

# The economic costs of worker misclassification

**Fact Sheet** • By John Schmitt, Heidi Shierholz, Margaret Poydock, and Samantha Sanders • January 25, 2023

# Executive summary

- When employers misclassify workers as “independent contractors” instead of as “employees,” they are exposing those workers to economic costs and depriving them of fundamental labor rights.
- A 2022 EPI analysis of 11 commonly misclassified jobs estimates the cost of independent contractor status to these workers. For example, a typical construction worker, as an independent contractor, would lose out on as much as \$16,729 per year in income and job benefits compared with what they would have earned as an employee. A typical home health aide, as an independent contractor, would lose out on as much as \$9,529 per year in income and job benefits compared with what they would have earned as an employee.
- Landscapers, truck drivers, home health aides, janitors, and nail salon workers are among the occupations most at risk of misclassification, and many of these occupations already have relatively low median annual earnings. Allowing employers to exploit loopholes in labor law puts the economic security of these workers at greater risk.
- Policymakers at the federal, state, and local levels should act to crack down on misclassification and enforce the rights to which all workers should be entitled.

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Federal, state, and local labor laws provide extensive protections for employees, including the minimum wage, overtime pay, eligibility for state and federal unemployment insurance, Workers' Compensation coverage, and employer contributions toward Social Security and Medicare. Many employers, however, exploit the ambiguity in current government regulations to avoid contributing their share toward these worker protections by misclassifying some of their workers as independent contractors rather than as employees.

The way a worker is classified has serious implications and costs for their labor rights and economic security. When workers who are employees are misclassified as independent contractors, they lose the legal right to earn at least the applicable minimum wage and to be paid time-and-a-half for overtime hours. They are no longer eligible to participate in state and federal unemployment insurance systems or qualify for workers' compensation insurance covering treatment and benefits if they are injured on the job. They are no longer eligible for the protections in the National Labor Relations Act, which ensures workers' rights to form unions and bargain collectively to improve their working conditions. As independent contractors, misclassified workers must also assume the full financial cost of Social Security and Medicare, which is split evenly between workers and employers when workers are classified properly as employees.

Some employers and employer organizations have attempted to argue that classification as an independent contractor is preferable for many workers, who will supposedly gain some choice or flexibility over their work schedules in exchange for sacrificing foundational labor rights and employer-provided benefits. One of the reasons this line from employers remains so pervasive is that the actual cost of misclassification and its impact on individual workers' lives is difficult to quantify and easy to obscure. Previous national studies and state-level reports have provided estimates of the numbers of workers who are misclassified, the amount of wage theft experienced by misclassified workers, and the loss of income tax revenue to federal and state coffers.<sup>1</sup> A 2020 analysis from the National Employment Law Project, focusing on state-level reports on misclassification, estimated that as many as 10–30 percent of employers may misclassify their workers.<sup>2</sup>

In 2022, EPI conducted a new analysis of the costs of misclassification for 11 commonly misclassified types of jobs to illustrate how misclassification costs workers and social insurance programs alike. While misclassification can happen to any worker, because of occupational segregation and other labor market disparities people of color and immigrant workers are more likely to be in occupations where misclassification is common—such as construction and landscaping workers, home health care aides, housekeeping cleaners, or nail salon workers. Any policy conversations about worker classification status should center these types of occupations, as these workers are more likely to be misclassified, less likely to be genuine independent contractors with full control over their own work conditions, and more likely to be exposed to the harms of reduced earnings and loss of labor protections.

# The cost to workers

**Table 1** presents estimates of the cost of misclassification as an independent contractor for workers in 11 occupations researchers have identified as particularly vulnerable to illegal misclassification.<sup>3</sup>

