

Center for Growth and Opportunity at Utah State University
Public Interest Comment on the Department of Labor (DOL)
proposed rule

Independent Contractor Status Under the Fair Labor Standards Act

Authors:

Will Rinehart^a

Samuel McKenzie^b

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^a Will Rinehart is a Senior Fellow at the Center for Growth and Opportunity.

^b Samuel McKenzie is an Undergraduate Research Fellow at the Center for Growth and Opportunity.

The Department of Labor (DOL) recently proposed a rule change determining how an independent contractor (IC) classification is made, according to the Fair Labor Standards Act.¹ Ambiguity in the law led to developing a five-point test by the courts, but this system is not always clear to the public or universally applied. The Department of Labor hopes to create economic savings by clarifying this rule so that everyone better understands their position under the law.

The following comment includes two sections. After describing how the Department estimates the costs, a second section explains the benefits of worker flexibility.

Estimating the Cost Savings

The Department estimates that the rule change costs will be \$370.9 million in the first year.² Savings from the rule change stem from two main sources, savings from increased clarity and reduced litigation costs. Together DOL estimates that the rule change will save \$480.8 million every year. The assumptions behind these estimates are laid out below. All dollar values obtained from external sources are adjusted to 2019 dollars using the GDP deflator.

The Department estimates between 10.6 and 18.9 million independent contractors work in the US economy. The lower bound comes from the Census Department's Current Population Survey Contingent Worker Supplement (CWS) and only includes those who stated that independent contracting is their primary income source. IRS tax filings serve as an upper bound.

Three costs are laid out: regulatory familiarization costs, an increased clarity resulting in savings, and reduced litigation cost savings. Regulatory familiarization costs are an estimate of the expenses involved in reviewing and ensuring compliance with this new regulation, which is incurred by independent contractors as well as firms and government entities. The Department estimates \$370.9 million will occur in year one. Regulatory costs in future years are not estimated and are assumed to be negligible.

Increased clarity is expected to save time for both contractors and those who use their services. This estimation is made by multiplying the number of new employer-worker relationships, time spent per assessment, and the average wage rate for those whose time is spent determining the proper classification. The Department calculated that \$447.2 million would be saved over 10 years from increased clarity.

Finally, reduced litigation cost savings are expected to follow as a result of the increased clarity. The Department reviewed a random sample of 500 cases from 2014 and found that 7 percent were related to independent contractor status. Assuming a 10 percent reduction in litigation, 47 cases would be avoided annually under the new rule, for a total benefit of \$33.6 million per year.

All totaled, the Department of Labor estimates total costs to be \$370.9 million in the first year and total savings of \$480.8 million each year thereafter. These estimates result in net cost savings of \$109.9 million in year one and then \$480.8 million afterward. These values are annualized over a ten year period using the default discount rates of seven and three percent, resulting in \$369 million and \$374.8 million respectively.³

The Benefits of Flexibility

In addition to the cost savings calculated by DOL, another important result of the rule change is likely to be increased flexibility. While there is still much to learn about the relationship between independent contractors and labor markets, most labor models suggest flexibility is crucial in allowing labor markets to

1 Department of Labor, Notice of proposed rulemaking and request for comments, "Independent Contractor Status Under the Fair Labor Standards Act," *Federal Register* 85, no. 187 (September 25, 2020): 60600. <https://www.govinfo.gov/content/pkg/FR-2020-09-25/pdf/2020-21018.pdf>.

2 *Ibid.*

3 *Ibid.*

efficiently match workers with jobs, spur entrepreneurship, and act as an important source of countercyclical income during a recession.

Matching equilibrium models, as they are called, are concerned with labor market tightness, a variable defined by the relationship of vacant jobs to job seekers.⁴ In this class of labor models, adjustments are made according to the probabilities of finding a job or hiring a worker, in addition to a wage-adjustment process.

Labor market tightness is a key metric for understanding the health of the economy. Finding workers isn't an easy process, and labor markets take time to reach equilibrium. As such, there is a clear benefit in job flexibility to aid in the mutual search between workers and firms by reducing time-to-hire frictions.⁵ Although this flexibility is hinted at in the rule change, workers' benefits are real but simultaneously difficult to calculate.

Cross country comparisons show that this flexibility matters. In one study, freelance independent contractors seem to promote entrepreneurial activity. A 10 percent rise in the freelance workforce was associated with a 1 percent increase in entrepreneurial activity.⁶ In short, having a flexible workforce is a key ingredient to having an entrepreneurial economy. It is well known that the United States has a much higher job churn than its European counterparts, which tends to lead to lower unemployment.⁷ Job churn is important because it can help workers ascend the income ladder and worker flexibility is a key component of that churn.⁸

Second and just as important, IC jobs can act as a source of countercyclical income in an economic downturn.⁹ Workers turn to alternative work arrangements to boost their budgets. Thus, the IC classification benefits are likely to grow if the United States labor market adapts to the recession spurred by the COVID-19 pandemic similarly as it did to the financial crisis of 2008.

Conclusion

As currently written, the proposed rule carefully quantifies the cost savings of reduced litigation and increased clarity. While these are important benefits, the proposed rule could be improved by also considering the benefits of flexibility to independent contractors and the economy as a whole. Research suggests that flexibility in labor markets can help speed up job matching, spur entrepreneurship, and allow for more fluid adjustments in an economic downturn. While estimation might be difficult, the benefits of increased flexibility from the proposed rule are nonetheless very real. The DOL should include these benefits as a key impact of the proposed rule.

4 Chugh, Sanjay K. *Modern Macroeconomics*. Cambridge, MA: MIT Press, 2015.

5 Pissarides, Christopher. "The Unemployment Volatility Puzzle: Is Wage Stickiness the Answer?" *Econometrica* 77, no. 5 (September 2009): 1339–69. <https://doi.org/10.3982/ecta7562>.

6 Burke, Andrew, Imran Zawwar, and Stephanie Hussels. "Do Freelance Independent Contractors Promote Entrepreneurship?" *Small Business Economics* 55, no. 2 (2019): 415–27. <https://doi.org/10.1007/s11187-019-00242-w>.

7 Bachmann, Rüdiger, Christian Bayer, Christian Merkl, Stefan Seth, and Heiko Stueber. "Worker Churn and Employment Growth at the Establishment Level." SSRN, October 23, 2017. https://papers.ssrn.com/sol3/papers.cfm?abstract_id=3056601.

8 Hunt, Ryan, and Josh Wright. "The Pulse of U.S. Hiring Activity: Labor Market Churn By Occupation and Metro." Economic Modeling . Career Builder, 2014. https://www.economicmodeling.com/wp-content/uploads/2014/12/Emsi_CB_Churn_Report_2014.pdf.

9 Farrell, Diana, Fiona Greig, and Amar Hamoudi. "The Online Platform Economy in 27 Metro Areas: JPMorgan Chase Institute." The Online Platform Economy in 27 Metro Areas | JPMorgan Chase Institute, 2019. <https://www.jpmorganchase.com/institute/research/labor-markets/report-ope-cities.htm>.