

New York State
Workers' Compensation:
How Big Is the
Coverage Shortfall?



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Preface

This report grew out of work by the Fiscal Policy Institute to develop an economic agenda for New York. FPI's recent report, *One New York: An Agenda for Shared Prosperity*, outlines policies to help the state's diverse regions and populations grow together and to strengthen and expand the middle class. Reforming New York's workers' compensation system has long been debated in Albany and plays a critical role in two aspects of the FPI agenda: leveling the playing field among businesses, and in enforcing labor standards. The need to ensure compliance with New York's requirement that employers provide workers' compensation coverage is the intersection of these two issues and the basis for this report.

FPI's work in this area builds on our experience from previous reports on various aspects of New York's labor market and economic trends, work on social insurance programs such as unemployment insurance, and several reports on the minimum wage. FPI is also working on a report on the fiscal and economic costs of fraudulent labor practices in the New York City residential construction sector. FPI's reports can be found at: www.fiscalpolicy.org.

This report was first released on January 25, 2007. This edition (February 5, 2007) includes an addendum with our comments on two responses that we received on the initial report.

Comments and questions on this report should be directed to FPI's Deputy Director and Chief Economist, James Parrott, Ph.D., who can be reached at 212-721-5624 or parrott@fiscalpolicy.org.

Executive Summary

Employer non-compliance with the state's workers' compensation program is a growing problem in New York. Many companies fail to provide this coverage for their workers. This deprives the workers of coverage and limits the insurance pool of workers covered, in turn increasing the premium costs for other employers and shifting the costs of medical care for injured workers to the injured workers themselves, taxpayers and other employers.

The scope of the problem is significant. Conservative estimates suggest that between 500,000 and a million New York workers who should be covered by workers' compensation are not. This shocking number comes from two sources of shortfall in the New York State workers' compensation system. The first is fall-off from coverage under unemployment insurance; many fewer workers appear to be covered by workers' compensation than by the unemployment insurance system. Second, a growing number of workers are misclassified by their employers as independent contractors in an attempt to evade employer responsibility for payroll taxes and social insurance programs, including both workers' compensation and unemployment insurance.

All workers who are covered by unemployment insurance in New York should also be covered by workers' compensation. Yet, in 2003 the total annual payroll of workers covered by workers' compensation was only 80 percent of the unemployment insurance payroll, meaning that roughly one in every five New York workers covered by unemployment insurance was not covered by workers' compensation. Although the quality of workers' compensation payroll data is not what it should be, it is unlikely that poor data explain away the coverage shortfall. "Misclassified" workers miss out on both workers' compensation and unemployment insurance. The scope of this problem can be estimated by analyzing trends in payroll employment and other economic data.

Premium payments are also dramatically lower than they should be. The total annual payroll for uncovered workers ranges from about \$25 billion to \$50 billion. These numbers translate into a substantial shortfall in revenues that should be coming into the workers' compensation system. At about \$1,000 per worker, evaded premiums amount to \$500 million to \$1 billion annually—all lost to the system. These estimates are necessarily rough because there has been so little effective compliance enforcement. New York State has not audited the payroll coverage data to ensure its reliability and indeed has not even compiled the total workers' compensation payroll before.

How can such a large workers' compensation coverage shortfall exist? While workers' compensation in the U.S. was first introduced under President Theodore Roosevelt in 1908, there is no federal oversight or regulation of state workers' compensation programs. In New York, the administration of workers' compensation is fragmented with private insurance companies bearing some of the responsibility and the State Workers' Compensation Board bearing some responsibility. Between the two, there is no overall strategic enforcement capability, much less systematic coordination with the Labor Department's unemployment insurance system, which does operate under federal oversight.

New York State Workers' Compensation: How Big Is the Coverage Shortfall?

The past two decades have seen significant economic and labor market transformations in the U.S. Some businesses have sought an unfair competitive advantage by skirting responsibility for payroll taxes and social insurance coverage for their workers. Just as government must police the streets to maintain public safety, it is up to government to police the labor market and employer labor practices. In New York, government has failed to do that.

Other states, including Florida, California, New Jersey and Delaware, have started to respond aggressively to such flagrant employer labor practices. Investigators in Florida close down construction sites for non-compliance and arrest violators. California and New Jersey are seeking to curb the misclassification of workers as independent contractors and California has targeted “consultants” who promote illegal labor practices. Delaware recently strengthened its mandatory insurance requirements and increased penalties for employer violations.

By not enforcing its own laws, the State of New York has allowed extensive non-compliance and the underground economy to proliferate. This harms workers and makes workplaces more dangerous. Not enforcing the law increases the costs for law-abiding employers who do pay for workers' compensation. It also threatens the viability of the state's workers' compensation system, and generates unfavorable publicity about New York's economic climate.

Introduction

Workers' compensation insurance was first established in the United States under President Theodore Roosevelt in 1908. State laws soon followed—New York's in 1911—with workers' compensation as a “no fault” system of insurance for workers injured on the job. Under workers' compensation insurance purchased by employers, an injured worker would receive medical care and partial wage replacement if injury made it impossible for him or her to work. In exchange, the worker would give up their right to sue their employer. Workers' compensation was the first form of social insurance in the United States.

