

## Testimony to

U.S. House Education & Workforce Committee's Workforce Protections Subcommittee

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Thank you, Chairman Kiley, Ranking Member Adams, and Members of the Subcommittee on Workforce Protections for the opportunity to testify. My name is Aaron Sojourner. I am a senior economist at the Upjohn Institute for Employment Research, a private, not-for-profit, nonpartisan, independent research organization that has studied policy-related issues of employment and unemployment since its founding in 1945.

### Overview

Employment rates and employer competition for talent are strong. As a result, workers' wages are rising, and workers have been able to quit lower quality jobs to move to better ones. A primary challenge in the U.S. labor market today is raising job quality enough to attract potential workers now out of the labor force so we can continue to grow our economy.

In any competition, well-enforced rules make the game sustainable and productive. When rules are ignored, competition degenerates into a race to the bottom as competitors seek any advantage they can get. When rules are not fairly and vigorously enforced, cheaters prosper and people doing right get hurt. A Department of Labor that vigorously enforces our nation's wage and hour laws helps improve job quality and shared prosperity. Workers, law-abiding employers, and the overall economy benefit.<sup>1</sup>

### The economy and labor demand are strong

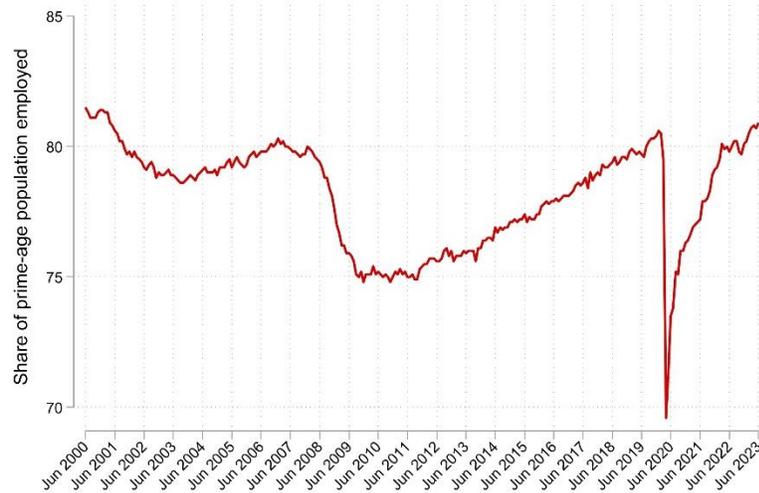
The economy and labor demand are strong. The U.S. has enjoyed the strongest economic growth of any major economy coming out of the pandemic recession, achieving the highest inflation-adjusted GDP growth in the G7 since pre-pandemic. Our core inflation rate is now lower than any other major economy's rate: lower than the U.K, Japan, France, Italy, the whole Euro Area, Canada, and even lower than Germany.<sup>2</sup> Inflation is falling even as the number of U.S. jobs grows.

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<sup>1</sup> Two of my recent papers describe how jobs are experience goods (their quality can't be fully known to a worker before starting) and how reducing a worker's risk of wage theft or other rights violations can increase their willingness to supply labor [Benson, Sojourner, & Umyarov (2020) "Can Reputation Discipline the Gig Economy?" *Management Science*. 66(5); Sockin & Sojourner (2023) "What's the Inside Scoop? Challenges in the Supply and Demand for Information about Job Attributes," *Journal of Labor Economics*]. The economic models and empirical evidence describe how, as the share of lawbreaking employers falls, the quality of jobs improves, and more potential workers join the labor market.

<sup>2</sup> Council of Economic Advisers, "Apples to Appfels: Recent Inflation Trends in the G7" June 27, 2023.

