MARCH 2021

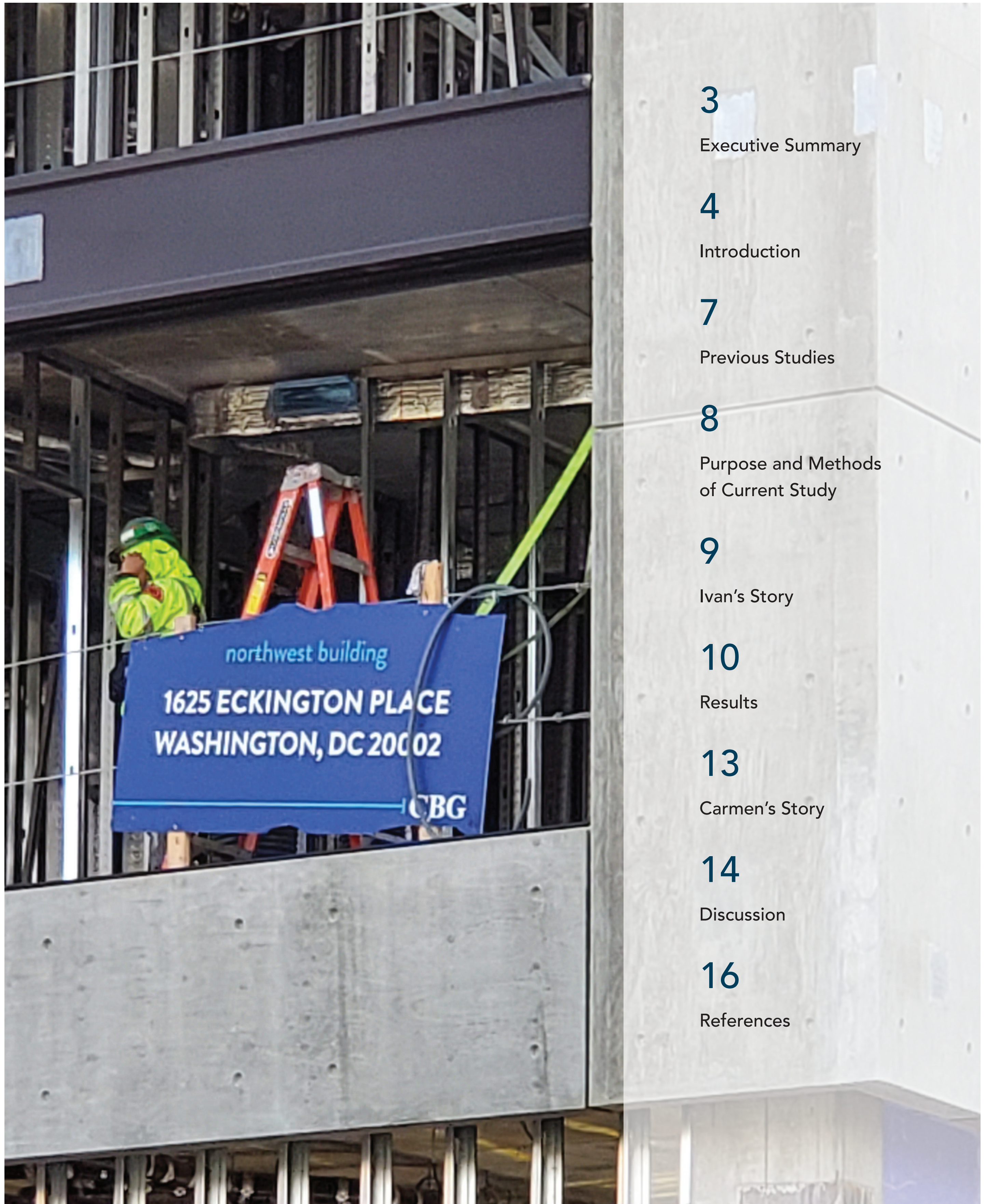
# THE UNDERGROUND ECONOMY AND WAGE THEFT

## in Washington DC's Commercial Construction Sector

Clayton Sinyai, Ph.D.
Ernesto Galeas

A study by the Catholic Labor Network, with generous support from the Catholic Campaign for Human Development

The Catholic Labor Network
SAINT JOSEPH THE WORKER








# The Underground Economy and Wage Theft in Washington DC's Commercial Construction Sector

**Executive Summary:** The construction industry in the District of Columbia features an extensive underground sector in which workers are misclassified as independent contractors or paid in cash off the books, denying the public necessary tax revenues and denying workers the protection of wage and hour laws – what this report will refer to as construction's "underground economy." While this has long been the case in single-family residential construction and renovation, today this form of workplace fraud has penetrated the largest commercial construction sites in the District of Columbia.

The Catholic Labor Network set out to investigate the prevalence of misclassification and wage theft in the D.C. commercial construction market and document patterns within the industry. We conducted extensive surveys with a stratified sample of 79 construction workers in various trades employed on 24 large commercial or public construction projects. We found that:

- Nearly half of the workers surveyed (47%) were part of the underground economy, either paid with a check without required payroll tax deductions or paid in cash.

- The underground economy was a major component of the private sector of the construction market. Of the 64 survey participants employed on private sector construction projects, 37 (58%) were part of the underground economy. In contrast, all 15 workers surveyed who were employed on public construction contracts received paychecks with legally required pay stubs and payroll tax deductions.

