductibility purposes, and workers would not engage in such paperwork if their expected return were not positive (otherwise independent contractors' tax forms are mostly similar to those used by employees). Heidi Shierholz, *EPI Comments on Independent Contractor Status*, 5–6.
12. 0.104 × $24,202 = $2,517. Note: this is a research-derived average willingness to pay of individually subjective valuations of job quality, which vary widely. The research indicates that there is a group of workers who highly value job flexibility, such as those providing care for family members, and that flexibility can make the difference on the extensive margin between their employment and non-employment. Moreover, although it is possible that some employers may try to treat reclassified workers like employees (i.e., provide no extra flexibility, only fewer benefits), doing so would be illegal.
13. $4,082 (cash-based compensation increase) − $6,185 (lost value of fringe benefits and increase tax liability) + $2,517 (valuation of work flexibility) = $414 average net annual benefit of a worker's reclassification from employee to independent contractor.
14. 0.34 × $6,186 = $2,103 per worker.
15. 0.25 × $2,103 = $525 per worker.
16. 0.75 × $2,103 = $1,577 per worker.
17. (530,000 × $414) + (9,800 × ($28,284 + $2,517)) = $219.4 million + 301.9 million = $521.3 million.
18. Employers dedicate $525 per worker whose classification is changed to expanding employment; $525 × 530,000 = $278 million dedicated to expanding employment. We assume that such employers hire only independent contractors whose annual income is the sum ($28,284) of Shierholz's estimate of contractors' annual income ($24,202) and our own estimated reclassification wage premium ($4,082), leading to around 9,800 additional independent contractors hired.
19. 530,000 × $1,577 = $836 million.

The DOL should thus include these expected effects of withdrawing the rule in its economic impact analysis:

- $836 million lost annually by employers
- $521 million lost annually by workers (and the permanent loss of 9,800 jobs)

However, these losses correspond only to the particular scenario crafted by Shierholz and adopted by the DOL (in which 530,000 workers change classification) and are not likely to reflect reality as well as an economic impact analysis conducted with proper due diligence. In providing this reassessment, we also illustrate to the DOL the sensitivity of Shierholz's findings.

COST OF REDUCING CLARITY

The DOL has previously estimated that final rule's greater clarity will provide $447.1 million in annual cost savings and an additional $48.7 million in annual cost savings attributable to reduced litigation. We have not assessed the DOL's analysis of these cost savings, but we mention it here because if the DOL withdraws the final rule, then these cost savings will be lost. They therefore should be added to the DOL's economic impact analysis of withdrawing the final rule. However, since this estimate was used by the DOL to argue in favor of the final rule, it should be accepted with a grain of salt until independent estimates are provided.

ANALYZING THE STUDIES CITED BY THE DOL IN ITS NOTICE TO WITHDRAW THE FINAL RULE ON INDEPENDENT CONTRACTOR STATUS

The DOL cites only four examples of external research in its proposal to withdraw the final rule. These studies represent a small, one-sided, and nonrepresentative cross-section of the total available research on the topics of worker classification, valuation of job attributes, and effects of employment cost changes.[20] They are therefore unable to provide accurate and generalizable inferences of the effect on the regulated community of the proposal to withdraw the final rule.

Although we adopt Shierholz's own methodology earlier in order to provide an impact assessment within the DOL's own accepted framework, we outline next our reservations to Shierholz's analysis:

20. The Office of Tax Analysis research cited by the DOL does not control for hours when comparing annual earnings between independent contractors or self-employed workers and employees that primarily earn wages, invalidating the DOL's use of this research as a basis for comparing hourly wage differences between independent contractors and employees. Similarly, the Center for New York City Affairs research fails to control for hours worked by independent contractors, meaning that it doesn't prove that independent contractors tend to make less than the applicable minimum wage, as the DOL argues. Lastly, the research by the Institute for Research on Labor and Employment cited by the DOL fails to account for the value of Uber and Lyft drivers' business expense tax deductions, and it does not appropriately adjust for minimum-wage workers' cost of commuting when comparing Uber and Lyft drivers' hourly earnings with those of minimum-wage workers. Emilie Jackson, Adam Looney, and Shanthi Ramnath, *The Rise of Alternative Work Arrangements: Evidence and Implications for Tax Filing and Benefit Coverage* (Washington, DC: US Department of the Treasury, Office of Tax Analysis, 2017); Lina Moe, James A. Parrott, and Jason Rochford, *The Magnitude of Low-Paid Gig and Independent Contract Work in New York State* (New York: Center for New York City Affairs at the New School, 2020); Michael Reich, "Pay, Passengers and Profits: Effects of Employee Status for California TNC Drivers" (IRLE Working Paper No. 107-20, Institute for Research on Labor and Employment, Berkeley, CA, October 5, 2020).