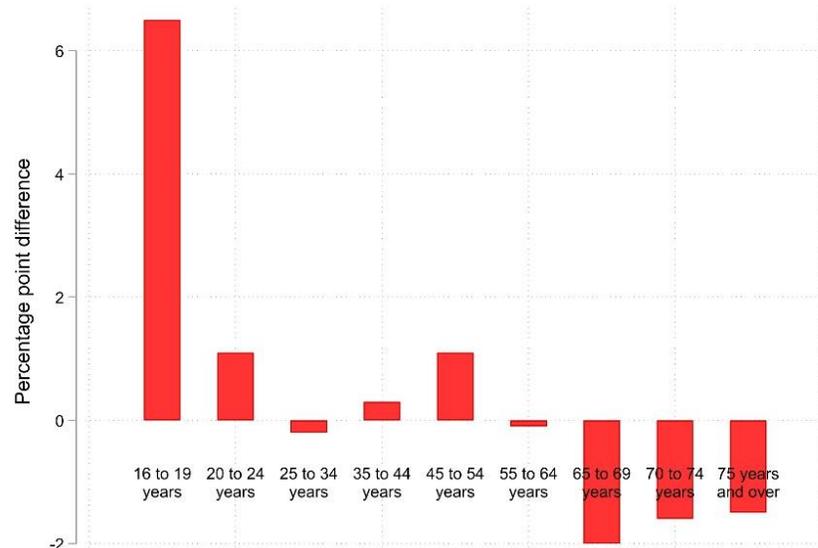
The employment rate of Americans in our prime working years – ages 25 to 54 – is now at its highest level in more than 20 years (Figure 1). The same is true for the prime-age labor force participation rate.



Note: U.S. Bureau of Labor Statistics Current Population Survey. @aaronsojourner

Figure 1: Trend in U.S. Employment to Population Ratio for 25 to 54 year olds

Employment rates are now about the same or higher than before the pandemic for every age group of Americans except for those over age 65.<sup>3</sup> More seniors have retired, in part due to increased health risks and disabilities from the pandemic. However, teens and working age Americans are more likely to be employed than before the pandemic.

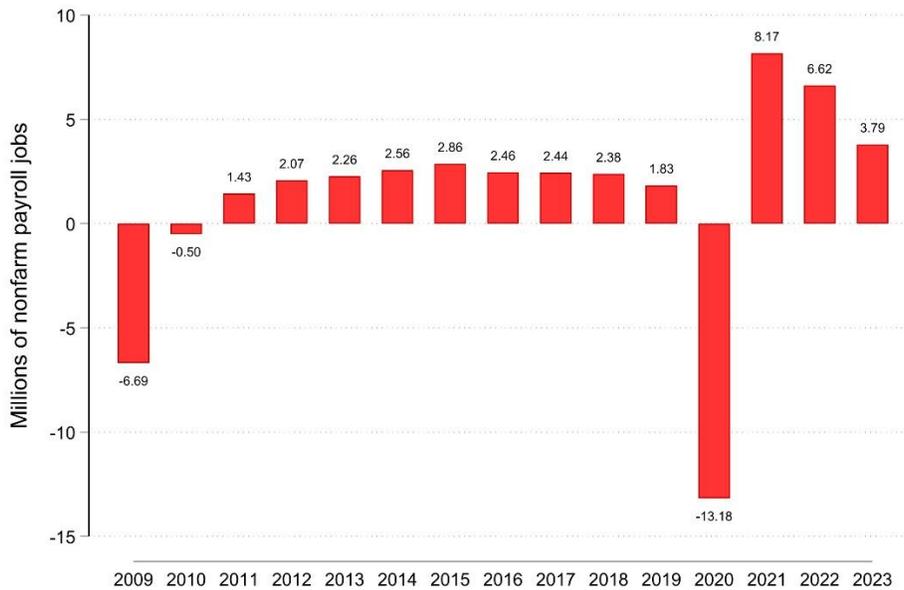


U.S. Bureau of Labor Statistics percent of population employed by age, not seasonally adjusted. Calculations and graph: @aaronsojourner

Figure 2: Difference in the share employed from Feb 2020 to June 2023, by age group

<sup>3</sup> Figure 2 shows differences in averages for the 3-month periods ending in those months.