When classified as an employee, the typical construction worker, for example, had annual earnings in 2021 of \$48,210 (column one). This includes the average value of supplemental pay (overtime, shift differentials, vacation, sick pay, and other forms of paid time off). When we include health insurance, retirement plans, and employer contributions to unemployment insurance, Workers' Compensation, and Social Security and Medicare, the full value of the job to the worker *when classified as an employee* rises to \$52,398 per year (column two). But when a worker is misclassified as an independent contractor—and loses access to legal protections, employer contributions to social insurance, and access to unemployment insurance and Workers' Compensation—we estimate that the value of that job for the typical construction worker falls to between \$35,670 and \$42,221 per year (columns three and four). The range depends on the exact assumptions we make about the degree to which the employer increases the base pay of independent contractors, if at all, to offset the fact that they are no longer providing supplemental pay, health insurance, or retirement benefits. According to our calculations, illegal misclassification costs the typical construction worker between \$10,177 and \$16,729 per year. These estimates are both conservative because we have not attempted to place a monetary value on the worker's loss, when misclassified as an independent contractor, of rights guaranteed by the National Labor Relations Act, including the possibility of union representation.<sup>4</sup>

The rest of the table shows the costs to workers in 10 other occupations. As employees, these workers had median W-2 earnings between \$25,770 and \$48,310 per year. Using our most conservative estimate, a switch to independent contractor status reduces the value of their jobs by \$4,558 (manicurists and pedicurists) to \$11,076 (truck drivers). Using equally plausible but less conservative estimates, the range of losses runs from \$6,471 to \$18,053 per year.

## The costs to social insurance

As mentioned, misclassification shifts Social Security and Medicare contributions from the joint responsibility of the employer and the employee to the sole responsibility of the individual worker. Misclassification also renders workers classified as independent contractors ineligible for participation in state and federal unemployment insurance and Workers' Compensation. This change in the legal status of workers is an important—though not singular—reason for the decline in the value of the job to the worker that we saw in Table 1. But misclassification does not just shift the full burden of social insurance to workers: It also reduces the total revenues received by the social insurance system.

Table **Summary of range of costs to workers of independent contractor status, by representative occupations, 2021 dollars**

Occupations	Median annual W-2 earnings	Value to worker, as employee	Range of value to worker of job, as independent contractor		Range of cost to worker of independent contractor status (\$)		Range of cost to worker of independent contractor status (%)	
			Low estimate	High estimate	Low estimate of cost to worker	High estimate of cost to worker	Low estimate of cost to worker	High estimate of cost to worker
<i>Construction workers</i>	\$48,210	\$52,398	\$35,670	\$42,221	\$10,177	\$16,729	19.4%	31.9%
<i>Truck drivers</i>	\$48,310	\$53,003	\$34,950	\$41,927	\$11,076	\$18,053	20.9%	34.1%
<i>Janitors and cleaners</i>	\$29,760	\$30,140	\$22,698	\$24,908	\$5,232	\$7,441	17.4%	24.7%
<i>Home health and personal care aides</i>	\$29,430	\$31,194	\$21,665	\$25,005	\$6,189	\$9,529	19.8%	30.5%
<i>Retail sales workers</i>	\$29,120	\$29,552	\$21,854	\$24,066	\$5,485	\$7,697	18.6%	26.0%
<i>Housekeeping cleaners</i>	\$28,780	\$29,147	\$21,944	\$24,081	\$5,066	\$7,203	17.4%	24.7%
<i>Landscaping workers</i>	\$34,430	\$34,869	\$26,292	\$28,849	\$6,021	\$8,577	17.3%	24.6%
<i>Customer service reps / call center workers</i>	\$36,920	\$36,673	\$28,184	\$30,328	\$6,346	\$8,490	17.3%	23.1%
<i>Security guards</i>	\$29,680	\$30,846	\$22,092	\$24,951	\$5,896	\$8,754	19.1%	28.4%
<i>Light truck delivery drivers</i>	\$29,280	\$30,883	\$21,803	\$24,999	\$5,884	\$9,081	19.1%	29.4%
<i>Manicurists and pedicurists</i>	\$25,770	\$26,099	\$19,628	\$21,541	\$4,558	\$6,471	17.5%	24.8%

**Notes:** The low estimate of the value to worker of job as an independent contractor is calculated as the occupation's median annual earnings via regular pay, which excludes supplemental pay, paid leave, and employer contributions to health insurance and retirement plans. The high estimate is calculated as regular pay plus the dollar value of employer contributions to health insurance and retirement plans. Some differences may not be exact due to rounding.

