

# Worker Misclassification in the U. S. Construction Industry

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## ABSTRACT

The US construction industry is one of the largest industries in the world, employing millions of workers each year in the U.S. alone. Unfortunately, the industry is rampant with several unethical practices- one of the most damaging and impactful, being the misclassification of workers. This occurs when companies catalog individual workers as independent contractors. This not only costs the government an estimated \$3.5 billion each year, but is incredibly damaging to the workers and their families. Often times workers categorized as independent contractors who are actual singular workers do not receive benefits such as social security services or health insurance. Additionally, independent contractors are not covered by the National Labor Relations Act, which leads to many of these individual workers being paid below minimum wage and not receiving overtime pay. While worker misclassification reduces a company's costs on an initial bid, this unfair advantage over other companies creates a negative push for others to break these laws as well. Thus, not only affecting employees, the workers, and their families- but also the general public through cost- shifting. This unethical practice of misclassification needs to come to an end.

**Keywords** : Misclassification, Cost-Shifting, Labour Costs, Misclassified Workers, Construction Industry, Independent Contractors, Worker Reform

## I. INTRODUCTION

### 1.1 Construction Industry

The construction industry is one of the largest industries in the world, employing millions of workers each year in the U.S. alone (1, 2). Different people involved in the construction industry like main contractors, subcontractors and dozens of material suppliers works at different organizations (3). The division of labor has much importance in the industry with respect to productivity. With the advent of recent technological advancements and complexity of construction designs (4, 5, 6), the construction

industry is evolving into a complex entity (7). For instance, one of these complex entity is using double skin facades to save energy and approaching green architecture (8). It is dependent on timely transfer of data and information to and from all its key players, like engineers, architects, contractors, trades, and owners (9, 10, 11).

### 1.2 Misclassification Background

Unfortunately, the industry is rampant with several unethical practices such as: Insufficient training, an inadequate pipeline of new labor, and the lasting

effects of the recession cause that construction industry will face workforce shortage, which has a negative effect on the delivery cost and completion time (12, 13). By using Virtual Project-Based Simulation Game, workforce could be trained (14, 15). However, this mean has some flaw such as technical difficulty like low speed and limit options (16). Also, other activities such as handle bulky and heavy standard materials and store at the site, increase the potential accident and injuries (17). Storing fragile material like glasses, Glass has been used in construction since approximately 2000 years ago (18), exacerbate this issue. Other factors influencing productivity are project environmental conditions and labor arrangements (19). One of the most damaging and impactful, being the misclassification of workers. This occurs when companies catalog individual workers as independent contractors. This not only costs the government an estimated \$3.5 billion each year, but is incredibly damaging to the workers and their families. Often times workers categorized as independent contractors who are actual singular workers do not receive benefits such as social security services or health insurance. Additionally, independent contractors are not covered by the National Labor Relations Act (NLRA) (20, 21), which leads to many of these individual workers being paid below minimum wage and not receiving overtime pay. While worker misclassification reduces a company's costs on an initial bid, this unfair advantage over other companies creates a negative push for others to break these laws as well. Thus, not only affecting employees, the workers, and their families- but also the general public through cost-shifting. This unethical practice of misclassification needs to come to an end.

Defining worker misclassification is not an easy thing to do. The most basic way to describe it is to say that an employee as an "independent contractor." According to Misclassification Conundrum there is a specific set of criteria that need to be met before an employee can be classified as independent. The employee cannot be an integral part of the company,

the work done by them is not important to the business, the person employed should be in business for themselves, their investment in their own company must be equivalent to that of their employers, their business skills and judgements must show individual business initiative, and it would be assumed that the independent employee would seek independence from their employer (21, 22). It seems that as a whole the industry knows that misclassification is happening but nobody wants to do anything about it. The industry needs to make finding a way to prevent this sort of thing from happening a higher priority than it currently is. We think that it will have to be a joint effort from both moral and ethical general contractors with some sort of government intervention cracking down on the issue. Worker misclassification in the construction industry has created a big problem in the industry and impacts everyone involved in a negative way. That is except for the employer utilizing these unethical practices. It has been a major contributing factor to the negative image that the construction industry has created for itself. There are many reasons for the worker misclassification; none of which justify the means.

### **1.3 Problem Statement and Objectives**

This paper is going to touch on the key points of worker misclassification. This is an issue that is common in the construction industry that needs to be discussed. Research draws mainly from peer reviewed articles and some construction websites. The aspects of misclassification vary in this review and are detailed accordingly. We have laid out problems and solutions to be looked at in this review. This will define, explain, and supply solutions for the issue that is worker misclassification.