- The underground economy was concentrated in the non-union sector of the construction market. Among the 68 workers surveyed who did not belong to a union, 37 (54%) were part of the underground economy. All 11 union members surveyed received checks with legally required paystubs and payroll tax deductions.

- There was a strong association between the underground economy and minimum wage violations. Eight workers in the sample (10%) were paid less than the DC minimum wage; all 8 were part of the underground economy. None of the workers issued a proper paycheck with a pay stub and tax deductions received less than the DC minimum wage.

- There was a strong association between the underground economy and overtime violations. Twenty-nine workers in the sample reported that they were not paid required overtime rates when they worked more than 40 hours per week. Of these, 28 (97%) were part of the underground economy.

- About half the interview participants employed by electrical contractors, and majority of workers employed by mechanical contractors (plumbing and HVAC) and drywall contractors, participated in the underground economy. A well-developed system of "labor brokers" – employers of record who pay employees on behalf of specialty contractors – has sprung up in these segments between the established firms and their workforce to facilitate payroll violations. Most of the workers recruited by these labor brokers were immigrants unfamiliar with their rights or hesitant to exercise them.

- The heavy concentration of payroll violations and wage theft on the District's large commercial construction projects, especially among employees of mechanical, electrical and drywall contractors, offers good opportunities for strategic enforcement initiatives targeting these specific sectors within the broader construction industry.

# Introduction

On August 6, 2018 the Washington DC Office of the Attorney General announced a lawsuit against Power Design, Inc., for misclassifying workers as independent contractors in order to deny these workers minimum wage and overtime protections and to evade required payroll tax contributions (Office of the Attorney General, 2018). Power Design was one of the nation's largest electrical contractors, listed in the ENR 600, the construction industry's equivalent of the Fortune 500. Power Design was found on some of the District's largest construction projects; the OAG complaint alleged that at least 535 employees were misclassified as independent contractors.

The Power Design case resulted in a payment of $2.75 million in damages and penalties and a consent decree enjoining Power Design from further violations of DC Wage and Hour laws. (Office of the Attorney General, 2020). Moreover, it revealed to the public that a practice widespread among small residential construction firms had migrated, at least in the District of Columbia, to the commercial construction sector. In a striking example of what David Weil has famously labeled "the fissured workplace," (Weil, 2014) major construction contractors and subcontractors have become accustomed to executing large construction projects with few employees of record. That doesn't mean that they have few employees – just that the employees performing the work are either misclassified as independent contractors or not reported at all. They are part of a vast underground economy in the District of Columbia's construction industry.

This practice hurts workers, law-abiding businesses, government, and taxpayers.

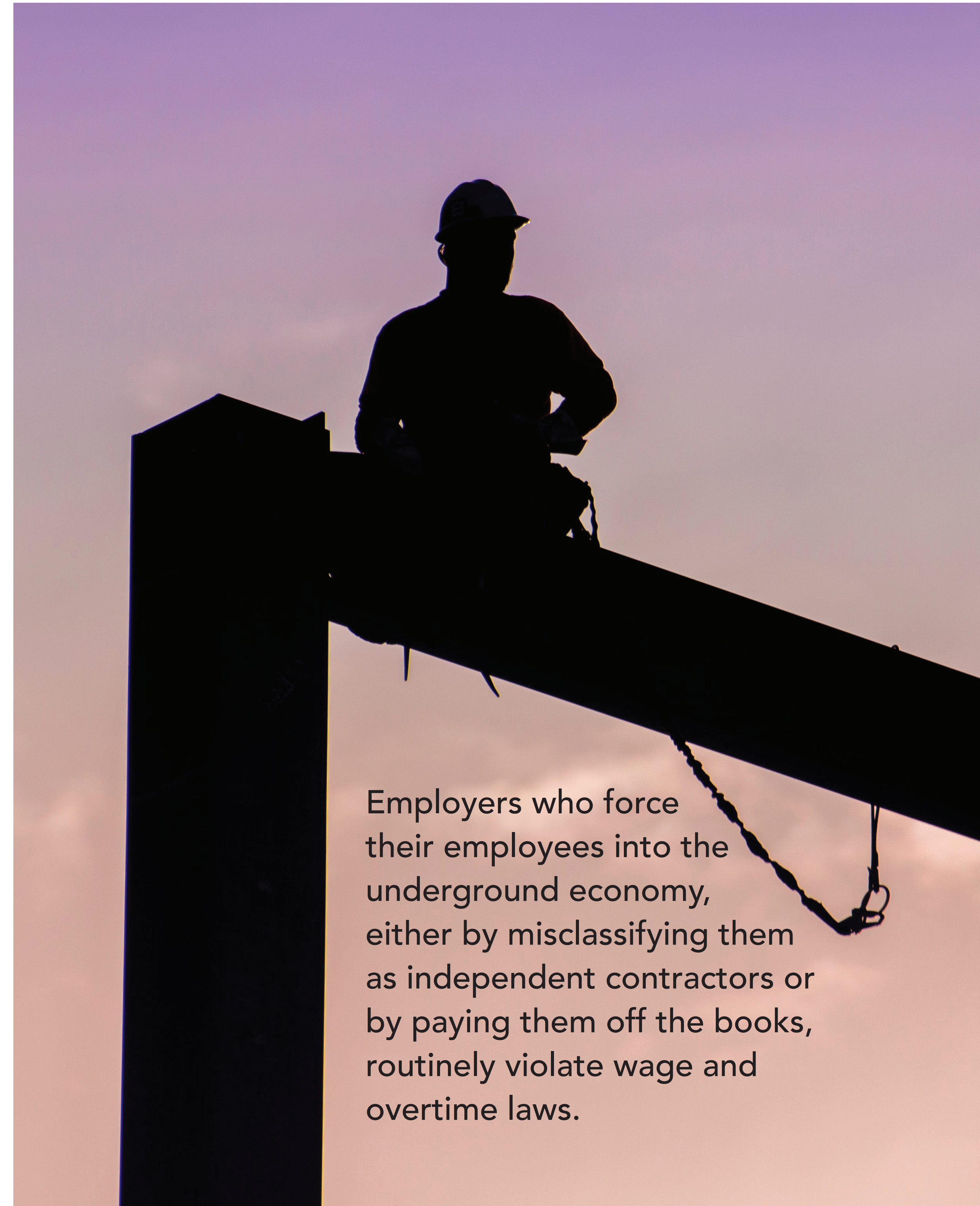
- Employers who force their employees into the underground economy, either by misclassifying them as independent contractors or by paying them off the books, routinely violate minimum wage and overtime laws. They do not pay workers' compensation or unemployment insurance premiums, leaving the workers themselves on the hook if they are injured or laid off. They do not pay required social security contributions, leaving these workers without proper retirement benefits.

