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Setting the Record Straight on Independent Contracting: Bold Solutions to End Misclassification and Deliver Stability and Flexibility for Workers

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Setting the Record Straight on Independent Contracting: Bold Solutions to End Misclassification and Deliver Stability and Flexibility for Workers

Thank you Chairman Kiley, Ranking Member Adams, and Members of the Subcommittee on Workforce Protections for this opportunity to testify today on the important subject of independent contracting. My name is Laura Padin, and I am the Director of Work Structures at the National Employment Law Project (NELP), a non-profit organization that promotes policies and programs that create good jobs, strengthen upward mobility, enforce hard-won worker rights, and help unemployed workers regain their economic footing through improved benefits and services.

True independent contractors are people who are in business for themselves. As such, they make all of the important decisions about how to run their business. They determine what goods or services to sell and at what prices, make capital investments to grow their business, and build a customer base. At NELP, we support policies that ensure these small business owners are treated fairly, such as the Freelance Isn't Free Act in New York City.

What we take issue with is when corporations mislabel the workers powering their businesses as "independent contractors," "self-employed," or "freelancers" even though these workers are not in business for themselves. Corporations do this to shift the risks and costs of the business onto their workers, while channeling wealth to investors and CEOs. When they engage in this sham practice, corporations depress wages and working conditions and shed responsibility for their workers while maintaining control over key decisions – such as where, how, and for how much money workers perform their jobs.[i] The result is that the very conditions that the Fair Labor Standards Act was designed to combat—conditions "detrimental to the maintenance of the minimum standard of living necessary for health, efficiency, and general well-being of workers," 29 U.S.C. § 202(a)—flourish. These conditions also constitute an "unfair method of competition in commerce," 29 U.S.C. § 202(a)(3), hurting law-abiding businesses.

Congress passed our bedrock labor and employment laws—such as the Fair Labor Standards Act and the National Labor Relations Act—because it recognized that there is a profound imbalance of power in most employment relationships, and that, absent government regulation, employers can force substandard working conditions on their workers under threat of poverty and loss of livelihood. But these critical labor and employment laws enshrined racist carveouts, excluding domestic workers, farm workers and tipped workers from their protections because these jobs were performed overwhelmingly by Black workers. Today Black and immigrant workers continue to be segregated in low-wage, labor-intensive occupations—such as trucking, delivery, home care, personal care, agricultural, and janitorial and building service occupations—where misclassification and other labor abuses are rampant. When regulators don't crack down on employers that misclassify their workers, and when policymakers interpret "independent contractor" to encompass low-wage, precarious occupations where people of color are overrepresented, we at NELP worry that history is repeating itself.

Misclassification also hurts responsible businesses and depletes public coffers. Because corporations that misclassify their workers can save 20 to 40 percent of payroll costs, they gain an unfair competitive advantage in labor-intensive industries and cause a race to bottom on labor standards. Government funds also pay an enormous price when employees are misclassified as independent contractors. Conservative estimates suggest that the federal and state governments lose billions of dollars per year in unreported payroll taxes and unemployment insurance contributions.

My testimony today highlights the scope and impact of the problem of misclassification, dispels some of the more common myths about the issue, and offers recommendations for creating the just and inclusive economy all workers deserve.

Independent contractor misclassification by employers depresses the wages and working conditions of millions of workers.

Every day, corporations impose take-it-or-leave-it contracts on their workers attesting to their "independent contractor," "freelancer," or "self-employed" status even though the corporation sets or controls most of the conditions of the work and these workers are integrated into the corporation's operations. Independent contractor misclassification is a a persistent problem in many growing industries where the work is poorly-paid and labor-intensive, including home care, janitorial, trucking, delivery, construction, personal services, hospitality and, more recently, in app-dispatched jobs.[ii]

Misclassification excludes workers from bedrock labor rights and protections, such as the right to minimum wage and overtime, the right to collectively bargain, and the right to a harassment and discrimination-free workplace.[iii] Because corporations that misclassify their workers as independent contractors shirk their responsibilities to pay into social insurance funds, their workers pay both the employer and employee shares of payroll taxes that fund Social Security and Medicare and are excluded from critical state social insurance programs like unemployment insurance and workers' compensation.