## **II. FINDINGS**

### **2.1 Direct Effects on the Workers**

Worker misclassification occurs when an employer intentionally labels an individual employee as an independent contractor. This unethical decision an employer makes most drastically affects the individual workers and their families, as it denies many workers protections and assistance they are entitled to (23). The National Employment Law Project conducted research that concluded about 30% of employers in the construction industry misclassify their workers (24). Another statistic shows that in Southern states, such as Texas, an estimated one-third of all construction workers are misclassified (25). Most of the workers who are misclassified as independent contractors rather than employees miss out on many benefits that typical employees would receive. This includes, but is not limited to Social Security benefits, Medicare, and protections from the NLRA (such as overtime pay, minimum wage restrictions, and unemployment compensation). Additionally, when companies mislabel their workers they also avoid paying taxes for those worker who then will eventually have to pay back the government for any withheld taxes that were not removed from their base pay. In one North Carolina case, Freeman and Associated Contracting had to pay four workers the sum of \$20,000 since “the company paid the workers straight time when they worked more than 40 hours in a week” (26). This is a big deal since many workers may be exceeding forty hours a week without getting paid overtime and there may be workers who are working in outrageous conditions getting paid below the minimum wage. The misclassification of workers gives companies an unfair advantage by removing payments and costs that come with a hiring an employee. In 2009, the U.S. BLS estimated “that more than 10.3 million workers in the United States are treated as independent contractors” (27). These costs include payments for overtime, Medicare, Social Security, workers’ compensation, unemployment insurance, and other benefits. (27) states that “classifying workers as independent contractors allows companies to avoid paying minimum wage and overtime Costs like workers’ compensation and

medical costs are a large expense since construction workers are exposed to much more danger than workers in other professions. This issue is important in the construction industry for the reason being that construction workers are not being treated in an ethical manner by their employers therefore giving the construction industry a negative image. While the industry continues to expand dramatically and the demand for construction projects also increases, the blatant disregard for these workers and their families can no longer continue to go on.

## 2.2 Why Companies Misclassify Workers?

For years many companies have been misclassifying their construction workers for multiple reasons. In one report, it is suggested that worker misclassification “may be an error” and that responsible employers may misclassify workers because “they are unclear or confused about how to apply complex, inconsistent and varying standards” (23). However, others suggest that worker misclassification is often “an intentional action to avoid employer legal and financial responsibilities” (28). Employers will often try to misclassify their workers as independent contractors. Doing so will benefit the company in many different ways. These benefits come in the forms of unfair advantages, cheaper labor costs, and limited liability. The construction industry is very competitive, making the winner the company with the less costly bid. Although “industry variations in relative wages are substantial” by misclassifying workers, companies get to reduce their labor costs meaning lower wages (29). The largest incentive for businesses to misclassify their workers is saving so much money on their taxes. They are not required to pay Social Security or unemployment insurance taxes for the independent contractors. In 2010, The Central New York Business Journal covered a case in which “employers illegally avoided paying more than \$80,000 in unemployment-insurance taxes” proving that they were misclassifying their workers for their benefit. (30). According to the

Department for Professional Employees, a 2013 report from the Treasury Inspector General for Tax Administration stated, “employers can save an average of \$3,710 per employee earning an annual income of \$43,007” when they misclassify their employees. (31) Another reason businesses practice misclassification is because independent contractors experience less discrimination. According to the American Bar Association, under federal law, as well as state laws, “independent contractors have modest protection against discrimination in the workplace” (32). It is important for businesses to know that their employees are respected and treated in the best way possible. Businesses also misclassify their workers as independent contractors because they are not required to pay them minimum wage or overtime pay (22). This allows companies to save so much money when they have to pay independent workers their salaries. Businesses also save on labor and administration costs. They also gain an advantage over their competitors. (Economic Policy Institute. 2016.) Overall, they are significant economic benefits to choosing independent contracting because these fixed costs can be avoided. (33). Though it is not always the companies’ fault-some workers choose to be classified as an independent worker. With specialized workers in such high demand due to their specific talents or technical expertise, these workers often indicate a strong preference to be labeled as independent contractors (22). The initiative of the worker also plays into why they chose to be an independent contractor. If they show the employer that they exercise good business judgment, the employer will be more prompted to make them an independent contractor (34). On average “it is estimated that business can save at least 30 percent in labor cost by using misclassification schemes” (35). It is said by the Department for Professional Employees that “the largest incentive for misclassifying workers is that employers are not required to pay Social Security and unemployment insurance taxes for independent contractors” (36). On the other hand, employers who do justly classify their employees do have to commit

to paying these costs and premiums. According to Donahue, “Avoiding workers’ compensation payments is the leading reason that employers intentionally misclassify workers... employers will take the risks associated with misclassification to gain a competitive advantage by not paying workers’ compensation premiums.” (21) If a company misclassified their workers, it has less costs and is in an immediate advantage over their honest competitors. Since the fraudulent company’s cost is lower, it can allow the company to submit a lower bid for a project and undermine ethical contractors who do follow the law. Since this issues has become a big concern “the focus on worker classification has even reached congressional levels” (37). However, despite all of these positive reasons, misclassification in construction remains a serious problem. According to the chairman of the Texas House Business and Industry Committee, Representative Renee Oliveira, says, “No business should gain a competitive advantage by avoiding taxes”. (By Comparison) Misclassification should not be used to disregard paying taxes (38).