- According to a 2019 study commissioned by the Office of the Attorney General, employers who successfully push their workforce into the underground economy (by mislabeling them independent contractors or paying them off the books) save between 16.7% and 48.1% of payroll and fringe benefit costs for their workers – substantially undercutting their law-abiding business competitors (Office of the Attorney General, 2019).

- When workers are forced into the underground economy by employers who misclassify them or do not report them at all, public programs experience significant tax losses. Social security contributions are not made; state and federal income taxes are not paid. Law-abiding taxpayers or cuts in crucial programs must make up the difference.

The Catholic Labor Network (CLN), a nonprofit worker advocacy organization based at Georgetown University's Kalmanovitz Initiative for Labor and the Working Poor, sought to investigate the patterns of wage theft and misclassification in the Washington DC commercial construction industry. The CLN canvassed DC jobsites and conducted extensive interviews with workers to determine the prevalence and distribution of violations. The findings are related in this report.







## Previous Studies

Wage theft is an extensive problem in the United States, one often associated with both the "fissured workplace" and the underground economy (Bernhardt, 2009). Workers in the construction industry are especially vulnerable, because of the vast, highly articulated networks of contracting and subcontracting that mark the sector. In conventional design-bid-build construction, a general contractor will develop an estimate for the project based on design drawings and place a bid to execute for the project owners, but will then subcontract most of the work to specialty contractors in large "packages" including mechanical (plumbing and/or HVAC), electrical, concrete, masonry, and drywall/interiors. Each of these specialty contractors may in turn identify particular tasks and subcontract these to smaller firms specializing in that type of work. This web of relationships featuring considerable legitimate subcontracting makes it easier to conceal independent contractor misclassification than in many other industrial sectors.

Previous investigations have substantiated the significance of this problem in the construction industry. One method of research is an audit of **employers** participating in the unemployment insurance system or – in some states – a state-run workers' compensation program. For example, a 2019 study that reviewed workers' compensation insurance audit data for the State of Washington found that between 2013 and 2017 an average of 19% of construction employers had misclassified at least some employees (Xu & Erlich, 2019). In Virginia, a 2012 Joint Legislative Audit and Review Commission report based on UI contribution of audits of several hundred construction employers in 2010 found that some 33% of construction employers had some misclassified employees – amounting to some 30% of workers (JLARC, 2012).

As high as these numbers are, they are almost certainly an undercount, for an audit of employers participating in unemployment insurance or workers' compensation will miss the most egregious violators, who don't report any employees to either program. An alternative method is to survey employees about misclassification. The Workers' Defense Project, based in Austin, Texas, has led a series of such studies – first in Austin, then the state of Texas, and finally across six cities in the Southeastern United States. The surveys found that between 32% and 41% of employees were misclassified or working off the books entirely (Theodore, Boggess, Cornejo, & Timm, 2017; Workers Defense Project, 2009, 2013).

Finally, one may rely on federal government statistics for a general, national assessment of the problem. While no government program can directly count misclassified or off-the-books employees, it is possible to compare programs that survey workers (such as the Census) and those that survey employers (such as the Occupational Employment Survey) to estimate how many construction workers are not reported. A recent study using this method estimated that in 2017, between 12.4% and 20.5% of the construction workforce nationwide was misclassified or working off the books at any given time (Ormiston, Belman, & Erlich, 2020).

## Purpose and Methods of the Current Study

The data gathered to date are sufficient to establish that an underground economy exists in construction, and that it is large. However, previous studies have not sought to identify the industry segments where violations are most widely practiced. The CLN determined that surveying a stratified sample of construction workers from a variety of project types, trades and occupations would enable us to provide a map of the construction industry's underground economy.

To build a sample, the Catholic Labor Network consulted the Dodge Reports, the construction industry's premier source for information on construction lettings, running a search for all construction projects underway in the District of Columbia with an estimated value of $25 million and up. CLN field representative Ernesto Galeas conducted site visits at all of the reported sites and identified several additional comparable sites not reported in Dodge, which were added to the sample.