Independent contractors can be divided into two categories: a small number of quite high-earning independent contractors—such as lawyers and consultants—who have the

individual bargaining power to negotiate or set very high rates for their services, and the large majority of middle and especially low-earning independent contractors who are falling behind employees in the same industries.[iv] A 2014 study of port truckers found that the median wage of port truckers driving an average of 59 hours a week was just $28,783 per year for independent contractors compared with $35,000 for employees.[v] A 2017 analysis by the Washington Center for Equitable Growth found that nearly ten percent of independent contractors earned less than the federal minimum wage of $7.25 per hour, and nearly 1 in 4 earned less than $15 per hour.[vi] The CEO of a portable workplace-benefits platform recently acknowledged the very different experiences of high-earner and low-earner independent contractors: "Freelance by choice and freelance by force. They have totally different experiences and totally different needs."[vii]

Digital labor platform workers—workers who obtain delivery, home care, rideshare, and other types of work through apps like Uber, Lyft, Handy, and DoorDash and are classified as independent contractors—similarly have earnings that are startlingly low. A 2019 analysis by the Economic Policy Institute found that the average Uber driver's wage was just $9.21 per hour after deducting fees and expenses, putting them in the lowest ten percent of wage earners, and earning lower than the minimum wage in the three largest cities.[viii] Other studies of app-based ride-hail and delivery workers' pay in Seattle and New York City conducted between 2018 and 2021 found that median earnings after expenses ranged between $8 to $14 per hour—at or below the minimum wage in effect in both cities during the same time period.[ix] Although the digital labor platform companies often characterize "gig" work as a side hustle, the reality is far different; in Los Angeles and New York City, for example, a majority of digital labor platform workers put in full time hours and rely on the work as their primary source of income.[x]

A growing body of research shows that many so-called independent contractors' incomes are very low and lagging behind their employee counterparts. The disparity in incomes between independent contractors and employees is especially stark in localities that have raised their minimum wage.

- A recent study by the New School that analyzed the incomes of independent contractors in 11 low-paying industries in New York found that these independent contractors are paid half to two-thirds of what employees receive in the same industries. And half of independent contractors in low-paying industries have no health insurance or rely on Medicare or Medicaid, while 63 percent of employees in the same low-paying industries have employer-provided health insurance directly or through a spouse.[xi]

- A recent study of tax filings of employees and independent contractors in DC from 2010 to 2018 found that a majority of independent contractors (about 60%) earn under $22,000 per year. Some of the most common occupations for the independent contractors in this income range are janitors, drivers, and hairstylists. Independent contractors earning under $20,000 per year had persistently stagnant incomes, whereas employees earning under $20,000 per year saw large increases in their incomes after 2013, likely due to DC's minimum wage increase in December 2013.[xii]

- Another recent New School study of New York independent contractors found that, within occupations, independent contractor wages lagged behind those of employees who benefitted from the state's rising minimum wage. In New York's construction sector, minimum wage increases helped to raise inflation-adjusted annual earnings of employees by 28.5 percent between 2013 and 2018, compared to an increase of just 7.6 percent for independent contractors in the sector. In the state's personal care sector, minimum wage increases helped to raise inflation-adjusted annual earnings of employees by 24.5 percent between 2013 and 2018, while independent contractors in the sector saw earnings decline by 3.9 percent.[xiii]

- A recent study by the University of California-Berkeley found that California construction workers misclassified as independent contractors suffer a 33 percent wage penalty relative to their employee counterparts.[xiv]

- A national study of digital labor platform workers found that 1 in 7 earned less than the federal hourly minimum wage, and 30 percent of digital platform workers received a Supplemental Nutrition Assistance Program benefit, compared to 15 percent of employees in comparable service-sector jobs.[xv]

For many independent contractors, their poverty-level incomes—coupled with their exclusion from employment-related social insurance programs like unemployment insurance and employment-related benefits like health insurance, retirement benefits, workers compensation, and paid leave—mean that their lives are incredibly precarious;[xvi] they live paycheck to paycheck, one accident or illness away from financial disaster, and without the means to ever take a break from working or retire.

Such low earnings also raise serious questions about whether these workers are truly running their own independent businesses and are lawfully excluded from minimum wage, overtime and other wage-and-hour protections. With up to 95 percent of workers who claim to be misclassified found to be employees after investigation, millions of workers are likely suffering poverty wages and degraded working conditions in part because they are improperly classified as independent contractors.[xvii]

Employers' misclassification perpetuates racists carveouts from labor and employment laws and exacerbates racialized inequities.

Independent contractor misclassification is strikingly racialized, occurring disproportionately in low-wage and labor-intensive occupations in which people of color, including Black, Latinx, and Asian workers, are overrepresented. As a group, workers of color—Black, Latinx, Asian/Pacific Islander, and Native American workers—are overrepresented in construction, trucking, delivery, home care, agricultural, personal care, ride-hail, and janitorial and building service occupations by over 40 percent; they comprise just over a third of workers overall, but between 47 and 91 percent of workers in these occupations.[xviii] In digital labor platform work, Black and Latinx workers are overrepresented by 45 percent—more even than in more traditional misclassification-prone sectors.[xix]

Congress passed the Fair Labor Standards Act and the National Labor Relations Act to enshrine minimum labor standards and to level the playing field between employers and their workers. But Congress excluded tipped workers, agricultural workers, and domestic workers from these laws' protections because this work was overwhelmingly performed by Black workers.[xx] When regulators don't crack down on employers that misclassify their workers, and when policymakers interpret "independent contractor" to encompass underpaid and precarious jobs performed predominantly by people of color, we at NELP believe history is repeating itself, and our government is once again enshrining racist carveouts from our foundational labor and employment laws.