Unlike most other forms of social insurance, there is no federal role in administering or regulating workers compensation for non-federal government workers. And as with private insurance generally, individual states have sole authority to regulate workers' compensation. In New York, most employer workers' compensation coverage is purchased from private insurance companies. There is a state fund that primarily serves as the insurer of last resort. Companies that can demonstrate sufficient financial capacity, also have the option of self-insuring. On a payroll basis, 54 percent of coverage is through private insurers, 32 percent through the state fund, and 14 percent is through self-insured arrangements.¹

This report identifies two sources of shortfall in the New York State workers' compensation system: falloff from coverage under unemployment insurance (i.e. many fewer workers appear to be covered by workers' compensation than are in the unemployment insurance system); and a growing number of workers who are misclassified by their employers as independent contractors in an attempt to evade employer responsibility for payroll taxes and social insurance premiums, including both workers' compensation and unemployment insurance. Both factors are the source of substantial shortfall in the workers' compensation system. This report develops estimates for the falloff from each source and quantifies the impact on the New York State workers' compensation system in terms of lost premium payments and assessments.

Comparing New York State Payrolls under the Workers Compensation and Unemployment Insurance Systems

In theory, the total New York State payrolls reported to the Workers Compensation (WC) system should be similar to those reported to the New York State Department of Labor (DOL), which administers the Unemployment Insurance (UI) system. Both systems cover employees working in New York State, and the respective specifications of payroll are similar. In practice, it appears there is a substantial discrepancy between the two payroll series. The New York State Compensation Insurance Rating Board (CIRB) supplied total payroll data for employers buying WC from the state insurance fund or private insurers. The New York State Workers Compensation Board (WCB) provided total payroll data for employers self-insured on a group basis and employers individually self-insured. The CIRB payroll data begins in 1991, but only goes through 2003. The payroll data for the two sets of

¹ Fiscal Policy Institute estimate based on CIRB and WCB data for 2003.

self-insured employers was for the years 2001 through 2005. Thus, payroll data for the universe of employers covered by WC were available only for the years 2001 to 2003.²

UI payroll data were obtained from the New York State Department of Labor website and are the standard total wage data from the Quarterly Census of Employment and Wages (QCEW, also known as the “202 series”).³ Under a cooperative arrangement with the U.S. Department of Labor, state labor departments administer the UI system and the QCEW payroll data are UI administrative data.

The following table compares New York State payrolls for the WC and UI systems.

Year	Workers Compensation	Unemployment Insurance	Ratio, WC to UI payrolls
2001	\$256.5 billion	\$393.5 billion	.652
2002	\$257.0	\$383.2	.671
2003	\$271.1	\$388.6	.698
2003 adjusted (see text)	\$310.9	\$388.6	.800

Sources: Workers compensation payroll: New York Compensation Insurance Rating Board, New York Workers' Compensation Board, and adjustments by Fiscal Policy Institute. Unemployment insurance payrolls: New York State Department of Labor, quarterly census of employment and wages.

As the table indicates, the ratio of WC to UI payrolls ranges from 65.2 percent to 69.8 percent. However, there are several categories of workers excluded from coverage under the New York State WC law. These include teachers in non-profit educational institutions; New York City public school teachers; New York City uniformed police, fire and sanitation employees; and federal government employees (including the postal service).⁴ In addition, there is a construction employment payroll limitation provision that serves to limit the WC premium paid for high-wage construction workers. FPI estimated the 2003 payroll affected by each of these exclusions and the construction limitation and made an adjustment for the likely increase in prior years' payroll totals as indicated by the CIRB. Together, these adjustments totaled nearly \$40 billion. Adding this adjustment to the 2003 WC payroll figure would make adjusted 2003 WC payrolls \$310.9 billion. In theory, this adjusted WC payroll should be

² Staff at the WCB indicated that the payroll data supplied to FPI for the employers self-insured on a group basis represented approximately 95 percent of the total payrolls for such companies. We adjusted the data to approximate the universe of such companies.

³ The U.S. Bureau of Economic Analysis wage and salary data that are part of the Personal Income series includes earnings for the self-employed (for 2003, the BEA wage and salary total for New York State is \$406.5 billion). The U.S. Social Security Administration data on workers covered by Medicare also includes the earnings of wage and salary workers and self-employed workers (for 2003, the SSA earnings total for New York State is \$406.5 billion, coincidentally, the same as the BEA wage and salary total). The BEA series is by place of work; the SSA series is by place of residence. The BEA Personal Income data also provide a separate series on the earnings of Sole Proprietors. As discussed below, the U.S. Census Bureau also maintains a data series for the number and receipts of “Non-employers” that is based on payments reported on Internal Revenue Service 1099 forms.

⁴ Barring these exceptions, all workers subject to UI coverage are also subject to WC coverage. New York State covers undocumented workers for WC purposes even though such workers are not eligible for UI.

roughly the same as the UI payroll since the worker coverage is conceptually similar. However, the ratio of the adjusted WC payroll figure to UI payroll is still only 80 percent.