Between January and November 2020, Galeas conducted interviews with 79 construction workers on major commercial and public construction sites across the District of Columbia, inquiring about their method of payment, hourly wage, and whether they were paid at overtime rates when working more than 40 hours in one week. The sample included workers employed by 43 different contractors across 24 DC construction sites. Respondents included 11 union members and 68 nonunion construction workers; 15 workers were employed on public construction sites at the time of interview, while the remaining 64 were employed on private construction projects.

## Table 1: Interview Participants in Sample (n = 79)

| | | |
|---|---|---|
| **By Union Status** | Union | 11 |
| | Nonunion | 68 |
| | | |
| **By Project Funding** | Public | 15 |
| | Private | 64 |
| | | |
| **By Employer Trade** | Concrete Contractor | 11 |
| | Drywall Contractor | 13 |
| | Electrical Contractor | 11 |
| | Masonry Contractor | 10 |
| | Mechanical (Plumbing/HVAC) Contractor | 22 |
| | Other Contractor | 12 |
| | | |
| **By Worker Occupation** | Bricklayer | 4 |
| | Carpenter | 15 |
| | Electrician | 11 |
| | Laborer | 19 |
| | Plumber/Pipefitter | 15 |
| | Sheet Metal Worker | 6 |
| | Other | 9 |



## Behind the Statistics: Ivan's Story

*Behind the statistics on the underground economy and wage theft are real people. Some of the workers we met in the course of our interviews shared their stories with us. Here's Ivan's story, in his own words.*

I'm 28 years old. I fled gangs in El Salvador four years ago and came to Houston, Texas. I was a bus driver in San Salvador, but the gangs were becoming more violent, and charged protection money from bus drivers, so I came to the United States. I worked as a car mechanic in Houston and sometimes as a carpenter. I moved to Woodbridge, Virginia because I heard wages were better here.

I was looking for work in February 2020 and heard that they were hiring at a job on Eckington Place. Advantage Mechanical was the sheet metal contractor doing ductwork for the air conditioning, but a man named Jimmy Rivas was doing the hiring. He asked if I had experience in HVAC. I said no, I was a carpenter, but I was willing to learn. He said he would hire me as a helper at $12 per hour and if I learned quickly, I would get a raise. He said there were no benefits like medical insurance. The minimum wage then in DC was $14 per hour but I needed a job, so I took it. He didn't ask me to fill out any paperwork like a W-4 or anything. I just showed up and signed in each day in a notebook.

When my first payday came on March 18, 2020, I got a check that read "R & L General Contractors." It didn't look like a paycheck, just a regular check, and didn't have a pay stub or anything. It was for $864, which is $12 an hour for 72 hours of work (the number of hours I had worked). There were no deductions for taxes or anything. I took it to the bank and tried to cash it, but they told me that there was no money in the account and I would have to wait two weeks to get my money.

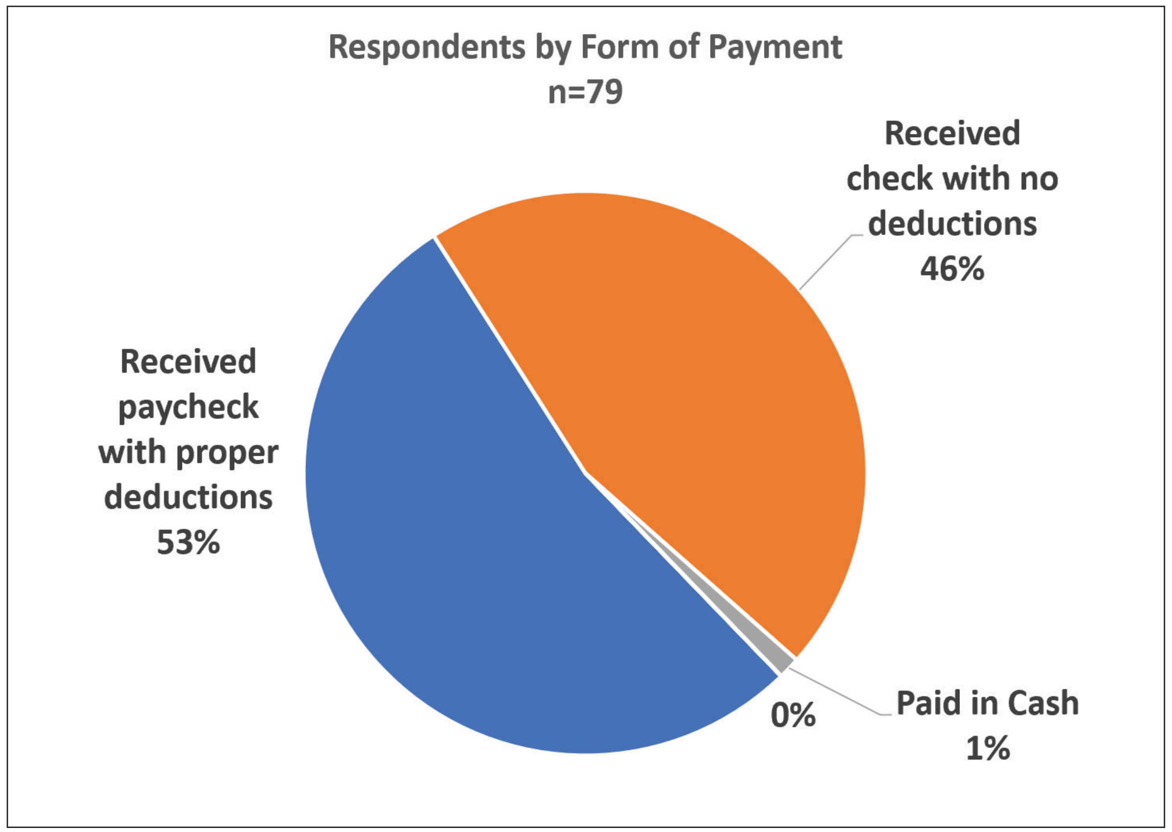
I learned from my co-workers that I was supposed to take my check to a special check-cashing place in Manassas where they would cash it for me after taking out a 2% fee. I guess Jimmy had some kind of deal with that place.

