S. HRG. 110–740

THE EFFECTS OF THE UNDERGROUND ECONOMY ON SMALL BUSINESSES AND WORKERS

HEARING

BEFORE THE

COMMITTEE ON SMALL BUSINESS AND ENTREPRENEURSHIP

UNITED STATES SENATE

ONE HUNDRED TENTH CONGRESS

SECOND SESSION

APRIL 28, 2008

Printed for the use of the Committee on Small Business and Entrepreneurship

Available via the World Wide Web: http://www.access.gpo/gov/congress/senate

U.S. GOVERNMENT PRINTING OFFICE

44–568 PDF WASHINGTON : 2008

For sale by the Superintendent of Documents, U.S. Government Printing Office
Internet: bookstore.gpo.gov Phone: toll free (866) 512–1800; DC area (202) 512–1800
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ONE HUNDRED TENTH CONGRESS

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THE EFFECTS OF THE UNDERGROUND ECONOMY ON SMALL BUSINESSES AND WORKERS

MONDAY, APRIL 28, 2008

UNITED STATES SENATE,
COMMITTEE ON SMALL BUSINESS AND
ENTREPRENEURSHIP,
Washington, DC.

The Committee met, pursuant to notice, at 10 a.m., at Bunker Hill Community College, Chelsea, Massachusetts, the Honorable John Kerry (Chairman of the Committee) presiding.

Present. Senator Kerry and Representative Tierney.

OPENING STATEMENT OF THE HONORABLE JOHN F. KERRY, CHAIRMAN, SENATE COMMITTEE ON SMALL BUSINESS AND ENTREPRENEURSHIP, AND A UNITED STATES SENATOR FROM MASSACHUSETTS

Chairman KERRY. The hearing of the Small Business Committee of the U.S. Senate will formally come into session. I am delighted to be here at Bunker Community College, Chelsea, and particularly happy to have my friend and colleague from the House of Representatives, Congressman Tierney, with us to explore what is a very disturbing trend in our economy and an issue of great concern to businesses and workers alike. Congressman Tierney has been working on this issue already in the House and has a piece of legislation which he will talk about in-a few moments. But this is an issue which over the course of a couple of decades now has seen a fair amount of talk and, frankly, not a lot of action.

By some estimates, America's underground economy is as big as $1 trillion—$1 trillion—contributing to over $100 billion in lost revenue a year. Think about that, $100 billion in lost revenue, folks, is an unbelievable amount of taxes that are lost, as well as income lost to individuals. And so our whole economy is disrupted as a consequence of behavior that is fundamentally illegal.

At the heart of the issue is the fact that many companies are taking short-cuts, sidestepping lawful hiring practices so that they can gain a competitive edge. This is an issue that impacts both large and small businesses. Employers across the United States have found that tax laws and worker protections can be avoided if they treat workers as independent contractors. Some companies go to great lengths to avoid paying employment taxes and providing benefits to workers. Let me give you an example.

Kellogg Brown & Root, Inc.—KBR, as it is referred to—has avoided paying payroll taxes by hiring workers through shell companies in the Cayman Islands, and that has resulted in the losses

of hundreds of millions of dollars in payroll taxes. Now, when I talk about a shell company in the Cayman Islands, do you know what I am talking about? I am talking about a building in which there may be 15,000 or so, or 5,000 similar companies with little brass plates, maybe a phone number, maybe a fax number, and that is it. There are no employees. There is no company. There is nobody working there. This is a pure and complete shell, a sham, a fraud. And it is there solely for the purpose of avoiding the law, of avoiding the responsibility that other people in the country live up to.

Tactics like that are literally inexcusable. All these big CEOs and folks who run around in fancy suits and expensive cars, live in nice homes, beat themselves on the chest, often talk about patriotism and love of country and live off the fat of the land; it is really inexcusable when you think about how unpatriotic, in fact, that is because it undermines the country. It destroys the tax base, not to mention violates the law.

I recently introduced legislation with Congressman Rahm Emanuel and others in the House to specifically address the question of Kellogg Brown & Root. Today we will hear from our witnesses about these issues.

Tax shelters in the Cayman Islands are not needed to cheat workers out of benefits, as we will hear today. Right here in Massachusetts, workers are being harmed by employers who want to take the easy way out and not pay unemployment insurance, which is there for a purpose; workers' compensation, which is there for a purpose; and Social Security taxes—all of which escape the cost of withholding income taxes, which then gives them more cash than the other people who are withholding them.

Too many workers are being misclassified as independent contractors, an arrangement in which the employer is not responsible for withholding income or paying unemployment taxes. Employers who erroneously misclassify their workers stand to save as much 30 percent of their payroll costs. This puts a law-abiding employer at a disadvantage.

The misclassification of workers is not just a financial issue. It is a values issue. Employers that wrongly treat their employees as independent contractors don't have to provide them with many of the worker protections that are considered to be fundamental in the country. And for more than a century, workers in this country have fought hard for these protections. They are the law of the land. And yet they are now taken for granted in many parts of the country. Employers should not be permitted to individually and arbitrarily take away these protections by simply filing a different tax form.

This morning we are going to hear from Scott Morrisey. Scott's company, Red Line Wall Systems, is constantly finding itself on the wrong end of procurement decisions because his company, which plays by the rules, can't compete with the pricing bids submitted by competitors who are getting away with these unscrupulous hiring practices.

We were also going to hear testimony from Sara Stafford, the sole owner of Stafford Construction Services, a small business with 65 employees, but unfortunately, an urgent family matter has prevented Ms. Stafford from being here with us today. But she has

submitted very important testimony about how difficult it is to compete with companies that don't play by the rules.

In her testimony, Ms. Stafford tells how Stafford Construction Services recently bid on and lost a $500,000 contract funded by Federal, State, and local taxes. An investigation by the Attorney General's Office revealed that the winning company had employed undocumented workers, as well as misclassified employees and had failed to pay benefits to workers in cash as the company had reported in its paperwork. As a result, her competitor was able to bid 15 percent less on the contract.

We also have two incredible advocates for workers in the State of Massachusetts here with us today to give us an idea of how workers are impacted by this. I want to welcome my friends Frank Callahan and Mark Erlich, who are two of the best friends Massachusetts' workers have ever had. Thanks to both of you for making time to be here.

And finally, we are going to hear about what actions Massachusetts is taking to end this abusive practice. Governor Patrick and Attorney General Coakley have done a terrific job on this issue, establishing a task force to look more closely at what can be done from a policy standpoint and also stepping up enforcement efforts for the laws that are already on the books.

Let me just say, enforcement folks, we are struggling with the problem of illegal immigration, and we are struggling with the problem of people who work off the books. A lot of the folks I just talked about also just get paid cash under the table. And that has the same impact, undermining everything else we are trying to do. Enforcement is the key. For all those people concerned about immigration and immigration reform, the biggest single missing link in the whole effort is enforcement. It is illegal to hire people illegally. And you can't tell me—and all of you know this as a matter of common sense—that there aren't an awful lot of employers all around the country who know exactly who they are hiring and how they are paying them.

We need stronger enforcement so that people believe that in this country we respect workers, and we are going to pay people appropriately and have an economy that works above the table, that is accountable and transparent. Everybody benefits when this happens. If we weren't paying people illegally in America, fewer people would decide to come where they can't get a job. They come because they know they can get the job. And in half the hotels of many communities—I am not going to name them all here today—you can go in the back rooms and kitchens and in the various workplaces of those hotels and find undocumented people. Everybody knows it—the hotel owners, the mayor, the law enforcement officials, and others.

So it is time for all of us to get serious with how we create an economy that works for everybody. As I said, I am delighted to be joined by John Tierney, who understands these issues as well as anybody. He has introduced legislation in the House, the Taxpayer Responsibility, Accountability, and Consistency Act, and we are very glad to have him here. I also look forward to hearing the testimony of each of our witnesses today who can share with us an important perspective on this problem.

So, without further ado, again, I thank Bunker Hill Community College for hosting us here today. This institution understands how important it is to train people for these jobs, and it matters that their students, when they graduate, go out and compete in a fair, competitive marketplace.

Congressman Tierney.

OPENING STATEMENT OF THE HONORABLE JOHN F. TIERNEY, A UNITED STATES REPRESENTATIVE FROM MASSACHUSETTS

Representative TIERNEY. Thank you very much, Senator. Thank you for your work on the Small Business Committee especially, in the Senate, but all the other work that you do there as well. And thanks for having this hearing and allowing me to join you, however briefly I will be able to stay. I appreciate the opportunity in no small part because we have been dealing with this issue in the House as well, and hopefully we will be able to work together with the Senate to bring some relief in fairly short order on this.

You have hit all the high points on this, and I think we will hear it repeated on down the line from our witnesses here who have different iterations of the same story. The fact of the matter is that when people misclassify, there are three groups of victims.

One, obviously, is the employer who does the right thing, as you mentioned, Senator, the person that goes and hires people the right way, makes all the payments, does the withholdings. And other people have figured out that they can save up to 30 percent if they don't do the withholdings, if they hire somebody off the books, and if they cheat. And, obviously, that becomes a competitive disadvantage. I know Mr. Morrisey is going to tell us about specific examples of that. And that has to stop. As a former small businessman myself—a real small business person who represented a lot of small business people—I know that aggravation, firsthand, that they would repeatedly suffer.

But the second group obviously are the workers themselves. If they get hurt on the job and they don't have any withholdings on that, no unemployment compensation and no workmen's compensation, they are really in terrible shape, as we know. It may even affect their Social Security and their Medicare benefits on down the line.

So there is a second group of victims, and then obviously the taxpayers. The taxpayers as a broad group are hurt seriously by this, and studies show—the Government Accountability Office, Congress' investigatory arm, did a study that showed that up to $4.7 billion in Federal income taxes alone in 1 year can be lost on that. And over a period of time—Pricewaterhouse did a study showing the tax receipts for the period 1996 to 2004 could have been increased by $34.7 billion.

So we talk about wanting to make sure people have the education and the job skills and training that they need to work in our society to deal with the advances in technology, to deal with jobs going overseas. We can find the money for these resources. People want to know how you are going to fund programs and issues that are there. We are going to find it by doing the right thing—by having people act in the appropriate way by paying their fair share, getting on board with the rest of us who pay our fair share in taxes

and withholdings and make sure that we put those resources to go work to strengthen the core of our country. We have national security issues abroad. We have homeland security issues. But part of our security is making sure that the very core of this country, whether it is our infrastructure or our human capital, are all moving in the right direction, that they are trained, they are educated, they are capable in this competitive international environment that we have.

So we have in the House, Senator, as you mentioned, formulated a bill called the Taxpayer Responsibility, Accountability, and Consistency Act. It is H.R. 5804. Frank Callahan, I noticed you mentioned it in your testimony, and I appreciate that. Richie Neal, my colleague from Springfield, and Jim McDermott, another colleagues from the State of Washington, spent a lot of time working on that trying to bring the various groups of people who had an interest in this together so that we could get a lot of the issues ironed out ahead of time. It basically amends the Internal Revenue Code so that there is a clearer vision of what would be a safe harbor that would be fair for everybody and not let people escape and use that as a way of avoiding their responsibilities. It moves forward in the right direction. There is better enforcement, higher penalties, all the things that I think we need to move on.

I want to just repeat what the Senator said about the good work that Governor Patrick is doing here in the Commonwealth; and George Noel, your group is doing well with the task force, and we think that is going to have steady progress. We have to see this happen in State after State. We are going to have to have a Federal commitment to changing that Internal Revenue Code to make it work. We have to make it easier for people to proceed on that. It will make a huge difference for all three of those groups that I talked about earlier.

Senator thank you for your work on this and for the hearing, and we look forward to working with you. Hopefully we can get a bill through that has all the facets on this.

Chairman KERRY. Congressman, delighted, and again, thanks for being here and taking the time to be with us.

We will go through each of our testimonies now. I will start down here with Scott Morrisey, and we will run right across the line. Director Noel, thanks so much for being here. We really appreciate it. And thank you, Ms. Stark, for representing the Attorney General's Office. We are glad to have you also.

So would you lead off, Mr. Morrisey.

STATEMENT OF SCOTT MORRISEY, OWNER, RED LINE WALL SYSTEMS, INC.

Mr. MORRISEY. Yes, thank you very much, Senator Kerry and Congressman Tierney, for the opportunity——

Chairman KERRY. Pull the microphone real close so everybody can hear you. There you go.

Mr. MORRISEY. On behalf of myself and my partner, Brian Cody, and Charles Doyle and the other 60 employees or so that we have at Red Line Wall Systems; companies like ours have been having a difficult time, as you have all just read. And so what I have said here is that construction has long been an industry filled with men

considered rough around the edges, unable to sit behind a desk or just good with their hands. And construction jobs gave these men an occupation that suited their disposition and still enabled them the opportunity to provide their families a solid, middle-class lifestyle.

Our company has prided itself on its ability to provide jobs with good wages and a generous benefit package. We understand that if a man does not have to worry about taking care of his family, he will be more productive on the job site. Cash-paid and 1099 underinsured subcontractors have always been a negative factor in our industry, but over the last 10 years, the ranks of these people have been exacerbated by a wave of illegal underground labor which is able to expand into and withdraw from any given region, depending on the workload. This can severely disrupt, or in some cases, destroy a small legitimate company that has long held ties to the local communities.