What is the implication of the fact that the statewide adjusted WC payroll is twenty percent lower than New York's UI payroll total?⁵ It might suggest that non-compliance with WC is a more widespread phenomenon than non-compliance with UI. Administrative differences may contribute to this discrepancy. UI premiums (and total payroll data) are submitted directly to the State Taxation and Finance Department along with state (and local in the case of New York City income tax withholding and payroll tax (social security and Medicare) payments. Large employers submit this information electronically on a monthly basis and small employers mail in their submissions quarterly.⁶

For WC, on the other hand, payroll data for all workers covered under the WC system are not even regularly compiled by a New York State government agency. (For that matter, it does not appear that an overall total payroll for all employers with workers' compensation has ever been compiled before.) Employers send their premiums (and payroll data) to either the State Insurance Fund or their private WC insurer, and the CIRB compiles the payroll data for companies purchasing WC coverage.⁷ The WCB compiles payroll data for companies that are self-insured for WC. Enforcement to ensure compliance with the New York State law mandating WC coverage is hampered by this fragmentation.⁸

While the 1996 workers compensation reform legislation gave WC insurance carriers enhanced enforcement tools, former State Insurance Superintendent Howard Mills does not believe the WC insurance industry has seriously enforced employer compliance with the state mandate to provide WC insurance. In his July 2006 decision denying the CIRB's request for a WC rate increase, Superintendent Mills stated:

Now, an entire decade after the enactment of that landmark (1996 WC) reform legislation the insurers' efforts to fight fraud—both claimant and employer fraud—can be said to be anemic, at best...The paucity of fraud savings in an industry which experiences fraud costs of approximately \$5 billion per year, according to the National Crime Bureau, is most unsettling...Without a greater commitment on the part of workers' compensation carriers in New York to fight fraud, this Department is hard pressed to justify any new overall average rate

⁵ In its latest annual report on workers' compensation, the National Academy of Social Insurance (NASI) published data for each state for workers' compensation covered wages. However, as that report's discussion of its methodology indicates, the data on workers' compensation covered wages were based on the amount of covered payroll under each state's unemployment insurance system. As this report makes clear, this is an inappropriate assumption, at least in the case of New York, and possibly for other states. Ishita Sengupta, Virginia Reno, and John F. Burton, Jr., Workers' Compensation: Benefits, Coverage, and Costs, 2004, Washington, D.C., National Academy of Social Insurance, July 2006.

⁶ New York State Taxation and Finance Department, Employer's Guide to Unemployment Insurance, Wage Reporting, and Withholding Tax, http://www.tax.state.ny.us/pdf/2006/wt/New_York_State50_506.pdf.

⁷ The CIRB is not a New York State government agency; it is essentially an association of private WC insurers that is designated under New York State law to compile data on the WC system and to recommend changes in WC premium levels and the rate structure.

⁸ It is also puzzling why the CIRB could not provide total payroll data for a period more recent than 2003.

increases. Thus, we can only conclude that the cost of fraud in the workers compensation system is merely being transferred to the insureds.⁹

The fragmented structure of New York's WC system undoubtedly complicates enforcement. Whereas Florida's targeted WC fraud enforcement in the construction industry (see below) involves an extensive system of field investigators visiting companies unannounced to check for WC insurance certificates, the New York State CIRB mainly uses phone interviews to conduct spot payroll audits. Compliance enforcement is up to insurance carriers who may hesitate to effectively enforce compliance out of fear of losing a customer. Often, compliance enforcement only occurs when a claim is filed. For all intents and purposes, there is no compliance enforcement for companies that are in self-insured trusts. While reportedly there have been payroll record comparisons between the two systems, there is apparently no coordinated enforcement with the state Labor Department's UI system. Given the substantial extent of non-compliance suggested by this analysis, the absence of a concerted enforcement effort is nothing short of astounding! Employers' misclassification of workers as independent contractors goes completely unchecked by WC insurers and the CIRB.¹⁰

While it is a felony to submit a fraudulent WC claim, it is only a misdemeanor for a business not to carry legally required WC insurance. A first offense for non-compliance is punishable by a fine of not less than \$500 nor more than \$2,500, or imprisonment for up to one year. (Section 52(1) of the WCL.)

The State of Florida presents a sharp contrast to the generally weak state of workers' compensation enforcement in New York. In the midst of a housing construction boom in 2003, the State of Florida reformed its workers' compensation system and launched an aggressive program to combat workers' compensation fraud. Florida now has nearly 100 investigators in its anti-fraud campaign that targets employers who attempt to evade the legal mandate to provide their employees with workers' compensation coverage, including those who claim their workers are "independent contractors." In its latest fiscal year report on workers' compensation fraud enforcement, Florida reports that 2,693 stop work orders were issued, \$58.8 million in penalties were levied; \$30.5 million in additional workers comp premium payments were collected; and that enforcement caused 12,366 new employees to be covered by workers comp insurance. Florida's enforcement efforts involved 224 arrests and 85 convictions of employers working without workers comp insurance.¹¹

⁹ New York State Superintendent of Insurance Howard Mills, "Opinion and Decision in the Matter of Workers' Compensation Insurance Rate Application of the New York Compensation Insurance Rating Board," July 12, 2006.

¹⁰ In the workers' compensation system, "misclassification" of workers refers to the practice whereby an employer will identify a given worker as being in a job classification with a lower premium rate than the actual job classification. The CIRB does conduct some enforcement of this "occupational misclassification."

¹¹ Florida Department of Financial Services, Division of Insurance Fraud and Division of Workers' Compensation, "Joint Report to the President of the Florida Senate and the Speaker of the Florida House of Representatives," January 1, 2007. http://www.fldfs.com/WC/pdf/01-01-07_Joint_report.pdf. For a summary of coverage requirements under Florida's workers' compensation law, see Florida Department of Financial Services, Division of Workers' Compensation, "Key Coverage and Exemption Eligibility Requirements." <http://www.fldfs.com/wc/keycoverage.html>.

Is There Under-reporting of Employment for the Unemployment Insurance System (and the Workers Compensation System)?

There is considerable evidence that many employers are treating workers as “independent contractors” when they are actually employees in order to circumvent their liability for payroll taxes and social insurance premium payments.