The other guys told me that they worked overtime sometimes but never got paid time and a half. A lot of people quit during the time I was there because of the low pay. I never got the raise Jimmy promised, so I quit in June. Labor brokers like Jimmy take advantage of us because they know we are immigrants and some of us are undocumented.

## Results

Of the 79 workers surveyed, 42 (53%) reported that they received a paycheck with a paystub and with taxes deducted, while 36 (46%) reported being paid with a personal or business check without any payroll deductions and 1 worker (1%) reported simply being paid in cash. That is to say, nearly half (47%) the workers in the sample appeared to be part of the underground economy (see Fig. 1). It was not clear whether the labor brokers that paid these workers were reporting them as independent contractors or not reporting them at all – most of them had worked less than a year and did not know if they would receive the 1099 required for independent contractors.

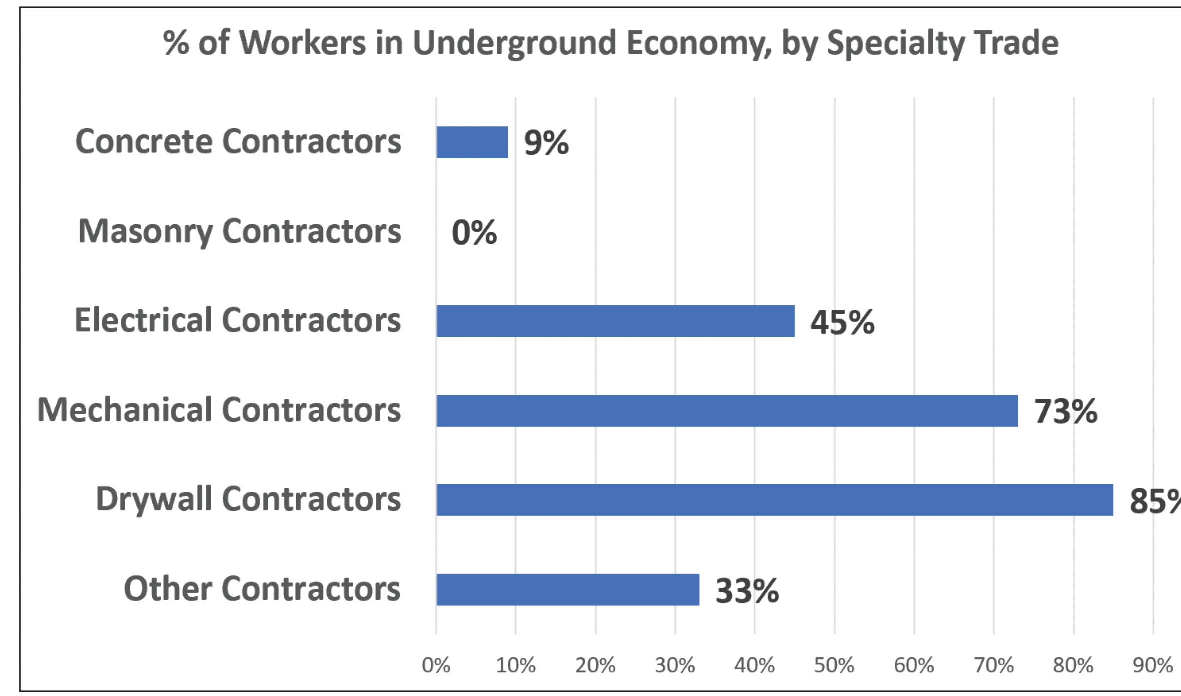
Fig. 1: Interview Respondents by Form of Payment

