



**BEACON**ECONOMICS

Understanding  
**California's**  
Dynamex Decision  
2018

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## Executive Summary

The California Supreme Court's decision in *Dynamex Operations West, Inc. v. Superior Court of Los Angeles* ("Dynamex") has the potential to be a watershed moment for the state's economy. In reaching their decision, the Court provided guidelines to determine whether certain categories of workers should be considered as employees or independent contractors, which has far-reaching consequences in relation to worker regulations and their protection under California Law. While the Dynamex decision specifically related to the trucking industry, the decision will potentially make it more difficult for companies to classify workers as independent contractors in other sectors of the economy. The decision is part of a broader legislative and judicial effort to define and understand the changing nature of employer-employee relations.

While worker classification and "alternative" work arrangements have received widespread media attention with the advent of the gig economy, alternative work arrangements have long been a part of modern economies. The purpose of this analysis is to shed light on independent contractors and similar alternative work arrangements as follows. The first step is to measure the scope of the independent contractor and alternative worker labor market in California. Second, the study examines trends in the data and evaluates whether there has been an increasing reliance on independent contractors and other alternative work arrangements in the state recently. Third, it reviews the available evidence on worker preferences for alternative work arrangements – for example, it will consider whether independent contractors might otherwise prefer standard forms of work. Finally, the report considers the potential effect of the Court's decision on work arrangements in California.

## Key Findings

- Independent contracting and so-called alternative work arrangements existed long before the rise of the modern day economy. Even at the height of industrial production in the U.S., many workers worked in informal, temporary, and secondary labor markets.
- Independent contracting and alternative work arrangements are generally defined in relation to standard work arrangements, which typically refer to full-time, permanent employment by a particular business enterprise.
- Independent contracting is used across a variety of industries, which challenges the suggestion that independent contracting is something specific to emergent sectors of the economy, such as the gig economy. In California, the entertainment, professional, scientific and technical services, transportation and real estate industries rely heavily on independent contractors.
- The extent of the use of independent contractors varies by industry; the contracting model works for some industries and not for others. In some industries, employers must upsize and downsize their workforce on a project-by-project basis. In the construction industry, for example, no two projects require the same number of workers.
- A failure to recognize that the effective operation of some industries requires a level of flexibility in recruitment practices could have an unprecedented and unpredictable impact on the state's economy.
- In California, traditional forms of employment are growing far more quickly than the number of independent contractor positions. For example, in California over the period 2010-2016, five employees have been added for every independent contractor job.
- The Department of Labor's survey of contingent workers is the most comprehensive survey of alternative work arrangements in the U.S. economy. It asks "contingent" workers whether they are satisfied with their work arrangement, or whether they would prefer a traditional form of employment. In 2017, the survey found that 79.1% of independent contractors preferred alternative work arrangements, while only 8.8% of

survey respondents expressed displeasure, stating their preference for a traditional work arrangement.

- Another measure of worker satisfaction is found in statistics relating to the number of part-time workers who would otherwise prefer full-time employment, but cannot find it due to unfavorable economic conditions. In California, the number of workers who fall into this category has decreased markedly the further the economy has moved from the Great Recession. Since 2010, the number of workers within this category has fallen by 54%.
- Direct costs to employers of reclassifying workers from independent contractors to employees include the cost of conforming to minimum wage laws, and the payment of payroll taxes and employee benefits.
- The cost of payroll taxes and other benefits represent a direct cost to companies and represent anywhere up to an additional 44% in the cost of employing a worker.
- Restraints on independent contracting also affect the benefits that many workers enjoy from such arrangements, such as the flexibility of choosing when and how many hours they work, and the opportunity to supplement primary sources of income.
- There would be benefits to some workers from gaining employee status. A small minority of workers engaged in alternative work arrangements would prefer traditional forms of work. Yet the benefits to such workers must be weighed against the broader costs of worker reclassification – including costs to other workers who benefit from alternative work arrangements, the added costs to employers, the reduction in socially valued services, and inefficiencies that are introduced into the economy.
- A key question for policy makers is whether there are more effective and efficient ways to assist the minority of workers who engage in alternative work arrangements, but would prefer traditional forms of work, that do not generate such risk for the economy.
- A wholesale reclassification of workers would have significant consequences for a variety of different sectors in the state's economy. Since the nature of, and reliance on, independent contracting varies by industry, a one-size fits all policy ignores the complexity and nuance of such work arrangements, and the value they bring to California's economy.

## Introduction

On Monday, April 30, 2018, the California Supreme Court reached a decision in the case of *Dynamex Operations West, Inc. v. Superior Court of Los Angeles*. At question was the employment status of independent contractors in California, and whether certain contractors should be otherwise classified as employees of the businesses for which they perform services. In reaching their judgment, the Court adopted a standard which presumes that all workers should be considered employees, and therefore subject to worker regulations and protection under California Law. In so doing, the Court placed the burden of proof on an organization to demonstrate that a worker is an independent contractor. Specifically, a worker can be classified as an independent contractor if they meet the standards laid out by the "ABC" test.

a) the worker is free from the control and direction of the hiring entity in connection with the performance of the work, both under the contract for the performance of the work and in fact.

b) the worker performs work that is outside the usual course of the hiring entity's business.

c) the worker is customarily engaged in an independently established trade, occupation, or business of the same nature as the work performed.

While the Court's decision could have implications for California's independent contractor and alternative worker labor market, at the outset, it should be made clear that Beacon Economics is not a law firm. Beacon Economics takes no position on how the ABC test will be interpreted by the Courts in subsequent cases, and how different categories of worker will be classified on an industry-by-industry or company-by-company basis. The purpose of the analysis presented here is four-fold. First, this study measures the scope of the independent contractor market in California. Second, it examines whether there has been an increasing reliance on independent contractors and other alternative work arrangements in the State recently. Third, the study will consider the available evidence to understand worker preferences for alternative work arrangements – for example, it will consider whether independent contractors might otherwise prefer standard forms of work. Finally, the report considers the potential effect of the Court's decision on work arrangements in California.

## Background

For decades, there has been widespread academic and policy interest in the evolution of the organization of work and the relationship between firms and employees. Recently, the issue has once again come to the fore with the perceived rise of alternative work arrangements, such as independent contracting, which have most visibly come to prominence in the guise of the so-called gig economy. Yet, the gig economy is only one part of the broader category of alternative work arrangements, and the related idea of “contingent” work.

Alternative work arrangements are defined in relation to standard work arrangements, which typically refer to full-time, permanent employment by a particular business enterprise. Alternative work arrangements, therefore, are those that do not meet this standard, such as part-time work, temporary positions, independent contracting, and workers who may hold multiple employment positions. It should be made clear that so-called alternative work arrangements existed long before the rise of the gig economy. Even at the height of industrial production in the U.S., a number of workers operated in informal, temporary, and secondary labor markets.

Whether firms choose to “make” – hire employees – or “buy” – contract out employment – can depend on a variety of factors, which vary from one industry to another. Some industries are characterized by pronounced variation in the nature and the flow of work, which manifests into short-term changes in the demand for employees. For example, in the construction sector, there is variation in the number of employees required from one project to the next. The same is true in the production of motion pictures. Employers often choose to contract out as a way to efficiently scale their workforce according to demand. In other industries, where the flow of work is more stable over a short-term time horizon, such as the manufacturing industry or education services, a constant, permanent workforce is preferred, and independent contractors are used much less.

Beyond reasons of recruitment efficiency, independent contracting is most commonly associated with cost savings. In relation to independent contractors, employers do not have to pay payroll taxes, cover independent contractors under workers' compensation insurance, and are not liable for payments under unemployment insurance, disability insurance, or social security. Furthermore, minimum wage and overtime regulations do not apply to independent contractors, nor do employers have to comply with other wage and hour law requirements such as providing meal periods and rest breaks, or reimbursing workers for business expenses incurred while performing their jobs.

The table below displays employer payroll taxes in California, both Federal and state. An employer is required to pay such taxes for contracted employees, but not for independent contractors. If a worker was recategorized from an independent contractor to an employee in the state, an employer would be required to ensure a worker is paid the minimum wage, plus pay the displayed payroll taxes for each worker.

