Research

Economic Costs of the PRO Act

ISABEL SOTO | JANUARY 21, 2020

The U.S. House of Representatives is expected to vote shortly on the Protecting the Right to Organize (PRO) Act (H.R. 2474). While the press and public have not given the PRO Act much attention, the bill deserves increased scrutiny as it would fundamentally change U.S. labor law and impose significant costs on our economy. The legislation seeks to strengthen labor unions and vastly increase their leverage in negotiations. The bill's provisions are a compilation of prior, mostly failed legislative initiatives, many of which faced bipartisan opposition, and regulatory actions that have been rejected by courts or subsequently revoked or modified for other reasons.

The PRO Act would, among other things:

- Significantly change the classification criteria for independent contractors (ICs) to make it harder to qualify as an IC, despite the fact that fewer than 1 in 10 ICs want to be reclassified, and such a provision potentially implicates 8.5 percent of gross domestic product and puts an additional $3.6 billion to $12.1 billion of annual upward cost pressure on employers;
- Expand the number of business arrangements subject to joint-employer liability, which would affect 44 percent of private sector employees, lead to $17.2 billion to $33.3 billion in lost annual output for the franchise business sector, and complicate many business-to-business contracts and arrangements, causing particular harm to small businesses;
- Repeal all Right-to-Work laws, stripping millions of employees of the right to refrain from joining a union, hindering private sector output, employment growth, and business migration; and
- Restrict employers from permanently replacing strikers, resulting in over $1.9 billion in total additional annual upward cost pressure.

While the stated intent behind the PRO Act is to increase worker protections, many of the bill's provisions are contrary to worker interests and ignore worker preferences. Furthermore, the PRO Act has the potential to harm employers and our economy across industries, delivering high costs that small businesses, including franchisees and entrepreneurs, may not be able to absorb.

Employer costs don't exist in a vacuum. Should this legislation be signed into law, the result will be higher prices for consumers and lost opportunities for small businesses, entrepreneurs, and workers. Before passing such a drastic change to U.S. labor law, lawmakers should seek to understand the economic costs and other tradeoffs of the legislation—many of which are at odds with the bill's purported purpose. This paper will assess the macroeconomic ramifications of the PRO Act and discuss some of the bill's other potential consequences.

Reclassification

The PRO Act would make definitional changes to the National Labor Relations Act (NLRA) in an effort to forcibly reclassify many independent contractors as employees. This reclassification would be contrary to the wishes of most independent contractors; data from the Bureau of Labor Statistics' (BLS) 2018 Contingent Worker Survey shows that, if given the opportunity, less than 1 out of every 10 independent contractors would prefer a traditional employment relationship. IC's enjoy flexibility, entrepreneurial opportunity, and a level of autonomy not typically found in hourly employment, making independent contract arrangements extremely valuable to many workers.

The PRO Act, however, would limit workers' ability to qualify as independent contractors, putting in jeopardy ICs' ability to set their own schedules, set their own prices, and in some cases even retain the small businesses they've built. The PRO Act does this by inserting what is known as the "ABC test" into the definition of employee under the NLRA. Under the test, "An individual performing any service shall be considered an employee and not an independent contractor, unless—

(A) the individual is free from control and direction in connection with the performance of the service, both under the contract for the performance of service and in fact;

(B) the service is performed outside the usual course of the business of the employer; and

(C) the individual is customarily engaged in an independently established trade, occupation, profession, or business of the same nature as that involved in the service performed."

The employer must show that the worker meets the criteria set forth under sections A, B, and C of the test for the worker to be considered an IC (hence, the "ABC test").

Businesses of all sizes and across industries rely on the work of independent contractors. Imposing the ABC test on these industries would inject uncertainty and cause a mass reclassification of workers from ICs to employees. The result would be large-scale changes to business models, significant costs for companies and consumers, and a reduction in flexibility, autonomy, and opportunity for many workers. AAF used BLS' 2018 Contingent Worker Survey, the breakdown of independent contractors by industry and occupation, and BLS' 2019 Employer Costs for Employee Compensation data to estimate the additional costs associated with different levels of worker reclassification. Assuming a conservative 15 to 50 percent of ICs would be reclassified as employees under the ABC test, we could see between $3.6 billion and $12.1 billion in additional costs to businesses. Most recently, the ABC test became part of California labor law through Assembly Bill 5 (AB 5), and previous AAF research found that a national version of AB 5 could put up to 8.5 percent of gross domestic product (GDP) at risk.

The percent of ICs reclassified could be much higher than 50 percent, however, given that the PRO Act does not include exemptions for certain industries that are included in AB 5. The companies garnering the most attention under AB 5 and similar measures have been app-based referral services, such as Uber, Lyft, and DoorDash. This fast-growing industry is extremely popular with both consumers and those who choose to earn money through the referral platforms. While the entire app-based referral industry could be negatively impacted by the ABC test, they would not be alone; construction, professional and business services, trucking and transportation, education, and the service industry would also be strongly and negatively impacted by the legislation given the high density of independent contractors in those industries.