**Source:** Economic Policy Institute analysis of data from the Bureau of Labor Statistics' National Compensation Survey's Employer Costs for Employee Compensation data and the BLS's Occupational Employment and Wage Statistics data.

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Table **Summary of range of losses to social insurance of independent contractors status, by representative occupations, 2021 dollars**

Occupations	Median annual W-2 earnings	Total employer and employee contributions to social insurance, employee status	Total contributions to social insurance, independent contractor status		Total cost to social insurance programs of independent contractor status (\$)		Total cost to social insurance programs of independent contractor status (%)	
			Low estimate	High estimate	Low estimate	High estimate	Low estimate	High estimate
<i>Construction workers</i>	\$48,210	\$9,407	\$6,443	\$7,627	\$1,781	\$2,964	18.9%	31.5%
<i>Truck drivers</i>	\$48,310	\$9,345	\$6,313	\$7,574	\$1,771	\$3,031	19.0%	32.4%
<i>Janitors and cleaners</i>	\$29,760	\$5,561	\$4,100	\$4,499	\$1,062	\$1,461	19.1%	26.3%
<i>Home health and personal care aides</i>	\$29,430	\$5,313	\$3,913	\$4,517	\$796	\$1,399	15.0%	26.3%
<i>Retail sales workers</i>	\$29,120	\$5,122	\$3,948	\$4,347	\$775	\$1,174	15.1%	22.9%
<i>Housekeeping cleaners</i>	\$28,780	\$5,378	\$3,964	\$4,350	\$1,028	\$1,414	19.1%	26.3%
<i>Landscaping workers</i>	\$34,430	\$6,434	\$4,749	\$5,211	\$1,223	\$1,685	19.0%	26.2%
<i>Customer service reps / call center workers</i>	\$36,920	\$6,489	\$5,091	\$5,478	\$1,010	\$1,398	15.6%	21.5%
<i>Security guards</i>	\$29,680	\$5,092	\$3,991	\$4,507	\$585	\$1,101	11.5%	21.6%
<i>Light truck delivery drivers</i>	\$29,280	\$5,924	\$3,938	\$4,516	\$1,408	\$1,985	23.8%	33.5%
<i>Manicurists and pedicurists</i>	\$25,770	\$4,816	\$3,546	\$3,891	\$925	\$1,270	19.2%	26.4%

**Notes:** The low estimate of the value to worker of job as an independent contractor is calculated as the occupation's median annual earnings via regular pay, which excludes supplemental pay, paid leave, and employer contributions to health insurance and retirement plans. The high estimate is calculated as regular pay plus the dollar value of employer contributions to health insurance and retirement plans. For further details, see "[EPI comments on DOL's proposed rulemaking on employee or independent contractor classification under the Fair Labor Standards Act.](#)" Some differences may not be exact due to rounding.

**Source:** Economic Policy Institute analysis of data from the Bureau of Labor Statistics' National Compensation Survey's Employer Costs for Employee Compensation data and the BLS's Occupational Employment and Wage Statistics data.

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**Table 2** looks at the typical worker in the same 11 occupations as Table 1 and summarizes the estimated impact of these misclassifications on total revenues for social insurance programs (Social Security, Medicare, Workers' Compensation, and federal and state unemployment insurance). Using construction workers as an example, in 2021 the typical construction worker classified as an employee and their employer jointly contributed a total of \$9,407 toward these social insurance programs. We estimate that the total payments toward social insurance programs fall to between \$6,443 and \$7,627 per construction worker when that worker is classified as an independent contractor. This represents a decline in social insurance revenues between \$1,781 and \$2,964 per construction worker per year.

The table also shows the estimated loss in total per-worker revenue received by the social insurance system in 10 other occupations. As employees, these workers and their employers together make social insurance contributions between \$4,816 and \$9,407 per year. When these same workers are misclassified as independent contractors, the full burden of social insurance payments falls on the worker and the total revenue received by the social insurance system falls. Our low estimate suggests a decline in total per-worker revenue received by social insurance programs between \$585 per year (security guards) and \$1,781 per year (construction workers). Our high estimate puts the range of annual per-worker revenue losses between \$1,101 (security guards) and \$3,031 (truck drivers).