Construction can be a very competitive, labor-intensive business. Most jobs work on a 5-percent profit markup, leaving no room for error. In our commercial drywall industry, labor will typically make up 40 to 50 percent of the total job cost. In a highly competitive industry like ours, labor tends to be the prime target when paring down costs for those willing to break established rules or bend vaguely written guidelines. Our company, which supplies health, disability, dental insurance, alongside other benefits like holidays and vacations, make these expenses a deal breaker when competing against the underground economy.

Using Red Line as an example and the aforementioned benefits, you get a feel for what we are up against. We have Social Security and Medicare at 8 percent that we have to add to our costs; unemployment, 5 percent; workers' compensation, 11 percent; health insurance, 16 percent; holidays and vacations, 8 percent—for a 48-percent markup to our base wages to be able to get our bids out the door.

When we bid against companies who bend or break established rules of engagement, who are willing to shortchange their workers in any one or all of these overhead categories, it can put us at a 20- to 25-percent cost disadvantage. This disadvantage is impossible to make up in the total project cost line items.

I would like to now explore some of the other myths and facts as we see them based upon our experience as a small company with 50 to 60 employees in the construction business.

Myth number one: Construction is a low-skilled occupation. Nothing can be further from the truth. It seems to be the perception today that the more a person sweats and gets dirty, the less skilled his occupation. As business owners, we understand that it takes about 5 years of training and field application to become a qualified commercial carpenter. This is a significant investment of time and treasure for any business.

Myth number two: Our company needs underground labor to get the job done. Well, the fact really is that this is yet another fallacy, many times driven by greed and companies overextending their abilities and qualifications. Good management is a lot like being a good farmer. Jobs and manpower have to be tended to and managed. Good management is hard work, but it is necessary for a

company to succeed in a competitive marketplace. Good management and oversight is being supplemented by lower-skilled, higher-volume labor, extending the survival of inefficient companies, while simultaneously increasing the ranks of the lower-skilled, less productive workforce today.

Myth number three: Underground workers fill a void of a stagnant industry that has no need for innovation or continued skill development. Well, the fact is, again, underground workers stymie innovation and productivity gains. If you oversupply an industry with cheap labor, there is no need to innovate, as long as a steady supply of cheap, inexpensive labor can be assessed whenever you need it.

In our industry, alone over the last 20 years, new tools, products, and equipment have increased labor productivity by up to 50 percent in certain applications. Going forward, I can envision an industry that uses more high-tech tools, machines, and materials making a highly trained and motivated workforce more desirable than a lower-skilled, more plentiful labor pool.

Myth number four, and this is my favorite: As long as underground workers pay at least some insurance, we are all protected, we are covered. Well, the fact is that underground workers tend to be underinsured and undertaxed, which increases the burden upon legitimate, fully insured, tax-compliant companies. Any accident, or incident caused by an underinsured company will eventually be met with an across-the-board premium hike. Many of these workers are using personal vehicles with no commercial underwriting to transport men and materials. Also, in many cases, under-the-table workers are straining our social safety nets by double-dipping. Some have no problem working a full week for cash while collecting an unemployment check that has been funded by taxed labor.

Some of the worst offenders are criminals, deadbeat dads, and illegals who only work for cash so as not to get caught up in a paper trail. Some employers understand this and actually use it to their advantage to drive down labor costs.

Even one additional point of reflection: We all feel that the underground economy may possibly be responsible for the mortgage meltdown we are now experiencing. The ability for some builders to exploit easily attainable underground workers fueled an already heated housing market to the point of overcapacity. Some industry experts estimate that our overbuilt inventory will last well into the year 2010. Had hot housing markets used naturally occurring internal labor shifts, much like we had during the Texas oil boom years, we quite possibly would not be in the unfortunate situation we find ourselves currently mired in.

I put together an example of what we are up against in dollars and cents, and what we have is our company and companies like ours, if we pay a skilled carpenter, a drywall carpenter $25 an hour, $200 a day, we pay their insurance and benefit package of about 48 percent, as we mentioned earlier, $96, we have a direct cost of $296. Gentlemen, I don't care how good your men are, but over the course of a year or over a project's time, the average production for that man is about 20 sheets of drywall a day, is what they are going to hang. This cost for us would be $14.80 per sheet.

Other companies that use 1099 non-compliant individuals, they might pay their men the same. They might pay them $25 an hour, give them $200 a day. But with no benefit package, their costs on a daily output of 20 sheets would be $10 per sheet. So if I had a project with 5,000 sheets of drywall, my cost would be $74,000 and my competitor's cost would be $50,000. That is certainly a wide spread. I would ask all of you, if you were the general contractor or the developer and owner, who would you hire? You are going to save 25 percent. Well, to date, Red Line Wall Systems' manner of competing with such cost structures is three-fold:

We find good men with good attitudes who want to go to work every day. We provide them with the training, tools, and equipment to safely maximize their own skill levels.

And we take care of our employees and their families the way we would like it if we were in their shoes.

The result—while not always the rule—is an above average range of performance. The same men that I told you would usually hang 20 sheets a day now hang 26, for an average cost of $11.39 per sheet. So that job I mentioned earlier of 5,000 sheets, we can now become more competitive at $56,900. While not the low bidder still, we are close enough for some contractors and owners to consider the best project value, not the lowest number, which is what we have been doing over the last decade. Unfortunately, we don't know if that can continue with the present rate of the economy.

[The prepared statement of Mr. Morrisey follows:]

Testimony Of:
Scott P. Morrisey
Red Line Wall Systems, Inc.
162 Hamilton Street
Leominster, MA 01453

Before:
The Senate Committee on Small Business and Entrepreneurship Committee Field Hearing.

Regarding:
The Effects on Underground Economy on Small Businesses and Workers.

Monday, April 28, 2008
Community Room, Chelsea Campus, Bunker Hill Comm. College
Chelsea, MA

Brief Bio for Scott P. Morrisey

I have been working in the construction industry for 27 years. In 1997 I joined with my current partners and started Red Line Wall Systems a commercial metal stud framing and drywall company. Specializing in commercial, industrial, institutional and health care facilities. Presently we employee 50 individuals and manage projects from $500 to $1,000.000. From age 16 to 21 I worked in the roofing trades moving to a union drywall firm until the age of 29. For several years I was self employed working on construction renovations until the founding of Red Line Wall Systems in 1997.

1981 – 1986 Worked in the roofing trades.
1986 – 1993 Worked with union drywall trades.
1993 – 1997 Self employed in construction renovations.
1997 – Present – Joined with partners in founding Red Line Wall Systems.

Construction has long been an industry filled with men considered rough around the edges, unable to sit behind a desk or just good with their hands. Construction jobs gave these men an occupation that suited their disposition and still enabled them the opportunity to provide their families a solid middle class life style. Our company has prided itself on its ability to provide jobs with good wages and a generous benefit package. We understand that if a man does not have to worry about taking care of his family he will be more productive on the job site.

Cash paid and 1099 under insured sub-contractors have always been a negative factor in our industry. But over the last 10 years the ranks of these people has been exacerbated by a wave of illegal underground labor which is able to expand into and withdraw from a region depending on work load. This can severely disrupt or in some cases destroy a small legitimate company that has long held ties to the local community.

Construction can be a very competitive, labor intensive business. Most jobs work on a 5% profit mark-up leaving no room for error. In the commercial drywall industry, labor will typically make up 60-70% of the total job cost. In a highly competitive industry like ours labor tends to be the prime target when pairing down costs for those willing to break established rules or bend vaguely written guidelines. Our company which supplies health, disability and dental insurance along side other benefits like holidays and vacations make these expenses a deal breaker when competing against the "underground economy".

Using Red Line as an example and the aforementioned benefits you can get a feel for what we are up against.

S.S.I. / Med	.08
Unemployment	.05
Workmen's Comp.	.11
Health Insurance	.16
Holidays / Vacations	.08
	.48*

*as a percentage of hourly wage.

When we bid against companies who bend or break established rules of engagement who are willing to short change their workers in any or all of these overhead categories, can put us at a 20 – 25% cost disadvantage. This disadvantage is impossible to make up in the total project cost line items.

Let us explore some of the myths and facts "as we see them" based upon our experience as a small company (50 plus employee's) in the construction business.

Myth 1. Construction is a low skilled occupation.

Fact: Nothing can be further from the truth. It seems to be the perception today that the more a person sweats and gets dirty the less skilled his occupation. As business owners we understand that it takes about 5 years of training and field application to become a qualified commercial carpenter. This is a significant investment of time and treasure for any business.

Myth 2. Our company needs "underground" labor to get the job done.

Fact: This is yet another fallacy many times driven by greed and companies over extending their abilities and qualifications. Good management is a lot like being a good farmer. Jobs and man power have to be tended to and managed. Good management is hard work but it is necessary for a company to succeed in a competitive market place.

Good management and oversight is being supplemented by lower skilled higher volume labor extending the survival of inefficient companies while simultaneously increasing the ranks of a lower skilled less productive work force.

Myth 3. Underground workers fill the void of a stagnate industry that has no need for innovation or continued skill development.

Fact: Underground workers stymie innovation and productivity gains.

If you over supply an industry with cheap labor there is a no need to innovate as long as a steady supply of cheap labor can be accessed.

In our industry alone over the last 20 years new tools, products and equipment have increased labor productivity by up to 50% in certain applications. Going forward I can envision an industry that uses more high tech tools, machines and materials making

a highly trained and motivated work force more desirable that a lower skilled more plentiful labor pool.

Myth 4. As long as underground workers pay at least some insurance we are all protected.

Fact: Underground workers tend to be under insured and under taxed which increases the burden upon legitimate fully insured tax compliant companies. Any accident caused by an under insured company will eventually be met with an across the board premium hike. Many of these workers are using personal vehicles with no commercial underwriting to transport men and materials. Also in many cases "under the table" workers are straining our social safety nets by "double dipping". Some have no problem working a full week for cash while collecting an unemployment check that has been funded by taxed labor.

Some of the worst offenders are criminals, dead beat dads and illegals who only work for cash so as not to get caught up in a paper trail. Some employers understand this and use it to their advantage to drive down labor costs.

Point of reflection. We feel that the underground economy was partly responsible for the "Mortgage Meltdown" we are now experiencing. The ability for some builders to exploit easily attainable underground workers fueled an already heated housing market to the point of overcapacity. Some industry experts estimate that our over built inventory will last well into the year 2010. Had hot housing markets used naturally occurring internal labor shifts much like we had during the Texas oil boom years we quite possibly would not be in the unfortunate situation we currently find ourselves mired in

Standard Example:

Company 'X' fully compliant drywall contractor.

Skilled drywall carpenter $25.00 per hour	$200.00
Insurance and benefit package as noted earlier 48%	$96.00
Total daily direct cost	$296.00

Average daily production 20 sheets a day or $14.80 per sheet.

Company 'Y' 1099 non compliant drywall contractor.

Skilled drywaller $25.00 per hour	$200.00
Insurance and benefit package 0%	0
Total daily cost	$200.00

Average daily production 20 sheets or $10.00 per sheet.

Project with 5,000 sheets of GWB:

Company 'X' Cost	$74,000.00
Company 'Y' Cost	$50,000.00

If this were your general contracting company who would you hire?

To date Red Line Wall Systems manor of competing with such cost structures is 3 fold.

1. Find good men with good attitudes who want to go to work everyday.
2. Provide them with training, tools, equipment to safely maximize skill levels.
3. Take care of the employee and their families the way would like if we were in their shoes.

The result while not the rule is above average performance.

The same men who once would hang 20 sheets a day will new hang 26 for an average cost of $11.39 per sheet so on the 5,000 sheet job we become competitive at $56,950.00.

While not the low bidder still close enough for some contractors and owners to consider the best project value not the lowest numbers.

Chairman KERRY. Thank you, Mr. Morrisey. I appreciate it.

[Applause.]

Chairman KERRY. We will come back to questions in a moment.

If I can ask everybody—I forgot to mention this. Everybody's testimony will be put in the record as if read in full. So if you want to just summarize, take about 5 minutes, that helps us, and then we can go from there.

Mr. Callahan.

STATEMENT OF FRANCIS X. CALLAHAN, JR., PRESIDENT, MASSACHUSETTS BUILDING TRADES COUNCIL, AFL–CIO

Mr. CALLAHAN. Thank you, Senator. Thank you, Congressman Tierney. For the record, my name is Frank Callahan. I am the president of the Massachusetts Building Trades Council. The Massachusetts Building Trades Council is comprised of 74 local unions and district councils which represent 75,000 construction workers across the Commonwealth who work for approximately 3,000 subcontractors and general contractors. Our members work for these contractors, and they earn good pay. They get good benefits, comprehensive health insurance, comprehensive retirement, defined benefit pension benefits, and they pay their taxes, and they play by the rules. That is why I would like to start by thanking you, Senator, for hosting this hearing to address this very serious issue.

The Mass. Building Trades Council fully supports the Committee's efforts to address this issue of the underground economy and the vast array of problems associated with it. Four years ago, we played an active role in securing changes in Massachusetts in the State statutes back in 2004. Currently, the Massachusetts definition of what an employee is versus what an independent contractor is,is widely regarded as the best in the Nation. It is the tightest out there. And when you go to different labor conferences and conferences of labor lawyers, that is the model that everybody wants to use.