## PAYROLL TAXES IN CALIFORNIA, 2018

Federal			State		Total
Federal Unemployment <sup>1</sup>	Social Security Tax <sub>2</sub>	Medicare Tax <sub>3</sub>	Unemployment Insurance <sup>4</sup>	Employment Training Tax <sup>5</sup>	
0.60%	6.20%	1.45%	3.40%	0.10%	11.75%

Source: California Employment Development Department

Furthermore, according to data from the U.S. Department of Labor's Bureau of Labor Statistics (BLS), worker benefits add an additional 44% to the costs of hiring a given employee.

## RELATIVE IMPORTANCE OF EMPLOYER COSTS OF EMPLOYEE COMPENSATION MARCH 2018

Compensation component	Private industry
Wages and salaries	69.5%
Benefits	30.5%
Paid leave	7.0%
Supplemental pay	3.9%
Insurance	8.0%
Health	7.5%
Retirement and savings	3.8%
Defined benefit	1.5%
Defined contribution	2.3%
Legally required	7.8%

Source: Bureau of Labor Statistics

There are also cost savings to certain industries from having workers own their own capital (such as a truck or taxi). It is on these grounds that independent contracting is most commonly criticized. According to critics, alternative work arrangements have been and continue to replace standard employment, generating inferior jobs for workers.

Others see advantages in alternative work arrangements, which enable workers to supplement their primary source of income, and enable flexibility and autonomy in work schedules. The argument that alternative work arrangements are a sub-optimal form of employment for workers is harder to make at a time when the national unemployment rate stands at multi-decade lows. Each month, the BLS releases the Job Opening and Labor Turnover Survey (JOLTS). The survey measures the ratio of the number of unemployed people to the number of job openings, making the survey, in essence, a measure of labor market tightness. The chart below tracks jolt since the year 2000. During the depths of the Great Recession, close to one job was created per 7 unemployed people. By June 2018, for every unemployed person in the economy, one job is created. While it may be possible to make the case that workers who are engaged in alternative work arrangements might seek more standard types of employment when the economy is operating below capacity, it is difficult to make this claim as the economy nears full employment. In other words, in a growing economy, workers should be much more able to find the types of employment they seek, subject to their qualifications.

<sup>1</sup> Federal Unemployment: Under Federal Unemployment Tax Act (FUTA). The tax applies to the first \$7,000 employer paid to each employee as wages during the year.

<sup>2</sup> Medicare Tax: Under Federal Insurance Contributions Act. No wage limits.

<sup>3</sup> Unemployment Insurance: Employers must pay federal unemployment tax on the first \$7,000 in wages paid to each employee in a year

<sup>4</sup> Employment Training Tax: Employers must pay Employment Training Tax on the first \$7,000 in wages paid to each employee in a year

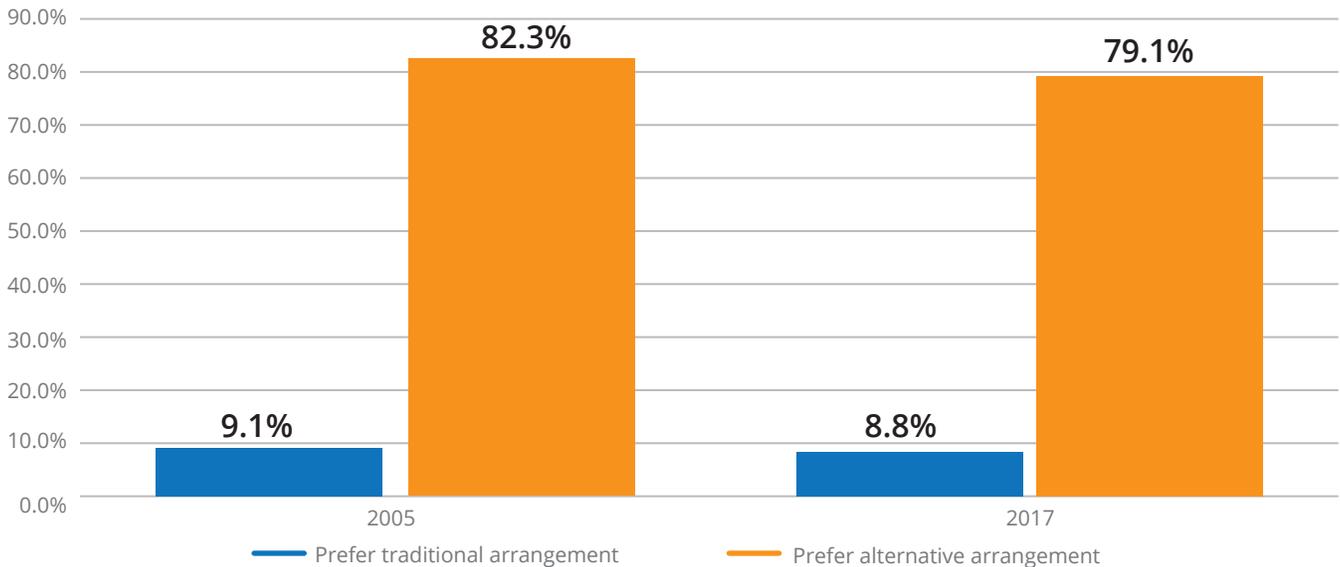
## JOLT, RATIO OF UNEMPLOYED PERSONS TO JOB OPENINGS



Source: Bureau of Labor Statistics

This point is further buttressed by a contingent worker survey, which the BLS publishes on an occasional basis. In 2005 and 2017, the BLS asked independent contractors whether they would prefer a traditional work arrangement. In both years, roughly eight out of ten workers responded that they preferred an alternative work arrangement. In 2017, for example, the survey found that 79.1% of the independent contractors surveyed preferred alternative work arrangements, while only 8.8% of survey respondents stated their preference for a traditional work arrangement.

## RESPONSES TO THE CONTINGENT WORKER SURVEY IN 2005 AND 2017



Source: Current Population Survey Contingent Worker Supplement

In summary, while there is renewed interest in alternative work arrangements, such work arrangements are mostly cast in a negative light. There can be negative aspects to independent contracting, particularly when such workers would prefer, but are unable to find, traditional forms of employment. Yet what often gets lost in the discussion is that independent contracting can generate efficiencies for certain industries and benefits for many workers.

## Methodology and Data

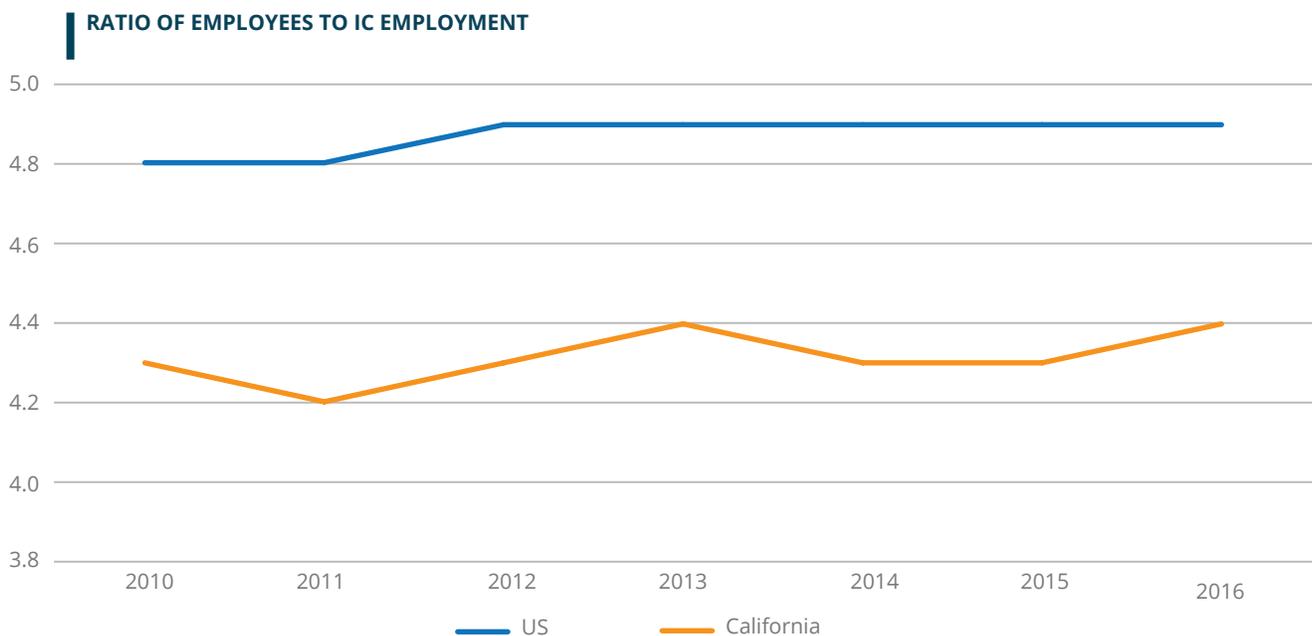
There is no direct way to broadly measure the number of independent contractors and the scope of alternative work arrangements from a single, reliable data source. Instead, a number of data sources can be used to answer two questions. First, how many workers gain their living through independent contracting or an alternative work arrangement, and has the number of workers in this category increased recently? Second, would such workers prefer a traditional work arrangement?

