

Worker Misclassification Has Reached Epidemic Proportions in the Pennsylvania Job Market

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Chair Muth and other members of the committee, thank you for the opportunity to testify at this important hearing. My name is Stephen Herzenberg. I hold a PhD in economics from MIT and am the Executive Director of Keystone Research Center. Our mission is to promote a more prosperous, equitable, and sustainable Pennsylvania economy, and a vibrant and responsive Pennsylvania democracy that will make possible a politics and economy that work for all. My testimony today starts with an overview of the widespread problem of worker misclassification in the United States and, in the construction industry--to the limited extent that data and research exist—in Pennsylvania. I then turn to the central question for your policy committee—what to do about this problem.

In the context of a federal administration that shares a deep concern with worker misclassification—and with the erosion of workers' union rights and labor standards over decades—and in the context also of an upcoming Pennsylvania gubernatorial race, now is an excellent time for this conversation. Your committee can play a central role in reining in worker misclassification as well as restoring balance between employers and workers more generally, using a methodical approach that seeks to reshape competition in more constructive directions sector by sector. I commend you for your leadership and your commitment to playing that role.

As you know, whether people are considered employees or independent contractors has significant consequences for workers, businesses, and governments. In the United States, workers who are classified as independent contractors:

- Are not covered by worker protection laws such as wage and hour laws, anti-discrimination laws, and laws providing collective bargaining rights.
- Do not receive unemployment benefits when they lose a job.
- Do not receive workers' compensation when injured on the job.
- And must pay the full payroll tax contribution to federal Social Security and Medicare programs

Whether workers are legally independent contractors depends on a set of legal tests related to how much autonomy workers' have in the direction of their work. For example, one legal test used by some states—but not Pennsylvania—is the three-part “ABC test.” Under this test, to be a legitimate independent contractor, the work must be:

- Done without the direction and control of the employer.
- Performed outside the usual course of the employer's business; and
- Done by someone who has their own, independent business or trade doing that kind of work.

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*Misclassification of Workers Is Widespread in the Construction Industry, Including in Pennsylvania*²

As early as 1984, Rice University economist Donald Huddle suggested that construction workers in Texas were being treated as independent contractors so that employers could avoid paying taxes.³ He claimed that one-third of all commercial construction jobs in the Houston area were filled by undocumented workers from Mexico, Central America, and South America.

The use of misclassification was expanded by the passage of the 1986 comprehensive Immigration Reform and Control Act (IRCA), a bill intended to stem the flow of migrants entering the United States from Mexico. Many business associations opposed IRCA because it contained penalties against employers who knowingly hired undocumented workers, but the legislation had an unintended consequence. Since the employer sanctions were only triggered if the new hires were employees, one alternative was to hire workers as independent contractors. A 1987 Associated General Contractors (AGC) Q&A sheet on the new law asked a rhetorical question: “What if I decide just to give up and have no one in my business other than independent contractors and leased employees?”⁴ In the wake of IRCA, immigration and misclassification became inextricably linked.

Between 1990 and 2000, the proportion of Hispanic male workers in construction increased four times as fast as the increase of white male workers.⁵ By the end of 2006, nearly one-third of recently arrived foreign-born Hispanics were working in construction, predominantly in the South and, to a slightly lesser extent, in the West.⁶ The Center for Migration Studies and the Migration Policy Institute estimated there were 1.7 million undocumented workers in Texas alone in 2014, 24% of whom worked in construction.⁷ Undocumented immigrants made up 15% of the total national construction workforce, outnumbering immigrant workers with valid working papers.⁸

By 1999, the Sheet Metal and Air Conditioning Contractors’ National Association (SMACNA), an association of unionized contractors, described the misclassification of employees as “an epidemic in the construction industry.”⁹ Union companies cannot misclassify workers since collective bargaining

² This discussion of the construction industry is based primarily on Mark Erlich, “Misclassification in Construction: The Original Gig Economy,” *ILR Review* 74(5): 1202-1230, October 2021; <https://journals.sagepub.com/eprint/IYFRNACS397W9HGEYTNF/full>.

³ “Crackdown on illegal aliens—the impact,” *U.S. News & World Report*, July 2, 1984.

⁴ Louis Hyman, *Temp: How American Work, American Business, and the American Dream Became Temporary* (New York: Viking), p. 252.

⁵ Rakesh Kochhar, “The occupational status and mobility of Hispanics,” Pew Research Center, December 15, 2005; <https://www.pewresearch.org/hispanic/2005/12/15/the-occupational-status-and-mobility-of-hispanics/>.

