

The ABCs of “ABC” Tests: Evidence-Based Policy on Worker Misclassification

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Two Types of ABC Tests

Traditional ABC Test

(A) Absence of control over the individual, both in contract and in fact

(B) the services provided are outside the usual course of the company's business or outside of all of the places of the company's business

(C) the worker is customarily engaged in an independent business.

Extreme ABC Test*

(A) Absence of control over the individual, both in contract and in fact

(B) the services provided are outside the usual course of the company's business ~~or~~ outside of all of the places of the company's business

(C) the worker is customarily engaged in an independent business.

**Used only in California and Massachusetts, but with legal exemptions for many occupations and industries*

The Problem with ABC Tests: Prong B

- Example 1: Freelancer writer has a legitimate contracting relationship with several magazines/newspapers
 - Under ABC, legitimate freelance writer may not be able to contract with those clients because writing is core part of the company's business (possible violation of prong B)
 - *Vox Media*: “AB5 makes it impossible for us to continue with our current California team site structure.”
- Example 2: Freelancer musician has a legitimate contracting relationship with several music venues
 - Under ABC, legitimate freelance musician may not be able to work with music venues because musicians are a core part of the company's business (possible violation of Prong B)
- Example 3: A tutor has a legitimate contracting relationship with many clients—individual households, schools, small businesses
 - Under traditional ABC test, if tutor is providing services at property of one client (e.g. local school or even virtual teaching platform), might be in violation of ABC test

Goal of ABC Test: Reduce Misclassification, Increase W-2 Employment

ABC Test Story:

- A company is hiring independent contractors (misclassified)
- Under ABC Test: Company will be forced to reclassify some (or all) workers as employees

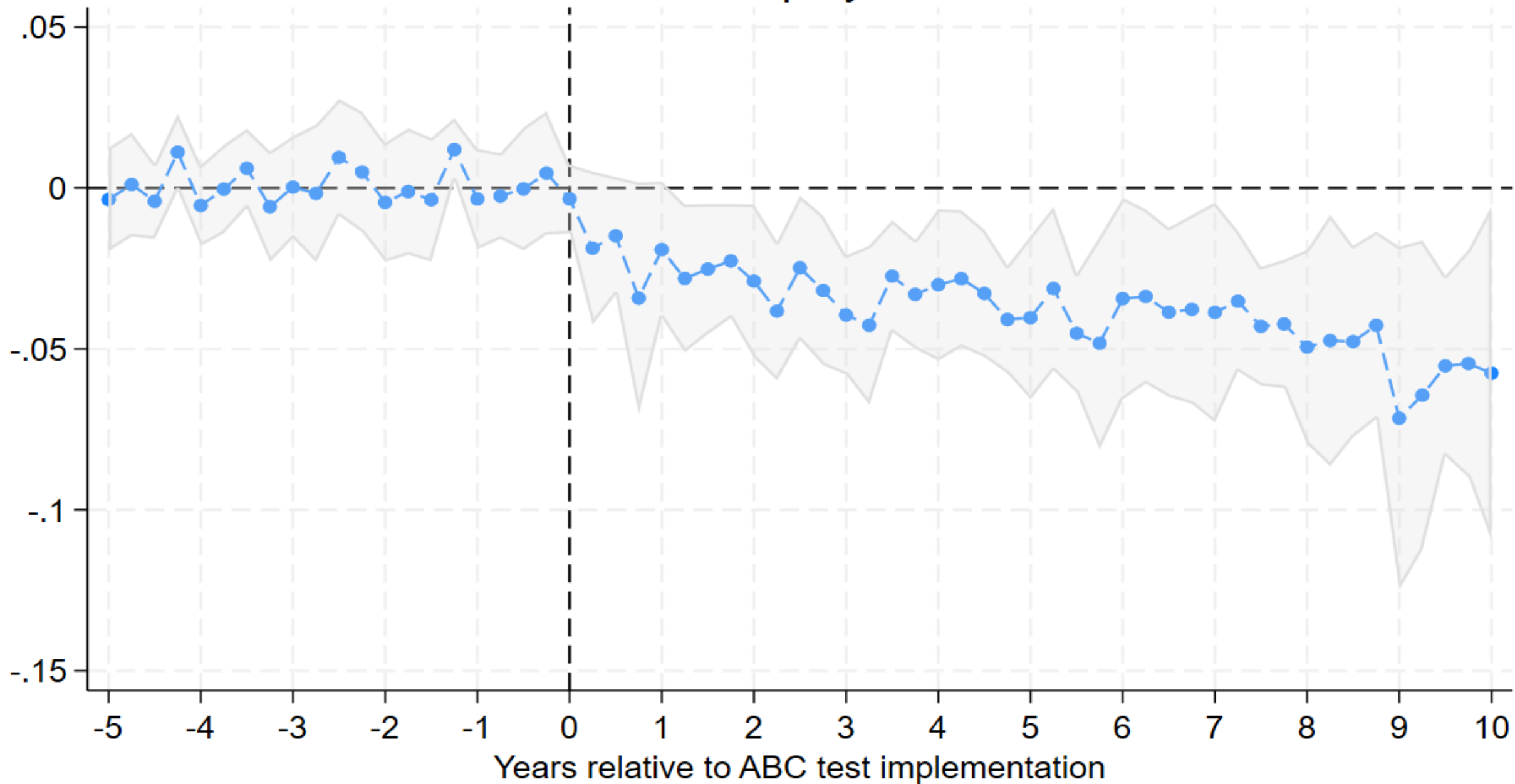
Expectations:

- Increase in workers as W-2 employees
- Decrease in some workers as independent contractors (if misclassified)
- Impact on overall employment: Depends on whether the increase in W-2 employment is greater than the reduction in self-employment

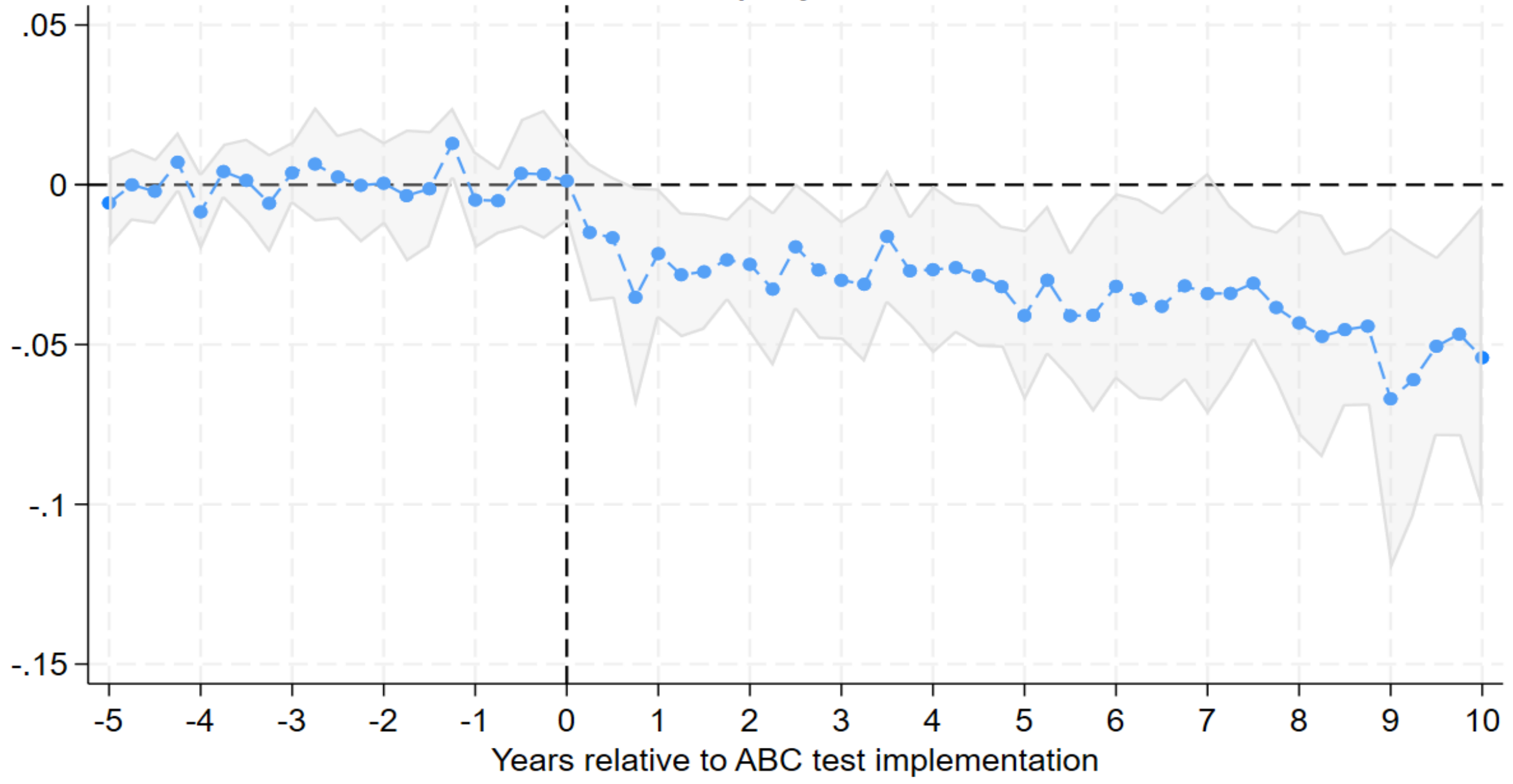
Our 'ABC' Test Study

- **Goal:** Investigate the causal effect of implementing an "ABC test" on employment conditions and economic outcomes
- **Difference-in-Differences (DiD):** This method allows us to estimate the causal effect of the ABC test by comparing changes in employment outcomes in states that implemented the test (treatment states) against those that did not (control states).
 - Built a dataset of state worker classification tests across various statutes, including implementation date of an ABC test for wage & hour, UI, and WC
- **Data:** Bureau of Labor Statistics' Current Population Survey (CPS), 1990-2024
 - Overall Employment
 - Traditional (W2) Employment
 - Self-Employment
 - Labor Force Participation