## Policy recommendations to combat misclassification

Policymakers at the federal, state, and local levels should act to curb misclassification and enforce the rights to which all workers should be entitled. Policymakers should:

- Establish or expand the use of a strong, uniform protective legal test for determining employee status, **such as the ABC test**;
- Pass the **Protecting the Right to Organize (PRO) Act**, which would make it harder for employers to misclassify employees in order to prevent them from forming a union and bargaining collectively;
- Strengthen enforcement of wage theft and misclassification, and fully fund the federal and state agencies responsible for enforcing workers' wage and hour rights;
- Require employers to provide workers with transparent statements of their employment status and a justification for their classification;
- Extend basic wage and hour protections, workplace health and safety protections, paid sick leave, and other protections to independent contractors to discourage misclassification as a "race to the bottom" for worker rights; and
- Improve coordination among state and federal tax and labor enforcement agencies by establishing interagency misclassification task forces with dedicated resources and staff and strong co-enforcement partnerships capable of effectively cracking down on

## Notes

1. For discussions of occupations where workers are particularly vulnerable to misclassification as independent contractors, see Annette Bernhardt, Sarah Thomason, Chris Campos, Allen Prohofsky, Aparna Ramesh, and Jesse Rothstein, *Independent Contracting in California: An Analysis of Trends and Characteristics Using Tax Data*, UC Berkeley Labor Center and California Policy Lab, March 2022; Françoise Carré, *(In)dependent Contractor Misclassification*, Economic Policy Institute, June 2015; National Employment Law Project, *Independent Contractor Misclassification Imposes Huge Costs on Workers and Federal and State Treasuries* (policy brief), October 2020; Lisa Xu and Mark Erlich, *Economic Consequences of Misclassification in the State of Washington*, Harvard Labor and Worklife Program, December 2019; Dale Belman and Aaron Sojourner, *Illegal Worker Misclassification: Payroll Fraud in the District's Construction Industry*, Office of Karl A. Racine, Attorney General of the District of Columbia, September 2019; and Russell Ormiston, Dale Belman, and Mark Erlich, "An Empirical Methodology to Estimate the Incidence and Costs of Payroll Fraud in the Construction Industry," Working Paper, January 2020.
2. See National Employment Law Project, *Independent Contractor Misclassification Imposes Huge Costs on Workers and Federal and State Treasuries* (policy brief), October 2020.
3. For discussions of occupations where workers are particularly vulnerable to misclassification as independent contractors, see Annette Bernhardt, Sarah Thomason, Chris Campos, Allen Prohofsky, Aparna Ramesh, and Jesse Rothstein, *Independent Contracting in California: An Analysis of Trends and Characteristics Using Tax Data*, UC Berkeley Labor Center and California Policy Lab, March 2022; Françoise Carré, *(In)dependent Contractor Misclassification*, Economic Policy Institute, June 2015; National Employment Law Project, *Independent Contractor Misclassification Imposes Huge Costs on Workers and Federal and State Treasuries* (policy brief), October 2020; and Lisa Xu and Mark Erlich, *Economic Consequences of Misclassification in the State of Washington*, Harvard Labor and Worklife Program, December 2019.
4. For a discussion of the methodology used here, see Heidi Shierholz, John Schmitt, and Margaret Poydock, "EPI Comments on DOL's Proposed Rulemaking on Employee or Independent Contractor Classification Under the Fair Labor Standards Act," Comments submitted on behalf of Economic Policy Institute to U.S. Department of Labor, December 2022.
5. For more on interagency misclassification task forces, see Rebecca Smith, *Public Task Forces Take on Employee Misclassification: Best Practices* (policy brief), National Employment Law Project, updated August 2020. For more on co-enforcement partnerships, see Janice Fine, Daniel Galvin, Jenn Round, and Hana Sheperd, "Strategic Enforcement and Co-enforcement of U.S. Labor Standards Are Needed to Protect Workers Through the Coronavirus Recession," *Boosting Wages for U.S. Workers in the New Economy* series, Washington Center for Equitable Growth, January 2021.