Courts have interpreted the ABC test in California to apply to franchise relationships as well. If the PRO Act's reclassification provision applies to franchising, the impact would be even more substantial. The International Franchise Association voiced its concern over the test when it was being considered in California, stating, "A.B. 5 could mean the death of the franchise model."[1] The core strength of the franchise model lies in the franchisor providing support and brand recognition to its franchisees, but franchisees may not meet the criteria outlined in the ABC test, potentially converting the franchise relationship into an employment relationship. The parent company will in turn face increased liability for its franchisees. Such liability incentivizes the parent companies to rescind the support they provide to franchisees or end their use of the franchise model entirely.

Broadening the Joint-Employer Standard

The PRO Act would make significant changes to the joint-employer standard under the NLRA. In short, joint-employer rules determine when two or more employers are jointly responsible for the same employees. Take, for example, the relationship between a construction company and a subcontractor. If the construction company is deemed a joint employer, it would be held liable for any NLRA violations committed by the subcontractor.

For decades, it was very clear under the NLRA who was and who was not a joint employer. In 2015, however, the National Labor Relations Board (NLRB) issued its decision in *Browning-Ferris Industries* (*BFI*), muddling the issue by inserting vague terms into the definition in an effort to drastically expand the standard. Prior to this decision, a company was a joint employer if it exercised *immediate* and *direct* control over the employees of another company. The *BFI* decision expanded joint employment to situations where a company only had *indirect* or *potential control* over a group of another company's employees. The NLRB struggled to provide clear guidance on implementing the *BFI* standard, and the Board is currently revisiting the standard through rulemaking. The distinction between direct and indirect control has substantial impact on the economy, particularly given the nebulous nature of terms *potential* and *indirect* control. AAF research found that the broadened joint-employer standard would impact 44 percent of private sector employers or 54.6 million workers.

Depending on its scope, the joint-employer standard can impact a variety of business-to-business relationships, including contractors, subcontractors, and franchisees. A broad and vague standard, such as the one in *BFI*, makes it more difficult for companies to impose minimum standards on their subcontractors and vendors and for franchisors to assist franchisees with a host of business issues without triggering possible joint employment liability. As a result, the standard incentivizes companies to change how they structure relationships and source work. Specifically, the *BFI* joint-employer standard incentivizes firms to either impose complete control by bringing work in-house or totally separate from vendors, franchisees, or contractors by refusing to set any standards or offer any guidance. In either case, those who are hurt most are small businesses, their employees, and the ICs who rely on outsourced work from larger companies.

The franchising model would be hit especially hard by the broadened standard. Under this model the franchisor typically provides important support to its franchisees in the form of training and advising. Under the *BFI* definition, that support could classify franchisors as joint-employers, so they are likely either to stop providing the help they can offer under the narrow definition or to take a much more active role and ultimately end franchise agreements. Not only does this change affect those who already own franchises, but it would likely lower franchise ownership overall due to the increased risk that would come with franchisors not providing support and services. Research done by Dr. Ronald Bird finds that the broadened joint-employer standard would lead to an annual loss of economic output totaling between $17.2 billion and $33.3 billion for the franchise business sector. This change will devastate the franchise model, one that has seen higher employment growth rates than non-franchises and that has created 10.9 percent of new private sector jobs since 2012.

Repealing Right-to-Work

The PRO Act would repeal Right-to-Work (RTW) laws across the country, which protect workers' right to refrain from joining a union as a condition of employment. In the absence of such laws, workers could be required to pay union fees or risk losing their jobs.

RTW legislation has been around since 1947 when section 14(b) of the Taft-Hartley Act gave state governments the power to outlaw mandatory union fees or membership as a condition of employment. There are currently 27 RTW states in the country. RTW laws ensure that workers are not forced to pay fees to an organization with whom they do not agree or that they believe does not provide them with a service. RTW laws not only give more power to workers but also keep unions accountable to those they represent.

Existing data also shows how RTW states perform in relation to non-RTW states and just how crucial these laws are to worker freedom and economic growth:

- Between 2001 and 2016, RTW states saw a 37.6 percent increase in real private-sector output, compared to non-RTW states that only saw a 28.5 percent change in output;
- During this same timeframe, RTW states saw 26.7 percent employment growth compared to non-RTW growth of 15.4 percent; and
- From 2001 to 2015, the number of firms increased by 10.2 percent in RTW states and only 2.8 percent in non-RTW states.

Replacing Striking Workers

The NLRA is carefully crafted to allow unions and employers to use economic weapons, such as strikes and lockouts, to settle disagreements, but the law appropriately places limits on both parties' reliance on such weapons in order to contain the impact on the economy.

The PRO Act would disrupt this balance by removing employers' ability to permanently replace striking workers, regardless of the length of the strike or attempts at bargaining. This provision, along with several others, would shift bargaining power strongly in favor of unions, leaving employers with little choice but to accept union demands, even if such demands could risk long-term viability of the company. Not allowing employers to permanently replace striking workers could incentivize an increase in the instances of strikes, drive up prices, and consequently destroy businesses that do not have the resources available to defend themselves against large-scale attacks by organized labor.