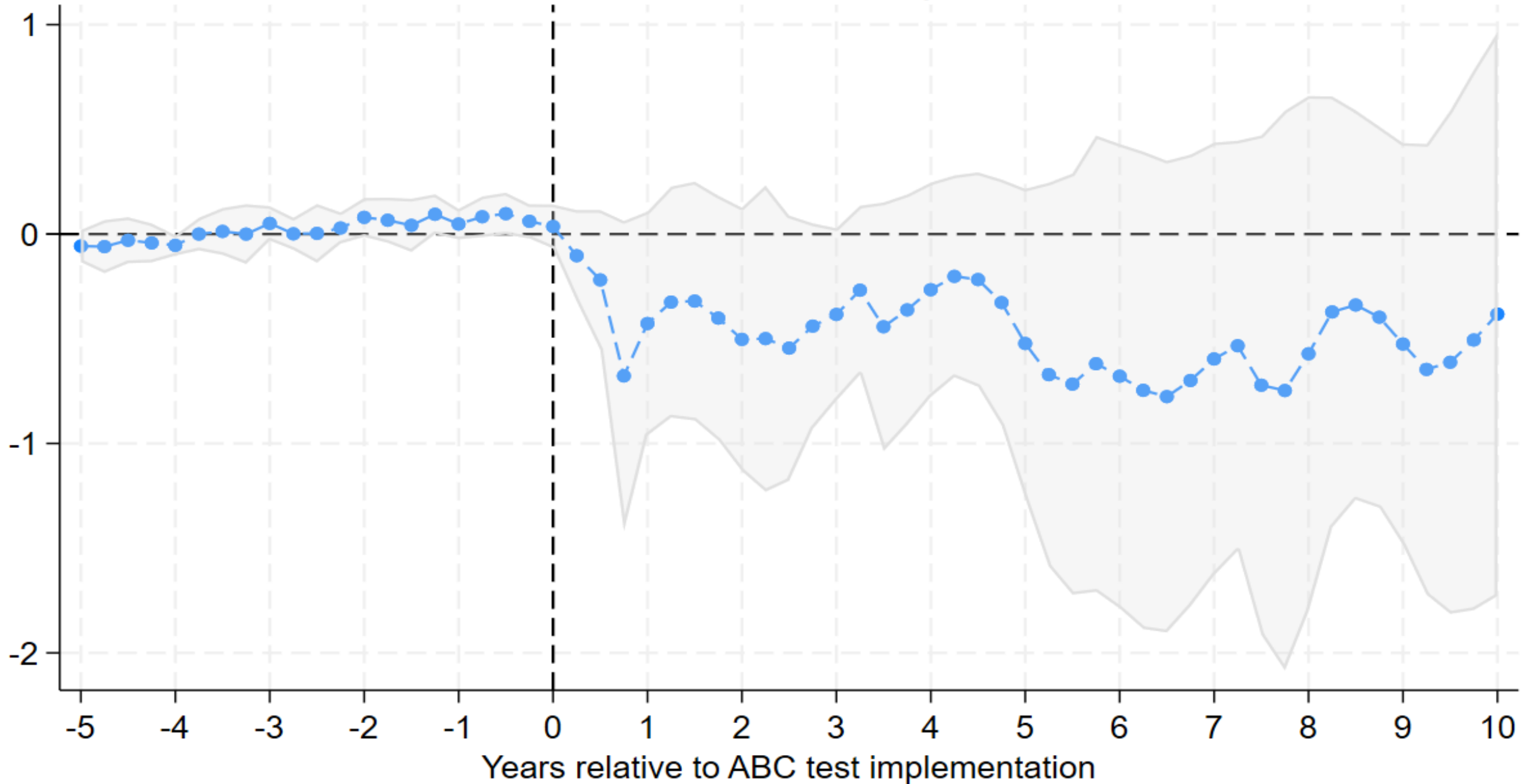
W2 Employment



Employment



Labor Force Participation



ABC Tests: Main Results

1). ABC Test Reduced Traditional (W2) Employment

- The implementation of the ABC test **led to a 5.31% decrease in W-2 employment**, highlighting a substantial shift away from standard employment forms.
- This effect is also statistically significant at the 1% level.