To answer these questions, the data in this analysis will be drawn from three primary sources. First is the U.S. Census Bureau's Non-employer Statistics (NES), which is the most direct measure of the number of independent contractors in the economy. Second is the Current Population Survey (CPS), which provides broader measures of the scope of alternative forms of work arrangements. The third results from a rare supplement to the CPS specifically related to contingent workers. Each dataset will measure different dimensions that enable us to cast light on the potential impact and scope of the Dynamex decision on the California labor market and economy.

## Alternative Employment as Measured by Non-employer Firms

The most comprehensive measure of the number of independent contractors is found in the Census Bureau's NES. The NES are an annual dataset, covering the period 1997-2016. A non-employer business is an entity that has no paid employees but is subject to Federal income taxes, and has annual business receipts of \$1,000 or more. The dataset is a commonly used measure of independent contractors since non-employers are self-employed individuals operating unincorporated businesses. In this study, a non-employer will be referred to as an "IC". It should be noted that the income earned by an IC may not be an individual's primary source of income – for example, a worker would be included in this category even if they have another form of employment. One key benefit of the data is that it enables researchers to study the number of independent contractors over an extended time period, at a fine-grained level of industry definition.

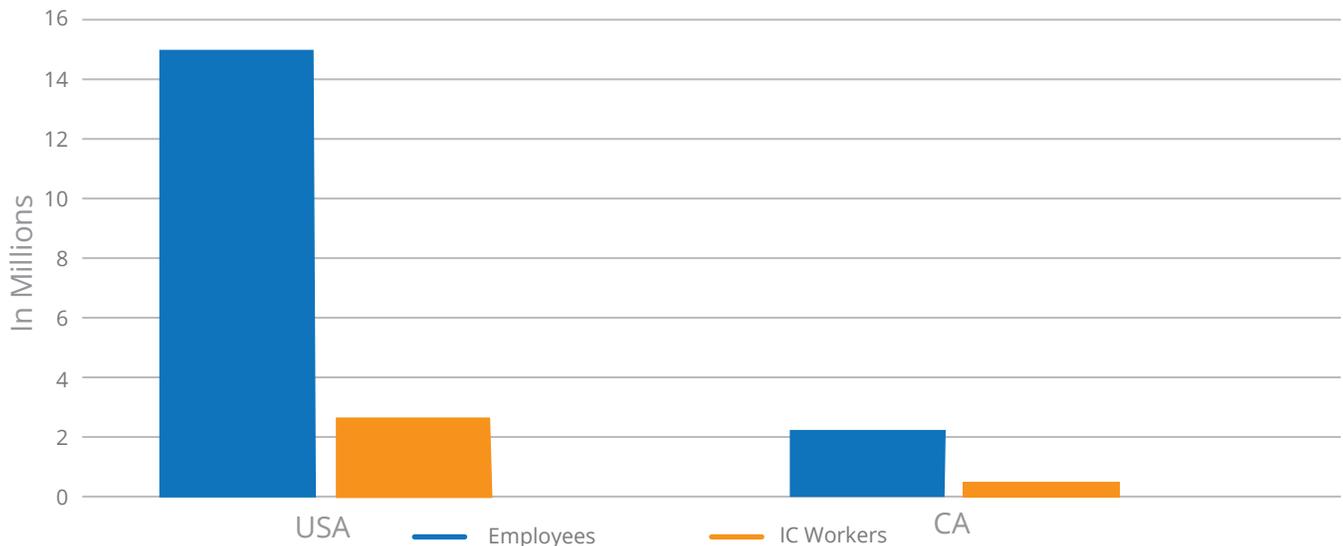
The chart below depicts the ratio between the number of employees and IC workers<sup>6</sup>. Since 2010, the ratio has been constant at both the national level and for California, which suggests that the growth of IC jobs is not outpacing the growth of traditional forms of employment. For every IC job in California, there are 4.5 employees.



<sup>6</sup>Total employees is measured using the Bureau of Labor Statistics' Quarterly Census of Employment and Wages (QCEW). QCEW is employment and wage data generated from employer payments into federal unemployment insurance programs. The dataset, therefore, covers the population of "employees", or those who are directly employed by an enterprise.

In California in 2016, there were over 3 million ICs – in the national economy at this time there were nearly 25 million ICs. The chart below illustrates the growth of IC and employees in the U.S. and California economies over the period 2010-2016. IC employment has been growing significantly more slowly than the rate at which companies have been adding permanent employees.

**GROWTH IN EMPLOYEES AND IC WORKERS  
2010-2016**



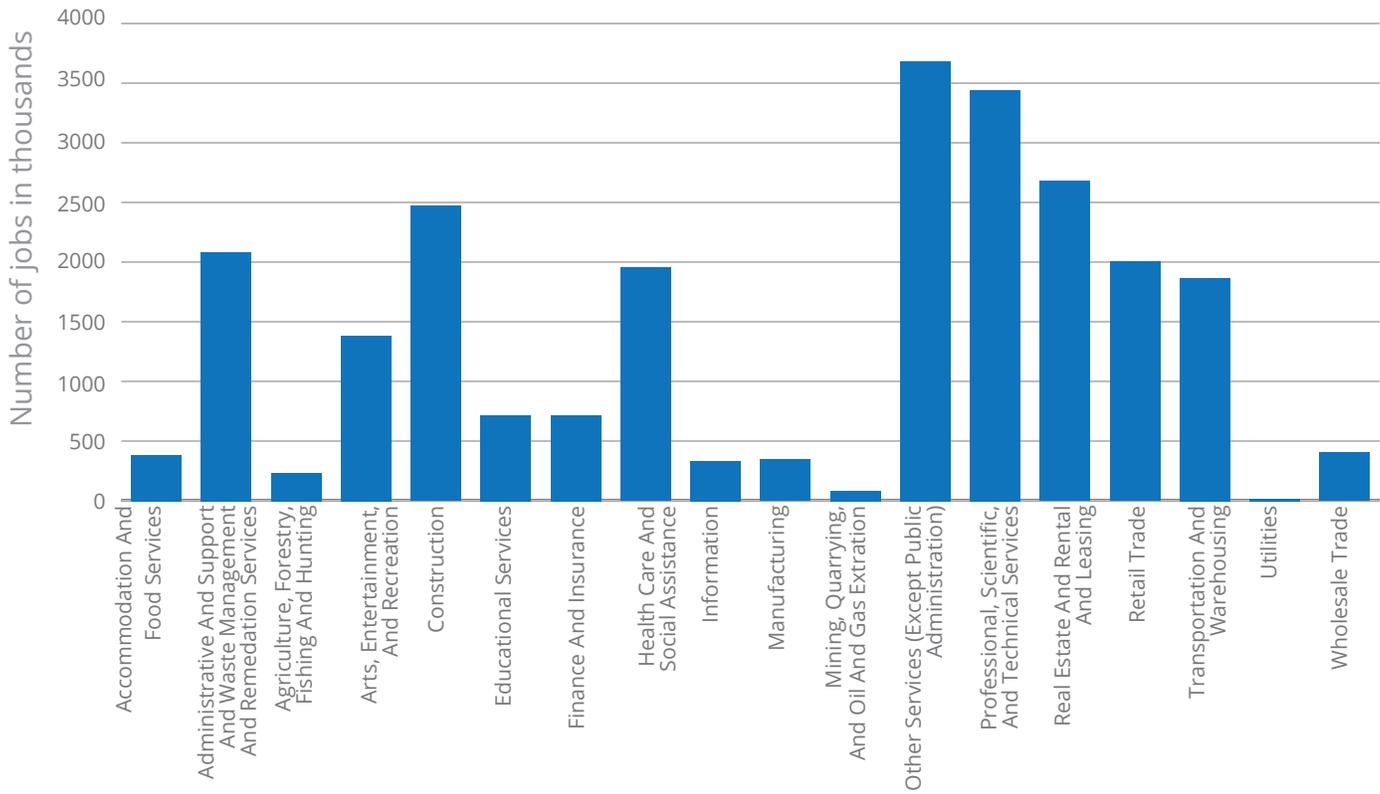
Source: Non-employer Statistics and Quarterly Census of Employment and Wages