Since that time, we have worked closely with Governor Deval Patrick's office, the Executive Office of Labor and Workforce Development. I see my good friend George Noel is here; Suzanne Bump's office has been great, and the Attorney General's Office, Martha Coakley's office, the Fair Labor and Business Practices has just been outstanding. They have been very aggressive. They have been very serious about enforcing the law, and we have already started to see some results.

These efforts were formalized even further back in March. We were privileged at our convention to have Governor Patrick sign the executive order which formalized the relationship that had already been ongoing between all the different agencies of State government—the Attorney General's Office, Division of Industrial Accidents, Division of Unemployment Assistance, the Department of Labor. So they are talking to each other and not just doing piecemeal efforts on their own behalf. But typically what we find is we have a contractor who is not paying the proper wages; chances are they are not paying workers' comp or unemployment. If they are not paying workers' comp or unemployment, chances are they are not paying their taxes. It is usually the bad actors out that we are

really after, and we feel with this combined effort, we can make some great strides.

One of the main reasons we have been involved in this is not just the direct impacts that were addressed by Mr. Morrisey earlier, and by other panelists that I know it will be in their testimony. But this strikes at the very core—you alluded to it earlier, Senator—of the social contract between workers and their employers. This has developed over the last hundred years, largely due to the efforts of labor unions. Many of the people in this room are still involved in those struggles with workers' compensation, with unemployment insurance, with the uncompensated care pool—basically the social safety net. There is a social contract that if you go to work every day, you put on your boots; you put in 8 hours of work; you get 8 hours of pay; and you get treated decently.

As was mentioned by Mr. Morrisey—and I won't repeat a lot of the things he said—our industry is highly competitive in the construction industry. I have seen $40-million projects where the difference in the low bid and the second bid is $40,000. That is a pretty tight margin. A lot of the contractors are using the same software, but if you have those types of advantages that Mr. Morrisey alluded to, the people that are willing to cheat are going to be the ones who are going to be able to compete most effectively. And that is not what we want in our industry.

So the impact that Mr. Morrisey outlined is true. That is a very serious impact on our contractors. But the impact on our members is enormous because when those contractors that don't play by the rules get those projects, our members lose paychecks. Our members lose the ability to contribute to their pensions, to their health insurance. Some of them because of the way our Health and Welfare programs are set up may lose eligibility for their health insurance. Our apprentices lose the on-the-job hours that are required to complete their apprentice training programs. We have the best training programs in the industry, but they take anywhere from 3 to 5 years to complete. It is in-the-classroom training and it is on-the-job training for hands-on experience. If they don't get their man-hours they need to do that training, they will not progress and achieve journeyman status.

And as serious as the impact on our members is, the impact on misclassified workers is even worse. As I mentioned, it strikes at the very core of the social contract between employers and employees that has evolved over the last hundred years. Those workers are denied decent wages. They are ineligible for unemployment insurance benefits. Oftentimes, they are denied workers' compensation benefits. They don't accrue Social Security credit. And they almost always lack health insurance.

They are also responsible for paying employer and employee side FICA and FUTA taxes, roughly 15 percent of their gross wages, while people are properly classified as employees pay only 7.65 percent.

And, most importantly, on the social contract issue that you addressed, Senator, they lost the protections of a host of labor laws, including the minimum wage protections, overtime pay, workplace safety, discrimination, sexual harassment, the Family and Medical Leave Act, and even the right to join a union, because you have to

be an employee first before you can petition the National Labor Relations Board for a union election.

Although the construction industry experiences a higher incidence of this abuse, this problem is not limited to construction. The impact on misclassified workers is obvious, but employees, employers, and taxpayers who play by the rules also pay a very high price all across our economy for those employees who seek to avoid their legal responsibilities.

Just a few quick bullet points for the impact on Massachusetts. Most of these come from a 2004 study performed by Harvard University and the University of Massachusetts, which was sponsored by the Center to Protect Workers' Rights.

The Massachusetts General Fund loses an estimated $152 million in unpaid income taxes. The Unemployment Insurance Trust Fund loses $35 million in revenues. There is $91 million in unpaid workers' compensation premiums over a 2-year period, forcing the rest of us to cover injured workers in the Workers' Compensation Trust Fund. That fund covers workers who might not normally be covered. In fiscal year 2004, approximately $4,331,000 was paid to uninsured claimants. That is an assessment that ends up getting levied on the rest of us and the responsible employers.

Laid-off or injured workers lacking unemployment or workers' compensation benefits are forced to turn to public services, including the uncompensated care pool, now renamed the Health Safety Net Fund. And those workers show up at emergency rooms, further draining the Health Safety Net Fund because they don't have their regular insurance to go see their primary care doc, and those costs, as we all know, are much higher when you show up at the emergency room.

The impact on the national level includes three quick bullet points:

The Federal Treasury loses an estimated $4.7 billion in unpaid taxes annually. The General Accounting Office estimates that 10.3 million workers, or 7.4 percent of the total workforce, were misclassified in the year 2005. And the IRS in its most recent analysis found that 15 percent of employers misclassified employees as independent contractors.

While much progress has been made and we are expecting more progress in Massachusetts, there is still much work to be done at the Federal level. We urge the Committee and the Congress to adopt changes that will end or at least curb these abuses of the underground economy. The Massachusetts Building Trades Council supports the passage of House Resolution 5804, the Taxpayer Responsibility, Accountability, and Consistency Act, which Congressman Tierney addressed earlier and is one of the lead sponsors.

I won't go through all the main points since they were already addressed by the Congressman. But we need to tighten up that definition, and we need to get enforcement. That is what it is all about. We can't have these games. Currently, the Social Security Administration has a 20-point test to determine who is an employee and who is an independent contractor. Many of those points are legitimate, but a lot of them are, unfortunately, used as an effort, as I like to say, "feather bedding for the Bar Association" to

get around the law as opposed to finding out how to comply with the law.

We would like to see those definitions tightened up. Massachusetts has essentially compressed the 20-part test into a 3-part test, which is very rigorous and we think does the job. And it has been followed up with responsible enforcement by the Attorney General's Office and by the Department of Labor. They are not going after all the groups that you will hear about. When this law was passed in 2004, we heard about bike messengers, hairdressers, people delivering water, kids cutting grass. It is really just a sham that is put out there by folks on the other side. Those aren't the people that we are going after. These are legitimate businesses—I am sorry, illegitimate businesses that have a substantial number of employees, and they are doing this for the reasons Mr. Morrisey outlined: just to simply avoid their responsibilities.

Many in the business community will argue that this puts them in a trap, that they are really just trying to play by the rules, and the rules are too confusing, and if they break the law inadvertently, that they will be subject to serious penalties. This is simply not true. This is a calculated effort to avoid taxes, to avoid unemployment, to avoid workers' compensation, to avoid paying proper wages, and to avoid all the responsibilities that go along with being an employer, and those rights and responsibilities that transfer to that individual employee. It is an illegal action. It is tax fraud. It is workers' comp fraud. It is employment fraud. And it is a fraud on the American people and a fraud on the American workforce. It fosters a race to the bottom, and the winners in that race, unfortunately, are those who are willing to most aggressively violate the law. The losers are the rest of us—the taxpayers, the workers, and the honest employers.

I applaud your efforts in this to bring some light onto this issue at the Federal level. We are willing to work with the Committee and with the Congress in whatever efforts are necessary to make this happen, and I thank you for the opportunity to testify here today.

[The prepared statement of Mr. Callahan follows:]

MASSACHUSETTS BUILDING TRADES COUNCIL, AFL-CIO
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April 25, 2008

Testimony of the Massachusetts Building Trades Council, AFL-CIO
Senate Committee on Small Business and Entrepreneurship
April 28, 2008

Senator John F. Kerry, Chairman
Committee on Small Business & Entrepreneurship
Washington, DC 20510-6350

Dear Senator Kerry:

The Massachusetts Building Trades Council is an 88-year-old organization that represents over 75,000 working men and women belonging to 74 local unions and district councils across the Commonwealth of Massachusetts. Our members work for thousands of union contractors that pay good wages, provide comprehensive health and retirement benefits, pay their taxes and play by the rules.

The Massachusetts Building Trades Council fully supports the Committee's efforts to address the issue of the underground economy and the vast array of problems associated with it. Four years ago we played an active role in securing changes to the Massachusetts misclassification statute that is regarded as the best in the nation. Since that time we have worked closely with Governor Deval Patrick's Executive Office of Labor and Workforce Development and Attorney General Martha Coakley's office to crack down on employers that misclassify their workers. These efforts were formalized in March of this year when Governor Patrick signed an executive order establishing a Joint Task Force on the Underground Economy and Employment Misclassification. We have consistently supported these efforts because the spread of abuses associated with the underground economy threaten over 100 years of progress that unions have made in the construction industry.

The construction industry is highly competitive. Our contractors compete for work on a daily basis. When they bid for work their costs include: decent wages, social security and Medicare contributions, workers compensation premiums, and unemployment insurance premiums. They cannot compete against contractors that deliberately misclassify their workers to avoid these costs which amount to about 30% of an honest contractor's labor costs. This often costs an honest contractor the job, which in turn results in lost work opportunities for our members.

The impact on our members is enormous: They lose paychecks, contributions to their retirement plans, and sometimes eligibility for healthcare coverage. Our apprentices lose the on-the-job training hours required to progress through our apprentice training programs. The end result of the underground economy is a race to the bottom in which the winners are those employers that are willing to cheat the most aggressively.

While the impact on our members is very serious, the impact on misclassified workers is worse. Misclassification strikes at the core of the social contract between employers and employees that has evolved over the last 100 years. In addition to being denied decent wages, misclassified workers are ineligible for unemployment benefits and workers compensation benefits, do not accrue social security credits and almost always lack health insurance. They are also responsible for paying the employer and employee-side FICA and FUTA taxes, or 15 % of their gross wages, while employees pay only 7.65%. Most importantly, they lose the protections of a host of labor laws including: minimum wages, overtime pay, workplace safety, discrimination, sexual harassment, the family and medical leave act, and the right to join a union.

Although the construction industry experiences a higher incidence of this abuse, this problem is not limited to construction. The impact on misclassified workers is obvious, but employees, employers and taxpayers who play by the rules also pay a high price for those employers who seek to avoid their legal responsibilities.

The impact on the Commonwealth of Massachusetts includes:

- The Massachusetts General Fund loses an estimated $152 Million in unpaid income taxes.
- The Unemployment Insurance Trust Fund loses $35 Million in revenues.
- $91 million in unpaid workers compensation premiums were lost over a 2-year period, forcing the rest of us to cover injured workers in the Workers Compensation Trust Fund. In fiscal year 2004, approximately $4,331,754 was paid to uninsured claimants from assessments levied on the rest of us.
- Honest employers are forced to compete with employers who deliberately misclassify their workers to undercut labor costs. This results in lost business for them and lost work opportunities for their employees.
- Laid-off or injured workers lacking unemployment or workers compensation benefits are forced to turn to public services to survive.
- Those workers show up at hospital emergency rooms further draining the Health Safety Net Fund.

The impact at the national level includes:

- The federal treasury loses an estimated $4.7 billion annually.
- GAO estimates that 10.3 million workers, or 7.4% if the total workforce, were misclassified in 2005.
- IRS found in its most recent analysis, that 15% of employers misclassified employees as independent contractors.

While much progress has been made in Massachusetts there is still much work to be done at the federal level. We urge the committee and the congress to adopt changes that will end or at least curb the abuses of the underground economy. To do this the Massachusetts Building Trades Council supports the passage of H.R. 5804 - Taxpayer Responsibility, Accountability, and Consistency Act.

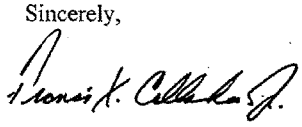
H.R. 5804 - Taxpayer Responsibility, Accountability, and Consistency Act:

- Repeals Section 530 of the 1978 Revenue Act, the "safe harbor" provisions that prohibit the Internal Revenue Service from collecting employment taxes from employers that reasonably misclassify their workers. It would replace it with a new safe harbor provision contained within Section 3511 of the Internal Revenue Code that lawmakers said would clearly define who can be classified as an independent contractor.
- Allows workers to petition the IRS for a review of their classification status.
- Requires the Treasury Department to send Congress annual reports on worker classification.
- Increases the penalties imposed on taxpayers for failing to file correct information returns to the IRS.

Many in the business community have argued that these changes will jeopardize their ability to utilize legitimate independent contractors and unjustly penalize those that make honest mistakes. This is simply not true. The misclassification of workers as independent contractors is not an innocent mistake by an employer or employer's accountant. It is a **calculated and deliberate illegal action** to gain an unfair advantage in the marketplace by avoiding financial responsibility to state and federal governments, insurance providers and to workers. It fosters a race to the bottom whose winners are those that are willing to break the most laws. The losers are the rest of us who play by the rules.

Thank you for the opportunity to testify before the committee today. The Massachusetts Building Trades Council and its affiliated local unions look forward to working with the committee to address these issues.