Employers have added jobs at a very rapid pace: 3.79 million jobs over the last year. This is more than simply recovering the jobs lost in the pandemic, all of which were recovered by June 2022. In the year since, the pace of job growth has been more than twice as fast as it was in the same period in 2018 and 2019 when the economy added 1.83 million jobs (Figure 3). Over the last year, the unemployment rate has been lower, and the prime-age labor force participation rate has been higher than over the year to June 2019, meaning that the labor market has been tighter, and it is now in some sense harder to add new jobs. Even so, job growth has been more than twice as fast.



Source: U.S. Bureau of Labor Statistics Current Employment Statistics. Graph: @aaronsojourner.

Figure 3: Change in U.S. jobs over the 12 months to June of each year

While payroll jobs have grown past pre-pandemic levels, self-employment spiked at the beginning of the pandemic. It has now fallen back to its pre-pandemic level. When workers lack leverage, self-employment rises. When they have it, most seek payroll jobs.

Though prime-age employment is at its highest level in twenty years, Baby Boomers --- one of the largest demographic cohorts in American history --- are inevitably crossing into retirement age. Many working seniors retired during the pandemic and its immediate aftermath. Employers are clamoring for more workers to replace older workers who have left the workforce. Making jobs better can help employers seize opportunities for growth. Better job quality boosts retention so employees can increase their productivity with greater on-the-job training and experience.

Job quality is improving as working families are seeing improving earnings opportunities. Adjusting for inflation, average real hourly wages are higher now than

before the pandemic for all workers and for the 4 in 5 workers who are frontline production and non-supervisory workers. Higher wages are a key part of job quality, but other aspects matter too. Broadly, workers' job satisfaction just hit the highest level since the Conference Board started polling in 1987.<sup>4</sup> We cannot rely on tight labor markets and more retirements to drive employers to improve job quality. Well-functioning rules for the labor market cement the improvements we have made and deprive lawbreaking employers of any competitive advantage.

### **Currently, violating labor and employment laws does pay**

When the law enforcers are sleeping or not paying attention, rules do not enforce themselves. Cheaters prosper and people who do right suffer. Currently, violating labor and employment laws pays because enforcement is too weak and unreliable, leaving workers without the pay they have earned, law-abiding employers at a competitive disadvantage, and taxpayers on the hook for extra burdens.

Economist Anna Stansbury of MIT Sloan School of Management recently examined to what extent U.S. employers have an incentive to comply with wage and hour laws. She compared the extra profits firms can earn through noncompliance versus the expected costs of noncompliance in terms of expected legal sanctions.<sup>5</sup> In the case of minimum wage and overtime provisions, typical willful violators, if detected, are required to pay back wages owed and additional penalties in some cases. Given typical penalties, employers would need to expect a chance of at least 78 percent that its violation would be detected to have an incentive to comply with the law. The expected probability of detection is likely much lower than this. The Wage and Hour Division has just 1 enforcement staffer for every 170,000 U.S. workers whose earned wages they are responsible to protect.<sup>6</sup>

Many firms avoid paying overtime wages by exploiting a federal law that allows them to exempt employees classified as "executives" and pay a salary above a pre-defined dollar threshold. Studying millions of job listings, a team of economists recently found that salaried positions with managerial titles exhibited an almost five-fold increase around the federal regulatory threshold (Figure 4). This is strong evidence of widespread firm strategies to avoid paying workers' earned overtime.<sup>7</sup>

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<sup>4</sup> The Conference Board, "Survey: US Job Satisfaction Hits All-Time High" May 11, 2023.

<sup>5</sup> Stansbury A. (2021) "Do U.S. Firms Have an Incentive to Comply with the FLSA and NLRB?" *Peterson Institute for International Economics*.