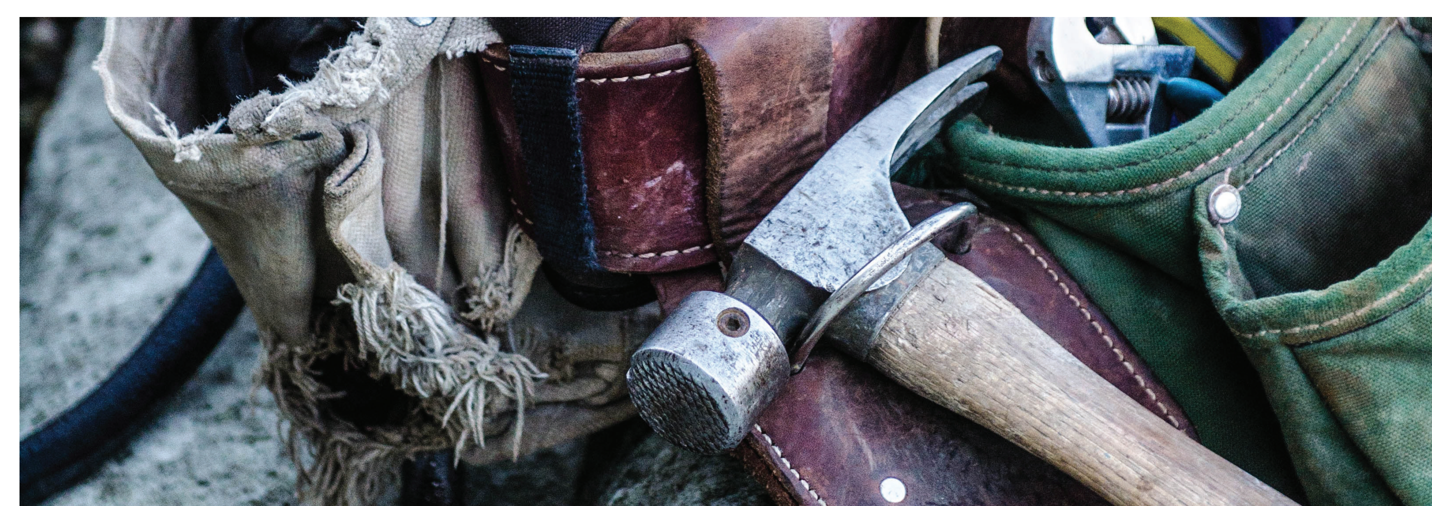



**_Could they have been actual independent contractors?_** Independent contractors are a real part of the construction industry who have specialized skills, tools and equipment, and perform tasks for hire on a construction project. Readers might ask, were some or all of these workers legitimate independent contractors? However, the interview participants in this sample all understood themselves to be employees, either of a specialty contractor or a labor broker working as their agent. All reported to work on a schedule determined by their employer or supervisor and were paid by the hour or day, not by the piece or by the contract. They had no opportunity for profit or loss. It is highly unlikely that any of these workers could meet the legal requirements to establish independent contractor status.

In the sample, the underground economy was concentrated in particular specialty trades, while largely absent in others (Fig. 2). Very few employees of masonry (0%) or concrete (9%) contractors were in the underground economy. On the other hand, nearly half (45%) of the workers employed by electrical contractors were part of the underground economy, as were a majority of workers employed by mechanical contractors (73%) and drywall contractors (85%). Some one-third (33%) of workers employed by other specialty contractors – a category including asphalt pavers, glaziers, roofers, siding installers, painters, elevator constructors, and site cleanup contractors – were part of the underground economy.

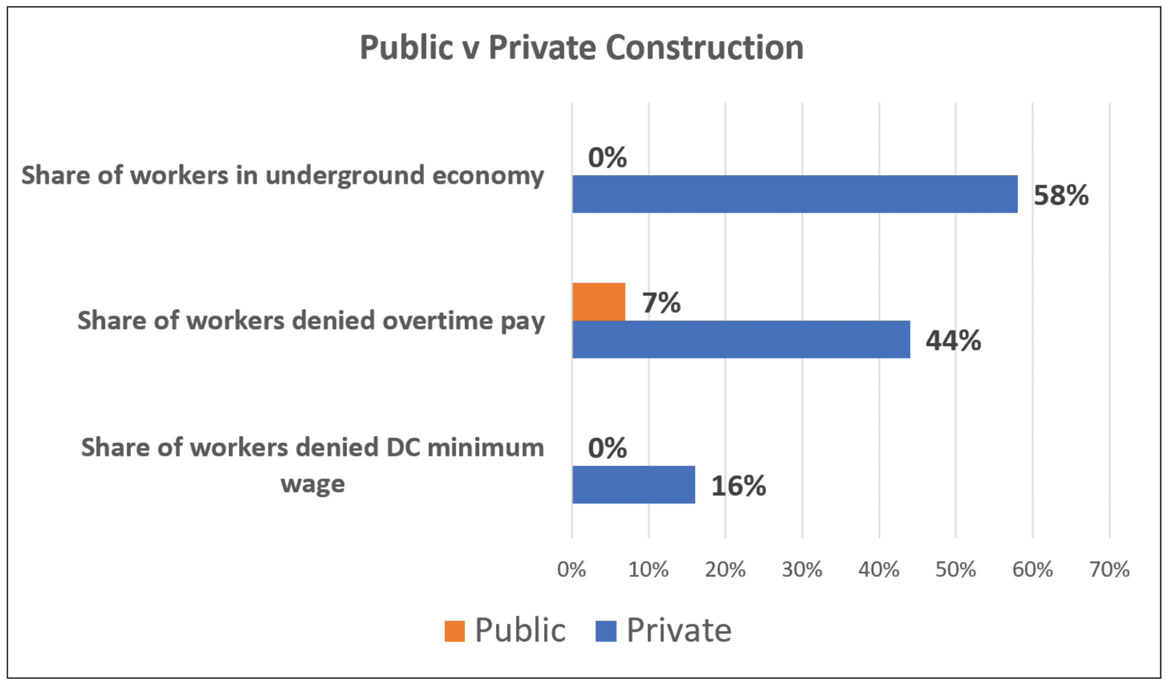
Fig. 2: Percent of workers in underground economy, by specialty trade