2). ABC Test Reduces Overall Employment

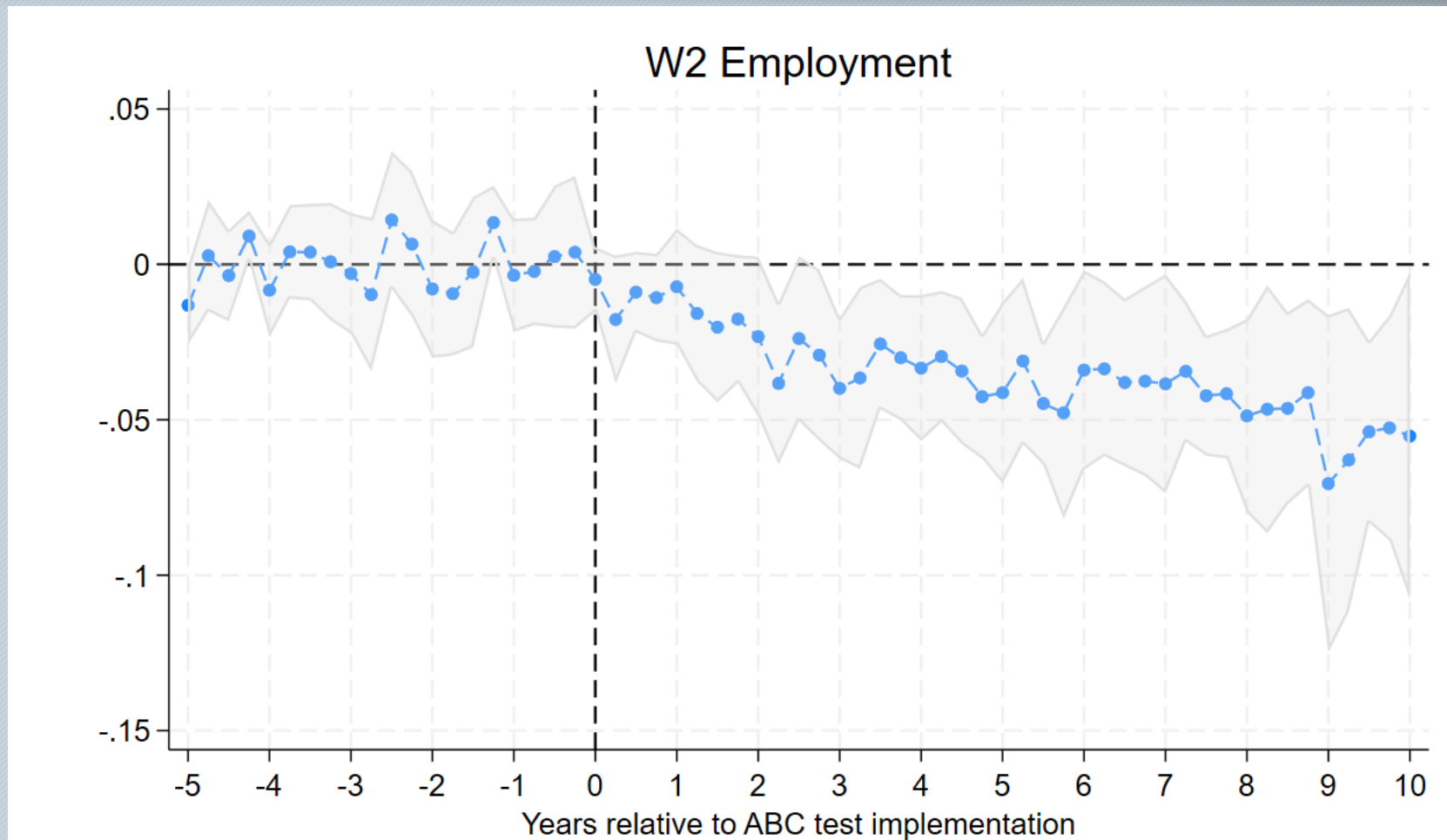
- The implementation of the ABC test **caused a 4.95% reduction in overall employment**, a statistically significant effect at the 1% level

3). ABC Test Reduces Labor Force Participation

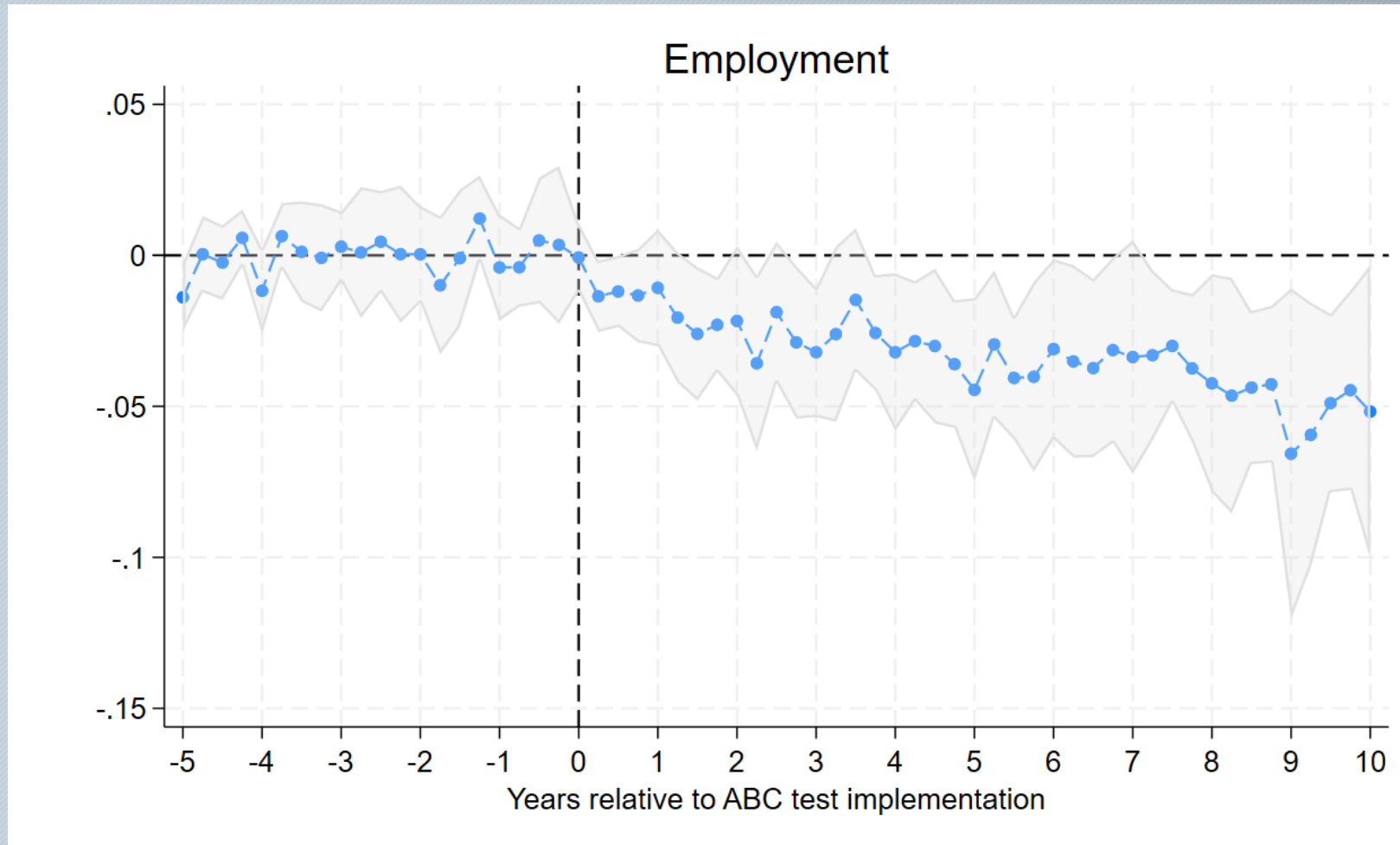
- The implementation of the ABC test **caused a decrease of .506 percentage points in labor force participation in the first 10 years after implementation**, statistically significant effect at the 5% level