⁶ Pew Research Center, “Construction jobs expand for Latinos despite slump in housing market,” March 7, 2017.

⁷ Robert Warren, “US undocumented population drops below 11 million in 2014, with continued declines in the Mexican undocumented population,” *Journal on Migration and Human Security*, 4(1): 1–15, August 8, 2018; <https://journals.sagepub.com/doi/10.1177/233150241600400101>.

⁸ Jeffrey Passell and D’Vera Cohn, “Occupations of unauthorized immigrant workforce,” Pew Research Center, November 3, 2016.

⁹ BNA Construction Labor Report, Bureau of National Affairs. Newsletter, April 28, 1999.

agreements require that their workforce be employees. For non-union contractors that already paid lower wages and provided minimal benefits, however, the temptation to realize significant labor cost savings and to further extend the compensation gap and competitive edge became virtually irresistible. Contractors can save up to an estimated 30% through avoidance of overtime payments and taxes (for unemployment insurance, Social Security, and Medicare), and circumventing workers' compensation costs required for workers classified correctly as employees.¹⁰ According to the Bureau of Labor Statistics, "Although independent contractors represent only 7% of the total national workforce, roughly 20% of all independent contractors work in construction."¹¹

The most recent and comprehensive national study suggested that, in 2017, between 12.4% and 20.5% of the construction industry workforce (1.3 to 2.2 million workers) were either improperly classified as independent contractors or employed informally off-the-books.¹² Depending on worker income assumptions, the study concluded that fraudulent employers may have realized between \$6.2 and \$17.3 billion in labor cost savings, an amount lost annually to state and federal coffers as well as workers' compensation insurers. Using the standard 4% rule in Pennsylvania (i.e., the Pennsylvania population was 3.9% of the U.S. population in 2019), this range translates into \$248 to \$692 million in labor cost savings in Pennsylvania.

In on part of a January 2019 report, Keystone Research Center surveyed the growing national literature on the extent of worker misclassification and other labor standards violations in construction.¹³ While the research and data on Pennsylvania specifically are sparse, the other half of the report also brought together suggestive evidence that worker misclassification has also become widespread in our state.

For example, the number of cases pursued under Act 72, the Pennsylvania Construction Worker Misclassification Act rose from an average of 28 between 2011 and 2014, in its first four years under Governor Corbett, to 190 on average from 2015 to 2020 (182 or more from 2015 to 2018 but only 72 in 2020, presumably because of the pandemic).¹⁴ Administrative penalties equaled \$12,700 in 2014, the first year they were imposed, and an average of \$397,299 from 2015 to 2020. Even with this increased

¹⁰ The weakening and repeal of state prevailing wage laws is a well-known component of how policy enabled the spread of worker misclassification in construction. Less well known is the enactment in 1978 of Section 530 of the Revenue Act of 1978, when Democrats had a 292-143 margin in the U.S. House, a 61-38 margin in the U.S. Senate, and held the presidency. This Act, and amendments in 1982—with a 243-192 Democratic majority in the U.S. House—responded to companies who complained the IRS was imposing costly reclassification penalties when determining if independent contractors were really employees. Congress granted a "safe harbor" to employers that had a "reasonable basis" for treating workers as non-employees—giving a green light to the spread of independent contractors. For more detail, see Erlich, "Misclassification in Construction."

¹¹ United States Bureau of Labor Statistics, "Contingent and Alternative Employment Arrangements News Release," June 7, 2018; <https://www.bls.gov/news.release/conemp.htm>

¹² Russell Ormiston, Dale Belman, and Mark Erlich, "An empirical methodology to estimate the incidence and costs of payroll fraud in the construction industry;" Accessed at <http://stoptaxfraud.net/wp-content/uploads/2020/03/National-Carpenters-Study-Methodology-for-Wage-and-Tax-Fraud-Report-FINAL.pdf>.

¹³ Stephen Herzenberg and Russell Ormiston, "Illegal Practices in the Philadelphia Regional Construction Industry," Keystone Research Center, January 2019; <https://www.keystoneresearch.org/sites/default/files/KRC%20Illegal%20Labor%20Con%20Final.pdf>.

¹⁴ Jennifer Berrier, Acting Secretary, Pennsylvania Department of Labor & Industry, "Administration and Enforcement of the Construction Worker Misclassification Act," March 1, 2021; <https://www.dli.pa.gov/Individuals/Labor-Management-Relations/llc/act72/Pages/default.aspx>.

activity, enforcement driven by worker complaints—with the most vulnerable workers least likely to complain—only scratch the surface of the worker misclassification problem.

