

**The Economic Costs
of
Employee Misclassification
in the
Construction Industry**

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Why Should You Care?

FREE MARKETS REQUIRE FAIR MARKETS!

- **Misclassification allows unfair contractors to sabotage a competitive bidding process;**
- **Misclassification allows unfair contractors to decrease payroll costs as much as 15-30%;**
- **Misclassification allows unfair contractors to reduce their unemployment insurance tax;**
- **Misclassification allows unfair contractors to reduce their workers compensation premiums;**
- **Misclassification allows unfair contractors to reduce social security contributions;**
- **Misclassification allows unfair contractors to reduce their administrative payroll costs;**
- **Misclassification forces higher overall workers compensation premiums onto fair contractors.**

The Scope of a Study

- **Studies begin with data collected from unemployment insurance (U.I.) audits in a given state. Though reliable, this understates the problem.**
- **Some states are more “friendly” than others. Time and cost to obtain data.**
- **Data systems vary from state to state.**
- **De-identified data is mandatory.**
- **Different definitions of ‘Ind. Contractor’**

Misclassification: Definition

- Employee misclassification is defined as the case where employers treat workers as independent contractors that would otherwise be wage or salaried employees. If an employee is classified as an independent contractor, the employers are not required to pay a variety of payroll costs (e.g. social security, unemployment insurance, workers compensation insurance, etc.) and the independent contractor is not fully protected by various labor laws (UI, union, etc.)

Misclassification: The Problem

Misclassification negatively impacts society in several ways.

- The conditions for a fair and competitive marketplace are sabotaged. Firms that misclassify can reduce payroll costs by as much as 30%. Honest employers suffer a distinct competitive disadvantage. **Misclassification allows employers who violate state statutes to be rewarded.**
- “Gaming the system” - (1) Sub-Subs and Labor Brokers
(2) Exploitation of the ‘undocumented’
(3) H2B-Visa scams
- Workers who are misclassified also suffer. If a worker needs to apply for unemployment insurance benefits, they may be denied those benefits, since there may be no record of them having worked. Again, the violating employer is rewarded because the laid-off employee is not charged to their unemployment insurance account. Other protections and labor rights are also voided.
- States lose substantial revenues (UI taxes, income taxes, WC tax)

Example: Lost state revenues due to misclassification for all industries (2001-2003): Massachusetts

- **State Income Taxes: \$91 to \$152 Million**
- **Unemployment Insurance Taxes: \$13 to \$35 Million**
- **Workers Compensation Premiums not paid: \$91 Million**

-- “Independent Contractors” -- Growing and Out of Control

- Workers with “**alternative**” work arrangements make up an increasing percentage of the workforce -- 11.0% of the total workforce in February, 2005.
- The BLS defines alternative work arrangements as:
 - (1) independent contractors [**70% of total**]
 - (2) on-call workers
 - (3) temporary help agency workers
 - (4) workers provided by contract firms.
- **An examination of independent contractors by industry showed that the construction sector accounted for 22.0% of all independent contractors, the highest level of concentration of independent contractors in all industries.**

Misclassification: A Growing Problem

Misclassifying employees as independent contractors is a growing problem in states around the nation. Recent studies have shown that misclassification by employers is increasing.

In a report by the National Employment Law Project, it was reported that US DOL quarterly audits found 30,135 employees misclassified in 2002. This was a 42% increase from the prior year.

A Construction Industry Problem

- **Several studies have shown the problem of misclassification to be particularly acute in the construction sector.**
- Projections show that for the period from 2004-2014 the growth in construction employment is projected to increase 11.4%. Add to this the growing impact of unauthorized immigration, which now accounts for 14% of total construction employment [according to the non-partisan PEW Hispanic Center].
- Even if illegal employer behavior were to hold steady on this issue, these other two factors will insure that the problems caused by misclassification in the construction industry will only get worse.