## A Sectoral Analysis of ICs

NES data can be broken down into different industrial categories. The charts below, show how ICs are distributed across the different industries of the U.S. and California economies. For the most part, ICs are similarly distributed across industries for these two regions. There are some key differences, however. For the entire U.S. economy, there is a larger share of ICs in the construction sector. This could be due to differences in local employment regulations in California that might limit the use of independent contractors in the sector. Other differences are found in professional, scientific and technical services – where California has a larger share of ICs, and transportation and warehousing services, where California has a larger share than does the whole of the U.S. This variation reflects differences in the industrial composition of the respective economies, whereby California has a larger share of tech and logistics workers than is the case for the national economy.

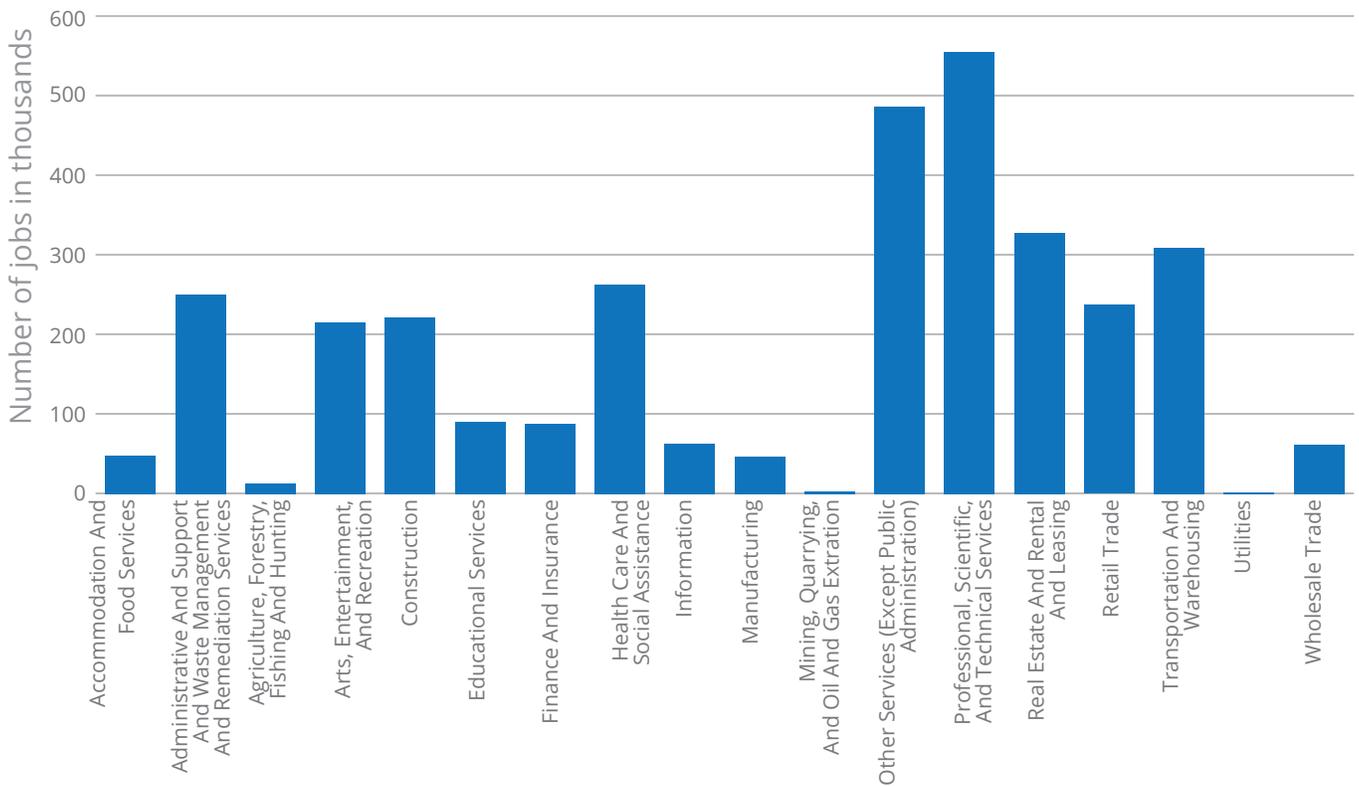
Another key feature of the charts are the extent to which independent contractors are distributed across a variety of industries. Popular perceptions that independent contracting is the child of the gig economy contradicts the evidence, which shows that the use of independent contracting is widely practiced across a variety of sectors, and has been since before the gig economy emerged.

### NUMBER OF IC WORKERS IN US, BY INDUSTRY 2016



Source: Non-employer Statistics

### NUMBER OF IC WORKERS IN CALIFORNIA, BY INDUSTRY 2016



Source: Non-employer Statistics

For California in 2016, the table below shows the distribution of ICs and employees across different sectors of the economy. There is significant variation in the reliance on ICs by industry. In those industries where we see short-term variation in the demand for employment, such as construction and arts and entertainment, we see a high reliance on IC workers. We also see a high reliance on ICs in sectors where there are benefits to companies from having workers own their own capital, such as a car or a truck. This is the case for the real estate, and transportation and warehousing industries. We see a much smaller reliance on ICs in industries where employment patterns are more stable in the short-term, such as the manufacturing, and accommodation, and food services industries. There is also less contracting in industries where the location of production is stable. A wholesale reclassification of workers would have significant consequences for a variety of different sectors in the state's economy.