It is becoming more common in everyday life to encounter workers who formerly worked for a well-known company who are now considered independent contractors. For example, express package delivery drivers frequently are treated by their employers as independent contractors. Or, the person installing a cable television hook-up or broadband cable, who used to work for the phone company or a large cable company, is now treated as an independent contractor even though he or she arrives in a truck with the cable company’s name on it and must report to a supervisor from that company before and after completing a cable installation.

In the labor standards arena, this practice of considering workers who are really employees as independent contractors is referred to as “misclassification.” (In the WC system, “misclassification” has a different meaning: when an employee is considered to be assigned to a different occupation that has a lower WC premium rate than the occupational class to which they should be assigned.) In this report, we use the broader labor standards definition for employee misclassification.

There is more than anecdotal evidence that the misclassification of workers is on the rise. A February 2000 report prepared for the U.S. Department of Labor stated that:

The number one reason employers use independent contractors and /or misclassify employees is the savings in not paying workers’ compensation premiums and not being subject to workplace injury and disability-related disputes.¹²

The Planmatics study for the USDOL examined UI employer audit data from nine states to gauge the extent of employee misclassification. The report concluded: “The percentage of audited employers with misclassified workers ranged from approximately 10 percent to 30 percent. The percentages of UI tax revenues underreported due to misclassification varied from 0.26 percent to 7.46 percent.”¹³

More recently, studies by researchers at the University of Massachusetts and Harvard University looking at UI audits in Massachusetts and Maine have reached similar conclusions. The Massachusetts study stated:

¹² Planmatics, Inc. “Independent Contractors: Prevalence and Implications for Unemployment Insurance Programs,” Prepared for the U.S. Department of Labor, Employment and Training Administration, February 2000, p. iii.

¹³ Planmatics, p. iii.

Across all industries, 13 percent of employers were found to under-report worker wages and UI tax liability to the Commonwealth and thus to have misclassified workers. This represents about 26,000 employers statewide. This conservative estimate is based on audits of employers that, while not selected by fully statistically random methods, are considered random, or non-targeted, audits in common auditing practices.¹⁴

Using audit data provided by the Illinois Department of Employment Security, a December 2006 study by researchers at the University of Missouri-Kansas City estimated that 8.5 percent of all employees in Illinois were misclassified as independent contractors in 2005, representing a 55 percent increase in the “misclassification rate” in Illinois from 2001 to 2005.¹⁵

Employee misclassification creates significant problems for workers. Misclassified workers are not covered by WC or UI and are liable for the full Social Security and Medicare payroll tax (15.3 percent).¹⁶ They also lose access to employer-provided health and other benefits, such as retirement benefits and paid time off. In addition, employers who are abiding by legal requirements are subjected to unfair competition from non-compliant employers. While the studies of misclassification are usually based on UI audits, misclassification for UI purposes almost always extends as well to the WC system. In addition to the growing problem of employee misclassification, it is likely that there has been a growth in off-the-books or underground economic activity where transactions are performed on a cash basis and hence are difficult to track or audit.¹⁷

Greater attention needs to be given to the unlawful misclassification of workers, particularly in light of a recent case where the Workers Compensation Board affirmed a decision by a Workers' Compensation Administrative Law Judge. In this case involving FedEx Home Delivery, the company was found to have a WC liability for a worker FedEx Home Delivery had deemed an independent contractor. The ruling over-turned a 1995 decision in a similar case that sided with the company's claim that the worker was an independent contractor.

¹⁴ Francois Carre and Randall Wilson, “The Social and Economic Costs of Employee Misclassification in Construction,” A report of the Construction Policy Research Center, Labor and Worklife Program, Harvard Law School and Harvard School of Public Health, Elaine Bernard and Robert Herrick, Principal Investigators, December 17, 2004, p. 1. <http://www.mccormack.umb.edu/csp/publications/misclassification.pdf>. Carre and Wilson, “The Social and Economic Costs of Employee Misclassification in the Maine Construction Industry,” A report of the Construction Policy Research Center, Labor and Worklife Program, Harvard Law School and Harvard School of Public Health, Elaine Bernard and Robert Herrick, Principal Investigators, April 25, 2005. <http://www.law.harvard.edu/programs/lwp/Maine%20Misclassification%20Maine.pdf>.

¹⁵ Michael P. Kelsay, James I. Sturgeon, and Kelly D. Pinkham, “The Economic Costs of Employee Misclassification in the State of Illinois,” A Report by the Department of Economics, University of Missouri-Kansas City, December 6, 2006. Since workers misclassified as independent contractors are known to underreport their personal income for tax purposes, this study estimated that Illinois lost from \$150 million to \$250 million in personal income tax collections in 2005 related to employee misclassification.

¹⁶ The combined employer and employee payroll tax rates for Social Security and Medicare total 15.3 percent of gross wages.

¹⁷ For example, while reliable data from the Census Bureau and F.W. Dodge indicate a considerable expansion in residential construction activity in New York City since 2000, the official state labor department employment data, based on the QCEW, indicate only a marginal increase in residential construction employment. Fiscal Policy Institute, forthcoming study of the fiscal and economic costs of employee misclassification and the underground economy in the New York City affordable housing sector.