Studies of worker misclassification in other states suggest that, if Pennsylvania has rates of misclassification in the construction industry comparable to those in other states, it loses about \$10 million in unemployment insurance taxes, at least \$15 million in income tax revenues (and possibly three times as much), as much as \$83 million in workers compensation premiums, and \$200 million in federal income taxes.

In recently published research based on interviews with 96 immigrant workers from 2006-2010, Iskander and Lowe found that the small-scale contractors and free-lance ‘flippers’ who predominate in city of Philadelphia housing construction and renovation rely primarily on a labor market that is largely informal—i.e., it operates essentially outside the boundaries of US labor law.¹⁵ In a variation of classic “piece work,” workers in crews of two to six would receive materials at the beginning of the day and be told, “I’ll be back in six hours. I’ll give you \$X.”¹⁶ Other workers lived in unfinished buildings in exchange for rehabbing them. Beyond misclassification, these cash economy workers are beyond the reach of U.S. labor standards. This makes it difficult—perhaps impossible—for contractors who seek to abide by the law to compete.

Iskander and Lowe also documented high rates of injury on the job in Philadelphia residential construction. “Fully a third” of workers that they interviewed suffered injuries on the job that took them out of work for a week or more. Injuries resulted partly from the use of unfamiliar power tools and partly from inadequately designed scaffolding. The city’s Department of Licenses and Inspections staff, officially responsible for compliance with permitting requirements and building codes, but nonetheless with expertise on safety, would end up in the unfamiliar role of providing on-the-spot advice on how to improve scaffolding or strengthen temporary retaining walls built on demolition jobs. “‘A lot of contractors will put their employees in positions that make us cringe,’ explained one inspector, ‘and that is when L&I will issue stop work orders to get people out for their own safety.’”¹⁷

Misclassification of Workers Is Rampant in Other Sectors Too

Worker misclassification is by no means limited to the construction industry. For example, research by Steve Viscelli has documented that misclassification is rampant in the trucking industry.¹⁸

¹⁵ Natasha Iskander and Nichola Lowe, “The Transformers: Immigration and Tacit Knowledge Development,” NYU Wagner Research Paper No. 2011-01, p. 17; <file:///C:/Users/herzenberg/Downloads/SSRN-id1745082.pdf>. See also Natasha Iskander and Nichola Lowe, “Building Job Quality from the Inside-Out: Mexican Immigrants, Skills, and Jobs in the Construction Industry,” *Industrial and Labor Relations Review*, Vol. 66, No. 4, Special Issue on Job Quality (July 2013), pp. 785-807; <https://journals.sagepub.com/doi/10.1177/001979391306600403>.

¹⁶ This paragraph is based on Natasha Iskander and Nichola Lowe, “Turning rules into resources: Worker enactment of labor standards and why it matters for regulatory enforcement,” *ILR Review*, 74(5), October 2021, pp. 1258–1282.

¹⁷ Iskander and Lowe, “Turning rules into resources,” p. 1275.

¹⁸ Steve Viscelli, “Truck Stop: How One of America’s Steadiest Jobs Turned Into One of Its Most Grueling,” *The Atlantic*, May 10, 2016; <https://www.theatlantic.com/business/archive/2016/05/truck-stop/481926/>. See also Steve Viscelli, *The Big Rig: Trucking and the Decline of the American Dream*, University of California Press, 2016.

Misclassification emerged in long-haul trucking in the wake of the late 1970s industry deregulation under President Jimmy Carter. In the regulated industry, “truckload” service, in which a driver delivered a load filling the entire truck from point A to point B, co-mingled with “less-than-truckload” (LTL), which combines shipments from multiple customers that each fill less than a full truck. LTL trucking requires investment in intermediate locations where shipments from common origins are disassembled and then reassembled into shipments going to common destinations. Once the industry deregulated, truckload could no longer shoulder part of the capital cost for the unnecessary intermediate locations and became a distinct industry segment. Particularly with loads in which quality and service were not major considerations (shipping potatoes from Maine to New Jersey), the name of the game became how little could you pay the driver per hour.