4). **Results robust** to excluding states that passed ABC test close to the pandemic (California, Nevada), and robust to excluding states that passed ABC test close to the financial crisis (New Hampshire, Illinois)

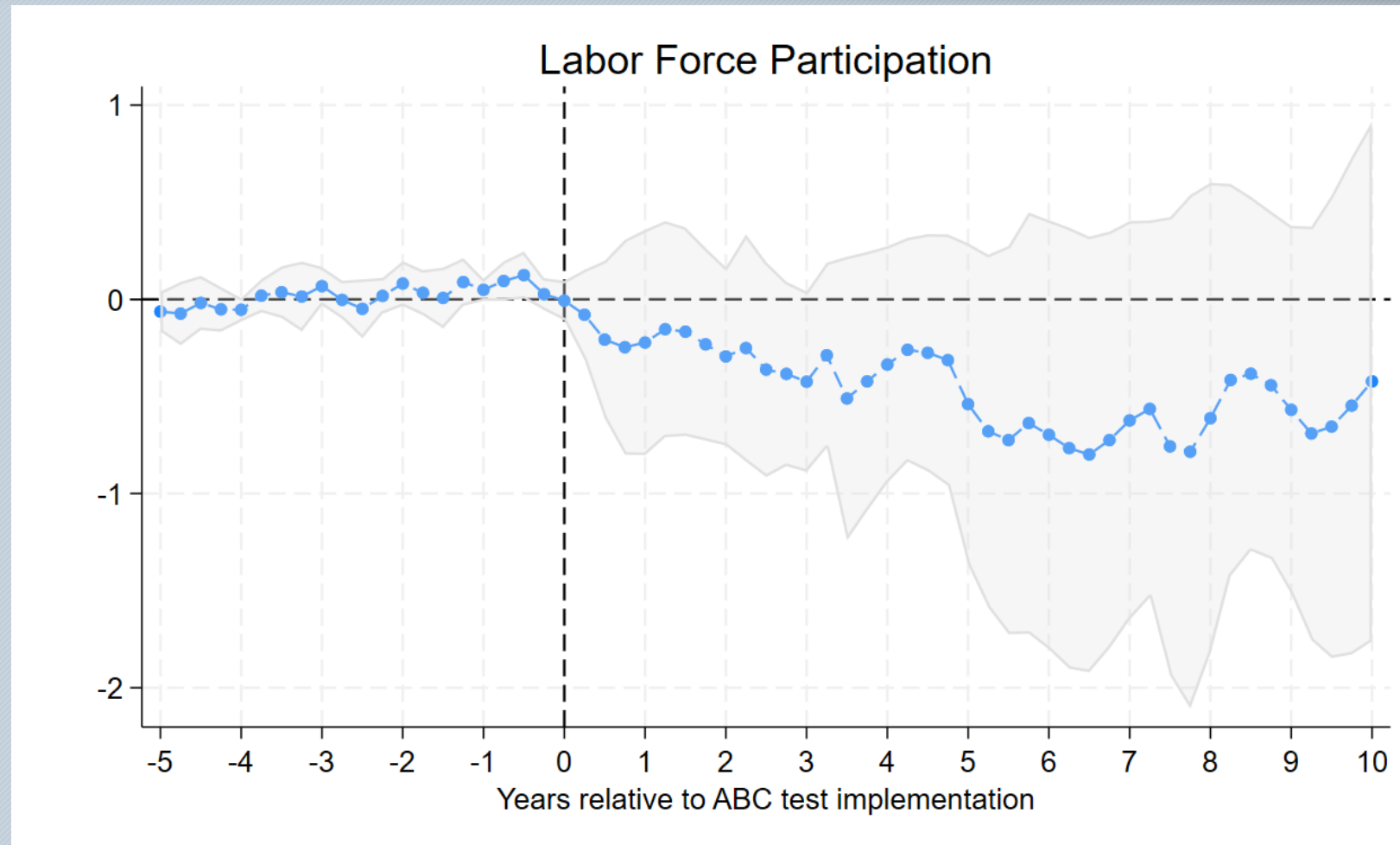
W-2 Employment: Excluding pandemic



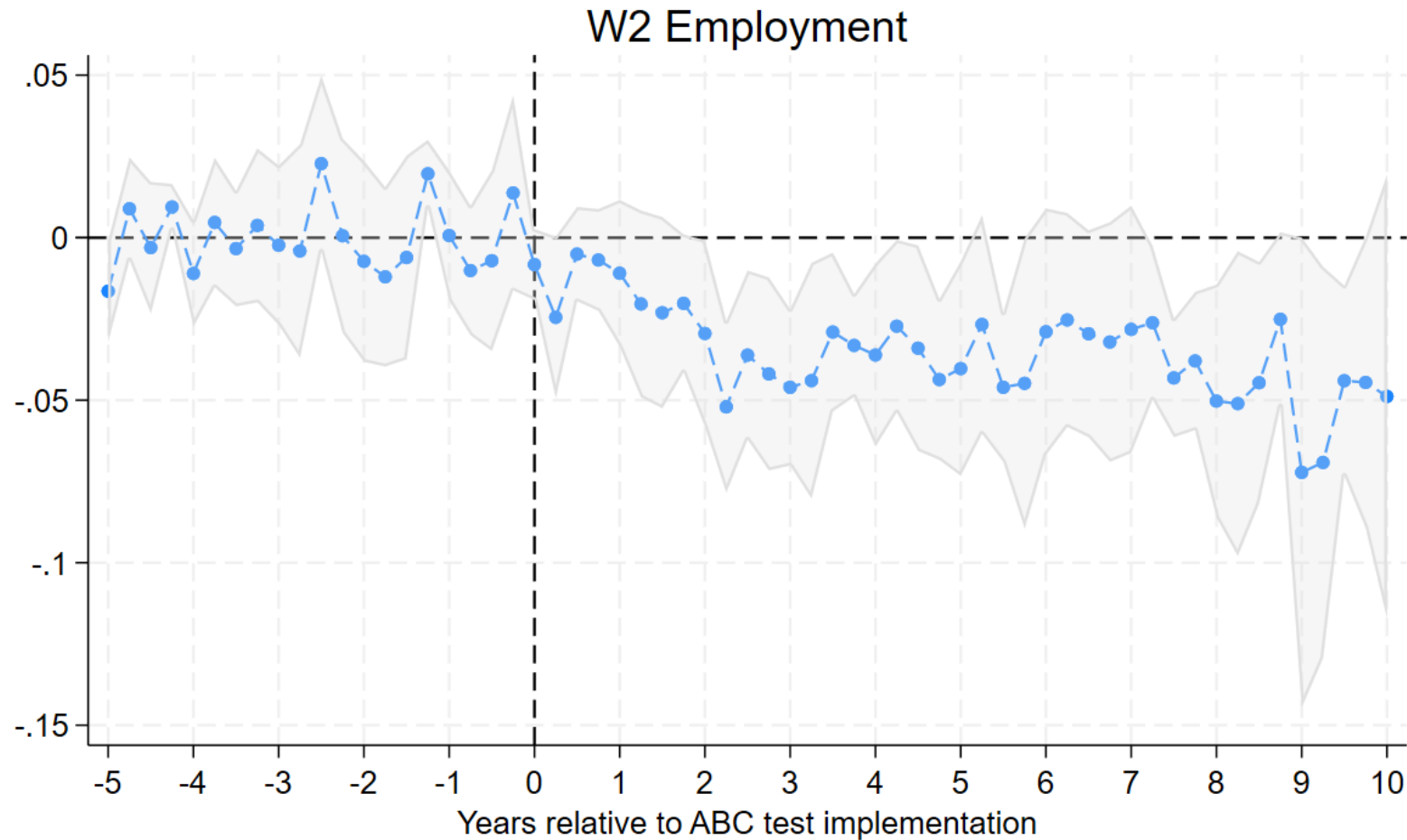
Employment: Excluding pandemic



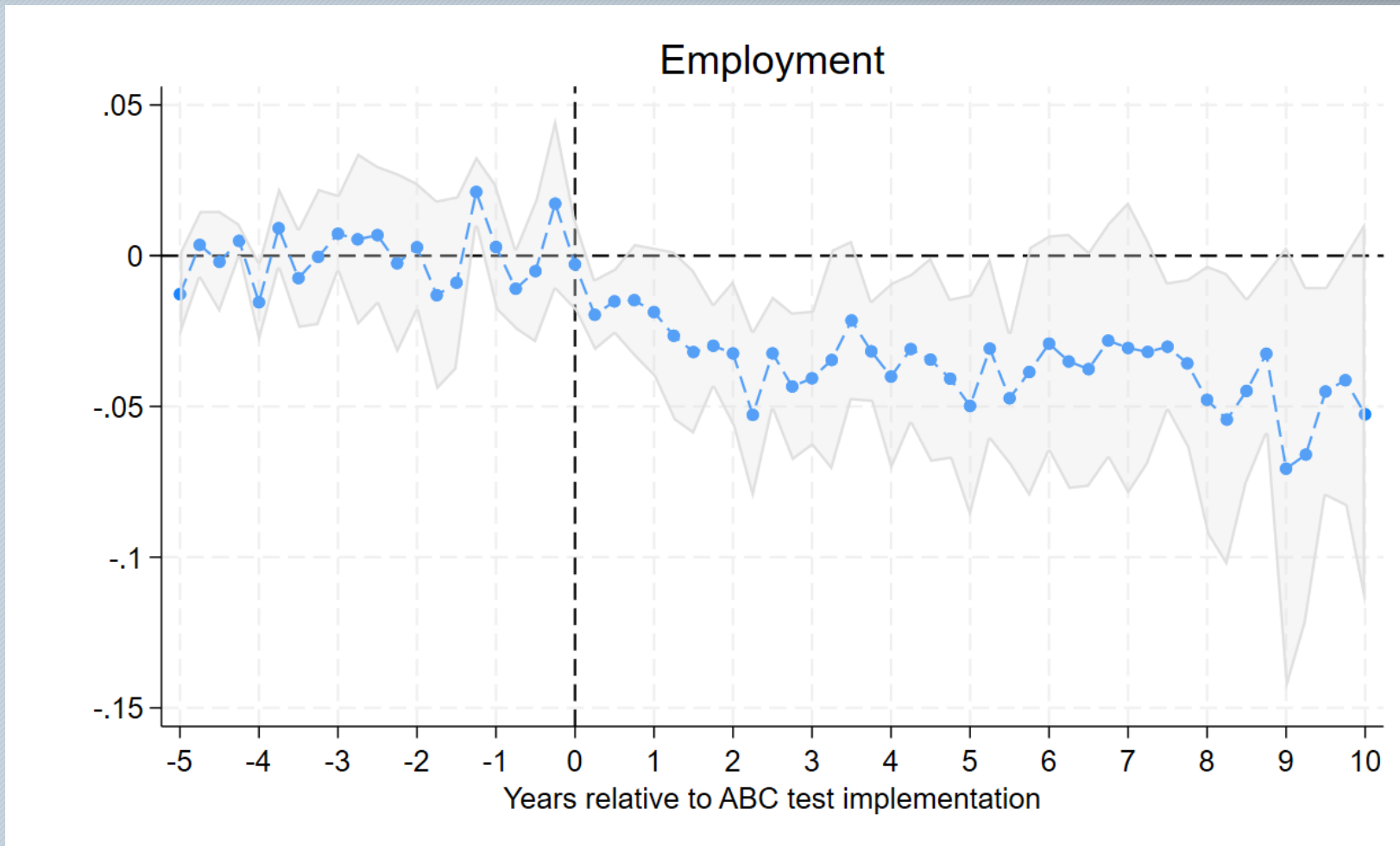
Labor Force Participation: Excluding pandemic