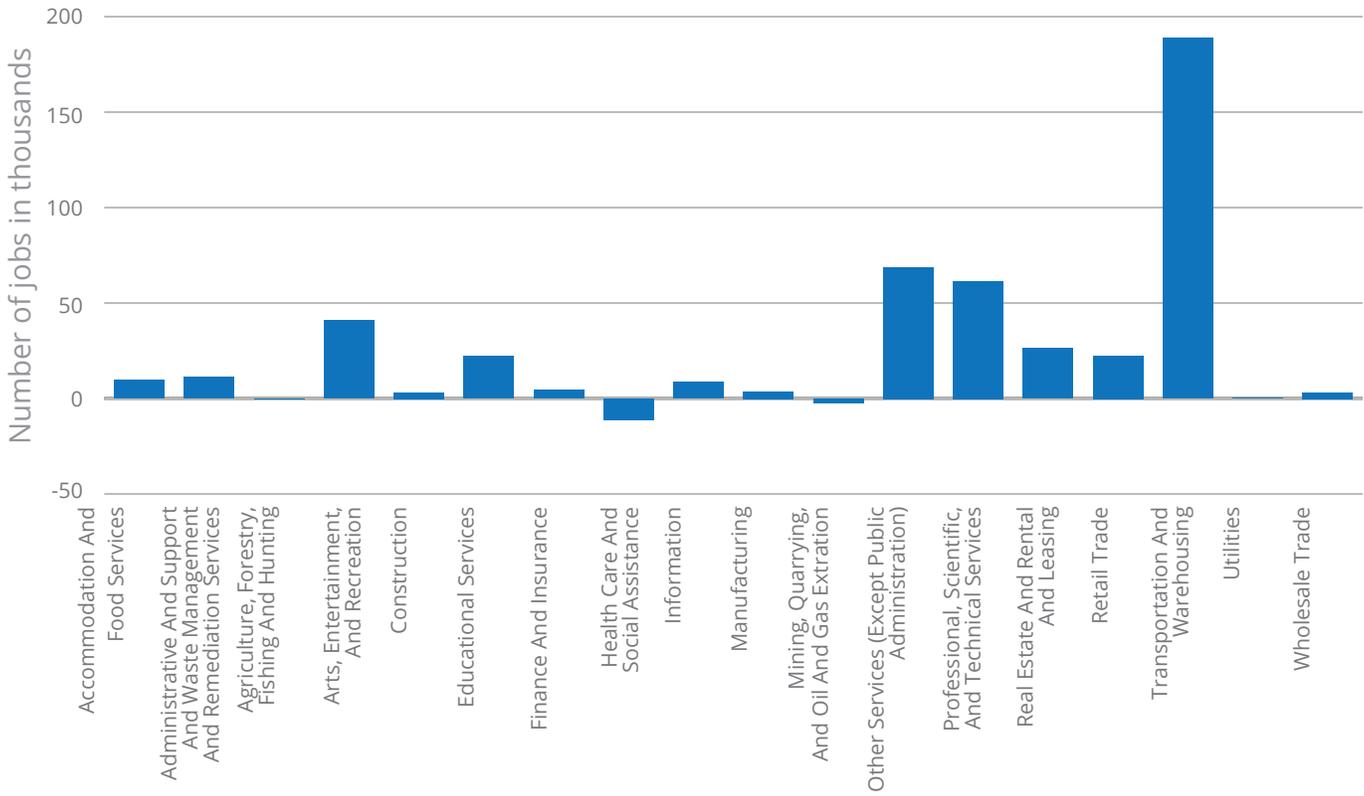
#### IC WORKERS BY SECTOR 2016

	Total Work force	IC Share of Total Work Force
Agriculture	436,594	3%
Mining	25,001	12%
Utilities	59,884	3%
Construction	991,451	22%
Manufacturing	1,340,819	3%
Wholesale Trade	777,913	8%
Retail Trade	1,905,357	12%
Transportation and Warehousing	820,746	38%
Information	580,762	11%
Finance and Insurance	628,744	14%
Real estate	603,812	54%
Professional, Scientific, and Technical Services	1,766,926	31%
Admin Support	1,328,588	19%
Education	394,781	23%
Health Care	2,428,406	11%
Arts, entertainment and recreation	514,447	42%
Accommodation and Food Services	1,633,914	3%
Other services	1,005,270	48%
Total	17,243,415	19%

Source: Non-employer Statistics and Quarterly Census of Employment and Wages

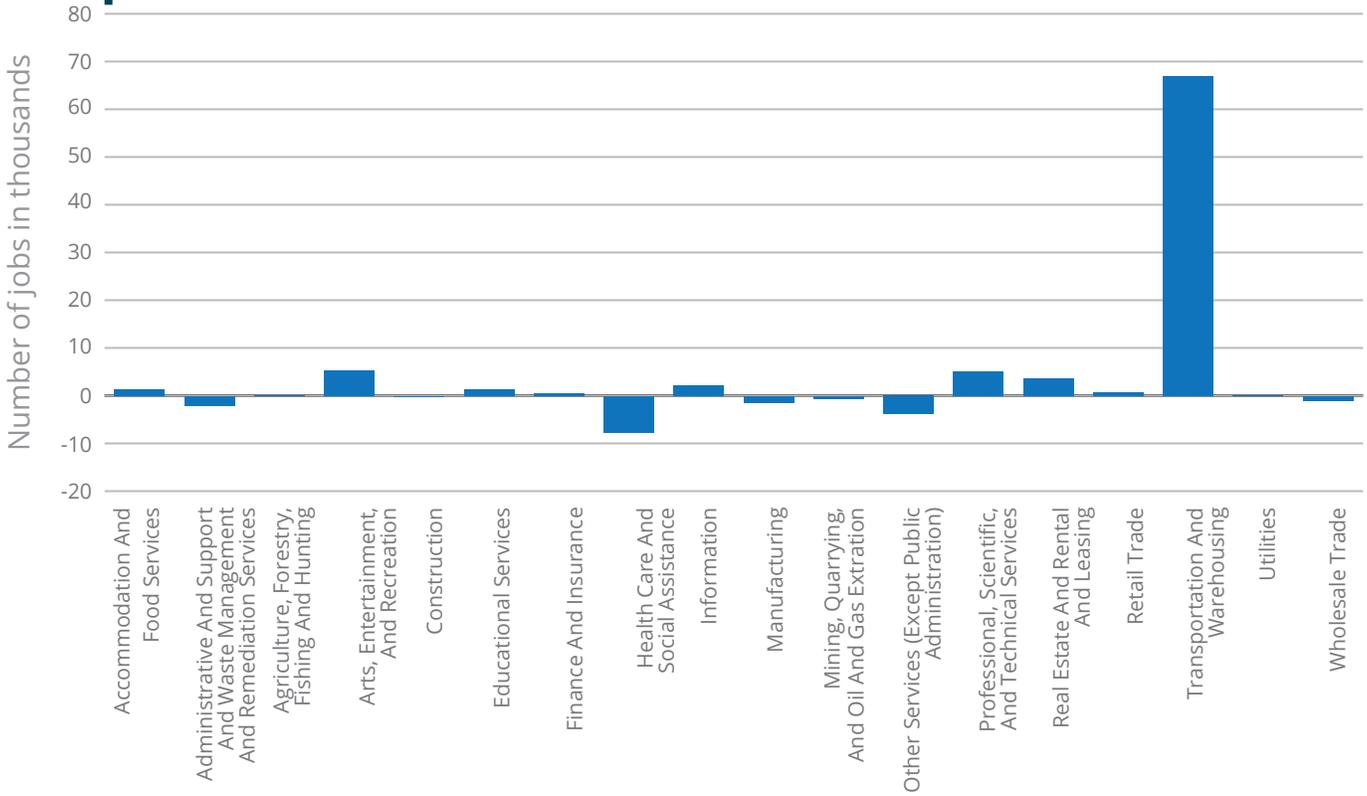
The charts on the following page show the change in ICs by sector in California for two periods, 2010-2016, and 2015- 2016. These periods account for growth since the depths of the Great Recession and growth in the most recent period for which the data are available. The most significant change over both periods is found in the growth of ICs in the transportation and warehousing sector of the economy. Over the period 2015-2016, 95% of all IC growth in California was in this sector. Over the period 2010-2016, transportation and warehousing accounted for 40% of all IC growth in California.