Independent contractor misclassification fosters a second-tier workforce of predominantly workers of color stripped of bedrock employment protections.[xxi] Because it also comes with the significant wage and benefit penalties noted above, this corporate practice perpetuates growing racialized income and wealth inequities and health disparities in the U.S.

Workers should have labor protections and scheduling flexibility.

Major corporations—including retail and delivery giants like Amazon, Target and WalMart, digital labor platforms like Uber and GoPuff, and temporary staffing agencies like Kelly Services—are joining forces to exclude more and more workers from foundational labor and employment protections under the guise of scheduling flexibility.[xxii] Through their corporate lobbying group, the Coalition for Workforce Innovation, they have advocated for the Worker Flexibility and Choice Act, a bill introduced in the House last session that would allow employers to require workers to sign away foundational rights—the right to a federal minimum wage, as well as most state and local labor and employment rights—as a condition of work. In return, workers would get a modicum of flexibility—the "choice" to reject shifts offered to them—but not the flexibility to actually choose their schedule.[xxiii]

Contrary to what these corporations are suggesting, employees can enjoy scheduling flexibility, and they need not trade in bedrock labor protections to have it.[xxiv] Due to the historically tight labor market, many more employees, including shift workers like hotel housekeepers and manufacturing plant workers, are getting the scheduling flexibility they need, including choosing their hours, working shorter schedules, and signing up for shifts using apps.[xxv]

In fact, some businesses now use app-based platforms to offer *their employees* shifts and enable *their employees* to have flexible scheduling. Gale Health, a nursing staffing agency, connects nurses with healthcare facilities in need of clinical support through an online platform, which allows nurses "to log in and book work within seconds of a shift becoming available."[xxvi] Because the nurses are Gale Health's employees, they maintain a floor of labor protections. Similarly, a major grocery chain in the Midwest recently negotiated a union contract with app-based flexible scheduling.[xxvii] Workers have been organizing to demand true flexibility, a hallmark of economic stability, supported by living wages, paid leave, benefits, and reasonable schedules.

It is also worth pointing out that the 'flexibility' touted by companies that classify their workers as independent contractors is often a mirage. While the sliver of highly-compensated independent contractors can set their own schedules and rates, for low-income

workers, "flexibility has become entangled with the idea of just-in-time labor and staffing, a practice that cuts costs by slashing back on full-time work and making up any shortfalls with overtime, reduced breaks or last-minute workers brought in from staffing agencies."[xxviii] Much of the so-called flexible scheduling benefits employers and hiring entities, while leaving workers to compete with each other over shifts and jobs.

Many corporations that hire workers as independent contractors offer flexibility in theory, but pressure workers to perform when and where the business demands. For example, while owner-operator truckers may in theory have control over their own schedules, they often need to work full-time in order to pay vehicle costs, insurance, other overhead, and eke out a living.[xxix] For many on-demand and app-based workers, so-called flexibility is monitored, mediated, supervised, and carefully managed by big-brother type behavioral nudges that allow the companies to control when, how long, and how they work.[xxx] As courts have recognized, the question "is whether a [worker's] freedom to work when she wants and for whomever she wants reflects economic independence, or whether those freedoms merely mask the economic reality of dependence."[xxxi]

Corporate misclassification disadvantages law-abiding businesses and depletes government coffers.

Misclassification of employees as independent contractors causes negative ripple effects in the community. Cheating businesses make it more difficult for law-abiding businesses to compete, especially in the labor-intensive and bid-based jobs named above: construction, janitorial, home care, delivery, and others. The practice, as the United States Treasury Inspector General found, "plac[es] honest employers and businesses at a competitive disadvantage."[xxxii] Businesses that misclassify their employees pocket between 20 to 40 percent of payroll costs they would otherwise incur for unemployment insurance, workers' compensation premiums, the employer share of social security, and health insurance premiums.[xxxiii] They pressure their competition to shed labor costs, creating a "race to the bottom" where firms try to remain competitive by following suit.[xxxiv] A 2010 study estimated that misclassifying employers shift $831.4 million in unemployment insurance taxes and $2.54 billion in workers' compensation premiums to law-abiding businesses annually.[xxxv] Over time, fewer honest businesses can compete.

