

Illegal Labor Practices in the Philadelphia Regional Construction Industry: an Assessment and Action Plan



by
Stephen Herzenberg
Russell Ormiston

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About the Authors

Stephen Herzenberg is an economist and the Executive Director of the Keystone Research Center (KRC) (www.keystoneresearch.org), a Pennsylvania-based, independent, non-partisan economic research organization. He holds a Ph.D. in economics from the Massachusetts Institute of Technology and a bachelor's degree in mechanical engineering from Harvard University. He has published on topics such as the service economy, workforce and economic development, international labor standards, the Pennsylvania economy and public policy, and the auto, construction, caregiving and other industries.

His publications for national audiences include forthcoming academic book chapters on “just transition” for carbon-economy workers and on U.S. labor unions; *Losing Ground in Early Childhood Education*, Economic Policy Institute; *New Rules for a New Economy: Employment and Opportunity in Postindustrial America*, Cornell/ILR press; and *U.S.-Mexico Trade: Pulling Together or Pulling Apart?* US Office of Technology Assessment (OTA). Before joining KRC, Dr. Herzenberg worked at OTA and the U.S. Department of Labor. In 1993, he served on the negotiating team for the labor side agreement to the North American Free Trade Agreement.

Russell Ormiston is an associate professor of economics at Allegheny College in Meadville, Pa., and a research scholar for the Institute for Construction Economics Research. Dr. Ormiston has published articles on the construction industry in academic journals such as *Industrial Relations* and the *Labor Studies Journal*. He has also co-authored a chapter on the residential construction sector that will be included in the forthcoming book, *Shifting to the High Road: Job Quality in Low-Wage Industries*, that will be published by MIT Press.

About the Keystone Research Center

The Keystone Research Center (KRC) was founded in 1996 to broaden public discussion on strategies to achieve a more prosperous and equitable Pennsylvania economy. Since its creation, KRC has become a leading source of independent analysis of Pennsylvania's economy and public policy. KRC is located at 412 North Third Street, Harrisburg, Pennsylvania 17101-1346. Most of KRC's original research is available on the KRC website at www.keystoneresearch.org, www.pennbpc.org (the Pennsylvania Budget and Policy Center (PBPC) is a project of KRC), and www.thirdandstate.org (the joint blog of KRC and PBPC). KRC welcomes questions or other inquiries about its work at 717-255-7181.

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Destructive Competition in the Southeast Pennsylvania Construction Industry: How Irresponsible Contractors Victimize Workers and Taxpayers in the Philadelphia Area

Stephen Herzenberg

Summary

This brief, buttressed by the companion national literature review by Professor Russell Ormiston of Allegheny College, presents multiple sources of complementary evidence that point to a single, simple conclusion: US and Pennsylvania labor law and labor standards are routinely violated by many contractors in the Southeast Pennsylvania regional construction industry. These violations threaten to transform growing shares of the construction sector—an industry that still provides significant numbers of well-paid jobs to highly skilled non-college workers—into low-wage, low-skill jobs, further undermining the region’s middle class and increasing already-gaping inequality.

Labor standards violations victimize workers and their families, taxpayers, law-abiding contractors, and construction customers including public sector entities.

- Workers get cheated of the pay they have earned and need to support their family.
- Local businesses suffer because lower-wage workers, some from outside the region, consume less.
- Taxpayers lose because worker victims of wage theft pay less in taxes. Taxpayers also lose in some cases because irresponsible contractors win public contracts awarded to low bidders and then use “change orders” to increase project cost beyond the original bid.
- As well as losing income, workers and their families may suffer because of injuries suffered on the job. Such injuries are more common among contractors who violate labor standards and, in some cases, rely on informal labor markets essentially outside the purview of labor law.
- Law-abiding contractors lose business and profits—and pay higher unemployment insurance taxes and workers compensation premiums—because their competitors underpay. Law-abiding contractors also face pressure to begin violating standards and cheating workers themselves—in a potential “if you can’t beat ‘em, join ‘em” downward spiral that spreads destructive competition.