Despite the fact that the claimant had signed a contract to perform services as an independent contractor, the WCB ruled that claimant exercised insufficient control over his work and that FedEx had clearly established an employer-employee relationship since it “exercised considerable control over the claimant’s day to day work activities, and had the authority to terminate its relationship with the claimant.”¹⁸ In explaining its decision, the Board stated:

In order to further the social policy of the Workers’ Compensation Law (WCL), the terms [employer, employee, and employment] were defined broadly in an attempt to bring as many workers as possible within the protection of the Law...In keeping with the liberal interpretation of the WCL, unless otherwise specifically delineated in the statute, it is presumed that a worker in a particular business is an employee and within the employ of such business...The presumption in favor finding an injured worker to be an employee is further emphasized and supported by the manner in which the Courts have interpreted and applied the WCL. The Courts have stated that it is sufficient to find a claimant was an employee, if any one of the many indicia of control is present. However, such is not true for a contrary ruling. An alleged employer is required to demonstrate that a great number of the factors are not present before a finding can be made relieving the alleged employer of liability ...The courts have denied businesses the right to insulate themselves against the “costs and bookkeeping inconvenience of workers’ compensation and other social benefits designed for the benefit of employees.”¹⁹

A significant growth in employee misclassification in New York State is suggested by various employment and self-employment data series. Workers who are paid as independent contractors receive an IRS 1099 form for tax purposes rather than a W-2 form at the end of the year. The U.S. Commerce Department counts workers paid on 1099 forms as “non-employer establishments.” Most people counted as “sole proprietors” are legitimately small businesses. And many people counted as “non-employer establishments” may indeed be truly consultants or independent contractors. However, the growth in these two series has been so much greater than the growth in the UI employment series that it likely reflects the practice on the part of employers of misclassifying workers who are really their employees as independent contractors.

Table 2 shows the much more rapid growth in New York State over the 1997 to 2004 period in sole proprietors (27.8 percent) and non-employers (28.0 percent) compared to the growth in UI covered employment (4.7 percent). The first two series are much smaller in number than the UI covered employment series, yet had absolute growth between 1997 and 2004 that was slightly larger than covered employment in the case of sole proprietors and more than three-quarters as great in the case of non-employers. (Table 4 below presents detailed industry comparisons between the non-employer series and the Current Employment Survey series.)

¹⁸ Cathy Ruckelshaus, attorney with the National Employment Law Project, indicates that the New York decision in the FedEx case is typical of cases brought in several states against FedEx having to do with misclassification of workers and liability for workers’ compensation and unemployment insurance. Personal communication, January 9, 2007.

¹⁹ New York State Workers’ Compensation Board, Matter of FedEx Home Delivery, WCB #3040 1455, July 16, 2006.

Year	UI covered employment	Sole Proprietors	Non-employers
1997	7,902,044	1,430,230	1,101,776
2004	8,275,266	1,827,364	1,410,301
Percent change 97-04	4.7%	27.8%	28.0%
Absolute growth 97-04	373,222	397,134	308,525

Sources: New York State Department of Labor website (UI covered employment); U.S. Bureau of Economic Analysis (Sole Proprietors); U.S. Census Bureau (Non-Employers). The covered employment and sole proprietors series pertain to people who work in New York State; the non-employers series pertains to people who are New York State residents.

The Social Security Administration also compiles data on wage and salary employment and self-employment for each state based on place of residence. Table 3 shows that for the 2000 to 2003 period, while New York state residents' wage and salary employment dropped by 1.2 percent (a decline of 109,410 workers), self-employment among New York State residents grew by a like amount, increasing by 110,806 for a 10.8 percent growth rate.

Year	Wage and salary employment	Self-employment
2000	9,476,587	1,029,090
2003	9,367,177	1,139,896
Percent change 2000-2003	-1.2%	+10.8%
Absolute change 2000-2003	-109,410	+110,806

Source: Social Security Administration, Office of Policy Data.

To better understand the nature of growth in the non-employer series, Table 4 presents a detailed industry-by-industry comparison with the Current Employment Survey (CES) payroll series. The CES covers non-agricultural employment and is slightly different than the insured UI payroll employment series. The CES is compiled from a monthly survey of establishments, is based on place of work, and is periodically benchmarked to the administrative databased UI covered employment series. Since consistent industry detailed data are not available on the new industry classification system (NAICS) for the UI data prior to the year 2000, Table 4 uses the CES series.

In the transportation sector, which includes couriers and package delivery companies, payroll employment actually declined slightly between 1997 and 2004 yet the number of non-employers increased by 17,600, or over 27 percent. When the State of California targeted the courier industry for enforcement against misclassification, it found that 12,700 drivers were

misclassified as independent contractors who should have been reported as employees.²⁰ In the information sector, New York's payroll employment declined by almost 10,000, while the number of non-employers increased by slightly over 10,000. Several sectors had very rapid growth in the number of non-employers, often far exceeding the rate of growth in payroll employment. In six sectors—real estate, administrative support, educational services, health and social services, leisure, and other services—the growth in non-employers was three to six times as fast as the growth in payroll employment.

Overall, the growth in non-employers totaled 308,500 compared to a growth in payroll employment of 394,800. In 1997, payroll employment was more than seven times the size of the number of non-employers in New York State. The growth rate for non-employers was 28 percent, over five times the 4.9 percent growth rate in the number of payroll jobs. While it is possible that there really was faster growth in self-employment over this period, particularly during and after the 2001-2003 recession and slowdown, it is also very likely that the sizable growth differential between the two series reflects a substantial spurt in employers misclassifying workers as independent contractors in order to reduce their payroll costs for workers compensation, unemployment insurance, payroll taxes, and employee fringe benefits. For the more recent years, the contrast between the payroll employment and non-employer series is pronounced. Looking at the 2000 to 2004 period, the number of non-employers grew by 207,391 while the Current Employment Survey payroll employment level had a net decline of 194,500. In construction, for example, New York's payroll employment had a net decline of 5,100 between 2000 and 2004, while the number of non-employers grew by 13,350. In 2004, 27 percent of the combined sum of payroll and non-employer construction workers were classified as non-employers in New York.