**IC GROWTH IN CALIFORNIA BY INDUSTRY  
2010-2016**



Source: Non-employer Statistics

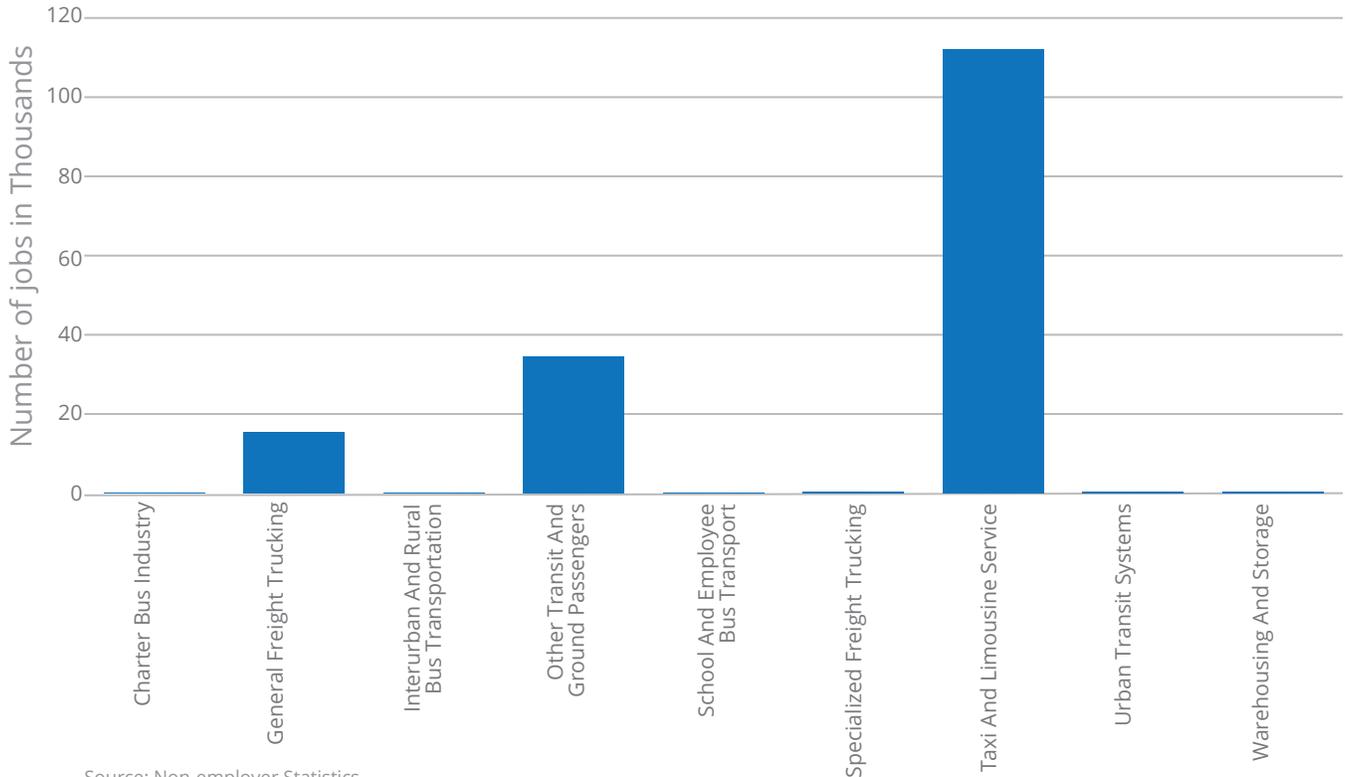
**IC GROWTH IN CALIFORNIA BY INDUSTRY  
2015-2016**



Source: Non-employer Statistics

The chart below looks at sub-sectoral IC growth within the transportation and warehousing sector of California's economy. The taxi and limousine subsector has accounted for 68% of the IC growth in the transportation and warehousing sector since 2010, and 65% of the growth since 2015. Over the period 2010-2016, taxi and limousines have accounted for 24% of all IC growth in California.

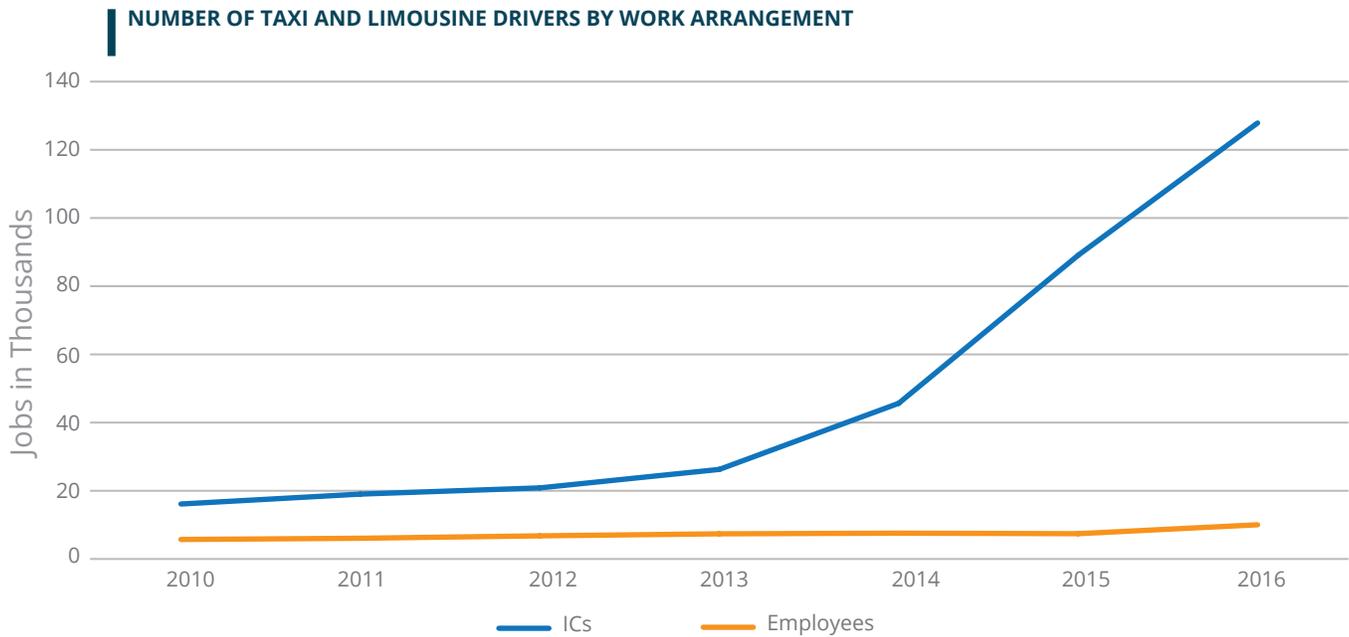
**IC TRANSPORTATION AND WAREHOUSING GROWTH BY SUBSECTOR  
2010-2016**



Source: Non-employer Statistics

In California, the number of IC taxi and limousines drivers has increased from 16,000 in 2010 to 128,000 in 2016. This conforms to the perception that ride-sharing sectors of the economy have generated significant levels of new employment since the Great Recession. There are a number of conclusions that can be reached from this finding. First, while the number of ICs has been increasing in the taxi and limousines sector of the economy, the evidence reveals that this has not come at the cost of permanent employment in the industry (see the chart below). Second, even before the rise of ride-sharing services, ICs accounted for the majority of the employment in the taxi and limousine industry. Third, since the number of taxi and limousine ICs has increased in such a pronounced way since 2010, this suggests that gig economy platforms have generated new demand for taxi and limousine services. These new platforms in the industry have generated demand that did not exist in the traditional formulations of the sector.

In summary, according to the data presented here, the number of ICs has increased and is becoming a larger share of work in the national and California economies. In the California context, the majority of IC growth has occurred in taxi and limousine services. However, more traditional forms of employment are growing more quickly than the number of ICs in the state. This is the case nationally, as well. There is widespread use of ICs, across a variety of industries, which flies in the face of the idea that independent contracting is something specific to emergent sectors of the economy, such as ride-sharing platforms. This also means that any broad-based reclassification of workers from independent contractor to employee status will have implications across many sectors of the economy, both old and new.