The evidence for these problems comes from:

- The growing body of national research literature surveyed in more detail by Professor Ormiston.
 - Studies of worker misclassification in other states suggest that, if Pennsylvania has rates of misclassification in the construction industry comparable to these other states, it loses about \$10 million in unemployment insurance taxes, at least \$15 million in income tax revenues (and possibly three times as much), as much as \$83 million in workers compensation premiums, and \$200 million in federal income taxes.
 - More recent studies based on surveys of workers suggest higher rates and costs of worker misclassification.
 - One study showed that 70% or more of workers in Los Angeles residential construction experienced non-payment of overtime and working of the clock.
 - A new study in Michigan found 73% of workers in residential construction misclassified as independent contractors. Misclassified workers lost an estimated \$6,000 per worker—or \$7.9 million annually—in just drywall contractors in this one

region. Researchers also estimated a loss of \$8.8 million in Social Security and Medicare taxes and \$9.5 million in state workers compensation and unemployment insurance payments.

- The research literature shows labor standards violations bleeding into commercial construction, including of publicly funded multi-family housing.
 - Five studies document higher injury rates higher among non-union construction contractors than unionized contractors. (Construction in the United States accounts for nearly one in four fatalities on the job, over four times its share of US employment.)
- Enforcement of Act 72, the Pennsylvania Construction Worker Misclassification Act, implemented in 2011. Since 2014, the number of cases pursued under the Act annually has risen from 50 to 185 to 297 cases, including 46 cases in metropolitan Philadelphia in 2017. Administrative penalties collected under the Act have risen nearly 30 times since 2014: from \$12,700 to \$360,360 in 2017. Even with this increased activity, enforcement driven by worker complaints—with the most vulnerable workers least likely to complain—only scratch the surface of the worker misclassification problem.
 - Numerous settled class-action suits in which construction contractors agreed to compensate workers for violating overtime laws on projects within Southeast Pennsylvania.
 - A dozen interviews with workers with experience working for non-union contractors in the SE Pennsylvania construction industry.
 - Academic research documenting that the Philadelphia residential construction industry operates “informally,” without even a pretense of applying US and Pennsylvania labor law and standards.

Since the evidence is overwhelming that irresponsible contractors are a presence in the regional construction industry, the Pennsylvania Department of Labor & Industry, Attorney General, and local governments in SE Pennsylvania should partner with industry stakeholders and philanthropy to develop a comprehensive multi-year research project to better gauge the scope and nature of this problem. Responsible statewide and local government entities should also develop an enforcement and technical assistance plan that can drive compliance with the law to 100% (which is, after all, the goal). This should include a study using up-to-date methods informed by earlier studies conducted in other states on the extent of worker misclassification in the construction industry (using UI records and audits, and also using Pennsylvania’s data sharing agreement with the Internal Revenue Service); a comprehensive analysis of data extracted to date through enforcement of Act 72; a larger-sample and in-depth interview-based study that uses innovative methods to ensure adequate sampling of vulnerable workers likely to be victimized by irresponsible contractors; interviews with insurance companies and regulators; and qualitative research on the “business strategies” of law-abiding contractors, both non-union and union, to distill lessons for how to use carrot and stick to get more contractors to deploy such strategies and comply with the law.

The desirability of more comprehensive data does not obviate the need for action now to reduce this problem. One of the most obvious first steps for public sector entities is to increase vigilance to ensure that irresponsible contractors do not participate in and profit from publicly funded construction work. One tool that has virtually eliminated participation of irresponsible contractors on 70 individual projects and \$25 billion of construction in SE Pennsylvania—private as well as public—is the use of Project Labor Agreements (PLAs). As well as preventing participation of contractors that violate labor laws, PLAs can be used to increase participation of local labor (e.g., from the school district, municipality and/or county of the project) and to ensure economic opportunity for a diverse population.

