

**TESTIMONY FOR THE SENATE COMMITTEE ON SMALL
BUSINESS & ENTREPRENEURSHIP**

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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.