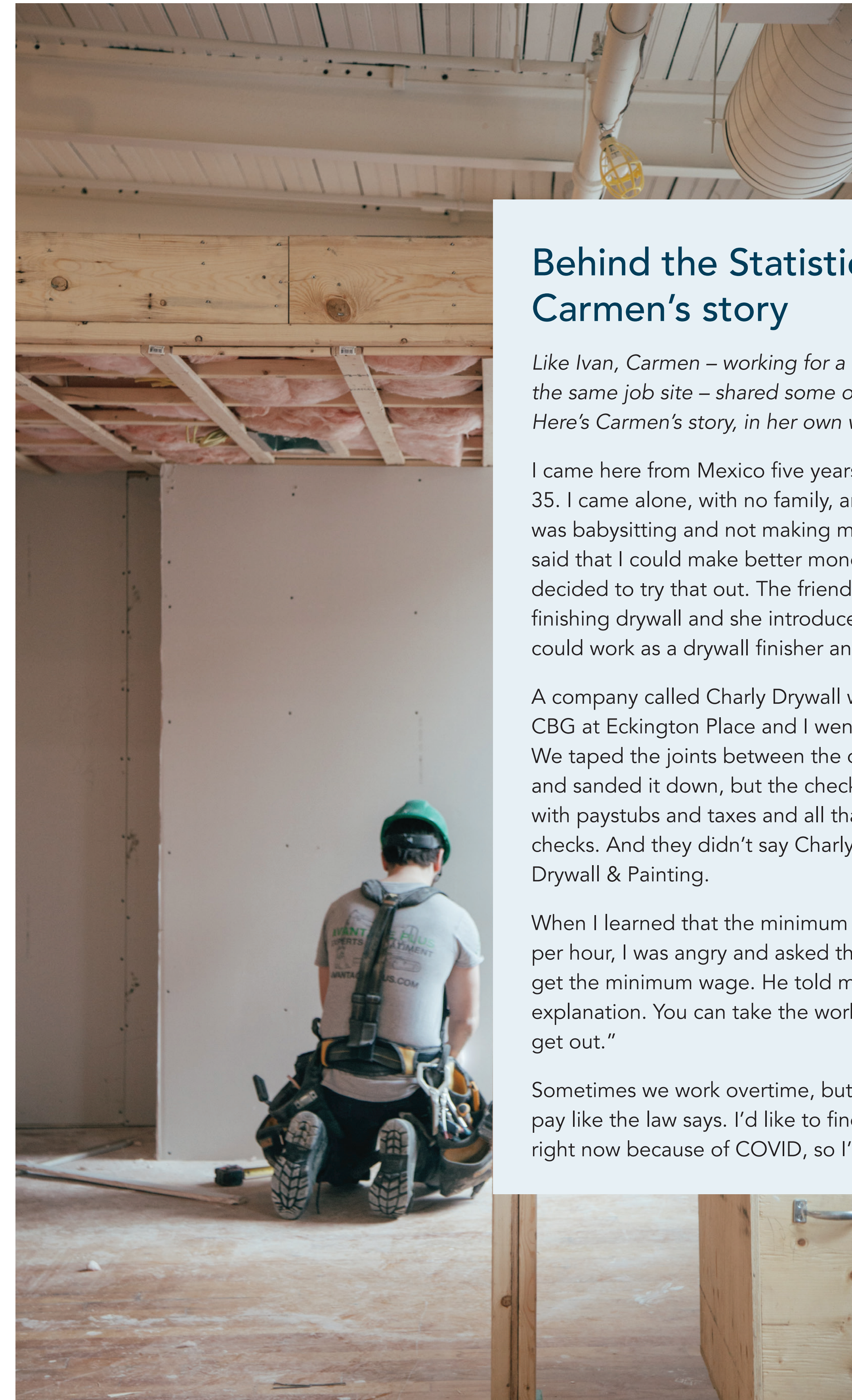
In the sample, the underground economy was a much larger factor in the private commercial construction sector than in public construction (Fig. 3). Some 15 of the interview respondents were employed on public construction projects, while the remaining 64 were employed on large-scale private construction projects. All 15 workers employed on public sector construction projects reported being paid as employees with taxes deducted from their paychecks, and none reported a minimum wage violation; 1 (7%) reported not receiving overtime pay when working more than 40 hours per week. Of the 64 employed on private commercial projects, 37 (58%) belonged to the underground economy, with 10 (16%) reporting that they had not received the minimum wage and 28 (44%) that they had not been paid required overtime rates.

Fig. 3: Public v. Private Construction




Finally, there was a virtual wall of separation between the union sector and the underground economy. Of the 11 union members interviewed, all were properly paid by law and none were victims of wage and hour violations, whether of overtime or minimum wage.





## Behind the Statistics: Carmen's story

*Like Ivan, Carmen – working for a different subcontractor at the same job site – shared some of her story with us. Here's Carmen's story, in her own words.*

I came here from Mexico five years ago for a better life. I'm 35. I came alone, with no family, and live in Centerville VA. I was babysitting and not making much money, and a friend said that I could make better money in construction, so I decided to try that out. The friend told me that I could work finishing drywall and she introduced me to a man who said I could work as a drywall finisher and would get $12 per hour.

A company called Charly Drywall was doing the drywall for CBG at Eckington Place and I went to work finishing drywall. We taped the joints between the drywall, mudded the joints and sanded it down, but the checks we got weren't paychecks with paystubs and taxes and all that, they were regular checks. And they didn't say Charly Drywall, they said LG Drywall & Painting.

When I learned that the minimum wage in DC was $15 per hour, I was angry and asked the boss why we don't get the minimum wage. He told me "we don't owe you an explanation. You can take the work at the rate we pay or get out."