Introduction

A large body of evidence accumulated over many decades documents that competition in the construction industry can take place along two sharply different paths. Especially in residential and light commercial construction, the construction industry is prone to low-wage, low-skill competition. Low capital costs and few barriers to new firms entering the market make it possible for “low-road” firms to compete based on low wages with inexperienced workers, in many cases violating health and safety laws and other basic labor standards and stealing from their workers. In more capital-intensive parts of the non-residential market, such as the pharmaceutical and petrochemical sectors in Southeastern Pennsylvania, industrial customers would never risk the compromises of safety, worker skills, and productivity associated with irresponsible contractors. In fact, these industrial giants routinely rely almost exclusively on unionized trades workers because of their high level of apprenticeship training and extensive collective experience.

Since labor violations occur in the shadows of the construction industry, the research literature on them is not large; moreover, the best studies have not been conducted in the Philadelphia region or in Pennsylvania. Yet the circumstantial evidence from multiple sources is strong: it is virtually certain that irresponsible contractors have a significant foothold in the Philadelphia region and their market share may be growing, including on jobs with funding from state and local government.

This brief relies on multiple methodologies, touching “the elephant” in many places to gain an overall sense of the potential for labor standards violations in the Southeast Pennsylvania construction industry.

- A review of the research literature on labor standards violations in the US construction industry.
- State data on worker misclassification in the construction industry within the Pennsylvania and regional construction industries.
- A summary of settled class-action lawsuits documenting wage theft due to violations of overtime rules within the regional construction industry.
- Data on apprenticeship training in the construction industry in Pennsylvania.
- Interviews with workers who have worked in non-union construction.

Violation of Labor Standards Is Pervasive in the US Construction Industry

A national literature review commissioned for this project finds violations of labor standards endemic in the residential construction industry, with signs of the spread of these violations to commercial construction. References for any findings not sourced here can be found in that national literature review, which is included as the second part of this document and PDF.

Wage theft: A 2009 study of residential construction in New York, Chicago, and Los Angeles found that over 70% of residential construction workers experienced “nonpayment of overtime” and “working off the clock.” One in eight workers reported violations of the minimum wage. Is it plausible that Philadelphia, another big city now enjoying a building boom, is immune from such problems?

Wage theft is not limited to nonresidential construction. The Workers Defense Project surveyed 1,194 workers on commercial or multi-family residential construction sites in five of the biggest cities in Texas. It

found that half reported nonpayment for overtime and 22% experienced nonpayment for work. The Brennan Center found wage theft pervasive on public housing and subsidized housing projects.

Worker misclassification: Misclassification of workers as independent contractors is a second widespread problem in construction (including in Pennsylvania as we document below). Contractors can save up to an estimated 30% through avoidance of overtime payments and taxes (for unemployment insurance, Social Security, and Medicare), and circumventing workers' compensation costs required for workers classified correctly as employees. A New York audit of state unemployment insurance forms estimated that about 15% of construction employees in the state were incorrectly classified as independent contractors. A Virginia audit found one third of construction workers in the state misclassified as independent contractors.

Studies based on worker interviews suggest that audits of UI records underestimate the extent of misclassification. A study of 71 residential construction drywall contractors in Southwest Michigan found that:

- Nearly three quarters of workers (73%) were misclassified independent contractors.
- Workers misclassified lost an estimated \$6,000 per worker annually because of the loss of overtime pay (\$7.9 million total).
- Contractors underpaid state workers' compensation and unemployment insurance by an estimated \$9.5 million and Social Security and Medicare by an estimated \$8.8 million.

In the Texas, the Workers Defense Project found 41% were victims of payroll, misclassified, or paid off the books in cash.

Several state studies over the past 15 years have estimated how much worker misclassification in the construction industry reduces state unemployment insurance, workers compensation premium collections, and state income tax collections (and, in one case, federal income tax collections). Table 1 uses three of these studies to estimate what Pennsylvania costs would be if scaled up based on the size of the Pennsylvania economy relative to the size of the economy in other states at the time they were studied.