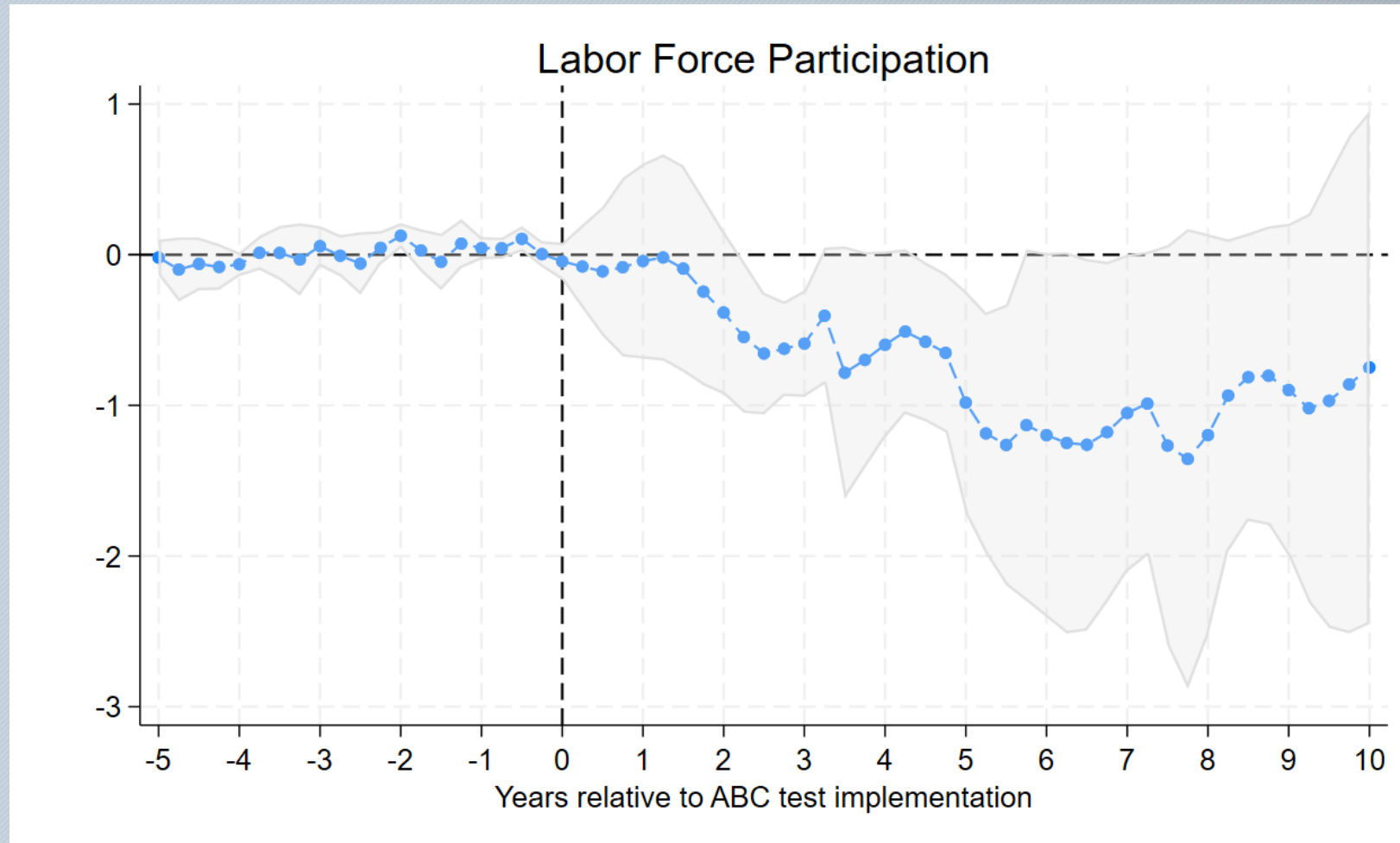
W-2 Employment: Excluding pandemic & financial crisis