Sometimes we work overtime, but we don't get any overtime pay like the law says. I'd like to find a better job but it's hard right now because of COVID, so I'm still here.

## Discussion

The findings confirm the picture painted by past researchers of a substantial segment of the construction workforce who are either misreported as independent contractors or not reported at all. They also document the strong association between this underground segment of the construction economy and wage theft. When employers failed to pay required overtime pay or failed to pay the DC minimum wage, the victims were almost always workers in the underground economy.

If this sample is representative of large-scale commercial construction in the District of Columbia, both the underground economy and violations of minimum wage and overtime laws appear to be heavily concentrated in the private sector construction market. The District's prevailing wage laws may play a role in this; public sector construction projects in the District of Columbia require employers to submit certified payrolls for review in compliance with prevailing wage laws. While independent contractor misclassification and wage theft are not unknown on public construction projects, the requirement to submit certified payrolls for review makes payroll fraud easier to detect, the potential consequences of violations more severe, and multiplies opportunities for both public agencies and third-party enforcement organizations (such as the Foundation for Fair Contracting) to police labor practices. (The current study did not attempt to assess prevailing wage violations, a form of wage theft common in public construction with no counterpart in the private sector.)

Likewise, both the underground economy and wage theft appear to be entirely confined to the nonunion sector of the construction industry. This finding is important but unsurprising. Union workers who are denied legally required minimum wage or overtime pay, or who are pressured to work off the books or accept designation as independent contractors, can turn to their union to resolve these issues. Consequently, the authors suspect that union-signatory contractors seldom engage in these practices.

Somewhat less expected was our finding that the underground economy in the DC commercial construction sector was heavily concentrated among the mechanical, electrical and drywall contractor workforce. While independent contractor misclassification of drywall carpenters has been widely documented for decades, for a long time it appears that the mechanical and electrical trades, with their licensing requirements, were relatively immune from these violations. This study found that much of the workforce in each trade had been forced into the underground economy.

The authors note that construction is a complex industry with a large number of distinct market niches, each contested by a limited number of competitors. If a single contractor bidding on large private sector mechanical packages shifts the bulk of its labor force into the underground economy and realizes the 17-48% labor cost savings estimated in *Illegal Worker Misclassification: Payroll Fraud in the District's Construction Industry* (Office of the Attorney General, 2019), its competitors will rapidly be forced to follow suit or be driven from that market. The result would be a market segment dominated by an underground labor market, which is what this study found.

Indeed, the interviews revealed that these three segments of the market – mechanical/HVAC, electrical and drywall – had evolved a highly developed network of labor brokers as intermediaries between the subcontractor of record (who had been awarded the work by the general contractor) and the worker. These labor brokers functioned as a temp or labor leasing agency supplying workers to the subcontractor and issuing checks for payment to the workers – checks without tax deductions taken out. The network of labor brokers allows large subcontractors to maintain a measure of deniability for the payroll violations performed for their benefit. Most of the workers interviewed who were recruited into the underground economy in this way were recent immigrants unfamiliar with their rights or fearful of exercising them.

If there is a promising finding from this research, it is that the underground economy in DC's commercial construction market, though substantial, still appears to be highly concentrated in certain market segments. It is vulnerable to disruption by strategic enforcement actions targeting these market segments: mechanical, electrical and drywall construction on large privately funded building projects in the District. If the relevant enforcement agencies resolve to end this unlawful activity, through site-based audits and other interventions, they may find success. Without action, however, this labor market model may penetrate the remaining segments of the District's commercial construction market.

# References


Office of the Attorney General, D. o. C. (2018). AG Racine Sues Power Design for Cheating Hundreds of Electrical Workers Out of Wages and Benefits [Press release]. Retrieved from https://oag.dc.gov/release/ag-racine-sues-power-design-cheating-hundreds

Office of the Attorney General, D. o. C. (2019). *Illegal Worker Misclassification: Payroll Fraud in the District's Construction Industry.* Retrieved from https://oag.dc.gov/sites/default/files/2019-09/OAG-Illegal-Worker-Misclassification-Report.pdf.

Office of the Attorney General, D. o. C. (2020). AG Racine Announces National Electrical Contractor Will Pay $2.75 Million to Workers and the District to Resolve Wage Theft Lawsuit [Press release]. Retrieved from https://oag.dc.gov/release/ag-racine-announces-national-electrical-contractor

Ormiston, R., Belman, D., & Erlich, M. (2020). An Empirical Methodology to Estimate the Incidence and Costs of Payroll Fraud in the Construction Industry.

Theodore, N., Boggess, B., Cornejo, J., & Timm, E. (2017). Build a better South: Construction working conditions in the southern US. In: Workers Defense Project Austin, TX.

Weil, D. (2014). *The fissured workplace : why work became so bad for so many and what can be done to improve it. Cambridge, Massachusetts: Harvard University Press.*

Workers Defense Project. (2009). Building Austin, Building Injustice: Working Conditions in Austin's Construction Industry.

Workers Defense Project. (2013). *Build a Better Texas: Construction Working Conditions in the Lone Star State: a Report: Workers Defense Project.*

Xu, L., & Erlich, M. (2019). *Economic Consequences of Misclassification in the State of Washington.* Retrieved from https://lwp.law.harvard.edu/files/lwp/files/wa_study_dec_2019_final.pdf


The **Catholic**

SAINT JOSEPH THE WORKER

**Labor Network**