<sup>6</sup> Hamaji, K., R. Deutsch, C. McNicholas, H. Shierholz, and M. Poydock. (2019) "Unchecked Corporate Power: Forced Arbitration, the Enforcement Crisis, and How Workers Are Fighting Back." *Economic Policy Institute*. There's also the possibility of criminal conviction but, even when a violation is detected and judged as willful, firms face less than a 0.4% chance of a criminal conviction [Stansbury 2021].

<sup>7</sup> Cohen et al. (2022) "Too Many Managers: The Strategic Use of Titles to Avoid Overtime Payments" *National Bureau of Economic Research working paper*.

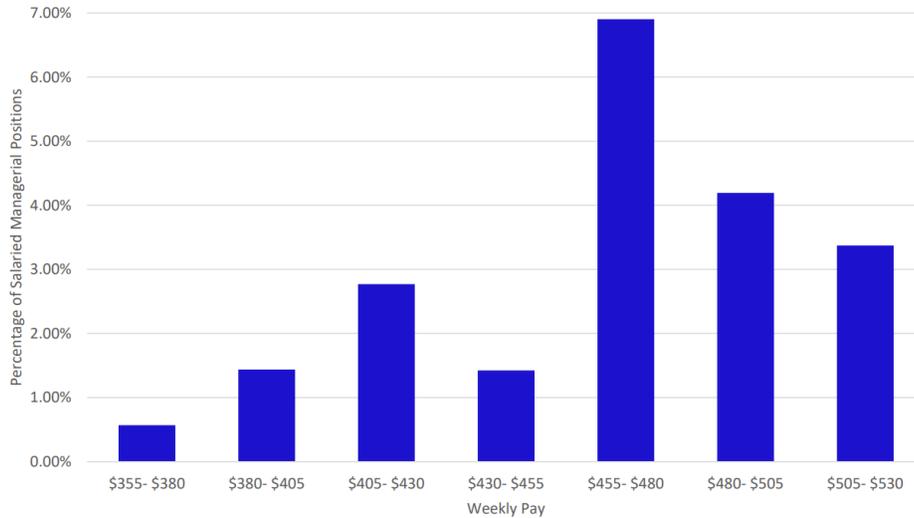


Figure 4: evidence of gaming: five times more postings of salaried positions with managerial titles are immediately above the \$455/week overtime exempt threshold than below it. (Cohen et al, 2022: Figure 2)

Positions with managerial titles such as “Directors of First Impression” had job responsibilities that were otherwise equivalent to non-managerial employees, in this case, a front desk assistant. Figure 5 gives others. The researchers found evidence of many employers playing such games blurring lines between managerial and non-managerial titles to avoid overtime obligations and cheat employees out of earned pay. Firms avoid roughly 14% of their overtime obligations for each strategic “manager” hired. These strategies are used by large and small companies and the study named names (Figure 6).

Employee	Manager
Receptionist	Front Desk Manager
Front Desk Clerk	Director of First Impressions
Reservation Clerk	Lead Reservationist
Host/Hostess	Guest Experience Leader
Carpet Cleaner	Carpet Shampoo Manager (Trainee)
Asset Protection Specialist	Asset Protection Coordinator
Barber	Grooming Manager
Food Cart/Coffee Attendant	Food Cart/Coffee Cart Manager

Figure 5: employers who want to hide overtime obligations give managerial titles to people with non-managerial responsibilities (Cohen et al, 2022: Appendix Figure A)

This is one example of a larger pattern.<sup>8</sup> The Wage and Hour Division is overstretched trying to enforce the law. Working families, law-abiding employers, and taxpayers would benefit from more vigorous enforcement of our nation’s wage and hour laws.