²⁰ Between January 2004 and June 2005, the California Employment Development Department audited over 200 courier businesses. This investigation resulted in over \$28.4 million in tax assessments, penalties and interest. California found that third-party contract providers had been perpetrating an illegal scheme to allegedly provide the appearance of an arm's-length relationship between courier companies and certain drivers. The State of California mounted the targeted enforcement campaign in response to complaints from law-abiding businesses whose competitive position was being undermined by this illegal employment practice. California Employment Development Department, "Tax News for Tax Professionals," www.edd.ca.gov/taxrep/taxnews.htm.

Table 4: Payroll employment vs. non-employer growth, NYS, 1997 - 2004

NAICS	Non-employers				Payroll employment			
	1997	2004	change '97-'04		1997	2004	change '97-'04	
0 Total	1,101,776	1,410,301	308,525	28.0%	8,067,100	8,461,900	394,800	4.9%
21, 22 Mining, Utilities	1,814	1,939	125	6.9%	50,400	45,100	-5,300	-10.5%
23 Construction	101,125	116,974	15,849	15.7%	265,500	322,200	56,700	21.4%
3 Manufacturing	18,596	18,253	-343	-1.8%	797,100	597,000	-200,100	-25.1%
42 Wholesale trade	32,508	31,647	-861	-2.6%	361,900	354,200	-7,700	-2.1%
44-45 Retail trade	110,548	108,565	-1,983	-1.8%	820,500	868,000	47,500	5.8%
48-49 Transportation & Whsg.	64,477	82,106	17,629	27.3%	228,900	225,200	-3,700	-1.6%
51 Information	16,037	26,735	10,698	66.7%	278,700	269,100	-9,600	-3.4%
52 Finance & Insurance	48,991	50,913	1,922	3.9%	548,900	519,700	-29,200	-5.3%
53 Real estate	107,114	160,695	53,581	50.0%	171,100	182,200	11,100	6.5%
54 Prof., sci., tech. services	213,066	215,997	2,931	1.4%	458,000	517,300	59,300	12.9%
56 Admin. Support	50,831	72,412	21,581	42.5%	388,000	420,100	32,100	8.3%
61 Educational services	19,671	37,403	17,732	90.1%	270,800	343,200	72,400	26.7%
62 Health care & social assist.	97,284	164,570	67,286	69.2%	1,023,800	1,176,800	153,000	14.9%
71, 72 Leisure	88,361	126,379	38,018	43.0%	584,500	663,500	79,000	13.5%
81 Other services	124,215	189,081	64,866	52.2%	299,900	352,900	53,000	17.7%

NAICS	Combined payroll employment and non-employers		Non-employer share of combined total		Non-employer change '97 - '04 as share of change in combined total
	1997	2004	1997	2004	
0 Total	9,168,876	9,872,201	12.0%	14.3%	43.9%
21, 22 Mining, Utilities	52,214	47,039	3.5%	4.1%	n.m.
23 Construction	366,625	439,174	27.6%	26.6%	21.8%
3 Manufacturing	815,696	615,253	2.3%	3.0%	0.2%
42 Wholesale trade	394,408	385,847	8.2%	8.2%	10.1%
44-45 Retail trade	931,048	976,565	11.9%	11.1%	-4.4%
48-49 Transportation & Whsg.	293,377	307,306	22.0%	26.7%	126.6%
51 Information	294,737	295,835	5.4%	9.0%	974.3%
52 Finance & Insurance	597,891	570,613	8.2%	8.9%	n.m.
53 Real estate	278,214	342,895	38.5%	46.9%	82.8%
54 Prof., sci., tech. services	671,066	733,297	31.8%	29.5%	4.7%
56 Admin. Support	438,831	492,512	11.6%	14.7%	40.2%
61 Educational services	290,471	380,603	6.8%	9.8%	19.7%
62 Health care & social assist.	1,121,084	1,341,370	8.7%	12.3%	30.5%
71, 72 Leisure	672,861	789,879	13.1%	16.0%	32.5%
81 Other services	424,115	541,981	29.3%	34.9%	55.0%

Sources: Non-employer series, <http://www.census.gov/epcd/nonemployer/download/ndownload.html>
 Payroll series, Current Employment Survey, NYS DOL

Note: Agriculture (NAICS 1..), Government (NAICS 9..) and Management of companies & enterprises (NAICS 55) not included in details above

What does all this mean?

This analysis suggests that there may be a serious non-compliance issue for New York State's WC system. For 2003, total WC payrolls, adjusted for the exclusion of several categories of workers and the construction industry limitation, were 20 percent lower than total UI payrolls. This difference is quite substantial, amounting to \$77.7 billion in payroll. Even if only 25 percent or 50 percent of the difference in adjusted WC and UI payrolls represents non-compliance with the WC system, very large numbers of workers and substantial sums of payroll are illegally outside the WC system. If the workers included in this payroll total earned the average wage in New York State of nearly \$50,000, the number of workers *not covered* who should be would range from about 390,000 to 780,000.