Sincerely,



Francis X. Callahan, Jr.
President

FXC/scc

Chairman KERRY. Well, we thank you for coming.

Mark Erlich of the Carpenters.

STATEMENT OF MARK ERLICH, EXECUTIVE SECRETARY-TREASURER, NEW ENGLAND REGIONAL COUNCIL OF CARPENTERS

Mr. ERLICH. Thank you. My name is Mark Erlich, and I am the head of the 24,000-member New England Regional Council of Carpenters. We are partners with over 1,400 union contractors, most of them small businesses.

Senator Kerry, Congressman Tierney, we thank you for being willing to shine a light today on our Nation's growing underground economy and its consequences for workers and legitimate businesses.

During the recession of the early 1990s, some construction employers at that point began to label their employees as "independent contractors," thereby avoiding legally obligated tax payments and costly workers' compensation premiums in order to cut costs and gain a competitive advantage. We have seen over time that during recessions, as folks are looking for an advantage, they will look for new and creative ways of doing business.

Construction is a straightforward business of labor and materials. Since materials are generally the same for all bidders, companies can only undercut one another with higher productivity or lower labor costs. But if a company can cheat the State and the Federal Government, as well as insurance companies—and get away with it—they have successfully gamed the system.

By the late 1990s, the economic boom increased demand for workers in the Massachusetts building industry, and our region witnessed an influx of immigrant workers, many of whom were undocumented.

The employers who had been willing to cheat through misclassification now realized that they could take advantage of this new workforce. They simply began to forget the niceties of misclassification and just pay in cash, off the books and under the table. In many parts of our industry, particularly the private nonunion construction sector, this approach has become standard practice.

How bad is the problem? Well, it is impossible to measure precisely because so much of this economic activity is unreported. One study claimed that the shadow or underground economy in the United States grew by 28 percent between 1990 and 2003. And a 2005 Bear Stearns report that has been referred to suggested that the overall underground economy was nearly $3 trillion a year, nearly 9 percent of our GNP.

What is the impact? You have obviously heard testimony from contractors who will explain that they cannot compete on such an unlevel playing field. Last fall, a local drywall contractor in this area informed his workers that he was putting them back on the books after years of misclassifying them as independent contractors as a result of enforcement activities by the Government and the Attorney General. As a result, he cut their wages by 30 percent—a figure that I believe constitutes a "fraud index."

The impact on State and Federal revenues is even more severe. The current estimate of the tax gap is $290 billion, and an IRS spokesman says that 30 percent of this is attributable to misclassification. As mentioned, the GAO suggests misclassification reduces Federal income tax revenues by up to $4.7 billion.

But these staggering numbers only reflect payments by employers who are still filing some sort of paperwork. What we forget is that losses from those who keep a workforce completely off the books cannot even begin to be measured. So all of these numbers are really low-ball estimates. At a time of Federal and State budgets deficits, we are cutting crucial public services while these dollars go uncollected.

But what I would like to speak about today is the human side of this public policy crisis. Companies that cheat on taxes and workers' compensation premiums are more likely to cut corners and expose their workers to unnecessary risks and dangers. A New York study reported a 40-percent increase in construction fatalities in 2006 compared to the previous 5 years, an incredible spike that the authors attributed to practices in the underground economy.

Oscar Pintado is an example. Last year this 27-year-old died on a 450-unit residential project in Woburn. The builder, Avalon Bay Communities, a giant Virginia-based development firm, had been cited by OSHA for failure to meet fall protection standards on other projects. Pintado fell 45 feet down an elevator shaft as he stepped on and broke a piece of substandard particle board.

Pintado worked for National Carpentry Contractors, a large framing contractor working for Avalon Bay that claims it has no employees—just 150 independent contractors. National Carpentry told OSHA inspectors that Pintado worked for an entity that actually did not exist and whose alleged owner conveniently disappeared and has not been located since the fatality. Pintado was, of course, paid in cash and, therefore his family was not eligible for any benefits or compensation.

Until this situation is corrected, taxpayers and legitimate companies will continue to pay an enormous price for wanton law-breaking. But there are also the thousands and perhaps even millions of Oscar Pintados working on construction sites in this country. Most are citizens, some are here illegally, but all of them are invisible victims of this Nation's shadow economy.

Those of us who live and work in Massachusetts are fortunate that we have a Governor and an Attorney General who understand this issue and have made heightened enforcement of the Commonwealth's laws a priority. Their sense of urgency has to be translated to the Federal Government and its enforcement agencies.

Therefore, we recommend, as Frank said, a clearer and stronger definition in Federal law of what constitutes a legitimate independent contractor and what is an employee—as defined by what is known as the "ABC" test that Frank referred to. In this situation, both employers and employees are entitled to concise rules of the road.

We also support the repeal of Section 530 of the Tax Code, the "safe harbor" rule as outlined in the House Taxpayer Responsibility, Accountability, and Consistency Act of 2008 that Congressman Tierney has sponsored, which we appreciate, and support Sen-

ate 2044, the Independent Contractor Proper Classification Act of 2007.

And, finally, we believe that there should be a creation of a Federal task force of all the impacted agencies—similar to what is happening in Massachusetts, New York, New Jersey, and other States around the country—to root out the underground economy. It should not be a question of lack of resources. New dollars spent on enforcement will produce exponentially more money in recaptured revenues.

Our industry and our Nation need urgent action. We thank you again for taking this action today.

[The prepared statement of Erlich follows:]

TESTIMONY OF
MARK ERLICH
EXECUTIVE SECRETARY-TREASURER
NEW ENGLAND REGIONAL COUNCIL OF CARPENTERS
SEN. KERRY HEARING
APRIL 28, 2008

My name is Mark Erlich and I am the head of the 24,000 member New England Regional Council of Carpenters. We are partners with over 1400 union contractors, most of them small businesses.

Sen. Kerry, we thank you for being willing to shine a light today on our nation's growing underground economy and its consequences for workers and legitimate businesses.

During the recession of the early 1990s, some construction employers began to label their employees as "independent contractors", thereby avoiding legally obligated tax payments and costly workers compensation premiums in order to cut costs and gain a competitive advantage.

Construction is a straight-forward business of labor and materials. Since materials are generally the same for all bidders, companies can only undercut one another with higher productivity or lower labor costs. But if a company can cheat the state and federal government as well as insurance companies – and get away with it – they have successfully gamed the system.

By the late 1990s, the economic boom increased demand for workers in the Massachusetts building industry, and our region witnessed an influx of immigrant workers, many of whom were undocumented.

Employers who had been willing to cheat through misclassification now realized they could take advantage of this new workforce. They simply began to pay in cash, off the books and under the table. In many parts of our industry, particularly the private non-union construction sector, this approach has become standard practice.

How bad is the problem? It's impossible to measure precisely because much of this economic activity is unreported. One study claimed that the shadow or underground economy in the US grew by 28% between 1990 and 2003. A 2005 Bear Stearns report suggested that the overall underground economy was nearly $3 trillion a year, nearly 9% of our GNP.

What is the impact? You will hear testimony from contractors who will explain that they cannot compete on such an un-level playing field. Last fall, a local drywall contractor informed his workers that he was putting them back on the books after years of misclassifying them as independent contractors As a result. their wages were cut by 30% – a figure that I believe constitutes a "fraud index".

The impact on state and federal revenues is even more severe. The current estimate of the "tax gap" is $290 billion and an irs spokesman says 30% of this is attributable to misclassification. The GAO suggests misclassification reduces federal income tax revenues by up to $4.7 billion. **And these staggering numbers only reflect payments by employers who are still filing some form of paperwork. Losses from those who keep a workforce completely off the books**

cannot even begin to be measured. At a time of federal and state budgets deficits, we are cutting crucial public services while these dollars go uncollected.

But there is also a human side of this public policy crisis. Companies that cheat on taxes and workers compensation premiums are more likely to cut corners and expose their workers to unnecessary risks and dangers. A New York study reported a 40% increase in construction fatalities in 2006 compared to the previous five years, a spike that the authors attributed to practices in the underground economy.

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Until this situation is corrected, taxpayers and legitimate companies will continue to pay an enormous price for wanton law-breaking. And there are also the thousands and perhaps millions of Oscar Pintados working on construction sites in this country. Some are citizens, some are here illegally, but all of them are invisible victims of this nation's shadow economy.

Those of us who live and work in Massachusetts are fortunate that we have a Governor and an Attorney General who understand this issue and have made heightened enforcement of the Commonwealth's laws a priority. Their sense of urgency has to be translated to the federal government and its enforcement agencies.

We recommend

1. A clearer and stronger definition in federal law of what constitutes a legitimate independent contractor and what is an employee – as defined by what is known as the "ABC" test. Both employers and employees are entitled to concise rules of the road.

2. Repeal Section 530 of the tax code, the "safe harbor" rule as outlined in the House "Taxpayer Responsibility, Accountability, and Consistency Act of 2008", and support S. 2044, the "Independent Contractor Proper Classification Act of 2007".

3. The creation of a federal task force of all the impacted agencies to root out the underground economy. New dollars spent on enforcement will produce exponentially more money in recaptured revenues.

Our industry and our nation need urgent action. Thank you.

Chairman KERRY. Thank you so much, Mr. Erlich. Appreciate it. [Applause.]

Chairman KERRY. Director George Noel, we are delighted to have you here representing the Department of Labor for the State, and we recognize your good work in this field. Thank you.

STATEMENT OF GEORGE NOEL, DIRECTOR OF LABOR, EXECUTIVE OFFICE OF LABOR AND THE WORKFORCE, MASSACHUSETTS DEPARTMENT OF LABOR

Mr. NOEL. Thank you, Senator and Congressman. Good morning. My name is George Noel. I am the Director of the Massachusetts Department of Labor. I wish to begin my remarks by expressing my appreciation for the Senator's and the Congressman's quest for fairness. I have not forgotten your leadership in my former life supporting the defense authorization Build American amendments. But today I am here to talk about the underground economy, its effect on small business and workers.

I want to first talk about defining the underground economy, then discuss who I believe is harmed by it, and some of our efforts that the Governor has asked us to undertake.

The underground economy is a plague that has infected not only the financial system of the Commonwealth of Massachusetts, but that of the United States as a whole. It consists of individuals and businesses that willfully avoid labor, licensing, and tax laws. These individuals and businesses misclassify employees as independent contractors or deal in cash or other "off the books" schemes to conceal their activities and their true tax liability from licensing, regulatory, and tax agencies.

While the precise scale of these extra-legal and illegal activities is by definition difficult to calculate, we can reasonably and conservatively estimate the impact on the Massachusetts economy running into many millions of dollars. We heard Mr. Callahan talk about the Harvard study, and I am not going to rehash some of those statistics. But the broader economic toll, which takes into account lower wages and the knock-on effects of unfair competition on employers, may well be impossible to calculate.

The Fiscal Policy Institute, in a study on New York's construction industry, estimated last year that nearly one-third of New York City's residential construction workforce is "off the books" and working in the underground economy. With New York City's 8 million residents to the Commonwealth's 6.5 million, we think these numbers are a reasonable reflection of the scale of the problem here.

In essence, the underground economy is an illegal gray market which lowers living standards, undercuts wages and workplace protections, undermines fair competition for businesses, pitting residents against one another in a race to the bottom.

Who is affected by the underground economy?

Operating in the underground economy is not a victimless crime, as some would lead us to believe. Workers, legitimate business owners, consumers, government, and society in general shoulder the burden shirked by employers who operate in the shadows of the underground economy.

Workers, usually the most vulnerable, are exploited by irresponsible employers who engage in employment fraud. These workers are usually on the lower wage scale and are often undocumented workers.

Another set of workers who are adversely affected by the underground economy are workers who work for employers who play by the rules. These workers suffer from depressed wages and benefits or end up in the unemployment line, all because their employers commit the cardinal sin of playing by the rules. Some workers have no other choice but to slip into the underground economy themselves. The same Bear Stearns report that Mr. Erlich just referenced also says that "four to six million jobs have shifted to the underground economy, as small businesses take advantage of undocumented workers." It is safe to assume that tens of thousands of Massachusetts jobs have suffered the same fate by that migration. One only has to look at some of the Home Depot parking lots or Foss Park in Somerville to find evidence of these "street corner hiring halls" that have spouted around the Commonwealth and the United States.

The Commonwealth of Massachusetts and the United States lose tax revenue due to unreported wages. The Internal Revenue has developed the idea of the tax gap as a way of measuring taxpayer compliance with Federal tax laws. The General Accounting Office found that the Federal tax gap in the tax year of 2001 ranged anywhere from $312 billion to $353 billion.

Consumers are also affected. They are exposed to unregulated and potentially unsafe goods and services through the underground economy. Legitimate employers like Mr. Morrisey face an unfair advantage from employers operating in the underground economy themselves over legitimate employers and their workers. These employers pay their workers' compensation premiums. They pay their unemployment taxes. They pay into Social Security. They pay their payroll taxes.

What is the task force that you have heard a little bit about today?

In his efforts for broad economic growth, Governor Patrick is committed to creating good jobs at good wages, proper protections for employees and employers, and assurances of fairness. That is why he signed the executive order that Mr. Callahan referred to on March 12th.

