

UNDERGROUND CONSTRUCTION ECONOMY OF WASHINGTON

WASHINGTON STATE INSTITUTE FOR PUBLIC POLICY

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UE Taskforce

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WASHINGTON STATE INSTITUTE FOR PUBLIC POLICY

Non-partisan research at legislative/board direction

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LEGISLATIVE ASSIGNMENT

ESSB 5693 (2022)

[... an appropriation] is provided solely for the Washington state institute for public policy to undertake a study on the **nature and scope of the underground economy and to recommend what policy changes, if any, are needed to address the underground economy in the construction industry, including whether greater cohesion and transparency among state agencies is needed.** The report must address the **extent of and projected costs to the state and workers of the underground economy.**

SB 6085 (2024)

The purpose of the task force is to study the **nature and scope of the underground economy and to recommend what policy changes, if any, are needed to address the underground economy, including whether greater cohesion and transparency among state agencies is needed.** To assist the task force in achieving this goal and to determine the **extent of and projected costs to the state and workers of the underground economy** in the construction industry, the task force may contract with the institute for public policy, or, if the institute is unavailable, another entity with expertise capable of providing such assistance.

AGENDA

- Setting scope for underground construction economy (UCE)
- Overview of estimates of size and cost of Washington's UCE
- State agency enforcement and barriers to collaboration
- Policies from other jurisdictions

The Underground Construction Economy:

The UCE encompasses all construction activity that *would* be legal if it were properly reported:

Businesses

- Misclassifying employees as independent contractors
- Paying workers under-the-table (not reporting employees)
- Underreporting activity, avoiding business taxes

Self-employed individuals:

- Independent contractors underreporting activity
- Unregistered independent contractors
- Independent contractors who are not bonded, and insured

UCE Costs

UCE activity results in losses to many stakeholders

- **Workers:** overtime, paid leave, fringe benefits, unemployment insurance (UI) and workers' compensation (WC), legal protections, collective bargaining power
- **Consumers:** risk financial loss from unregistered/uninsured independent contractor
- **Businesses:** harder for compliant businesses to compete for bids (race to the bottom)
- **Governments:** tax revenue leads to losses to Social Security, Medicare, and all tax-funded investments

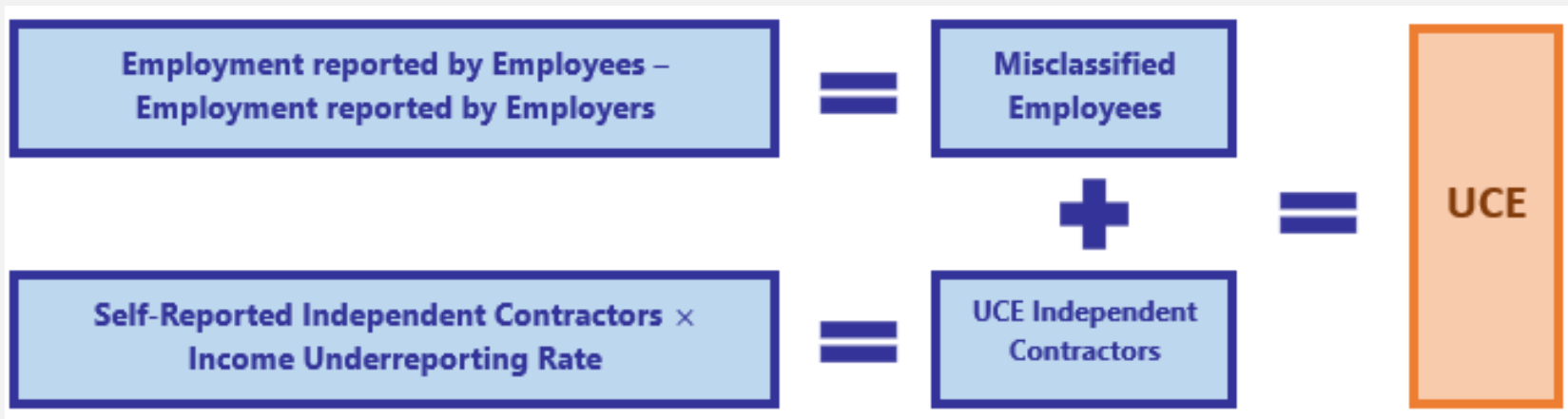
Size Estimates:

UCE is unobservable – have to measure indirectly

- General approach: look for discrepancies in the reporting of employment and income
- Account for 3 types of UCE activity:
 - **Businesses:** Misclassification of employees, paying workers under the table
 - **Individuals:** Independent contractors underreporting their income
- Can't account for underreporting businesses, unregistered/uninsured contractors