### **2.3 Direct Effects on the U.S. Government, the Public, and the Construction Industry**

Worker misclassification is important in the construction industry because it impacts thousands of construction workers every year (39). It unethically saves companies a substantial amount of money on a yearly basis (40). As well it provides an unfair advantage to contractors over responsible contractors who classify their workers correctly (41). The general public is also included in the list of the parties impacted. Worker misclassification can affect the public by generating a loss to the federal and state governments in the form of lower tax revenues. In a 1994 study it was determined that “the federal government would lose \$3.3 billion in revenues” and “\$34.7 billion in the period from 1996 to 2004” due to worker misclassification (42). It can potentially hurt law-abiding taxpayers and it can also hurt the

economy itself. Not only does worker misclassification within the construction industry affect the employees and employers but it also unconsciously affects the general public and the government in many ways. One way this affects the public via the construction industry through “cost shifting”. This happens when a misclassified worker is injured on the job and needs medical attention but the worker is not covered by any health insurance or worker's compensation. This eventually causes doctors to regain these uninsured expenses by increasing the cost of health care overall thus resulting in greater health costs for everyone and also higher health insurance payments. It is a fact that “among work-related injuries, the small fraction of disabilities that are of long duration account for a large fraction of workers' compensation costs” (43). Another way the public can be affected by this is that since many taxes are being unpaid by the employers this eventually requires more public assistance with unpaid taxes. When it comes down to public construction projects such as schools and hospitals, the public is affected because they pay taxes and this money is used in the construction projects but sometimes this money is not always being used in the proper way since some companies fail to pay their construction workers overtime or even the required minimum wage. Worker misclassification affects the government since it “loses at least \$3.5 billion annually on average” just by classifying workers as independent contractors (35). In his article, Bauer states that since “independent contractors underreport more than employees, the federal government and state and local government lose billions of dollars in tax revenue” (2014). Employers also benefit from misclassifying workers by hiring immigrants as workers who are hired as independent contractors, “observation revealed that the residential construction industry is dominated by immigrant workers” (44). “It is a lucrative employment source of immigrant, often undocumented, workers and unscrupulous employers use their workers’ alleged independent contractor status to circumvent employer obligations under federal immigration laws.” (23) Employers can

take advantage of this by hiring “cheap” labor and most of the jobs that immigrants work on “provide limited scope for advancement for immigrants and more often than not involve work environments that are demeaning, unsafe, and physically demanding” (45). The Center for Construction Research and Training researched and discovered that “only 22% of Hispanic construction workers had health insurance through their employment” leaving the other 78% unprotected (2010). Although “workers can report violations of employment laws to state and federal agencies,” these cases of wage theft tend to go unreported (46). Worker misclassification is important in the construction industry because it impacts thousands of construction workers every year. It unethically saves companies a substantial amount of money on a yearly basis. As well it provides an unfair advantage to contractors over responsible contractors who classify their workers correctly. The general public is also included in the list of the parties impacted. Worker misclassification can affect the public by generating a loss to the federal and state governments in the form of lower tax revenues. In a 1994 study it was determined that “the federal government would lose \$3.3 billion in revenues” and “\$34.7 billion in the period from 1996 to 2004” due to worker misclassification (44). It can potentially hurt law-abiding taxpayers and it can also hurt the economy itself.

### III. CONCLUSIONS

The Construction Industry faces many challenges. Among these are the number of workers that are misclassified. Worker misclassification is the act of stating that a worker is an “independent contractor” instead of paying them an hourly or salaried wage. This is a problem because it takes revenue away from the insurance companies, the government in the form of taxes, and it leaves the workers without any form of unemployment or workers. General Contractors who hire appropriately end up having higher employee costs and usually get underbid by contractors who

practice worker misclassification. This is causing more construction companies to start misclassifying employees in order to keep a competitive edge on other companies to secure a bid (43). With the increasing number of workers being misclassified it is only creating a greater problem within the industry. Companies who have chosen to save millions of dollars in revenue, by cheating the government and their workers out of deserved allowances have led to one of the most damaging, unethical practices within the construction industry- the misclassification of individual workers as independent contractors. This unethical practice of misclassification needs to come to an end.

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