Employers That Misclassify

- When an employer practices misclassification the results show that this behavior is pervasive.
- 28.8% of workers are misclassified by employers that were found to be misclassifying for the period 2001-2005.
- The rate of misclassification for violating employers had increased 21% from 2001-2005.

Impact on State Income Taxes

- According to the IRS, wage earners report 99% of their wages; **non-wage earners (such as independent contractors) report approximately only 68% of their income (conservative estimate).**
- This loss in revenue could be used to fund future construction projects, balance state budgets, restore social program spending cuts and other essential services.

Role of Workers' Compensation

- **The costs of workers' compensation is the single most dominant reason why employers misclassify** (Planmatics, 2000)
- **High rates in the construction industry.**
- **The abuse of 1099's by employers further destroys the fairness and legitimacy of the bidding process.**

Worker's Comp. in Construction

- **Workers compensation premiums are much higher in the construction trades.** For example, in Illinois the statewide rate for all industries is less than \$3.00 (per \$100 of payroll). However, within construction, rates can range from \$8.01 for electrical wiring to \$27.94, per \$100 of payroll, for concrete construction.
- Using an average rate of \$15 per \$100 of payroll, **we estimate \$34.8 million in lost workers compensation premiums from the construction trades in Illinois annually.**

Troubling Associated Costs

- Workers who are misclassified do not receive pension or health insurance benefits
- The lack of health insurance coverage exacts a large toll on the uninsured – the costs borne by the uninsured include a greater probability of avoidable deaths, reduced preventive care, and a smaller likelihood of early detection of medical problems.
- 33 percent of emergency room visits were for health reasons that did not require emergency room care and could have been avoided.

Tremendous Societal Costs

- The health system also bears an economic cost as well. It is reported that \$34.5 billion in uncompensated care was received by the uninsured in 2001.
- Taxpayers also bear economic costs of the uninsured and underinsured. Federal, state, and local governments support care of the uninsured through public clinics, and payments to certain care facilities that care for the poor and uninsured.
- The Commonwealth Fund reported that these intergovernmental (taxpayer) expenditures were approximately \$30.6 billion annually.
- Safety concerns - Misclassification leads to under-reporting of injuries (especially re: 'undocumented')
- Hispanics = most injured ethnic group (construction)

Injuries: Human and Economic Burdens

- **Direct costs (reported):** lost earnings and health care expenses related to occupational injury and disease.
- **Indirect costs borne by employers:** additional hiring and training costs, disruption of work, damaged equipment, and the effects of workplace injuries on the productivity of co-workers who feel heightened risk.
- **Indirect costs borne by the injured workers and their families:** loss of other income, depletion of savings, reduced standard of living; increased expenditures for professional therapy and caregiver services in the home; home modifications and equipment related to disability; and deferral or loss of education for family members.
- **Additional costs** may fall on the community in the form of increased need for social service programs.

Partnering with Academics

- **We conclude that misclassification is an increasing problem and the operation of fair, competitive markets are compromised when the bidding process is undermined by the practice of misclassification.**
- **Every state should benefit from better documentation on misclassification along with measures that help to improve compliance with the state and federal laws.**

Partnering with Academics

- **We have had the opportunity to become involved in the issue of misclassification in both the state of Illinois and in Kansas**
- **We have provided research in both states and have testified to both houses of the legislature in Kansas**
- **Positive results from changes in the law in Kansas (info sharing, revenue)**

Good News for Illinois

- Along with expressions of concern from the office of Illinois Governor Blagojevich, Lisa Madigan, the Illinois' Attorney General, has announced that due to our research on this topic she intends to create a special task force to tackle the growing problem of employer misclassification in the state of Illinois.
- Other state agencies slated to be involved are the Department of Labor, Department of Revenue, and the Department of Employment Security, among others, in addition to the Attorney General's office.
- We congratulate the State of Illinois for taking this stand. This is the kind of impact that academic research can have for the benefit of working people.