The Governor asked me to chair this task force, which unites various State agencies with the goal of surfacing the underground economy.

The task force is a large-scale, collaborative effort between State and constitutional offices. The Joint Task Force brings together the Attorney General's Office of Fair Labor and Business with a variety of State agencies. We also worked closely with other partners such as the Office of Refugees and Immigration and the Insurance Fraud Task Force to achieve our goals.

It is important to note, just like Mr. Callahan noted earlier, that we have been working together in an informal fashion. What this does is codify it. And our partners over at the Attorney General's Office have been very helpful to us.

The task force's stated goal is to surface the underground economy in Massachusetts by pooling resources and sharing information, enforcing licensing, labor, and tax laws. We have found that working together is the most effective way to surface the underground economy. We have looked for best practices in California and New York to help us lay the foundation for our own task force.

Our task force has six goals: eliminate unfair business competition; protect workers by ensuring that they receive all the benefits and protections they are due under the law; protect consumers by ensuring that businesses are properly licensed and adhere to consumer protection regulations; reduce the burden on law-abiding citizens and businesses by ensuring compliance with the Commonwealth's licensing, regulatory, and tax laws; reclaim rightful revenue for the Commonwealth through increased compliance with State tax laws; and continuously evaluate and improve our own effectiveness by developing new procedures, promulgating new regulations, and proposing new legislation.

The task force is managed by a director who coordinates the activities of the task force from the Department of Industrial Accidents. He is here with us today—Mr. Michael Bradley.

His job is to coordinate the efforts, primarily by educating business owners, employees, and the public about relevant requirements and conducting targeted investigations and enforcement actions against violators.

The underground economy is most prevalent and target task force resources accordingly, assess investigative and enforcement methods, and develop and recommend strategies to improve these methods.

We are organized into six sub teams. I am not going to go through all of them. They each have their job. But one thing I do want to talk about is some of the communications that we have done.

We have developed a tip line that has been developed with a general message that can be heard in English and Spanish. That phone number is 1–877–96-Labor-2267. Additionally, we have developed a Web site that has a lot of information on how to report these irresponsible, illegal employers.

Governor Patrick has charged Secretary of Labor and Workforce Development Suzanne Bump with creating an advisory panel to engage employer, labor, and community groups to solicit feedback and input as part of the information-sharing process.

Once again, I wish to close by expressing my gratitude to the Committee for taking the time to explore this important issue. And I believe that we all must work together if we are to be successful in achieving what I believe is our shared aspiration of driving this scourge from the Commonwealth of Massachusetts and our great country.

Thank you.

[The prepared statement of Mr. Noel follows:]

TESTIMONY FOR THE SENATE COMMITTEE ON SMALL BUSINESS & ENTREPRENEURSHIP

APRIL 28, 2008

GEORGE NOEL-DIRECTOR

MASSACHUSETTS DEPARTMENT OF LABOR

Good morning, my name is George Noel. I am the director of the Massachusetts Department of Labor. I wish to begin by expressing my appreciation to the Committee for giving me the opportunity to share my thoughts with you today about the effects of the underground economy on small businesses and workers.

I will begin my remarks by defining the underground economy. I will then discuss who we believe is harmed by the underground economy. I will share what Governor Deval Patrick has asked us to do to surface the underground economy.

What is the Underground Economy?

The underground economy is a plague that has infected not only the financial system of the Commonwealth of Massachusetts but the United States of America as a whole. It consists of individuals and businesses that willfully avoid labor, licensing and tax laws. These individuals and businesses misclassify employees as independent contractors or deal in cash and other "off the books" schemes to conceal their activities and true tax liability from licensing, regulatory and tax agencies.

While the precise scale of these extra-legal and illegal activities is by definition difficult to calculate, we can reasonably and conservatively estimate the impact on the Massachusetts economy running into many millions of dollars. A 2004 Harvard study, "The Social and Economic Costs of Employee Misclassification in Construction" – dealing with just one sector of our economy – conservatively estimated that the Commonwealth lost nearly $100 million in unpaid income tax payments and another $100 million in unpaid workers' compensation contributions between 2001 and 2003 due to the

underground economy. The broader economic toll, which takes into account lower wages and the knock-on effects of unfair competition on employers, may well be impossible to calculate.

The Fiscal Policy Institute, in a study on New York City's construction industry, estimated last year that one-third of New York City's residential construction workforce is "off the books" and working in the Underground Economy. The report claimed that as many as 17,000 workers may be paid off the books and so do not show up in the official employment numbers – and another 13,000 workers identified as self-employed in Census Bureau data may actually be employees who are misclassified by their employers as independent contractors. With New York City's 8 million residents to the Commonwealth's 6.5 million, we think these numbers are a reasonable reflection of the scale of the problem.

In essence, the Underground Economy is an illegal "gray market" which lowers living standards, undercuts wages and workplace protections, undermines fair competition for businesses, pitting residents against one another in a race to the bottom.

Who is affected by the underground economy?

Operating in the underground economy is not a victimless crime. Workers, legitimate businesses, consumers, government and society in general shoulder the burden shirked by employers who operate in the shadows of the underground economy.

Workers, usually the most vulnerable, are exploited by irresponsible employers who engage in employment fraud. These workers are usually on the lower wage scale and are often undocumented workers.

Another set of workers who are adversely affected by the underground economy are workers who work for employers who play by the rules. They miss the opportunity to work on jobs that their employers in which their employers are unable to compete. These workers suffer from depressed wages and benefits or end up in the unemployment line. Some workers have no other choice but to slip into the underground economy themselves. According to a 2005 Bear

Stearns Report, "four to six million jobs have shifted to the underground economy, as small businesses take advantage of undocumented workers." It is safe to assume that tens of thousands of Massachusetts jobs have made the same migration. This has resulted in an expansion of day laborer employers. One only has to look at the Home Depot parking lots and places like Foss Park in Somerville to find evidence of "street corner hiring halls" that have sprouted around the Commonwealth.

The Commonwealth of Massachusetts and the United States of lose tax revenue due to unreported wages. The Internal Revenue Service has developed the idea of the "tax gap" as a way of measuring taxpayer compliance with federal tax laws. The General Accounting Office found that the federal tax gap in the tax year of 2001 to range from $312B to $353B.

Consumers are exposed to unregulated and potentially unsafe goods and services.

Legitimate employers face an unfair advantage from employers operating in the underground economy themselves over legitimate employers and their workers. These employers pay their workers compensation premiums; pay their unemployment, social security, payroll taxes.

What is the Joint Task Force on the Underground Economy and Employee Misclassification?

In his efforts for broad economic growth, Governor Patrick is committed to creating good jobs at good wages, proper protections for employees and employers, and assurances of fairness.

In that spirit he signed the executive order on March 12th of this year which created the Joint Task Force on the Underground Economy and Employee Misclassification. His vision for this Task Force is to strengthen efforts to prevent dishonest employers from engaging in practices that shortchange workers and undercut law-abiding businesses.

The Governor asked me to chair this Task Force which unites various state agencies with the goal of surfacing the underground economy.

The Task Force is a large-scale collaborative effort between state and constitutional offices, the Joint Task Force brings together the Attorney General's Office of Fair Labor; the Departments of Labor, Revenue, Industrial Accidents, Public Safety; and the Divisions of Occupational Safety, Professional Licensure, Career Services, Apprentice Training, Unemployment Assistance and the Office of Refugees and Immigration. We will also work closely with partners like the Insurance Fraud Bureau to achieve our goals

It is important to note that the Commonwealth's state agencies already mount impressive efforts to surface the underground economy, but these efforts have historically been uncoordinated.

The Task Force's stated goal to surface the underground economy in the Commonwealth of Massachusetts by pooling resources and sharing data of the partner agencies charged with regulating and enforcing the Commonwealth's licensing, labor and tax laws. This mission will be accomplished by vigorous and targeted enforcement against unscrupulous businesses.

Working together is the most effective way to surface the underground economy. It allows participating agencies to address multiple violations of the law at once. The State of California has been operating in this fashion since 1993 with its "Joint Enforcement Strike Force on the Underground Economy". The State of New York by Executive Order has established "The Joint enforcement Task Force on Employee Misclassification" and they have been very helpful to us as we lay the foundation of our Task Force.

The Task Force's six goals are to:

- Eliminate unfair business competition.
- Protect workers by ensuring that they receive all the benefits and protections that are due to them under law.
- Protect consumers by ensuring that businesses are properly licensed and adhere to consumer protection regulations.

- Reduce the burden on law-abiding citizens and businesses by ensuring compliance with the Commonwealth's licensing, regulatory and tax laws.
- Reclaim rightful revenue for the Commonwealth through increased compliance with state tax laws.
- Continuously evaluate and improve Task Force effectiveness by developing new procedures, promulgating new regulations and proposing new legislation.

The Task Force is managed by a Director who coordinates the activities of the Task Force from the Department of Industrial Accidents (DIA).

The Task Force Director coordinates efforts: primarily, educating business owners, employees and the public about relevant requirements and conducting targeted investigations and enforcement actions against violators.

The Task Force Director also establishes protocols to facilitate timely information sharing between participating agencies; identifies sectors where the Underground Economy is most prevalent and target Task Force resources accordingly; assess investigative and enforcement methods, and develop and recommend strategies to improve those methods; solicit the cooperation of other relevant enforcement agencies, including the Insurance Fraud Bureau; work cooperatively with stakeholders including elected officials, employers, labor, and community groups.

UNDERGROUND ECONOMY TASK FORCE ORGANIZATION

We have organized the Task Force into six sub teams. The New York State Task Force has been very successful organizing itself in this manner.

- Research/Targeting: To develop and review leads for the Task Force
    - Investigators from each partner agency have already met to analyze potential targets for sweeps and smaller joint enforcement operations that are currently underway.

- Sweeps Team: to plan and execute coordinated on-site inspections and visits (sweeps)
- Audit/Investigations Teams: to plan and execute follow-up audits and investigations on any non-compliance found in the course of the sweeps conducted.
- Legal Team: to address legal issues arising in connection with the implementation of the executive order and the Memorandum of Understanding between Task Force members.
- Communication Team: To develop strategies focused on keeping the public informed of Task Force activities, to develop multi-lingual documents for sweeps, and to assist in providing avenues for the public to contact the Task Force with tips and complaints.
    - A "Tip Line" has been developed with a general message that can be heard in English & Spanish. That phone number is 1-877-965-2267 (1-877-96-Labor).
    - Additionally, personnel from the D.I.A. and the Governor's Office have developed a web-site dedicated to the Underground Economy Task Force. That site has links to the Executive Order, ALL partner agencies, information concerning employer duties & employee rights. Downloadable "tip" forms and various data associated with the goals of the Task Force.
    - Regional Town Hall Meetings across the Commonwealth
- Reporting Team: To coordinate and develop the Report to the Governor required by the Executive Order

Governor Patrick has charged Secretary of Labor and Workforce Development Suzanne M. Bump with creating an advisory panel to engage employer, labor and community groups to solicit feedback and input as part of the information sharing process.

I wish to close as I began by expressing my gratitude to the Committee of taking the time to explore this important issue. I believe that we all must work together if we are to be successful of achieving what I believe is our shared aspiration of driving this scourge in the Commonwealth of Massachusetts.

Chairman KERRY. Mr. Noel, thank you. Very helpful and very important.

[Applause.]

Chairman KERRY. Thank you.

Finally, Jennifer Stark, Assistant Attorney General, we appreciate your being here, and you are testifying on behalf of Ms. Goldstein.

Ms. STARK. I am. Thank you.

Chairman KERRY. Thank you.

STATEMENT OF JENNIFER STARK, ASSISTANT ATTORNEY GENERAL, POLICY AND GOVERNMENT RELATIONS DIVISION CHIEF

Ms. STARK. Good morning, Senator Kerry and Congressman Tierney. For the record, my name is Jennifer Stark. I am the chief of the Policy and Government Division of the Attorney General's Office, and I am delivering this testimony on behalf of the Policy and Government Division. And I am delivering the testimony on behalf of Joanne Goldstein, who is the chief of our Fair Labor Division. And on behalf of her and Attorney General Martha Coakley, I would like to thank you for allowing us to have the opportunity to comment on this very important issue.

The Fair Labor Division of the Office of the Attorney General is statutorily mandated to enforce the wage and hour laws of the Commonwealth. This includes minimum wage, overtime, prevailing wage, vacation, commission, and child labor laws, just to name several of them. We handle over 3,000 complaints annually, and a vast majority of these can be considered within the underground economy designation.

The underground economy encompasses a wide variety of offenses that we enforce, which includes an employer who pays employees in cash, often below minimum wage; employees who work hours significantly above 40, but don't get paid the statutorily required time and a half for all of the hours worked. Often, employees get a cash payment that covers only some of the time worked or may get only straight time for overtime hours worked. It is not uncommon for unscrupulous employers to pay overtime from a separate account to shield the overtime payments from scrutiny and taxes.

There are employers who give employees—often minimum wage workers—checks that bounce, week after week, or intermittently. A lot of these employees are reluctant to seek other employment without getting their back wages; but when they stay in these jobs, it also leaves them vulnerable to additional weeks without a paycheck.