The economic impact of this provision could be massive. Based on BLS data of major strikes in the last year and state productivity data, over $1.9 billion of output could be implicated annually as a result of this specific PRO Act provision. That said, BLS only provides data on strikes in which more than 1,000 workers participate, so the true figure could be significantly higher when accounting for strikes where fewer workers are involved. Additionally, there is no way of knowing the extent to which this provision could incentivize unions to strike more often.

Additional Provisions

There are a number of other regulations and changes to U.S. labor law that would likely increase estimated costs and harm both employers and their workers.

Worker Privacy and Choice

It's odd that a bill intended to protect workers would include provisions that limit worker choice and infringe on their privacy, but the PRO Act contains numerous provisions that would do just that.

The PRO Act's card check provision greatly diminishes employees' right to a secret ballot when choosing whether or not to be represented by a union. Secret ballot elections would be replaced in many circumstances with "card check," a system that forces employees to sign union authorization cards in front of coworkers and union organizers. Allowing card check eliminates the privacy that comes with a secret ballot and would enable unions to pressure workers into signing authorization cards. Secret ballot elections have been a cornerstone of workers' rights and an integral part of labor relations since the earliest days of the NLRA. Efforts to impose card check on union representation elections have been tried in the past, and they were defeated on a bipartisan basis by Congress when Democrats controlled both chambers.

Another PRO Act provision would codify the NLRB's "Ambush" Elections Rule, which greatly shortened the timeframe for union representation elections, diminishing employees' opportunity to hear about potential downsides of union representation or problems with the union that is seeking to represent them. Additionally, the PRO act requires employers to provide union organizers with employees' *private* personal contact information, including phone numbers, email addresses, home addresses, job classification, and even assigned shifts. The NLRB recently revisited aspects of the Ambush Rule and has proposed additional changes to the election rules to help protect the freedom of worker choice.

Additional Complications

The Ambush Rule would also strip employers' right to address key issues affecting an election, such as which employees should be in the bargaining unit, before the election is held. This change is a liability trap for employers, who could accidentally violate the law as a result of mistakenly regarding an employee as a supervisor, and is misleading for employees, who will not fully understand the make-up of the bargaining unit prior to voting.

The PRO Act would also codify the Department of Labor's defunct Persuader Rule, which was withdrawn by the Department after being struck down by several federal courts. The rule was widely criticized, including by the American Bar Association, for its interference with attorney-client confidentiality and negative impact on employers' ability to find counsel.

Furthermore, the PRO Act would allow unions to protest and boycott companies that are not directly involved in a labor dispute by eliminating the NLRA's 70-year ban on secondary boycott activity. If this provision is signed into law, unions could target not only the employer involved in a labor dispute but also any company that does business with that employer. For example, if a grocery store and a union representing its employees had a dispute, the PRO Act would allow the union to disrupt the operations of the local bakery that provides the store with bread. A union might target this bakery, because it is smaller and less equipped to withstand boycotts and reputational attacks than the grocery store. The more companies the union targets, the more other businesses, the public, and politicians will pressure the employer involved in the labor dispute to acquiesce to the union's demands and end the dispute.

Broad Impacts

Taken together, the PRO Act's provisions are collectively designed to greatly expand union leverage at the bargaining table. The PRO Act achieves this goal by diminishing employee and employer rights and making fundamental changes to labor law that would likely damage the economy.

In addition, dramatic increases in union density could itself have negative consequences for the economy. Previous AAF research found statistically significant evidence that growth in union density is associated with a decline in the growth rates of a states' real GDP, number of jobs, weekly earnings, and total wage earnings. An increase of one percentage point in union membership rates is associated with a reduction of 0.25 percentage points of a state's real GDP growth rate. Additionally, declines in union density in a state led to benefits for both GDP and workers:

- an additional $115.9 billion in real economic output;
- 393,189 additional jobs;
- an average $6.08 increase in weekly earnings; and
- an additional $35.1 billion in total wage earnings.

A rapid increase in union density could be even more problematic if it occurs in industries that have not typically experienced unionization or where unionization may not be a good fit because of low barriers of entry, low cost of labor-replacing technology, or other economic alternatives that result in fewer domestic job opportunities. The rapid unionization that the PRO Act could usher in could hurt employees, employers, consumers, and the economy, as it could generate major disruptions in jobs and declines in economic growth.

Conclusion

By increasing union leverage at the expense of small businesses, GDP growth, and workers, the PRO Act has the potential to do serious harm. It is a flawed approach that promises negative consequences for the economy and the rights of workers and employers alike.

[1] See International Franchise Association letter to California State Legislature at 1 (August 27, 2019) (available at https://www.franchise.org/sites/default/files/2019-08/IFA%20CA%20Coalition%20Letter%208.27.19_0.pdf).