Substantial anecdotal evidence, several reputable studies and the strikingly rapid growth in "non-employers" in New York State compared to the growth in payroll employment in recent years strongly suggest that there has been an explosion in employers misclassifying their workers as independent contractors. An examination of the industry level detail comparing the 1997 to 2004 (or 2000 to 2004) growth in payroll employment and the growth in non-employers, suggests substantial employee misclassification at work in the very sectors that the anecdotal evidence and the limited enforcement record indicate have been characterized by extensive misclassification.

Table 5 on the next page details assumptions behind a low and a high estimate for the range of the possible shortfall in WC coverage, payroll, and lost premium payments. This method results in estimates for a range of WC premiums annually lost to the New York State WC system due to non-compliance and illegal employee misclassification. This range extends from \$506 million to \$1.0 billion per year in lost WC premiums (including assessments). The broad range reflects the fact that this is a very inexact exercise. This inexactness is a function of the lack of attention that has been given to effective enforcement of compliance with New York State's WC and UI laws, and the unknown reliability of the workers' compensation payroll data.

Various assumptions have to be made to generate any estimates along these lines. Readers are encouraged to challenge these assumptions and to provide data that can be used to improve on these estimates.

The Fiscal Policy Institute is currently working on a study of the New York City residential construction sector in order to shed greater light on the issues discussed in this report. It is particularly revealing that during the tremendous housing construction boom in New York City in recent years, there has been only a slight reported growth in residential construction payroll employment while widely accepted measures of the growth in residential construction activity have grown by over 100 percent.

Table 5: Estimates of NYS Workers' Compensation Shortfall: Number of workers affected and premium shortfall

A. Gap between Total 2003 Payrolls for Workers' Compensation and Unemployment Insurance

i. Total 2003 amount that UI payroll exceeds adjusted WC payroll (\$ millions)	\$77,700	20%	Low estimate of WC shortfall	High estimate of WC shortfall
ii. assumption regarding % of difference that represents WC non-compliance			25%	50%
iii. assumed magnitude of WC non-compliance payroll shortfall (\$ millions)			\$19,425	\$38,850
iv. Average NYS wage, 2004	\$49,953			
v. Est. number of workers not covered (iii./iv.)			388,866	777,731

B. WC payroll shortfall due to employment misclassification

i. Growth in 1997-2004 number of NYS "non-employers"	308,525		Low estimate of WC shortfall	High estimate of WC shortfall
ii. 1997-2004 growth in non-employers if growth rate had been only twice the NYS payroll growth instead of nearly 6 times	107,974			
iii. Difference between i. and ii. that might reflect employment misclassification	200,551			
iv. Assumption regarding share of iii. that represents misclassification			50%	100%
v. Number of workers assumed misclassified (iii. X iv.)			100,275	200,551
vii. Estimated payroll for misclassified workers (\$millions) (v. X A.iv.)			\$5,009	\$10,018

C. Combined WC payroll shortfall from non-compliance and misclassification

i. Payroll total (A.iii. + B.vii). (\$ millions)			\$24,434	\$48,868
ii. Estimated employment total (A.v. + B.v.)			489,141	978,282

D. Lost WC premium payments due to non-compliance and misclassification

i. Average WC premium rate, 2005	1.75%		Low estimate of WC shortfall	High estimate of WC shortfall
ii. Assessment rate applied on top of premium rate, 2005	18.4%			
iii. Overall premium and assessment rate	2.07%			
iv. Lost WC premium payments (including assessments) due to non-compliance and misclassification (\$ millions)			\$506	\$1,013
v. Lost WC premium per worker	\$1,035			

Source: Estimates by Fiscal Policy Institute, Jan. 23, 2007.

Conclusion

The growing problem of employer non-compliance with the workers compensation system is undermining the integrity of a social insurance system that New York State helped pioneer during the Progressive Era nearly a century ago. Workers' compensation was established early in the last century to spread the risk of industrial accidents and provide "no fault" minimum benefits to workers injured on the job. WC was also meant to serve as an important tool to encourage employers to provide workplaces that are healthy and safe. By evading their legal responsibility for WC, that incentive ceases to function and affected workplaces become more dangerous, jeopardizing the health and safety of workers.

The past two decades have seen significant economic and labor market transformations in the U.S. Some businesses have sought an unfair competitive advantage by skirting responsibility for the payment of payroll taxes and social insurance premiums for their workers. Large-scale non-compliance with workers' compensation is an instance of that. It is up to government to police the labor market and employer labor practices just as government must police the streets to maintain public safety. In New York, government has failed to do that.

By not enforcing its own laws, the State of New York has allowed extensive non-compliance and the underground economy to proliferate. This not only harms workers and makes workplaces more dangerous, it creates an unfair competitive threat to law-abiding businesses, it threatens the viability of the state's workers' compensation system, and it generates unfavorable publicity about New York's economic climate. Broader negative repercussions also result: the failure to enforce employer compliance undermines other social insurance protections, namely unemployment insurance, and it leads to the evasion of payroll taxes, and ultimately, a broader evasion of business and personal income taxation.

States such as Florida, California and New Jersey have shown that targeted enforcement efforts can effectively combat workers' compensation fraud by non-compliant employers.²¹ Also, the recent decision by New York's Workers' Compensation Board in a case involving Federal Express again reiterates the state's clear position on the independent contractor issue. Now, New York State needs an aggressive effort to combat workers' compensation employer fraud connected to both general non-compliance and to the growing employer practice of misclassifying workers as independent contractors. Reform of the workers' compensation system should include institution of an aggressive enforcement effort to combat employer fraud.