Even in the public construction arena, the underground economy issues flourish. Employers fail to pay prevailing wage, take credit for deductions for health or pension plans, but never remit the premiums to the plans, or pay less than the full rate or fail to register apprentices.

Some employers hire undocumented workers despite our Federal requirements that they confirm immigration status and then exploit the status of the workers by not paying them, or paying them less than the law requires, or requiring illegal offsets for transpor-

tation, tools, and other costs, knowing that these employees are unlikely to report due to their status.

In one particularly egregious case, an employer never paid any employee at all. Instead, he hired a crew of undocumented workers, worked them for several weeks, let them go and kept cycling through new crews of undocumented workers every few weeks, never paying any of them at all.

One of the most pervasive practices within the underground economy is the misclassification of employees, as you have heard from the other witnesses on this panel. And although this is commonly referred to as classifying individuals as independent contractors, not as employees, as they should be classified, this is somewhat of a misnomer because often these people are not just misclassified, they are not classified at all. They are not true independent contractors, running their own businesses, having independence and autonomy, being paid by check and then reporting income with the proper documentation. Instead, they receive a set sum of money, usually in cash, often below the proper rates of pay with no pay stub or other record.

And this issue has an impact on employees and small businesses, as you have heard from Mr. Morrisey today. The impact on employees is unmistakable. Employees deprived of their just wages, or any wages, simply cannot live. They cannot pay rent, utilities, buy food for their families, provide health care, transportation, or any of the other basic necessities for their lives and their families. Often, they are unskilled, perhaps undocumented, frequently uncomfortable reporting violations. We should not tolerate, in Massachusetts or anywhere in the United States, the exploitation of workers. Not only are workers harmed economically, they are demoralized by being treated so poorly. It is hard enough, especially in this economy, to live paycheck to paycheck, but when the checks don't come in, oftentimes lives for these people become impossible.

The Attorney General recognizes that small businesses face challenges different than, and probably greater than, larger businesses. They find it hard to sustain viability. Clearly, expenses and taxes and the challenges of running a small business make success more elusive. Some find it tempting to skimp on employee obligations. Interestingly, we hear from many legitimate small businesses that they are thrilled that the Attorney General is vigorously enforcing the wage and hour laws. They concur with the Attorney General's assumptions that enforcement of the law will level the playing field within the small business community and allow them to become more successful, as they will no longer be undercut by businesses that are not playing by the rules. And you have heard some of those examples today.

We have been advised that for the first time in many years, small businesses are filing complaints against their own competitors who are not playing by the rules because they know that the Attorney General's Office is vigorously enforcing these cases.

In a number of industries, such as car washes, flooring and drywall, all of which are rife with underground economy problems, the Attorney General's actions have led to a change in the culture of the industries, and businesses are being more receptive to playing by the rules. One noteworthy example of our success is a small

company that employs between 10 and 50 and complies with wage and hour laws. The company has historically bid 30 to 40 percent higher than many of its competitors who don't play by the rules. And now that we have demonstrated our commitment to enforcing actions in the construction industry, the company in question reports that his competitors are bidding in the same range as he is, and they are in greater compliance with the law, so that he is right in the mix of the bid range with his competitors at this point. This is certainly a success story in this area.

So looking at the effect of the underground economy on small business, it is clear to the Attorney General that continued, meaningful enforcement of wage and hour laws will have a positive and sustained impact on legitimate small businesses.

The Attorney General has also made enforcement of wage and hour laws, as I have said, a priority in her office, and she has devoted resources and personnel to the issue in about the year and a half that she has been in office. Some of the highlights of her first year in office include: Consistent, visible, and vigorous enforcement of the wage statutes, with a focus on those businesses and employees who are part of the underground economy; we have processed complaints more quickly and efficiently; we have issued citations with orders of restitution to the workers and fines that are commensurate with the violations.

We have also obtained criminal complaints against those businesses whose wage and hour violations meet the criteria for criminal enforcement. We advise businesses that failure to comply with our procedures no longer results in a minor fine, but that these businesses are now subject to significant, legitimate fines and orders of restitution.

There is also an open-door policy in our office for businesses, unions, workers, and advocacy groups who want to discuss issues with us and resolve complaints. And we have also done outreach to all stakeholders, and we have revised all of our written materials for distribution.

We have increased our language capacity so that we can reach more employees, especially those that are in the underground economy for whom English is their second language. We have also made presentations and had information sessions to industry groups, unions, law firms, legal and other professional associations.

We are in the process of revising our Independent Contractor/Misclassification Advisory that is going to be issued very soon, and it hopefully is going to give stakeholders a better understanding of the enforcement guidelines. We are participating in the Governor's Underground Economy Task Force, and we have also assigned two new victim/witness advocates to the Fair Labor Division. That division has never had victim/witness advocates before, and they will be able to assist employees who are victims of wage violations. And we are hoping that this will also foster trust so that the word will get out and these workers will report more often.

Thank you for your efforts to address this problem, and we look forward to working with you toward this effort.

[The prepared statement of Ms. Stark follows:]

Jennifer Stark
Chief, Policy and Government
Joanne F. Goldstein
Chief, Fair Labor Division
Office of the Attorney General
Commonwealth of Massachusetts

United States Senate
Committee on Small Business & Entrepreneurship
April 28, 2008

Senator Kerry, distinguished guests and all other invitees:

On behalf of Massachusetts Attorney General Martha Coakley, I would like to thank Senator Kerry and the United States Senate Committee on Small Business and Entrepreneurship for the opportunity to make some observations on the underground economy in Massachusetts and its effect on small businesses and workers. Further, I would like to mention the efforts that we have made over the past year to address issues of the underground economy and the impact our efforts have made on the economic climate in Massachusetts.

First, as has been well documented and discussed by other presenters to this committee, the underground economy has direct, systemic negative impact on workers, on legitimate businesses and on the tax revenues received by the Commonwealth, and the United States Government. There are also indirect costs, both for government and the economy in general. For example, extra costs assumed by government for health care or other social services for workers not provided them through their employers are shared by all taxpayers. Employees who do not receive the timely payment of wages or any wages are likely to have difficulty paying their rent, their utilities, and making other payments all of which impact the economy.

The Fair Labor Division of the Office of the Attorney General is statutorily mandated to enforce the wage and hour laws of the Commonwealth. This includes minimum wage, overtime, prevailing wage, vacation, commission, and child labor laws to name several. We handle over 3000 complaints annually. A vast majority of these can be considered within the underground economy designation. The underground economy encompasses a wide variety of offenses:

- An employer who pays employees in cash, often below minimum wage;
- Employees who work hours significantly above 40, but don't get paid the statutorily required time and a half for all hours worked. Often, employees get a cash payment that covers only some of the time worked, or may get only straight time for overtime hours worked. It is not uncommon for unscrupulous employers to pay overtime from a separate account to shield the overtime payments from scrutiny and taxes.

- There are employers who give employees, often minimum wage workers, checks that bounce, week after week, or intermittently. Employees are reluctant to seek other employment without getting back wages; but staying leaves them vulnerable to additional weeks without a paycheck.
- Even in the public construction arena, the underground economy issues flourishes. Employers fail to pay prevailing wage, take credit for deductions for health or pension plans but never remit the premiums to the plans, or pay less than the full rate or fail to register apprentices.
- Some employers hire undocumented workers, despite the federal requirement that they confirm immigration status, and then exploit the status of the workers by not paying them, paying them less than the law requires, or requiring illegal offsets for transportation, tools and other costs, knowing that they are unlikely to report the employer to governmental authorities.
- In one particularly egregious case, an employer never paid any employee. Instead he hired a crew of undocumented workers, worked them for several weeks, let them go and then kept cycling through new crews of undocumented workers every few weeks, never paying any of them.
- One of the most pervasive practices within the underground economy is the misclassification of employee by companies. Although this is commonly referred to as classifying individuals as independent contractors, not as employees, as they should be classified, this is somewhat of a misnomer. Often the individuals are not just misclassified, they are not classified at all. They are not true independent contractors, running their own businesses, having independence and autonomy, being paid by check and then reporting income on Form 1099s and paying appropriate taxes. Instead, these individuals receive a set sum of money, usually in cash, often below the proper rates of pay, with no pay stub or other record, no reporting to the taxing authorities or payment of taxes, and no ability to obtain restitution later because of the lack of records, undocumented status of the employees and other variables.

IMPACT ON EMPLOYEES AND SMALL BUSINESSES

The impact on employees is unmistakable. Employees deprived of their just wages, or any wages, cannot live. They cannot pay rent, utilities, buy food for their families, provide health care, transportation or any of the other basic necessities for their lives and their families. Often, they are unskilled, perhaps undocumented, frequently uncomfortable reporting violations to government agencies, and rarely with the discretionary time to pursue cases against their employers.

We should not tolerate, in Massachusetts or anywhere in the United States, the exploitation of workers. Not only are workers harmed economically, they are demoralized by being treated so poorly. It is hard enough to live paycheck to paycheck, but when the checks don't come in, life becomes impossible.

The AG recognizes that small businesses face challenges different than, and probably greater than, larger businesses. They find it hard to sustain viability. Clearly,

expenses and taxes, and the challenges of running a small business make success more elusive. Some find it tempting to skimp on employee obligations, particularly when a business is struggling.

Yet interestingly, we hear from many legitimate small businesses that they are thrilled that Attorney General Martha Coakley is vigorously enforcing the wage and hour laws. They concur with the AG's assumptions that enforcement of the law will level the playing field within the small business community and allow them to become more successful, as they will no longer be undercut by businesses that are not playing by the rules.

I have been advised that for the first time in many years, small businesses are filing complaints against competitors who are not playing by the rules, because they are comfortable that the AG will take appropriate action. In a number of industries, such as car washes, flooring and drywall, all of which are rife with underground economy problems, the AG's actions have led to a change in the culture of the industries and businesses being more receptive to playing by the rules.

One noteworthy example of our success is a small drywall company that employs between 10 and 50 and compiles with wage and hour laws. The company has historically bid 30-40% higher than many of its competitors who do not play by the rules in order to treat its employees right and pay proper taxes. Now that the Attorney General has demonstrated her commitment to enforcement by actual enforcement actions in the construction industry and her notice to the dry wall industry that she will do strategic enforcement of wage and hour laws within the industry, the drywall industry has already begun changing. This drywall company reports that his competitors are bidding in the same range as he is, as they are in greater compliance with the law, so that he right in the mix of the bid range. As a result, he is often selected by general contractors, who know that his work is good, that he is legitimate and now that his price is competitive, he has more work than he can handle. A success story within an industry which knows that enforcement has been and will continue to happen.

So in looking at the effect of the underground economy on small business, it is crystal clear to the AG that continued, meaningful enforcement of wage and hour laws will have a positive, sustained impact on legitimate small businesses.

ENFORCEMENT

The Attorney General of Massachusetts has made enforcement of wage and hour laws, particularly for those employees and businesses that are in the underground economy a priority. She has devoted resources and personnel to the issue and been supportive of all efforts of the Fair Labor Division to take on this important task.

Some of the highlights of the first year:

- Consistent, visible, vigorous enforcement of the wage statutes, with focus on those businesses and employees part of the underground economy;
- Processing of complaints more quickly and efficiently;
- Issuance of citations with orders of restitution to workers and fines commensurate with the violations;
- Obtaining of criminal complaints against those businesses whose wage and hour violations meet the criteria for criminal enforcement.
- Advising businesses that failure to comply with our procedures no longer results in a minimal fine, but subjects the business to significant fines and orders of restitution.
- An open door policy for businesses, unions, workers and advocacy groups who want to discuss issues and resolve complaints.
- Outreach to all stakeholders; revision of materials for distribution.
- Increased language capacity to reach employees in the underground economy for whom English is their second language;
- Presentations and information sessions to industry groups, unions, law firms, legal and other professional associations;
- Revision of the Independent Contractor/Misclassification Advisory to give all stakeholders a better understanding of enforcement guidelines;
- Participation in the Underground Economy Task Force and cooperation with other state agencies to target companies who are violating multiple state laws.
- Meetings and cooperate activities with the Fair Wage Campaign and advocacy groups.
- The assignment of two victim advocates to the Fair Labor Division, who assist employees, in recognition that individuals who are victims of wage statute violations are victims.

Thank you for the opportunity to make this presentation. We look forward to working with your committee and federal agencies towards elimination of the underground economy which would result in fair and legal payment for all workers, a level playing field for small (as well as large) businesses and the opportunity to compete and an assurance that the tax revenues that should come to the state and the federal government will be paid.

Chairman KERRY. Well, thank you all very, very much.

[Applause.]

Chairman KERRY. The testimony is very, very helpful.

Congressman Tierney has to catch a plane to Washington to make the city safe for my arrival.

[Laughter.]

Representative TIERNEY. Thank you very much, Senator. I want to thank all the witnesses again for this, and I will look forward to reading the question-and-answer sessions as well. Thank you.

Chairman KERRY. Thanks for being with us very, very much.

[Applause.]

Chairman KERRY. So now let's flesh the record out a little bit more, and I appreciate the Congressman being here and his leadership in the House. Obviously, this is an enormous issue. I want to try to get at it a little bit in real terms here. Each of your testimonies have been very candid and very helpful, and I think it paints a broad picture to hear from representatives of working folks who have a set of rules by which they operate and who have helped to improve the workplace in America; an entrepreneur who is trying to make it work; and one in absentia, and I put some of her testimony in here. But she has a very similar story to tell, as Mr. Morrisey's, about how the construction industry is impacted by this.