Employment: Excluding pandemic & financial crisis



Labor Force Participation: Excluding pandemic & financial crisis



ABC Test: Results on Self-Employment

1). ABC Test Reduced Self-Employment in the Short-Run

- The implementation of the ABC test led to a 4-9 % reduction in **in self-employment in the short-run (within first two years of implementation)**

2). Limited Effect on Self-employment in the Long-Run

- ABC test had a **negative, but not significant impact on self-employment in the long-run**
 - Small, non-significant decrease of 3.33%.
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- Investigating whether long-run effect due to later exemptions and case law interpretations
 - Investigating self-employment using other data sources

Study on California's AB5

- **Goal:** Investigate employment outcomes in California for affected (non-exempt) occupations post AB5
- **Difference-in-Differences (DiD):** Compare the employment outcomes of occupations that were affected by AB5 in California to those same occupations in other states before and after AB5 was enacted
- **Data:** Bureau of Labor Statistics' Current Population Survey (CPS), 2011-2023
 - Overall Employment
 - Traditional (W2) Employment
 - Self-Employment
 - Labor Force Participation

Results: Study on California's AB5

- We find **no robust evidence that traditional (W-2) employment increased post AB5 in affected occupations**
- AB5 is associated with a statistically significant decline in **self-employment, overall employment, labor force participation** for non-exempt occupations in California.
- Occupations with a greater prevalence of self-employed workers saw greater reductions in both self-employment and overall employment
- On average, 1 in 10 self-employed individuals may have lost self-employment opportunities in California among affected occupations, **While there is no evidence of an accompanying increase in traditional employment opportunities** among these occupations
- Robust statistical associations, not causal findings

Why Does W-2 Employment Fall with ABC Tests?

- We have not tested the mechanisms, but here are some possible scenarios
- Businesses that had workers on payroll and also relied heavily on independent contractors shut down because of the ABC test
- Businesses (that have both employees and independent contractors) move to other states that don't have ABC test
 - Overtime, there is a growth in W-2 employment in non-ABC tests relative to ABC test states
- In California, anecdotal evidence of employers closing their offices in the state
 - Stopped working with their California-based contractors altogether, and substituted them with non-California based contractors
- Anecdotal evidence from California that the small business were the ones that shut down
 - According to IRS tax records, small-and-low-wage firms (with under 20 employees) have seen the fastest growth in use of independent contractors: <https://www.irs.gov/pub/irs-soi/19rpindcontractorinus.pdf>

Any other data or research on ABC Tests?

- Anecdotal evidence
 - Almost all are on the negative effects of AB5 on workers (*New York Times, LA Times*)
 - One law paper highlighted how one company reclassified some workers as employees after AB5
- Xunyi, Wang, et al. “When Gig Workers No Longer Gig: The Impact of California Assembly Bill 5 on the Online Labor Market”
 - **Not a study on workers impacted by AB5:** They look at freelancers on Upwork (peer-to-peer platform, not a company hiring independent contractors vs. employees)
 - Geographic location of hiring parties does not correspond to the geographic location of the worker, so **workers on platform were not likely impacted by AB5**

Any other data or research on ABC Tests?

New School report (James Parrott, L.K. Moe) on construction in New York State

- Pg. 38 – 39: *“Some of the payroll employment increase **likely** came from off the books workers and previously misclassified workers being put on the books as employees.”*
- The report **does not** do an assessment of the ABC test impact on construction, it just notes that payroll for construction increased and assumes that was due to ABC test
- However, it’s quite **possible** that a **targeted approach** (ABC test) to one industry (construction) may have reduced misclassification without harming all other industries and W-2 employment across the state

ABC Tests: An Overkill?

- Goal of the policy should be: **Maximize benefits, minimize harm**
- Independent contractor workforce is **wholly diverse, with most in legitimate independent contracting relationships**
- Broad ABC approach to all independent contractors is a possible overkill
- Working Group on “Gig work and Non-traditional Work Arrangements” (Susan Houseman, Dmitri Koustas, Liya Palagashvili):
 - Brookings Institution, Harvard Kennedy School & American Enterprise Institute
 - “Non-traditional work encompasses many different industries and people of different income levels. A one-size-fits-all policy could have far-reaching, unexpected consequences.”
 - “Actions taken to correct perceived challenges may result in wide-ranging unintended consequences for workers and businesses”
 - <https://www.aei.org/workforce-futures-initiative/wfi-gig-workers/>

Better Policy Solutions for Worker Misclassification

Best approach: Increase resources and enforcement of existing law

- Targeted approach, minimizes harm to legitimate independent contractors
- Most cases of misclassification identified by the taskforce are already illegal under existing law

Not recommended (based on data and empirical research): ABC Test

- Overkill, not targeted approach (harm to legitimate freelancers)
- Doesn't lead to intended results (leads to W-2 employment falling)

Alternatives:

- Targeted approach to specific industries where misclassification may be prevalent
- Economic Realities Test (U.S. DOL for Fair Labor Standards Act)
- A&C Tests (Used by several states for UI, WC)