Size Estimates: Methodology

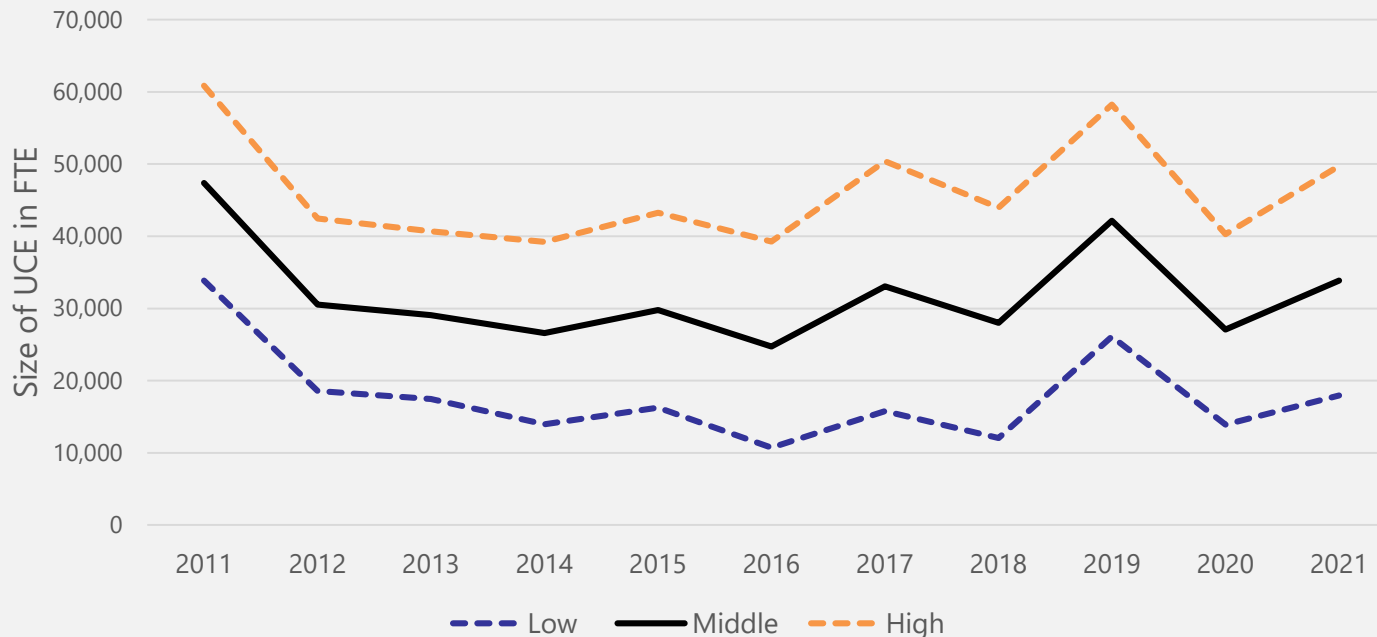
- Misclassified employees: compare census industry of employment surveys with state payroll records
- Underreporting independent contractors: estimate total, multiply by income underreporting rate



Size Estimates:

Middle estimates: UCE constitutes between 10% – 25% of construction workers in WA by year (average of 14.2%)

- Misclassification/under the table pay makes up an average of 5.3%



Cost Estimates

Stakeholders	Costs Included	Cost for 2021:
Workers	Overtime, paid leave, fringe benefits	\$197.6 million
State Gov't	Forgone UI and WC premia payments	\$59.5 million
Federal Gov't	Social Security, Medicare, federal income tax	\$370.9 million

Size and Cost Limitations

- Can't estimate extent and cost of all forms of UCE activity
- Size and cost estimates come with wide ranges
- If workers know they're in the UCE, might be less likely to respond to surveys
 - Sizes could be underestimated
- UCE workers likely paid less than compliant workers
 - Overestimate costs if paid the same once becoming compliant

Interagency Collaboration

L&I, ESD, and DOR carry out their own detection, auditing, and educational operations

- Joint Legislative Task Force (2008-2010)
- Construction Underground Economy Advisory Committee
- Business Entity Analytics and Research (BEAR) Database
- Tip sharing, joint workshops for businesses
- Work with AGO when audit findings are appealed

Barriers to Collaboration

The problem: lack of formal communication about detection and enforcement operations

- Agencies often do not know when others are investigating a certain business or individual
 - BEAR database does not record violations
- Being in violation of one agency's policies almost automatically means being in violation of others'
- Issues arise from conflicting privacy policies, statutes, missions with other agencies

Policies from Other Jurisdictions:

- Oregon Interagency Compliance Network
 - Taskforce composed of many agencies
 - Created database that allows for comparison between tax forms
- California Assembly Bill 1701(2018)
 - Makes general contractors liable for wage theft by subcontractors
- New York District Attorney's Stolen Wage Fund
 - Even when victims of wage theft win cases, often not made whole (e.g., forgone interest)

CONCLUSION

- Underground construction economies pose serious costs to workers, consumers, businesses, governments, and society at large
- Here in Washington, we estimate the UCE to include 1 in 7 construction workers annually, with total costs exceeding a half billion dollars per year
- State agencies employ a number of strategies to enforce reporting requirements – more could be done to formally communicate active operations

THANK YOU

Questions?

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