NAME	INDUSTRY
BOJANGLES	Food Services and Drinking Places
84LUMBER	Building Material and Garden Equipment/Supply Dealers
ARBY'S	Food Services and Drinking Places
SONIC DRIVE-IN	Food Services and Drinking Places
SPENCER'S	Miscellaneous Store Retailers
SPIRIT HALLOWEEN	General Merchandise Stores
WEIS MARKETS	Food and Beverage Stores
PIZZA HUT	Food Services and Drinking Places
DOMINO'S PIZZA	Food Services and Drinking Places
COMBINED INSURANCE	Insurance Carriers and Related Activities
JIFFY LUBE	Repair and Maintenance
POPEYES	Food Services and Drinking Places
BURGER KING	Food Services and Drinking Places
GNC	Health and Personal Care Stores
H&R BLOCK	Professional, Scientific, and Technical Services
LIFE TIME FITNESS	Amusement, Gambling, and Recreation
DAIRY QUEEN	Food Services and Drinking Places
BOSTON MARKET	Food Services and Drinking Places
MAINSOURCE BANK	Credit Intermediation and Related Activities
SUBWAY SANDWICHES	Food Services and Drinking Places
JIMMY JOHN'S	Food Services and Drinking Places
LITTLE CAESARS	Food Services and Drinking Places
CROSSMARK	Merchant Wholesalers, Nondurable Goods
OFFICEMAX	Miscellaneous Store Retailers
KFC - KENTUCKY FRIED CHICKEN	Food Services and Drinking Places

\*Includes firms with minimum 100 job postings with a weekly equivalent pay of \$455 +/- \$50 between 2010 and 2018. The sample includes positions in both firm-owned and franchised locations.

Figure 6: List of top 25 firms with the highest percentage of overtime avoiding positions (Cohen et al, 2022: Appendix C)

### Illegal misclassification assaults the foundation of American workers’ rights

Attempts to misclassify employees as contractors undermine the fundamental rights of American workers. Congress granted those rights to *employees* and so denying employees that status attempts to put them outside the circle of labor standards. Yet, by illegally misclassifying employees as independent contractors, an employer can easily save 15 to 30% on labor costs and muddy the workers’ access to labor and employment rights.<sup>9</sup> Once a competitor cheats and gets away with it, it becomes harder for other employers to stay in business without cheating too.<sup>10</sup>

<sup>8</sup> Mangundayao, McNicholas, Poydock, and Sait (2021) “More than \$3 billion in stolen wages recovered for workers in 2017 and 2020” *Economic Policy Institute*

<sup>9</sup> Belman and Sojourner (2019) “Economic Analysis of Incentives to Fraudulently Misclassify Employees in District of Columbia Construction” *Office of the Attorney General of the District of Columbia*. <https://oag.dc.gov/sites/default/files/2019-09/OAG-Illegal-Worker-Misclassification-Report.pdf>

<sup>10</sup> The State of Massachusetts unemployment insurance agency audited a random, representative sample of residential construction employers in 2017 to 2019 and found that more than 1 in 6 employers were

A report I wrote for the Office of the Attorney General of D.C. with Michigan State University School of Human Resources and Labor Relations economist Dale Belman analyzed the financial incentives an employer faces to illegally misclassify employees. We found that construction employers could easily reduce their hourly labor costs by 15-30%, gaining a large illegal advantage in competing for business by stopping paying workers comp premiums, unemployment insurance premiums, employer payroll taxes, overtime, and the like.

When employers misclassify their employees as independent contractors rather than employees:

- they stop paying into the workers compensation system (a 5% cost advantage),
- they stop paying into the unemployment insurance system (another 5% cost advantage),
- they stop paying the employers contribution into the Social Security and Medicare and Medicaid systems (another 7%),
- they stop paying overtime after 40 hours of work (another couple of percentage points),
- they stop ensuring they pay an hourly wage above the legal minimum (a big deal for some employers), and
- they do not recognize their employees' right to organize and collectively bargain, their right to be free from workplace discrimination, and their right to mandated family and medical leave.