1. The analysis assumes that there is no cash-based wage difference between independent contractors and employees, despite academic research showing that workers capture a majority of the value provided by compensation cost decreases.[21]
2. The analysis assumes that independent contractors do not receive supplemental compensation, despite widespread evidence to the contrary in the platform economy, such as signing and performance bonuses.[22]
3. The analysis assumes that workers assign zero value to flexibility (defined as control of their own schedule, choice of workplace, and workplace autonomy), despite academic research to the contrary.
4. The analysis assumes that the share of construction workers who are independent contractors or who work off the books is representative across the lowest-income quartile of the workforce, regardless of occupation.
5. The analysis assumes that the final rule would expand the number of independent contractors by 5 percent (through changing the status of workers who are currently employees).
6. The analysis assumes that the final rule will have zero effect on total employment, but this assumption is contrary to research investigating how labor demand responds to changing labor costs.[23]
7. The analysis presents a false dichotomy between perfectly competitive markets and monopsonies in order to make an unfounded assumption that 100 percent of the labor cost decrease goes to employers in the form of pure profit. However, perfectly competitive markets are not required in order to generate the changes in labor demand and wages as discussed in this comment. As is normally the case for market-based economies, including the US economy, most markets are sufficiently competitive such that workers claim the majority of value gained from reduced employment costs (as the empirical research we cite shows).[24]

Furthermore, we are concerned about the DOL's reluctance to include the value of workplace flexibility, which is the primary reason why many workers say they want to be independent contractors. The DOL chooses not to quantify the value of flexibility, saying that "employment and flexibility are not mutually exclusive. Many employees similarly value and enjoy such flexibility."[25] Although it is true that many employees could enjoy fully flexible working arrangements, the lack of employers' adoption of such practices suggests that producing such

21. Melguizo and González-Páramo, "Who Bears Labour Taxes and Social Contributions?"; Gruber "The Incidence of Payroll Taxation"; Ossi Korkeamäki and Roope Uusitalo, "Employment and Wage Effects of a Payroll-Tax Cut—Evidence from a Regional Experiment," *International Tax and Public Finance* 16, no. 6 (2009): 753–72; María Cervini-Plá, Xavier Ramos, and José Ignacio Silva, "Wage Effects of Non-Wage Labour Costs," *European Economic Review* 72 (2014): 113–37.
22. Kelsey Gee, "In a Job Market This Good, Who Needs to Work in the Gig Economy?," *Wall Street Journal*, August 8, 2017.
23. Lichter, Peichl, and Siegloch, "The Own-Wage Elasticity of Labor Demand."
24. Shierholz cites research by Alan Manning as support for monopsony markets. However, Peter Kuhn refutes this and shows that the economics profession has not accepted Manning's analysis. Shierholz also cites work by Arindrajit Dube and coauthors, but that paper discusses only monopsony markets *within* Amazon's MTurk and is not applicable to other markets. Alan Manning, *Monopsony in Motion: Imperfect Competition in Labor Markets* (Princeton, NJ: Princeton University Press, 2003); Arindrajit Dube et al., "Monopsony in Online Labor Markets," *American Economic Review: Insights* 2, no. 1 (2020): 33–46; Peter Kuhn, "Is Monopsony the Right Way to Model Labor Markets? A Review of Alan Manning's *Monopsony in Motion*," *International Journal of Economics and Business* 11, no. 3 (2004): 369–78.
25. US Department of Labor, Wage and Hour Division, Independent Contractor Status under the Fair Labor Standards Act; Withdrawal, 86 Fed. Reg. 14027, 14036 (proposed March 12, 2021) (to be codified at 29 C.F.R. pts. 780, 788, and 795).

arrangements is not as easy or widespread as some imagine it to be. Moreover, there is a stark difference between employers evaluating case-by-case (and often temporary) flexible-working requests by employees and a more complete overhaul of employers' production process to accommodate the flexible arrangements enjoyed by many independent contractors as the norm. We would argue that the DOL has an important responsibility to include the value workers place on self-determined schedules, choice of working environment, and self-directed production in its economic impact analysis.

If the DOL suggests that employees have work flexibility to a similar degree as independent contractors, then one should expect the empirical evidence to reflect this suggestion. But empirical research shows the opposite. First, as we have discussed earlier, studies show a willingness to pay for flexibility, meaning that workers are willing to accept lower compensation for more flexible arrangements, especially as independent contractors.[26] Second, at least 14 surveys provide evidence of an overwhelming consensus: independent contractors choose those types of work arrangements because of the flexibility it affords them.[27] Other surveys indicate that workers voluntarily leave (or want to leave) their current arrangements for more flexible arrangements.[28] This evidence highlights the importance of including the value of worker flexibility in the proposed withdrawal's economic impact analysis.

CONCLUSION AND OTHER JUSTIFICATIONS FOR WITHDRAWING THE RULE

The DOL believes that the final rule's withdrawal would not be costly or disruptive, but that perspective is inaccurate because it is measured from the wrong baseline. Any valid analysis of the final rule's withdrawal must be measured in reference to the anticipated cost and benefits of the previous rule. As things currently stand, the final rule becomes effective on May 7, 2021, and will provide annual costs and benefits of the sort estimated in an impact analysis. The DOL's proposal to withdraw the final rule would shift the country to a new state where those annual costs and benefits won't exist. By way of example, if an economic stimulus package were to be passed and later Congress were to debate retracting the stimulus package before the checks get sent, any

26. He, Neumark, and Weng, "Do Workers Value Flexible Jobs?," 26; Maestas et al., "The Value of Working Conditions in the United States"; Chen et al., "The Value of Flexible Work." The study by Chen and coauthors was conducted using UberX data in the United States between 2015 and 2016.