Government funds also pay an enormous price when employees are misclassified as independent contractors. Conservative estimates suggest that the federal and state governments lose billions of dollars per year in unreported payroll taxes and unemployment insurance contributions.[xxxvi] A 2009 report by the Government Accountability Office estimated that independent contractor misclassification cost federal revenues $2.72 billion in 2006.[xxxvii] Additionally, the Treasury Inspector General for Tax Administration estimates that misclassification contributed to a $54 billion underreporting of employment tax and losses of $15 billion in unpaid FICA taxes and UI taxes.[xxxviii]

State-level task forces, commissions, and research teams have also used agency audits along with unemployment insurance and workers' compensation data to document the huge impact of independent contractor misclassification. These state reports suggest that at least 10 to 30% of employers misclassify employees as independent contractors.[xxxix] In just one recent example, Pennsylvania's Joint Task Force estimated that the state lost up to $124.5

million in general revenues due to misclassification, with nearly 400,000 misclassified employees deprived of workplace protections in that state alone.[xl]

Conclusion and recommendations

Corporate misclassification of employees as independent contractors is an urgent problem: it erodes workers' wages and benefits, makes it difficult for law-abiding businesses to compete, undermines social safety net programs, and silences workers by stripping them of the right to organize. The practice reinforces racial and gender occupational segregation and promotes a second-tier workforce of predominantly workers of color in precarious jobs without bedrock protections. Combatting independent contractor misclassification should be a priority for policymakers regardless of party affiliation: doing so would benefit workers, businesses, and government coffers. Workers who are truly running their own businesses – with the power to set prices and make decisions and investments impacting profits and losses – can continue to do so, and high-road businesses will not be undercut by competitors skimping on employee payroll costs.

Every worker deserves livable wages and benefits, a tenable schedule, safe and healthy working conditions, equitable treatment, and the ability to exercise collective, democratic power at work. Federal policy can and should ensure that employers create jobs that deliver financial security and real flexibility for all workers. Ending the erosion of working conditions caused by independent contractor misclassification is a necessary first step and should include, at a minimum:

- **Final promulgation of the U.S. Department of Labor's Proposed Rule for distinguishing between employees and independent contractors under the Fair Labor Standards Act.**[xli] The proposed rule would implement the sensible and well-established approach developed over decades by the Supreme Court and appellate courts and clarify that the point of the analysis is to determine whether a worker is in business for themself, or dependent on the business that hired them. It would replace a rule promulgated in the final days of the last administration that caused confusion and conflicted with governing law. As NELP has pointed out, the Rule would be a necessary restoration, not a revolution.[xlii]

- Passing the **Protecting the Right to Organize (PRO) Act** to expand workers' organizing and collective bargaining rights, which is critical for workers who are misclassified as independent contractors and silenced on the job, and increase penalties for employers who violate the law.

- Passing legislation that makes misclassification a stand-along violation with significant penalties, and that authorizes and provides funding for an interagency task force that investigations misclassification—with a focus on low-wage, misclassification-prone industries—and takes interagency enforcement action against employers that misclassify their workers.

Yet federal policy can and should do more to deliver just working conditions for every person who works. It should guarantee true workplace flexibility with scheduling choice, paid leave, and caregiving supports.[xliii] Congress should pass a package of laws that deliver on the promise of ensuring work with dignity, including:

- The **Schedules That Work Act** to ensure that workers have the right to request scheduling changes, anti-retaliation protections for making such requests for flexibility, and schedules and pay that are stable and predictable.
- The **Healthy Families Act**, to establish a federal guarantee of one hour of earned sick time for every 30 hours worked, and the **Family and Medical Leave Insurance (FAMILY) Act**, to establish federally guaranteed access to up to twelve weeks of paid family and medical leave for workers regardless of work arrangement and employer size. Paid leave gives workers real flexibility to take time off work without losing pay.
- **Invest in high-quality universal childcare and other family care support** to give people freedom to choose whether and when to participate in the workforce.

Endnotes

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[xxx] *See* Rebecca Smith, *Flexibility in the On-Demand Economy*, NAT'L EMP. L. PROJECT at 4 (Jun. 2016), https://s27147.pcdn.co/wp-content/uploads/Policy-Brief-Flexibility-On-Demand-Economy.pdf ("In the end, a job with Uber or other on-demand companies comes with roughly the same degree of freedom as a job with a staffing agency or as a substitute teacher or day laborer: while a worker is ostensibly free to decide not to work on a particular day, she may not get a call the next time she wants to work, and she may be short on cash at the end of the month.").

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