Their wage and hour and payroll tax fraud increases the financial burdens on competitors who play by the rules, raising the burden on others.<sup>11</sup>

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misclassifying employees [Juravich, Ormiston, & Belman (2021) "The Social and Economic Costs of Illegal Misclassification, Wage Theft and Tax Fraud in Residential Construction in Massachusetts" *Institute for Construction Economic Research*].

<sup>11</sup> The Government Accountability Office estimated in 2009 that employee misclassification cost federal revenues of \$2.72 billion in 2006. [U.S. Government Accountability Office, Employee Misclassification: Improved Coordination, Outreach, and Targeting Could Better Ensure Detection and Prevention (Aug. 2009)] The U.S. Treasury Inspector General for Tax Administration estimated that misclassification contributed to a \$54 billion underreporting of employment tax and losses of \$15 billion in unpaid FICA taxes and UI taxes. [Treasury Inspector General for Tax Administration, While Actions Have Been Taken to Address Worker Misclassification, Agency-Wide Employment Tax Program and Better Data Are Needed, (February 2009)]. A study of the construction industry in Illinois, Minnesota, and Wisconsin found that these 3 states lose out on at least \$362 million in tax revenues annually due to misclassification of construction workers alone [Goodell and Manzo IV (2021) "Construction Costs WI, MN, and IL Taxpayers \$362 Million Per Year." Midwest Economic Policy Institute]. In 2019 alone, \$9.27 billion was stolen from workers who earned less than \$13 an hour and who were subject to forced arbitration agreements.

A 2022 Economic Policy Institute analysis estimates the cost to typical workers holding 11 commonly-misclassified jobs of being wrongly classified as an independent contractor rather than as an employee. A typical construction worker, as an independent contractor, would lose as much as \$16,000 per year in income and job benefits compared with what they would have earned as an employee. A typical home health aide would lose as much as \$9,000 per year in income and job benefits, the analysis found.

When classified as an employee, construction workers typically earn about \$48,000 a year, including the average value of supplemental pay (overtime, shift differentials, vacation, sick pay, and other forms of paid time off). When including health insurance, retirement plans, and employer contributions to unemployment insurance, workers' compensation, and Social Security and Medicare, the full annual value of the job to the worker when classified as an employee rises to about \$52,000. But when misclassified as an independent contractor, the employee loses access to legal protections, employer contributions to social insurance, and access to unemployment insurance and workers' compensation—the value of that job for the typical construction worker falls to between \$36,000 and \$42,000 per year. Illegal misclassification costs the typical construction worker between \$10,000 and \$17,000 per year.<sup>12</sup>

When law-abiding businesses are squeezed out of opportunities by competitors that illegally misclassify workers, they feel pressure to cut safety measures or depress worker pay and benefits to win business. They may start misclassifying workers themselves to compete. Misclassification can spread from a few bad apples and become an industrywide standard practice.<sup>13</sup>

## **Conclusion**

Employer demand for labor is strong. However, rules-based competition between employers, which enables workers to claim what they have earned under the law and blocks cheating employers from prospering, needs strengthening. Violations are widespread. Narrowing the scope of who is covered by labor and employment rights undermines the quality and sustainability of jobs. Rather than addressing existing problems, it exacerbates them.

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Further, as many as 26% of the 17.7 million private-sector, nonunion workers subject to forced arbitration, or 4.6 million workers, experienced wage theft in 2019. Most workers experiencing wage theft do not report the violation or seek legal remedy out of fear of retaliation from their employers [Baran and Campbell (2021) "Forced Arbitration Helped Employers Who Committed Wage Theft Pocket \$9.2 Billion in 2019 From Workers in Low-Paid Jobs" National Employment Law Project].

<sup>12</sup> These estimates do not attempt 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.

<sup>13</sup> Erlich, M. (2020) "Misclassification in Construction: The Original Gig Economy" *ILR Review*: 74(5).