Source: Non-employer Statistics and Quarterly Census of Employment and Wages

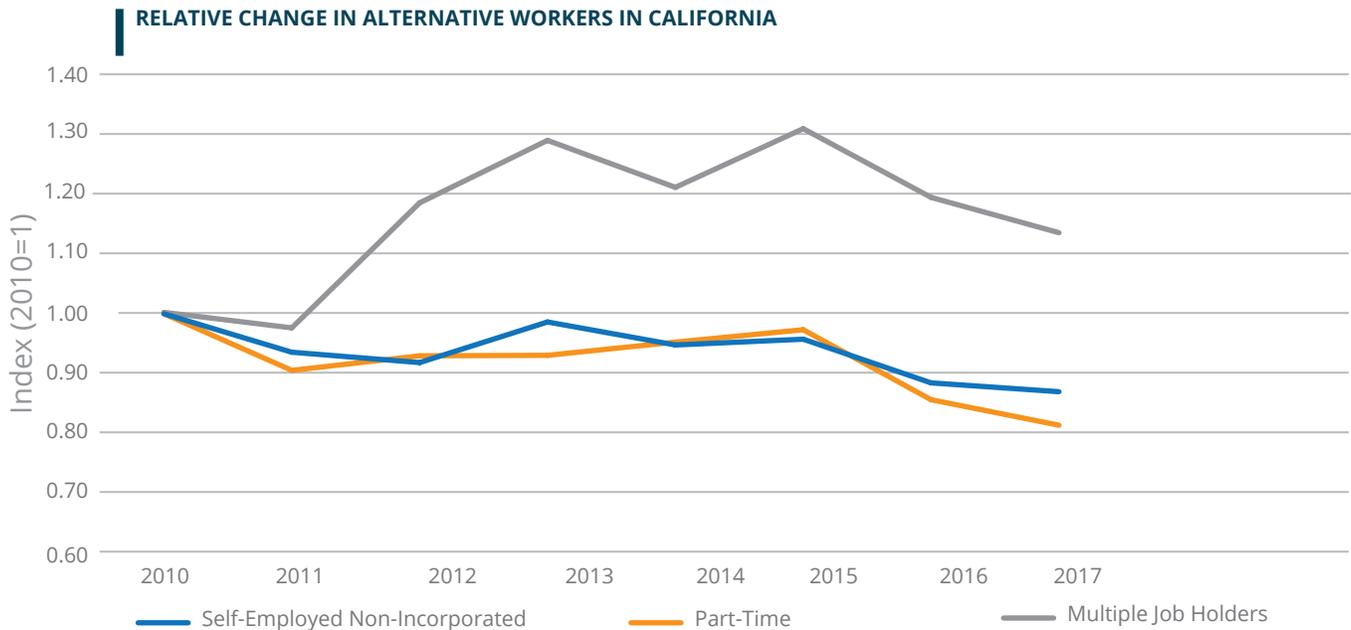
## Other Measures of Alternative Work Arrangements

There are other ways that it is possible to gauge the extent of non-traditional forms of work. Each year, the BLS administers the Current Population Survey (CPS), which is a monthly survey of households in the U.S. population. The survey provides a comprehensive body of data on various socio-economic characteristics of the U.S. population. The survey measures the number of part-time, self-employed, or multiple job holders, which are all categories of workers that fall outside of the classic permanent, full-time employee standard. These data can provide further insight into the extent to which non-traditional forms of employment are becoming an increasing share of the economy.

A part-time worker is defined as someone who works less than 35-hours per week. The CPS classifies self-employed workers according to whether they are incorporated or unincorporated. Incorporated workers, such as small-business owners, have established a legal corporation and may employ others. Unincorporated workers, such as freelancers, have not established a corporation and often operate alone. Most self-employed workers are unincorporated, according to the BLS, meaning that they share many characteristics of independent contractors. Multiple jobholders are defined by the BLS as those persons who, during the time of survey, either had two or more jobs as a wage and salary worker, were self-employed and also held a wage and salary job, or worked as an unpaid family worker and also held a wage and salary job.

In California, for both part-time and unincorporated self-employed workers, the number of workers has fallen over the period 2010-2017. In other words, as the economy has been adding more permanent positions, fewer people are employed in alternative work arrangements. In the case of part-time workers, this conforms to the expected change as an economy grows and nears full employment. As demand and output increases, employers typically expand the number of hours worked by their current staff, replacing part-time with full-time positions, before they add new employees.

The number of multiple job holders increased prior to 2015, since when the number has fallen significantly. In other words, as jobs were added to the economy following the recession, the opportunity for people to supplement their income with a second job increased. But as the economic momentum gained significantly – and job opportunities and wages increased – the need for a worker to hold multiple jobs decreased. Employment has fallen in each category as it has been increasing in the economy at large.



Source: Current Population Survey

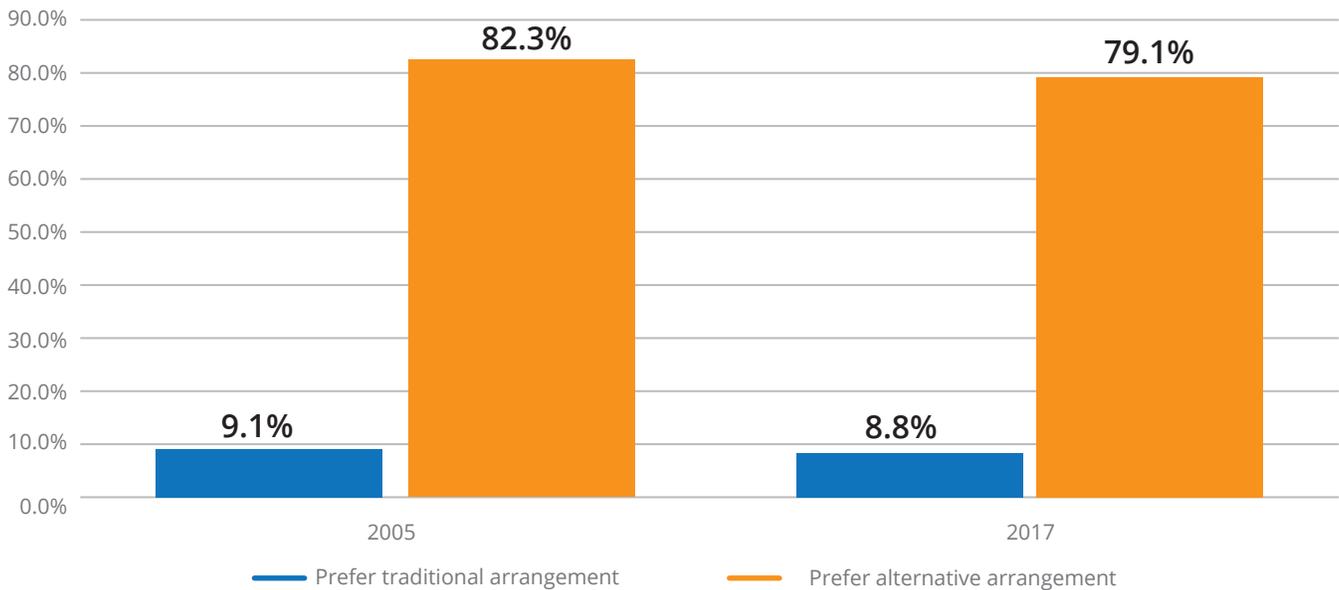
In summary, the CPS provides further evidence that alternative work arrangements represent a marginal share of total economy activity. This, again, challenges the idea that alternative work arrangements are increasing to the detriment of workers’ ability to find traditional forms of employment.

## Gauging Worker Satisfaction of Alternative Work Agreements

In the popular press, and in policy domains, there have been inferences that alternative work arrangements have replaced traditional forms of employment; the data presented above rebut such notions. But what about worker preferences for different types of work arrangements? Occasionally, the CPS provides a supplement, which asks questions specifically related to contingent and alternative work arrangements. In 2017, a Contingent Worker Supplement (CWS) was included in the CPS, which was the first time that the supplement had been administered since 2005. A contingent worker is someone who does not have an implicit or explicit contract for ongoing employment. Hence, it relates to non-traditional forms of employment.

According to the 2017 survey, there were around 15 million workers in the U.S. economy who made their living via an alternative work arrangement. For present purposes, one of the most interesting features of the survey is a question related to worker satisfaction with alternative work arrangements. Specifically, the survey asks “contingent” workers whether they are satisfied with their work arrangement, or whether they would prefer a traditional form of employment. In 2017, the survey found that 79.1% of the respondents preferred alternative work arrangements, while only 8.8% of survey respondents expressed displeasure, stating their preference for a traditional work arrangement. The number of contingent workers who would prefer a traditional form of employment has decreased since the survey supplement was last administered in 2005.