I think it is important to emphasize that it is not just the construction industry, and we; will talk about that a little bit more in a minute.

Ms. Stark, thank you very much. You know, none of this has a chance of being fixed unless the enforcement is rigorous, and we obviously appreciate what the Attorney General is doing to help make that happen. But let's try to simplify some of this and see if we can consolidate it.

First of all, the breadth of this, we have talked specifically about construction, but give us a better sense, if you will, or sort out the different examples that you are aware of in the different places where this is having an impact in the State of Massachusetts or in the country. Do you want to share—Director Noel, do you want to lead off on that?

Mr. NOEL. Sure. In fact, you and Mr. Callahan mentioned one case in your editorial today, in the Boston Herald, that talked about a young woman who is a janitor, worked at a nursing home, and was treated as a franchisee. And, you know, the company that she worked for, I think, made claims of $90 million of sales each year, claims only to have 300 or so employees, and they operate worldwide, but yet they have 8,500 franchisees. You know, they are really employees. Let's not kid ourselves. But they seem to exploit the most vulnerable workers.

Chairman KERRY. Well, how do they classify somebody as a franchisee?

Mr. NOEL. What they did was they actually told them that they were a business unto themselves. They gave them direction, gave them uniforms, procedures how to clear, but yet they basically sold this woman the business for $10,500 and made her buy all the supplies from them, was under their direction, and only paid her a cer-

tain amount of money and had her work an enormous amount of hours that she had to actually——

Chairman KERRY. And did the company set the hours of work?

Mr. NOEL. They told her originally that she only was going to be working 20 to 25 hours. However, you know, the work that she did far exceeded—the work they assigned her far exceeded that, so much so that she had to hire somebody else and pay them, you know, as if she was her own business. In the end, it was a losing proposition. She ended up—she couldn't make any money out of it.

Chairman KERRY. Did she believe she was her own business?

Mr. NOEL. I think at first she did, you know, but it really didn't turn out—and, in fact, that is what brought the case forward, that when she finally couldn't go on any further, she filed for unemployment, and that is what generated the case that you have talked about.

Chairman KERRY. Can any of you tell us from your experience how many people know that they are actually misclassified? Or how many people know how they have been classified, that they have been classified as an independent contractor and then find out later when there is a problem that that, in fact, is their status? Are you aware?

Mr. CALLAHAN. I could give you a personal example. My mother-in-law is working as a home health care aide. She was working roughly 20 to 25 hours a week. She went through an agency, and she was told she was an independent contractor. None of the withholdings were done for her, for her taxes. There was no workers' comp paid, no unemployment paid. And she knew she didn't really have a choice. She went to work. She got her pay. She was told when to be there, what she had to do. She was under their direction and control. And then when tax time came, she was responsible for all those—the employer's side of those taxes. She had to pay the FUTA, the FICA, all the other employment taxes. I know this because I had to write the check to cover her taxes come tax time because the IRS was coming after her.

Chairman KERRY. Did she think originally she was a full-fledged employee?

Mr. CALLAHAN. For the purposes of the law, I think she thought she was an employee, but she knew she didn't have a choice. That is part of the problem here. People work there; they are working under the table for cash. They know what the deal is.

Chairman KERRY. But they can't get the job otherwise.

Mr. CALLAHAN. They can't get that job otherwise, and that is really what it comes down to.

Chairman KERRY. What about in terms of enforcement, Ms. Stark. What is the biggest restraint on our ability to be able to enforce adequately?

Ms. STARK. Well, I don't know if there are restraints at this point. I mean, we have been spending the past year analyzing all of these complaints that have come into the office and actually doing the enforcement. The wage and hour laws we are happy with, and we are using them wisely and properly. It is just a matter of having that commitment to actually do the enforcement.

Chairman KERRY. Well, there has to be some restraint, because if you have all of these companies that are doing this, either there

aren't enough people, or there isn't enough insight, or there isn't enough effort, or something is happening. Companies ought to be living in total awareness that if they do it, they are probably going to get caught, and it is going to be costly.

Ms. STARK. Yes. I think maybe one of the restraints is there are folks out there that aren't reporting it to the Attorney General's Office, so we can't enforce something that we don't know——

Chairman KERRY. The reason they don't report it, Ms. Stark, in my judgment, is that they don't fear it is a deterrent. It is the absence of deterrence.

Ms. STARK. Right.

Chairman KERRY. They don't worry about it because the chances of getting caught aren't great. Am I wrong? If you have $312- to $353-billion worth of taxes that are not being collected, what would happen if we took $3 million—$10 million of that per State—I mean, what is that? That is $150 million, maybe, out of $312 billion, and said go do this, enforce this, wouldn't that make a difference? Suppose you had a larger division in your office.

Ms. STARK. Yes, it would make a difference. But I think, you know, we are seeing changes already over just 1 year of having this focus. Of course, it would make a difference.

Chairman KERRY. Mr. Morrisey.

Mr. MORRISEY. Senator, I can speak very frankly about that. We have seen almost immediate changes over the last 6 months where individuals that were coming down seeing the grass being greener in Massachusetts, specifically even some New Hampshire contractors. Now they are not so quick to come over the State line because the grass isn't so greener, because they have all been called in to the Attorney General's Office. From what I understand, the conversations are all very nice, but they have been given notice that the procedures cannot continue and must be changed. These individuals are not quick now to bring their workforce down here, which by and large, are those underground workforces.

So now they are staying back there, and it is opening up a new field for others now that I was having trouble trying to compete against. Now the competition is becoming more fair.

Chairman KERRY. How prevalent is the disadvantage to you in terms of the competition? Give me a percentage.

Mr. MORRISEY. Well, I will tell you that it used to be years ago I could get 50 percent of the jobs I quote. Now I am probably 25 percent, and it has been that way, you know, for the last 7 or 8 years. So it is tough.

Chairman KERRY. And do you see who the people are who get the jobs you quoted?

Mr. MORRISEY. Yes, and you have one of those things in your mind. If, you know, Company ABC is good competition, hey, they got us on one, they beat us fair and square. But when you hear about these others, you know, it really—it gets you pretty upset.

Chairman KERRY. But you know how they are competing.

Mr. MORRISEY. Yes, we do.

Chairman KERRY. In other words, you are very aware—you can see who won, and depending on who won, you know whether they competed on a fair basis or on an unfair basis.

Mr. MORRISEY. Right. And what you had for a long time is you had that gray area. Even legitimate companies would overextend themselves. Maybe the project was mismanaged by an owner or a developer, and so now they had too many going at once. Their 50 or 25 or 30 payroll employees couldn't keep up, so now they could go to this other resource and maybe even hire a legitimate guy, but knowing in the back of their minds—the old "Don't ask, don't tell"—knowing that they were bringing in these other workers. To be able to get this job done and meet the schedules, they just said, well, I will deal with the consequences if I have to when they continue on.

Chairman KERRY. And what is the greatest deterrent in your mind to their doing that or being willing to do that?

Mr. MORRISEY. The greatest deterrent is knowing now that there is an accountability. With all due respect to everyone here, there really didn't seem to be an accountability. We always heard about, quote-unquote, people being fined or having difficulties. You saw that in the insurance industry. If you didn't have workers' compensation, there was a fine or a penalty. But now, when we hear that the offices of the Attorney General are taking things much more seriously and they are looking into all of this, people now are waking up to the fact that, you know, there is going to be a reaction for their actions.

Chairman KERRY. Now, give me a good, hard list of the readily identifiable, tangible consequences, and then maybe some of the unintended consequences—or collateral consequences. Shall we call it that? Direct consequences.

Mr. NOEL. Well, I can speak to one just while we are on the subject of workers' comp. One of the departments I oversee is Industrial Accidents. One of the offices of investigation ensures that employers have workers' comp premiums. Just this past month alone, they issued 177 stop-work orders, which was unheard of. And it is due to a commitment that we have instilled in that office. And it is about commitment to enforcing the laws. Like our partners over at the Attorney General's Office, we have agencies—the Division of Occupational Safety oversees asbestos and lead abatement, and they have the power to issue stop-work orders.

One of the things that we are looking for now through the legislature is civil fines that we find would probably be a greater deterrent, because our only other resource would be to make it a criminal matter and overburden our already overburdened Attorney General's Office. But it is about commitment. It is about enforcement.

Chairman KERRY. But what I am trying to get at is in terms of unemployment compensation—or workers' compensation—you have the potential of employee injury and they are not covered.

Mr. NOEL. It is also—they may be covered, but there is a workers' comp—the trust fund would then pick up the payments.

Chairman KERRY. So citizens wind up paying more for other things than they should.

Mr. NOEL. The legitimate businesses pay into that, and they would be——

Chairman KERRY. That is number two. What else? Health care. People don't have a health care benefit.

Mr. NOEL. Right.

Chairman KERRY. People get injured, no compensation.

Mr. NOEL. You have unemployment.

Chairman KERRY. Shoddy work. Work may be less safe.

Mr. MORRISEY. Doesn't get done on time. You have to have someone come out then to finish it up because they tried to go with the low-ball guy. He can't keep up. It doesn't——

Chairman KERRY. It may wind up costing more.

Mr. MORRISEY. I can give you a case-by-case scenario where we profit because the guy that they chose didn't fulfill his obligation.

Chairman KERRY. And you wind up doing it.

Mr. MORRISEY. So we come in at the end and finishing, anyway. Chairman Kerry. What else?

Mr. MORRISEY. Increased fatalities.

Chairman KERRY. Increased fatalities.

Mr. CALLAHAN. A chilling effect on bidding. Mr. Morrisey mentioned the drop in the number of projects that he has been successful in winning. What he didn't mention was the number of contractors that tell us that they simply didn't bid the job.

Chairman KERRY. They won't even bid.

Mr. CALLAHAN. They walked in and they saw XYZ Construction. Chairman Kerry. I have heard that.

Mr. CALLAHAN. And they said, "I can't even compete; I am not going to spend $30,000 in 2 weeks to put together an estimate for a project I know I simply cannot win."

Chairman KERRY. Any other consequences?

Mr. MORRISEY. If you look at the long-term effects, Senator, you have these aging individuals that are 1099s. In my industry, you had it for years. Guys would go out. They would get the nice house, the nice truck. They would raise their children. But now all of a sudden they are at the age of 45 or so——

Chairman KERRY. And their income is going down.

Mr. MORRISEY. They have nothing. They are beyond their piecework prime years. They can't produce what they used to. And so now they are coming to folks like us to try to get them jobs. In some cases, we are able to put them on. But now you have that they have not saved for that rainy day. They don't have anything to back them up toward their retirement. So you are having this back-end issue. We put them on, and now they have got bad knees or the bad shoulder. Now you have a medical issue that has to be addressed because they couldn't do it when they were younger.

Chairman KERRY. How effectively is the Governor's task force working right now with the AG's Office in that collaboration? Is that working well?

Mr. NOEL. Actually, we have been working together since both administrations came into office. This more or less codifies it. We have, I believe, about 16 or 17 joint investigations, not just with the Attorney General's Office, but between the other government agencies. We have yet to perform a full sweep. You know, we are just starting to get underway, and there is a lot of stuff that we have to do before we get to the full sweeps. But there is a good partnership there.

Chairman KERRY. What do you think is the most important step that can or should be taken at the Federal level to augment what is happening in a few of the States?

Mr. NOEL. I think Mr. Callahan touched upon it as far as tighten up the definition of an employee.

Chairman KERRY. The classification.

Mr. NOEL. Classification. One of the——

Chairman KERRY. Of independent contractor.

Mr. NOEL. One of the obstacles that we face working together is—it is actually twofold: One is information that we can legally share with one another, and that is something that we are going to have to tighten up either through legislation or regulation. The other thing is different agencies have different definitions of what an employee is. You know, you have the Department of Revenue, which relies upon the 20-point test that the IRS has. And then, you know, some of us rely upon the 3-point test as defined under Massachusetts law.

Mr. ERLICH. Senator, if I may, one thing about this problem is it actually is a problem that can be fixed, as opposed to so many problems that folks in Congress are constantly banging their heads against the wall. The actions of the Attorney General and the announcement of the Governor's task force, as Mr. Morrisey has said, has already—the word is on the street, and, I mean, it is early and it is premature, but just the fact that there seems to be a heightened focus has meant that companies are starting to say, "Should I continue; am I now taking a risk by continuing to do business this way?" And some are beginning to change the way they do business. It is really—and that is at a very early stage.

Chairman KERRY. That is the whole purpose of law enforcement deterrence?

Mr. ERLICH. Exactly.

Chairman KERRY. You get the word out there that you are serious about something, people take note of it.

Mr. ERLICH. It is a business calculation.

Chairman KERRY. Absolutely.

Ms. STARK. And just to mention, there are two cases that we brought. One is still ongoing so I can't talk about it in too much detail, but one is—there is an action against FedEx, which you know, when you have a higher profile case going on, the word does get out a lot quicker; it is an independent contractor misclassification case. And we also have the issue with Wendy's where a Wendy's franchise had closed, and a ton of workers were just not paid. The Wendy's closed in western Massachusetts, and our office worked with the owner of Wendy's Corporate, and all of those workers were paid. And I think when people see those higher profile cases—the FedEx case—it also helps with deterrence.