In combination with deunionization, the race to the bottom in long haul trucking led to plunging wages and long hours of work as drivers attempted to maintain their weekly income. Lower wages and longer hours and extended periods away from home contributed to rising turnover. Partly in response to the challenges of holding onto workers, companies began to lure existing or inexperienced drivers into the industry as independent contractors, marketing the “freedom” of controlling your own hours and buying your own truck. By fronting drivers the cost of training to acquire a Commercial Drivers’ License—but then requiring drivers to pay this cost, plus heavy interest, if they left before a prescribed time—trucking companies could cut turnover among new drivers, turning them de facto indentured servants or “sharecroppers on wheels.” While independent contractors in name, these drivers are often restricted to working for their only customer—their employer—that wants drivers available for long hours and on call (i.e., immediately when needed).

We are not aware of Pennsylvania-specific research on misclassification in the trucking industry. As we recommend below, the state’s Misclassification Task Force and Wolf Administration, together with the city of Philadelphia, city of Pittsburgh, and office of the Attorney General should seek to plug the misclassification information hole in Pennsylvania in this industry—and others—with help from the Biden Administration.

Misclassification Is Also Widespread in Other Sectors

In recent testimony to the Pennsylvania Misclassification Task Force, Sarah Schalman-Bergen, Esq., also a Board member of the Keystone Research Center, noted that:

- According to a report commissioned by the U.S. Department of Labor, an estimated 30% of employers have misclassified workers.
- Misclassified workers are disproportionately workers of color.
- Workers are misclassified by employers in many occupations and industries, including janitorial services, trucking and transportation, retail, gig workers, hospitality, home care, and construction.¹⁹

Ms. Schalman-Bergen also noted that:

- A 2008 study found that 9% of PA’s workforce—580,000 workers—are misclassified as independent contractors each year.

¹⁹ National Employment Law Project (NELP), “Independent Contractor Misclassification Imposes Huge Costs on Workers and Federal and State Treasuries,” October 26, 2020; <https://www.nelp.org/publication/independent-contractor-misclassification-imposes-huge-costs-workers-federal-state-treasuries-update-october-2020/>.

- Misclassification resulted in a loss of over \$200 million to the unemployment compensation trust fund, and \$81 million to workers compensation system. (As noted above, extrapolating the newest national study of construction indicates that losses of this order of magnitude result from misclassification in construction alone.)
- A 2016 review of 4,061 audits identified 29,327 misclassified workers, and \$11.1 million in unreported taxes.

As suggested by the parenthetical sentence at the end of the second bullet above, these studies likely undercount the pervasiveness of the problem.

Pushing Back Against Misclassification

Serious push back against misclassification began to emerge toward the end of the second Obama Administration, under U.S. Department of Labor Wage and Hour Administrator David Weil, only to be abandoned and reversed under President Trump. Since then, progressive states have taken the lead, along with—including in Pennsylvania—some Attorneys General and cities.²⁰ Increased enforcement has been coupled with more creative partnership with unions and workers centers, and, in construction, the establishment of the Pennsylvania Foundation for Fair Contracting (<https://www.paffc.org/>) in 2016 by the union side of the construction industry. The potential now, with the Biden Administration in place, is for a federal-state-local—and public-private partnership—to root out misclassification. Pennsylvania needs to get on board this reform train.

Below is an expanded menu of options, relevant today including to the misclassification task force, to gubernatorial and legislative candidates next year, and to a new Governor and legislature beyond 2022. We welcome questions and further discussion about these and related options.

1. Complete a Robust Report of the Joint Task Force on Misclassification of Employees

One step the Pennsylvania legislature has already taken—and deserves credit for—is the establishment of the Joint Task Force on Misclassification of Employees (<https://www.dli.pa.gov/Individuals/Labor-Management-Relations/Ilc/Pages/Misclass.aspx>). We urge the Task Force to take a broad look at the problem of misclassification—drilling down on the problem in construction but also recognizing that it exists in other industries. We also urge the Task Force to take full advantage of the national research community with expertise on the industry. Keystone Research Center would welcome an opportunity, even with the Task Force well along in its duties, to assist the Task Force in accessing assistance, including from national experts such as Mark Erlich and Steve Viscelli, both collaborators on research projects with our organization. (As part of a KRC project on the “Future of Work,” a May 2021 digital forum on construction organized by the Keystone Research Center, “Building Forward Better in the Construction Sector” included participation of national researchers, advocates, and union leaders in

²⁰ For a more extended, although still brief, discussion of this reform movement, see Erlich, “Misclassification in Construction,” the section entitle, “The Response to Misclassification, the Absence of a Federal Agenda, and the Emergence of State Initiatives.” One consequence of the increased enforcement activity by the Pennsylvania Attorney General was a settlement in the Hawbaker case in which a contractor agreed to pay \$20 million to over a thousand Pennsylvania workers for violating state prevailing wage laws. See “Hawbaker sentenced, will pay workers more than \$20 million in stolen wages,” Office of Attorney General Josh Shapiro, <https://www.attorneygeneral.gov/taking-action/press-releases/hawbaker-sentenced-will-pay-workers-more-than-20-million-in-stolen-wages/>.

construction, along with top USDOL officials: former and current Biden Administration nominee for Wage and Hour Administrator David Weil, principal deputy administrator Jessica Looman, former executive director of the Minnesota building trades; and Patricia Smith, special assistant to USDOL Secretary Walsh.)