27. Some of these reports contain multiple years produced by the same organization (e.g., Bureau of Labor Statistics, Edelman Intelligence, and MBO Partners). Bureau of Labor Statistics, "Contingent and Alternative Employment Arrangements—May 2017," news release no. USDL-18-0942, June 7, 2018, https://www.bls.gov/news.release/pdf/conemp.pdf; Bureau of Labor Statistics, "Contingent and Alternative Employment Arrangements—February 2005," news release no. USDL-05-1433, July 27, 2005, https://www.bls.gov/news.release/archives/conemp_07272005.pdf; Adam Ozimek, *Report: Freelancing and the Economy in 2019* (Santa Clara, CA: Upwork, 2019); Tito Boeri et al., "Solo Self-Employment and Alternative Work Arrangements: A Cross-Country Perspective on the Changing Composition of Jobs," *Journal of Economic Perspectives* 34, no. 1 (2020): 170–95; David Storey, Tony Steadman, and Charles Davis, "How the Gig Economy Is Changing the Workforce," EY Global, November 20, 2018, https://www.ey.com/en_gl/tax/how-the-gig-economy-is-changing-the-workforce. For reports in years 2016–2019, see MBO Partners, *The State of Independence in America 2020*, 2020; James Manyika et al., *Independent Work: Choice, Necessity, and the Gig Economy* (New York: McKinsey Global Institute, October 2016); HyperWallet, *The Future of Gig Work Is Female: A Study on the Behaviors and Career Aspirations of Women in the Gig Economy*, 2017.

28. Twenty-five percent of women left employment for an independent contractor arrangement. HyperWallet, *The Future of Gig Work*. Workers prefer independent contractor arrangements over traditional arrangements because of flexibility. Bureau of Labor Statistics, "Contingent and Alternative Employment Arrangements—May 2017"; Bureau of Labor Statistics, "Contingent and Alternative Employment Arrangements—February 2005." A majority of independent contractors say that no amount of money could make them go back to traditional employment. Ozimek, *Report: Freelancing and the Economy in 2019*. Jesse Noyes, "7 Big Statistics about the State of Flexible Work Arrangements," *Workfest*, July 11, 2018; Gina Belli, "Workers Value Flexibility Perhaps Even More Than Employers Realize," PayScale, October 4, 2019.

analysis for doing so would include a discussion of "lost benefits" to citizens who would have received those payments.

On the basis of our reassessment of the economic impact analysis adopted by the DOL, we have showed that, for the average worker who might become an independent contractor as a result of the increased clarity of worker status provided by the final rule, cash-based compensation and the cash-valued work attributes (i.e., flexibility) would both increase, outweighing the lost value of fringe benefits. Employment would also increase as employers dedicate some of associated cost savings to hiring new workers, and the rest of the cost savings would be reinvested in capital or used for consumption. We estimate, on the basis of the DOL's adopted analysis, that withdrawing the final rule would result in a net annual economic loss of $1.85 billion rather than the economic benefit the DOL anticipates.

Furthermore, there are logical fallacies in the non-economic impact analysis of the DOL's notice. First, the DOL begs the question when it assumes that the final rule *might* cause confusion and, without providing a causal chain of how such confusion could occur, concludes that the final rule therefore *will* cause confusion and therefore should be withdrawn.

The DOL also commits circular reasoning when it argues that case law has not identified any factors of the independent contractor test to be probative and thus that the rule's identification of the core factors as probative is invalid. But the reason why case law hasn't yet identified any factors as being primary determinants of worker status is that the DOL has not previously issued rules and regulatory guidance that identifies such core factors. Taken together, the justifications the DOL is using to withdraw the rule are not substantive.

Moreover, the final rule improves legal and economic certainty regarding worker-employer relationships by identifying the factors that are the primary determinants of whether an individual is working as an employee or independent contractor. The final rule's clarification of which factors most clearly indicate that a worker is, in effect, running his or her own business—and therefore qualifies as an independent contractor—was a welcome change from the previous paradigm. Prior DOL regulations and legal precedent had been created to address a very different labor market, and the extensive growth of platform firms—intermediaries that connect customer and service provider—has increased the ambiguity of worker status. The final rule represents an appropriate adaptation of previous labor regulations to an evolving labor market.

By contrast, the DOL's proposal to withdraw the rule would harm workers, potential workers, and employers by attempting to squeeze the economy back into a box it has already outgrown. The return to an equal weighting of the factors determining worker status would herald a return to endless and circular disagreements over worker status. We encourage the DOL to be forward thinking to allow the economy to step into the future.