

**TESTIMONY OF
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SEN. KERRY HEARING
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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.

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 sub-standard particle board. Pintado worked for National Carpentry Contractors, a large framing contractor that claims it has no employees -- just 150 independent contractors. National Carpentry told OSHA inspectors that Pintado worked for an entity that 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. 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.