2. Strengthen Commonwealth-Attorney General-City and Public-Private Collaboration to Increase Enforcement

Over the past few years, the Commonwealth, Pennsylvania Attorney General, and City of Philadelphia have stepped up their enforcement of labor standards, the latter two entities each opening a new office focused on enforcement. In addition, Bucks County and the township of Warminster in Bucks have enacted responsible contractor ordinances. With the Biden Administration in place, the Commonwealth should initiate a more formal coordinated effort among these entities, and with private industry stakeholders and class-action lawyers.

3. Take an Industry-Specific Approach to Misclassification and to the Broader Challenge of Promoting “Constructive,” High Road Competition

Misclassification—and other violations of labor standards—emerges out of industry-specific competitive dynamics as the examples of construction and trucking above indicate. Misclassification is not a discrete problem but a manifestation of the holistic influences on how competition takes place, and how workers are treated, and utilized, in each industry. Attempts to enforce laws against misclassification should therefore be integrated with all the other ways that government touches industries—procurement, protection of union rights, funding including allocation of economic and workforce development funds, tax policy. Ideally, the foundation for government policy in any industry should be a well-grounded understanding of industry dynamics—based on research and vetted by high-road industry stakeholders. Pennsylvania’s workforce policy with KRC’s help took a step towards this approach with the publication of industry-specific reports on “Workforce Choices” in the 2000s. The Wolf Administration could make a similar set of industry foundational studies a parting gift to the next administration. The Pennsylvania Governor, under Governor Wolf and his successor, should also look to leverage Biden Administration efforts to embrace—and provide the research foundation for—an industry approach to misclassification, enforcing labor standards, and promoting more “constructive” competition.

4. Adopt Strategic, Industry Specific Labor Law Enforcement

In conjunction with the previous two recommendations, the state, Office of Attorney General, and localities in Pennsylvania should explicitly embrace a “strategic, industry-specific approach to labor-law enforcement.”²¹

5. Explore the Creation of Stakeholder Councils in Key Industries That Can Engage With State Government to Promote More Constructive Competition

²¹ For a simple, accessible introduction to strategic, industry specific labor-law enforcement, see the We The People Pennsylvania primer on “Wage Theft,” online at <https://drive.google.com/file/d/1uxV3VG-X-a85PRR2QuIjlv8xldw2ebWg/view>.

6. Explore the Enactment of an ABC Test Through Regulation and Through Legislation

Some legal experts on Pennsylvania believe that the Wolf Administration could pursue the adoption of an “ABC test” for misclassification through regulation. The Wolf Administration and the Task Force on Misclassification should develop options for both regulatory and legislation adoption of such a test.

7. The State Should Engage With Worker Organizations and Worker Centers On a Listening Tour in Sectors with Rampant Misclassification, Including in Trucking and Construction

As one component of ramped up enforcement efforts on misclassification and other labor standards violations, the Commonwealth should organize listening tours on these violations in different industries, including trucking and construction. Listening to individual workers who have been the victim of exploitation because of misclassification schemes can enable college-educated elected officials and policymakers to appreciate the depth of anger that often results. Lawmakers need to feel the pain of exploited workers, signal that they feel that pain, and use a new and more visceral appreciation for the imbalance in the labor market as inspiration for achieving reform. This would be good politics and good policy.

8. Leverage the Biden Administration

The Commonwealth and other Pennsylvania enforcement actors should systematically seek to leverage the Biden Administration, which is (re)assembling the “A Team” with respect to enforcement including on misclassification. We have discussed this earlier with respect to research and analysis. The leveraging should also be done with respect to data sharing, industry research, industry-specific stakeholder engagement, and efforts to enforce labor rights in each industry.

9. In construction, specifically, leverage federal infrastructure investment and a possible BBB Act.

Substantial federal money will be coming to Pennsylvania for infrastructure projects, with additional funds for climate infrastructure potentially not far behind. This is a historic opportunity to create more good union jobs and to ensure that companies that systematically misclassify workers and violate other standards cannot get this business.