Chairman KERRY. What about the argument that is made—and, Frank, you know this, Mr. Callahan, and Mr. Erlich, about the pushback we get on the prevailing wage argument, that people say we can't compete; we are not able to make this work because of the overall cost of the project is going to be too great, so we are not going to be able to do that, or we are not going to be able to make that improvement to the building. There is always that pushback.

What is your comment about that?

Mr. ERLICH. Just quickly, that is a discussion that actually is going on with folks in the housing community, especially in the affordable housing community, because they are strapped for money, and they see every rise in the cost of labor being one less affordable unit that is being built. And when we point out to them that—this isn't even about prevailing wage. This is simply about playing by the rules.

From my perspective, one of the reasons why we are seeing a lot of groups come together around this, including groups that have historically been opposed around labor issues, is that I think it is almost impossible—this is like apple pie and motherhood. This is just playing by the rules. This is not a question of prevailing wage. It is really not a question of other—it is simply cheating or not cheating. And I think it is very difficult for anybody to make a logical and concise argument that there is any reason not to make everybody play by the same set of rules, which is why I think that there is a reasonable chance of success here.

Chairman KERRY. Yes, Mr. Morrisey.

Mr. MORRISEY. To the point of prevailing wage, Senator, depending on which set you are working with, whether it be HUD or whatnot, it is not that big a step anymore. If you are paying all of your things that you need to pay, the step is not as great as some people will make you think it is. It is really not.

Chairman KERRY. And it is made up in the productivity, as Mr. Morrisey alluded to earlier. You are not getting some kid who is home from college for the summer, wearing a pair of sneakers and a baseball hat, pretending to be a carpenter so he or she can go back to school in September. You have people that have completed an apprentice program that takes anywhere from 3 to 5 years, where their skills and their productivity and quality of their work more than makes up for any differential in the wage scale.

Chairman KERRY. Has this had an impact on the numbers of workers you hire?

Mr. MORRISEY. Well, interestingly enough, we talked about that on the way in today, my partner and I. We could hire numbers of more individuals. We have applications coming in, you know, probably 12 or 16 every week. But you know, unless we get the jobs, you can't put them on.

In the short term, the past couple of years, we have been maxed out. We couldn't put anyone else on because we couldn't get enough work to sustain them all. We kind of had capped out a little bit. Although we have grown every year, we kind of capped out a little bit. So we would like to, but we are hoping this will make the other opportunity change.

Chairman KERRY. Is there any aspect, in terms of enforcement, that we have not been able to discuss thus far? Is there anything that is not on the table as to how we approach this problem? I just want to make sure there is nothing left unsaid. My sense is we have got a pretty good understanding of it.

The classification issue, is there some simplified way you would make that classification in your judgment so that we just don't have these crazy arguments?

Mr. ERLICH. There is what is called the ABC test. That is what Frank referred to.

Chairman KERRY. You think that is the simplest way to approach it?

Mr. ERLICH. It is simple, it is clear, the least confused, yes.

Chairman KERRY. Right, OK. Do you think that—and what about the illegal immigration component of it, is that somehow compounding the issue? Would the issue exist even if we didn't have that? It would?

Mr. ERLICH. It would exist, but I think not to the same degree.

Chairman KERRY. Not to the same degree.

Mr. ERLICH. And, you know, I think the State agencies that we are dealing with are taking the right approach, which is that is a Federal issue, it seems to be not being forthrightly addressed these days, but whoever is working out——

Chairman KERRY. If it were more directly addressed these days——

Mr. ERLICH. Clearly the problem would disappear. If everybody had to be treated legally as a—you know, then everything——

Chairman KERRY. You think that would signal the——

Mr. ERLICH. Absolutely. But the State has taken the position that everybody needs to function under the State laws, in any case, and that is good enough for us.

Chairman KERRY. All right. Well, this is very helpful, and I am going to make sure that this record gets appropriately distributed to our colleagues on the Committee, and we are going to try and press forward and see what we can do, both on the definition as well as the enforcement side. I am convinced, and I have been convinced for some time—this is sort of a part of our discussion now about tax reform. We need to do the tax reform and the tax piece would help it, but it is not going to cure it. The enforcement is perhaps the most critical thing of all, and we need to empower you. I am going to talk to the Attorney General about how we might augment those efforts, because I think that would be as significant as anything in making a profound impact.

You have already commented on the impact that is being had by virtue of what is going on. So I think if it gets more visibility, if more people are aware of it, and if the hammer comes down more rapidly on more people, boom, you are going to start to solve this problem significantly.

I tell you, every citizen in this room and everyone who is not here—every citizen—is negatively impacted by this. And every citizen would be better off if we were able to be out there collecting the taxes that are uncollected, the billions upon billions of dollars of taxes. I was driving today on some roads. I don't know how many of you—I mean, our roads in this State are in shocking disrepair. And that is true nationally, not to mention bridges and tunnels and buildings and all kinds of things that need repair. We could be putting people to work.

But part of it is everybody is saying, "Well, how are we going to pay for it?" Well, one of the reasons we are struggling with that is that people are avoiding their fair share of paying that burden. So we need to do it.

I appreciate everybody's——

Mr. NOEL. Excuse me, Senator, if I could just add one comment. You talked about the Attorney General's Office. Also some of the

Governor's agencies, also there is enforcement involved there. There are enforcement components. Some of those are federally funded. One I can think of is the Division of Occupational Safety. So if there is any help there that you could provide, it would be in that regard.

Chairman KERRY. I see a number of folks in this audience who I know are union either leaders or members, and I greatly appreciate their being here today to help focus on this issue. I greatly appreciate their leadership and efforts in this regard.

I want to just mention Steve Tewksbury, who is in the back here—he was, anyway. Where is he? There he is. He just came back in here. I just want to call attention, he is a union carpenter, the only guy I know who has had a town named after him here in the city.

[Laughter.]

Chairman KERRY. But he is deployed to Iraq, I guess four times already.

How many times have you been to Iraq? You have been how many?

He has been twice, but he is going in June again, folks, and I just want everybody here to acknowledge him and say thank you for his service.

[Applause.]

Chairman KERRY. Thank you.

So I thank you. I think that is a great note, people are willing to serve their country and willing to go abroad to do it. We have got to serve our country right here at home and do a better job of making things happen.

So thank you all for contributing to this record, and I can promise you we will try to take some actions on this down in Washington.

We stand adjourned. I appreciate it.

[Applause.]

[Whereupon, at 11:28 a.m., the Committee was adjourned.]

APENDIX MATERIAL SUBMITTED

Statement of Senator Edward M. Kennedy
Senate Committee on Small Business and Entrepreneurship
Field Hearing on the Effects of the Underground Economy on Small Businesses and Workers
April 28, 2008

I commend my colleague Chairman Kerry for calling this field hearing. We both have a strong interest in this issue. As Chairman of the Senate Labor Committee, I'm particularly interested in seeing that our laws to protect workers are scrupulously followed and vigorously enforced.

We all know that these are very difficult times for our economy, and especially for working families. Millions of Americans are now living paycheck to paycheck. Employees in the Commonwealth and across the nation are working hard and playing by the rules, struggling to attain the American dream. But millions of them are being paid under the table and off the books, or misclassified as independent contractors—which means that they're being denied essential labor protections.

Such misclassification harms workers and harms our economy. When unscrupulous employers misclassify workers, everyone loses out—workers, taxpayers, and responsible employers.

Workers are harmed because independent contractors don't receive the same rights under our laws. Basic protections such as the minimum wage, overtime pay, unemployment compensation, workers' compensation, a workplace free from discrimination, and protections from health and safety hazards don't apply to independent contractors.

That means the construction worker who falls and breaks his leg is denied workers' compensation. The truck driver who works 60 hours a week doesn't receive the overtime pay his family deserves to help cover the rising costs of food and energy. A hard-working single mother is discriminated against, and finds herself without a remedy. Millions of workers face higher risk and lower compensation, simply because they are wrongly classified as independent contractors by their employers.

Misclassification also hurts federal and state governments. The problem is widespread, and is costing billions of dollars in unpaid revenues, including the payments that support our unemployment insurance and workers' compensation systems. According to a recent study, misclassification cost the federal government alone $34 billion from 1996 to 2004.

Misclassification is also a serious problem here in our Commonwealth. A Harvard study estimated that between 2001 and 2003, misclassification and other practices of the underground economy cost Massachusetts more than $150 million in lost state income taxes and over $90 million in unpaid workers' compensation contributions. Particularly in this troubled economy, states need these resources more than ever.

When bad-actor companies don't pay their fair share, they harm responsible employers who follow the law. Law-abiding employers end up shouldering the burden that others are deviously avoiding. Responsible employers often lose business to companies whose prices and bids reflect lower labor costs due to illegal misclassification.

It will take a concerted effort to solve this complex problem. I'm proud that Massachusetts and other states are taking the lead in finding better ways to deter employers from misclassifying and mistreating their workers. In the past year, Massachusetts and New York have established interagency task forces to focus on every aspect of this festering problem. State officials have recovered millions of dollars from employers who didn't pay their fair share to workers and to the states. Other states have passed strong legislation raising the penalties for misclassifying workers. Both labor and corporate leaders are doing their part by helping state officials to expose employers who misclassify their workers. These leaders deserve great credit for standing up for workers and responsible employers.

States are demonstrating strong leadership on this issue and we need to attack this problem at the federal level too. That's why I support Senator Barack Obama's legislation to close the tax loophole that allows employers to get away with misclassifying their workers. I'm also working with House Education and Labor Committee Chairman George Miller on legislation to hold employers accountable for breaking wage and hour laws by misclassifying their workers. If we don't penalize law-breaking employers for misclassifying their workers, they'll continue to violate the law.

I hope that today's hearing will help to identify better strategies to end misclassification and other illegal conduct in the underground economy, and I look forward to working with Chairman Kerry to do our best to protect workers, responsible employers, and the American people.

Testimony of:

Sara A. Stafford, President and Sole Owner
Stafford Construction Services, Inc.
President- Elect of The Associated Subcontractors of Massachusetts
119 Main Street
Saugus, MA 01906

Before

The Senate Committee on Small Business and Entrepreneurship
Committee Field Hearing

Regarding

The Effects of the Underground Economy on Small Businesses and Workers

Monday, April 28, 2008
Community Room, Chelsea Campus, Bunker Hill Comm. College
Chelsea, MA

Chairman Kerry and members of the committee, it is a pleasure to address you today on these important issues of the underground economy adversely effecting the construction business in our country today.

I am the sole owner of Stafford Construction Services, Inc. a drywall and plastering firm, performing commercial work in the metropolitan Boston area. We are a union company. We have collective bargaining agreements with the carpenters, laborers, plasterers and painters unions.

We are a company that plays by the rules. Our bonding company, our insurance company and all four unions regularly audit our books. For the 65 employees that currently work for me, this means an assurance that their payroll taxes and benefits are paid and that they are receiving the correct pay rate for the work they are performing.

Recently we bid on a half-a-million dollar plaster project at a new police station not too far from here. The project was funded by federal, state and local taxes. We lost the bid. We just couldn't get our price low enough to compete and win the bid. 6 months later, after an investigation and many hours of work by the union, a radio station and the attorney generals' office, it was discovered that the contractor was cheating.

Firstly, he had illegal undocumented workers on his payroll. Secondly, he had misclassified the workers as tenders rather that journeymen to allow him to post a lower wage on his WH-347 prevailing wage reporting form. As it turned out he wasn't actually paying that rate to the workers. Thirdly, he wasn't paying his benefits in cash as he had

indicated on the form. For the two months prior to the investigation he worked on the job turning in those reports and no one on the project was paying attention. The IRS and the INS are now investigating further.

I was shocked this was going on in the public contracting arena. For that past eight years I have witnessed a steady decline in the enforcement of public contracting statues meant to protect the rights of individual employees and contractors. Construction contractors no longer have a level playing field. Employees are being exploited. It would appear the "public policy" now is to look the other way.

So, what was the benefit of hiring his company over mine? It is a savings to the general contractor of 15% of the contract price. If the GC decides to pass it on to the owner, the taxpayers could save much.

What was the cost of hiring his company over mine? Due to the lack of Social Security, Medicare and Unemployment benefits paid in, all businesses and individuals will have to pay a higher rates to cover the gap. The lack of Federal and State Tax payments made means that there will be less money to build schools, police stations and the like. Some say that the overall deficit in our tax base is 38%.

For my small business, the loss of contracts to this kind of cheating is hard to endure. However, as a taxpayer, it is even harder to endure. Where is the incentive to be honest? I know that in 10 years or many of these workers will be looking to retire here in the U.S. The tax base isn't going to support them. There will be no retirement savings or healthcare.

We have to enforce the laws that are on our bòoks now to stop fraudulent practices. American business has been weakened by this lack of enforcement. The enforcement of laws in an ethical environment is what makes us 'American Businesses". Without enforcement, we all might as well be operating our businesses in a third world environment of pay-offs, tax evasion, and exploitation of the workforce.

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