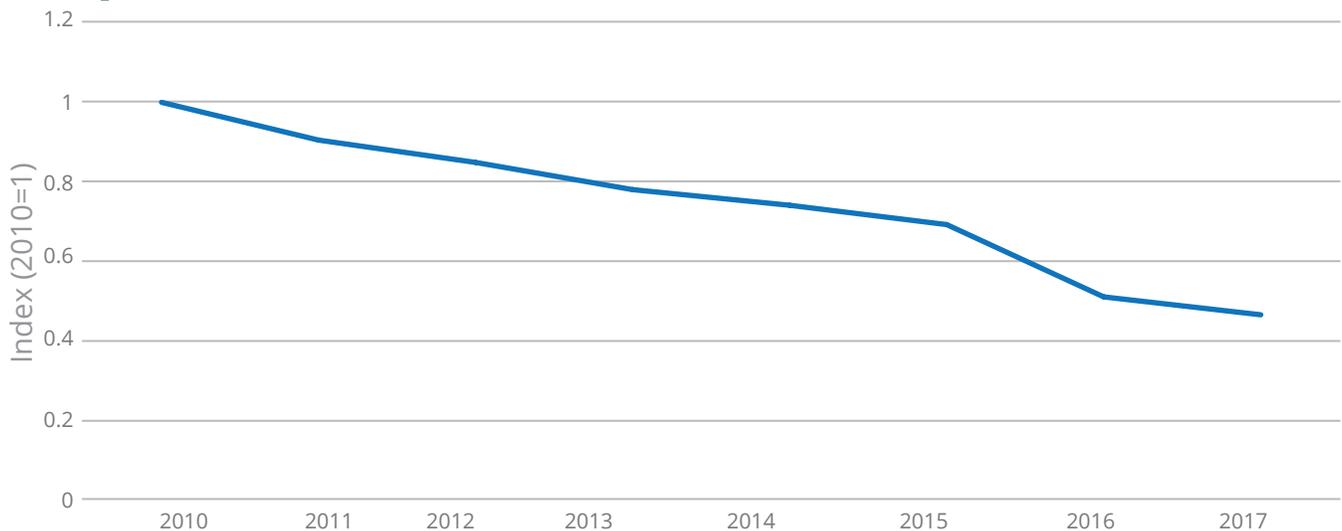
## RESPONSES TO THE CONTINGENT WORKER SURVEY IN 2005 AND 2017



Source: Current Population Survey Contingent Worker Supplement

The CPS provides another way to gauge the extent to which workers in non-traditional work arrangements would prefer a traditional form of work. The survey asks whether workers who work part-time do so for economic or non-economic reasons. The “non-economic” category of worker represents those who would otherwise like full-time employment, but cannot find it due to unfavorable economic conditions, such as the lack of availability of traditional forms of work. In other words, such workers work part-time but seek full-time employment. As the chart below reveals, the number of workers who fall into this category has decreased markedly in California the further the economy has moved from the Great Recession. Since 2010, the number of part-time workers who seek full-time employment has fallen by 54%. Again, this should not be an unexpected outcome. As the economy improves and nears full employment, the number of people who are involuntarily underemployed should decrease.

## RELATIVE CHANGE IN PART-TIME WORKERS FOR ECONOMIC REASONS IN CALIFORNIA



Source: Current Population Survey

If there was an increasing reliance on non-standard employment in the U.S. economy – the extent to which the labor market is increasingly comprised of alternative work arrangements – we would expect to see the number of part-time and self-employed workers, and the number of multiple job holders, increase. The evidence presented here suggests that many non-standard forms of employment are an increasingly smaller share of the overall economy. Furthermore, the evidence suggests that in many cases, non-standard work arrangements are preferred by the people engaged in such activities.

## Gauging the Cost of the Reclassification of Workers

Any analysis of the costs associated with re-classifying workers from independent contractors to employees is clouded by the fact that it's not possible to predict how courts will interpret the status of workers on a case-by-case or industry-by-industry basis. Even within a given company, the status of different types of workers will likely be treated differently by the courts. For example, within a given company, the Courts may interpret the status of janitor contractors differently from the status of tech contractors. In some instances, the Courts will side with workers, in other instances, with employers. As such, Beacon Economics will outline a framework for understanding the potential costs associated with reclassifying workers, which is not specific to a given industry or company. Below Beacon outlines different scenarios under which costs could emerge if the status of workers is changed from independent contractor to employee. The costs include private costs to companies and workers, as well as social costs that could arise from industrial inefficiency.

### No Change

In the first case, it is possible, if unlikely, that the courts will maintain the status quo, and that companies will preserve their current relationship with workers. Under this scenario, no additional cost (excluding legal fees) will be incurred by companies.

### Direct Costs

As outlined above, payroll taxes, unemployment insurance, minimum wages, and benefits are the primary costs to an employer from reclassifying workers from independent contractors to employees. First consider minimum wage regulations. If a worker earns less than the minimum wage, a direct cost to an employer would be the difference between how much a worker earns as a contractor and the prevailing minimum wage. In the case that the revenue generated from a given function does not cover the remuneration of a worker, this will represent a loss for a given company.

As the economy nears full employment, it is hard to imagine that an independent contractor would involuntarily earn less than the minimum wage, since there are opportunities for workers to find minimum wage employment in the broader economy. Given current economic conditions, there are reasons to assume that independent contractors do not earn less than the minimum wage <sup>7</sup>, and therefore, if an employer is suddenly required to conform to minimum wage requirements, this would not represent an additional cost for the employer.

As noted in table 1 above, Federal and State payroll taxes in California amount to 11.75% of a worker's salary. In addition to payroll taxes, there are other costs to employers from reclassifying workers from independent contractors to employees. These costs can include paid leave, health insurance, overtime, and reimbursing workers for business expenses. According to the BLS, such taxes and benefits amount to roughly 44% addition to a given worker's salary. Such taxes and benefits represent a private cost incurred by a company. It is important to note that this cost represents a gross rather than a net cost. In other words, it excludes the possibility that there might be a social gain from the payment of payroll taxes or other benefits.

Again, the extent of this private cost will depend on how many workers are reclassified as employees by the courts.

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<sup>7</sup> An exception in this regard might be the case of undocumented workers, who may not be able to find formal employment in the economy.

## Indirect Costs

In addition to the private costs borne by employers from reclassifying workers from independent contractors to employees, there are a number of indirect costs that could arise. The resultant increased worker costs would likely be passed on to consumers, as is often the case with minimum wage increases. In theory, increasing the cost of a good or service will reduce demand for the good or service. This will have two primary impacts. First, employment in these sectors will fall, creating private costs for these workers. Recall that the evidence presented in this paper suggests that many workers engaged in alternative work arrangements prefer such arrangements. Again, when the economy is near full employment, there are abundant opportunities for workers to find traditional forms of employment, if that is their preference. For the 80% of independent contractors who prefer this work arrangement, a change in their worker status would generate a private cost. In other words, if a population of workers reveals their preference for a particular type of work and the demand for such work is unmet, this will create a private cost for these workers.

Second, reclassifying workers from independent contractors to employees will affect the effective operation of certain industries. As mentioned at the outset of this paper, independent contractors are not used uniformly across different industries. The use of independent contractors enhances the operation of some industries, but not others. To the extent that some industries are forced to employ inefficient business practices, social costs will emerge. Consider ride-sharing platforms. As mentioned above, the recent rise in the number of workers in this sector suggests that such services have created new demand for taxi services. In other words, the industry has created new social value that did not exist in the traditional formulations of the industry. To the extent that worker reclassification means that the supply and consumption of such services is reduced, this will create a social cost. This same concept can be extrapolated to the many industries for which independent contracting is a critical part of their business operations.

## Conclusion

To read elements of the popular press and to follow public discourse, one could be forgiven for thinking that a radical reorganization of work has recently occurred in the U.S. and California economies. There is a common perception that alternative work arrangements are replacing traditional forms of work to the detriment of workers. The evidence presented in this paper suggests otherwise. Traditional forms of work are growing much more rapidly than non-traditional forms of work, and most workers who engage in alternative forms of work prefer such arrangements.

It is not clear how the California Courts will interpret the Dynamex decision. If the decision is applied in a way in which millions of the state's workers are reclassified as employees, there are a number of unpredictable consequences for the California economy. To assess fully the Court's decision, it is necessary to enumerate and measure the costs and benefits that could emerge. There would be benefits to some workers from gaining employee status. A small minority of workers engaged in alternative work arrangements would prefer traditional forms of work. Yet the benefits to such workers must be weighed against the broader costs of worker reclassification – including costs to other workers who benefit from alternative work arrangements, the added costs to employers, the reduction in socially valued services, and inefficiencies that are introduced into the economy.

A key question for policy makers is whether there are more effective and efficient ways to assist the minority of workers who engage in alternative work arrangements but would prefer traditional forms of work. Since the nature of, and reliance on, independent contracting varies by industry, a one-size fits all policy ignores the complexity and nuance of such work arrangements, and the value they bring to California's economy.



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