ASPEN TECH POLICY HUB

POLICY

How Companies Can Mitigate Pay Imbalances for Contract Work

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EXECUTIVE SUMMARY

The tech sector, an industry known for high wages and generous benefits, has accelerated its use of professional services contract workers who have responsibilities similar to those of full-time employees but are employed by staffing agencies. While these contractors work in core functions such as engineering, design, and research, they miss out on certain forms of compensation and benefits and incur additional costs such as job instability. This pay disparity exacerbates social inequities, since contract workers are more likely to be racial and gender minorities than their full-time counterparts.

By maintaining pay disparities between full-time and contract workers, companies extend social inequities that are incongruent with their stated values, reduce their hiring competitiveness and worker productivity, and risk reputational and regulatory harm. To adopt a more equitable compensation strategy for contractors that accounts for the hidden costs of contract work, we recommend that companies:

- Use the Contractor Pay Gap Calculator to better understand the ways their pay strategies may lead to unexpected or unknown gaps in compensation; and
- Update their pay strategies – by reviewing their overall hiring philosophy, updating contractor benefit standards, establishing contract length policies, and reviewing hourly pay – to fulfill the spirit of equal pay for equal work. More information on these pay strategies can be found in the Company Operational Plan.

BACKGROUND

Hiring white-collar workers through hiring agencies is a growing business trend, especially in Silicon Valley. In 2018, contract workers at Google outnumbered direct employees for the first time in the company's 20-year history.[1] Once viewed as a trend mainly among blue-collar roles, the outsourcing of full-time white-collar (also referred to as "professional services") roles has grown substantially. In 2016, economists Lawrence Katz and Alan Krueger found that workers in jobs with higher wages were more likely to have their services contracted out than those with lower wages, over the previous 2 decades.[2]

Contract workers miss out on many formal forms of compensation and face additional job challenges that affect their financial and personal well-being, such as job instability and uncertain career advancement. Although data about subcontracted work are historically opaque, several studies have shown a consistent trend of contracted workers making less than their full-time counterparts despite doing the same type of work.[3] In 2016, a University of California, Santa Cruz paper found that "white-collar workers employed in contracting industries earn an average of 35% less than their counterparts who are directly hired."[4] Similarly, in May 2019, a Recode analysis of self-reported salaries at Google found the median income for contractors to be 30% less than for full-time employees.[5]

Beyond salary and hourly pay, there are other material differences in full-time and contractor compensation that diminish contractors' economic livelihoods. While Silicon Valley is well known for industry-leading benefits like parental leave, child care, and healthcare, the agencies they use to hire contractors do not need to provide those services, leading to significantly higher out-of-pocket costs.[6] In addition, Silicon Valley companies hire contractors for fixed-length contracts, some as short as a few months, which leads to job instability for the workers.[7] This difference in job security was particularly highlighted during the COVID-19 pandemic. For example, when Airbnb laid off both full-time and contractor employees in April 2020, contractors received 7% of the severance pay of their full-time counterparts — 1 week versus 14 weeks.[8]

The principle of "compensation equity" means that individuals who do the same work should be paid the same. The Equal Pay Act, the federal government's definitive law governing equal pay, "requires that men and women in the same workplace be given equal pay for equal work. The jobs need not be identical, but they must be substantially equal."[9] California's Equal Pay Act builds on the concept by adding race and ethnicity as protected classes; it "prohibits an employer from paying its employees less than employees of the opposite sex, or of another race, or of another ethnicity for substantially similar work."[10] As white-collar contracting continues to rise, we are asking technology companies to apply the same principle to contract workers who are doing "core business" alongside full-time colleagues.

RECOMMENDATIONS

Companies should reduce pay equity disparities between employees and contractors for 3 reasons:

- **By maintaining pay disparities between full-time and contract workers, companies extend social inequities that are incongruent with their stated values.**
  The 2016 UC Santa Cruz study also found that white-collar contracted employees were 2.6 times more likely to be Black or Latino.[11] Data published by Project Include and TechEquity Collaborative in October 2021 further showed that "Black, Indigenous, Latinx, Asian, women, and nonbinary people are overrepresented as contract workers compared to the directly-employed tech workforce."[12] To this end, the practice of pay disparity between full-time and contract workers exacerbates America's well-documented racial wealth gap and other social inequities.[13]

- **By underpaying large portions of their core workforce, companies increase longer term costs through increased turnover, decreased hiring competitiveness, and worsened productivity.** While there can be financial pressure to underpay workers in the short term – full-time or contractors – companies take on long-term risks in maintaining such systems. Underpaying workers is associated with lower productivity and morale, and poor benefits can lead to decreased work performance and increased turnover.[14] And this turnover is not without costs: research shows that it costs an average of 40 percent of an individual employee's annual salary to find a replacement.[15] As Silicon Valley companies increasingly rely on subcontractors to do "core business" work, they risk creating a second tier of less productive, higher turnover workers through systemic undercompensation.

- **As regulatory and public pressure increases, companies can mitigate risk by proactively addressing contractor compensation equity.** Public attention is increasingly being paid to labor issues and worker equity.[16] At a legislative level, there is passed and pending legislation to increase pay equity transparency (such as California's SB 973) and even enforce pay equity for contract workers with roles similar to those of full-time employees (such as HR 7638).[17] Given the increased attention to tech companies in particular, companies that want to preempt this additional angle of public scrutiny, and proactively become thought leaders on pay equity, need to consider their compensation strategies for contract workers.

For those reasons, contractors who are performing work substantially similar to that of full-time employees should be compensated equitably. To reach this goal, companies should adopt a more equitable compensation strategy for contractors that accounts for the hidden costs of contract work, including missed monetary compensation, unequal benefits, and job instability.

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The following summarizes steps that a company can take to reduce the pay gap between contractors and full-time workers. The attached Operational Plan has more details.

- **Step 1: Understand the hidden costs that are passed on to contract workers**
  Companies that are hiring contractors, or are considering doing so, should evaluate their compensation strategy and understand whether they are fairly compensating contractors compared with full-time employees in similar roles. They can use the Contractor Pay Gap Calculator for this analysis.

- **Step 2: Define a contractor compensation framework tied to full-time compensation**
  Companies should create contractor-specific pay bands pegged to the median full-time salary for the equivalent full-time employee (same role, same pay band), and set goals accordingly to close the average gap.

- **Step 3: Promote self-transparency**
  Some Silicon Valley companies have begun publishing pay equity reports, segmenting their pay data by gender, race/ethnicity, and/or age, areas where there has historically been abuse and inequity. In addition to these breakdowns, companies should also disclose these data on full-time/contractor pay to the public to increase transparency and accountability.

- **Step 4: Update compensation strategy to minimize gaps**
  Companies should consider the following levers to increase pay equity between full-time and contract workers:

  - Evaluate whether a portion of their contract workforce can be converted to full-time employment;
  - Require that subcontracting agencies that they work with provide some of the same benefits as they provide full-time employees;
  - Address job instability issues inherent to contract work; and
  - Increase the hourly wage to compensate for benefits that contractors may need to pay for out of pocket.

See our Company Operational Plan for more details on how to implement these recommendations.

ABOUT THE HUB

The Aspen Tech Policy Hub is a Bay Area policy incubator, training a new generation of tech policy entrepreneurs. We take tech experts, teach them the policy process, and support them in creating outside-the-box solutions to society's problems.

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