²¹ In mid-2006, Governor Corzine directed New Jersey's Department of Labor and Workforce Development and the Department of the Treasury "to work together to ensure that employers don't misclassify their employees as independent contractors ..." In 2005, more than 26,000 workers were found to be misclassified as independent contractors. New Jersey Department of Labor and Workforce Development, "Update on Governor Corzine's Worker Misclassification Initiative," www.state.nj.us/labor/press/2006/0719WorkerMisclassification.htm. In order to identify potential non-compliance, the State of California requires businesses to provide all 1099s to the State. Delaware enacted workers' compensation reform in January 2007 that strengthened mandatory insurance provisions and increased penalties for employer violators. See <http://www.insurancejournal.com/news/east/2007/01/18/76015.htm?print=1>.

Addendum

February 5, 2007

Since this report was initially published on January 25, 2007, it has received considerable attention in the press and among individuals and organizations active in various aspects of the workers' compensation insurance industry. Below are our comments on two of the responses that we have received.

New York Compensation Insurance Rating Board Response to FPI Report

On February 2, 2007, the New York Compensation Insurance Rating Board (NYCIRB) released a response to FPI's report of January 25.²² In the response, NYCIRB's president, Monte Almer, asserted that this report's findings "have no validity especially as an indicator of employer payroll fraud within the workers compensation industry." Unfortunately, NYCIRB's response missed the main thrust of the FPI report—that given current administrative practices by NYCIRB and the Workers' Compensation Board (WCB), there is no way to assure that the entire universe of companies operating in New York State have workers' compensation insurance. Instead, NYCIRB's response raised a series of technical points that are clearly subordinate to the over-arching issue of verifying universal coverage.

Under the state's unemployment insurance system, administered by the Department of Labor, payroll data and unemployment insurance premiums are submitted to the Department of Taxation and Finance Department along with income tax withholding. These data describe the universe of companies operating in New York State. The obvious starting point for verifying universal workers' compensation coverage is to take the universe of companies in the state unemployment system and match it with data on workers' compensation coverage or self-insurance status from NYCIRB, the State Insurance Fund, and the WCB. In the absence of this matching, or a similar method that involves a reliable universe of companies, it is questionable how verification of universal coverage for workers' compensation purposes would be accomplished.

In this report, FPI made a first attempt at such a matching. We relied on the best data provided by the NYCIRB and the WCB, which authorizes and compiles data on companies that are self-insured, and made a series of adjustments for various exemptions to gauge how closely the adjusted workers' compensation payroll matched the unemployment insurance payroll. Our method involved conservative estimates to narrow the payroll gap between the two systems. We encouraged readers to challenge our assumptions and "to provide data that can be used to improve on these estimates" (p. 15).

²² Almer, Monte, "New York Compensation Insurance Rating Board Response to Report of Fiscal Policy Institute," NYCIRB, February 2, 2007. NYCIRB is a non-government organization controlled by New York's private workers' compensation insurance "carriers that is designated under state law to compile data on the workers' compensation system and to recommend changes in workers' compensation premium levels and the rate structure.

NYCIRB did not provide information on how they sought to ensure universal coverage, nor did they provide any quantitative data on the technical points they raised. The closest the NYCIRB response came to the question of universal compliance is the statement that “it is believed that, throughout history, only a small percentage of employers have failed to provide coverage to their workers.” But evidence abounds from around the country that many businesses are seeking to minimize their payroll costs by avoiding workers’ compensation and other social insurance as well as payroll tax and fringe benefit responsibilities. In some hazardous lines of work, such as construction, workers’ compensation costs often exceed the sum of payroll taxes and unemployment insurance premiums.

The imperative to ensure universal compliance with workers’ compensation is not NYCIRB’s responsibility alone. The State Insurance Fund and the WCB also have some responsibility. Without a systematic method in place to ensure compliance, many companies may be slipping through the cracks. This harms the workers involved, businesses that are in compliance, and taxpayers generally.

NYCIRB’s response also missed the point on the independent contractor issue. Almer said that the independent contractor problem is national and also that it may not be widespread in New York. It is indeed a growing national problem, but it is not a new issue, and New York State has one of the strictest tests for determining independent contractor status. If NYCIRB and private insurance carriers are to sell and regulate workers’ compensation insurance effectively, they need effective methods to identify and curb the practice of misclassifying workers to avoid employer responsibility.

At this stage in the review of New York’s workers’ compensation system, the exact magnitude of the shortfall in coverage is less important than the glaring fact that there currently does not exist an effective means to verify universal coverage. Many participants and observers also raise the need for better oversight regarding the employer audits conducted by NYCIRB.

Risk Metrics Letter to Governor Spitzer

In a February 2, 2007, letter to the Governor, a Risk Metrics official, Steven H. Axelrad, stated that a detailed match for 2003 between the New York workers’ compensation policyholder database with a Dun & Bradstreet database of all New York businesses found that over 200,000 out of 650,000 New York companies did not have workers’ compensation coverage.

Risk Metrics Corporation of Boca Raton, Florida, was founded in 1998 by former top officials for the National Council of Compensation Insurance, the nation’s largest provider of workers’ compensation and employee injury data and statistics. Risk Metrics markets database sales information systems to property and casualty insurance carriers.



The Fiscal Policy Institute is a nonpartisan research and education organization that focuses on tax, budget, and economic issues that affect the quality of life and the economic well being of New York State residents.

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