Table 1. Projected 2016 Annual Costs of Worker Misclassification (millions of dollars) in Pennsylvania Construction Industry Based on Studies in Other States

PA Estimated Costs	UC Taxes	State Income Taxes	Workers Comp. Premiums	Federal Taxes
Based on Illinois 2005	\$11.0	\$30.3	\$28.6	
Based on MN 1999-2002	\$6.1	\$47.2	\$83.4	\$199.7
Based on MA 2001-03	\$5.9	\$15.0	\$16.6	

Note: Estimates for other states scaled to Pennsylvania in 2016 based on the ratio of nominal GSP in Pennsylvania in 2016 to that in the states studied over the period of the study (nominal GSP reported by the Bureau of Economic Analysis at <http://www.bea.gov/bea/regional/gsp/default.cfm?series=NAICS>). State income taxes lost also adjusted based on the ratio of overall (weighted) average personal income tax rates in the states studied over the period of the study to Pennsylvania in 2015 using Institute for Taxation and Economic Policy "Who Pays?" reports.

Sources: (1) Illinois--National Employment Law Project, "Independent Contractor Misclassification Imposes Huge Costs on Workers and Federal and State Treasuries," July 2015; <https://www.nelp.org/publication/independent-contractor-misclassification-imposes-huge-costs-on-workers-and-federal-and-state-treasuries/>. (2) Massachusetts--Francoise Carré and Randall Wilson, "The Social and Economic Costs of Employee Misclassification in Construction," Construction Policy Research Center, Labor and Worklife Program, Harvard Law School, December 17, 2004; <https://lwp.law.harvard.edu/publications/social-and-economic-costs-employee-misclassification-construction>. (3) For Maine--Francoise Carré and Randall Wilson, "The Social and Economic Costs of Employee Misclassification in the Construction Industry," Construction Policy Research Center, Labor and Worklife Program, Harvard Law School, April 25, 2005; https://www.researchgate.net/publication/254695491_The_Social_and_Economic_Costs_of_Employee_Misclassification_in_the_Maine_Construction_Industry

Health and safety standards: Construction is one of the most dangerous industries in the United States. In 2016, it accounted for 19.1% of workplace fatalities, over four times its 4.7% employment share. Five different studies indicate that union jobs sites are substantially safer than non-union ones:

- One found construction fatality rates lower in states with greater union density.
- A second found that non-union contractors commit significantly more OSHA violations than their union counterparts.
- Researchers attribute better safety records among union contractors to greater worker training, safety awareness and enforcement of OSHA requirements at union sites, and a workplace culture that emphasizes safety.

Workers' compensation fraud: An emerging practice is the use of shell companies that rent out their certificates of insurance (COIs) to defraud state workers' compensation funds. A Florida task force of government agencies, insurance companies, construction unions, and employers estimated that this fraud costs the state more than \$1 billion annually.

Violation of Labor Standards Is Also a Problem in Philadelphia-Area Construction Industry

Although no comprehensive studies of labor standards violations have been conducted of the Pennsylvania and Philadelphia construction sectors, various sources indicate that the patterns of violations likely resemble those in other states and large metropolitan areas.

Wage theft and the informalization of Philadelphia construction. Based on interviews with 96 workers, academic research conducted by Iskander and Lowe from 2006-2010 found that "...the small-scale contractors and free-lance 'flippers'..." who predominate in city of Philadelphia housing construction and renovation rely primarily on a labor market that is "largely informal"—i.e., it operates essentially outside the boundaries of US labor law.¹ Job quality in Philadelphia residential construction varies by project, sometimes being organized by the day, in a variation of classic "piece work."² Workers in crews of two to six would receive materials at the beginning of the day and be told, "I'll be back in six hours. I'll give you \$X." Other workers live in unfinished buildings in exchange for rehabbing them. For these workers, US minimum wage and overtime laws, and health and safety standards, simply do not apply. This makes it difficult—perhaps impossible—for contractors who seek to abide by the law to compete. Iskander and Lowe also document high rates of injury on the job in Philadelphia residential construction. One third of workers that they interviewed (i.e., from the informal sector of the residential construction labor market) suffered injuries on the job that took them out of work for a week or more. Injuries resulted partly from the use of unfamiliar power tools and partly from inadequately designed scaffolding. The city's Department of Licenses and Inspections staff, officially responsible for compliance with permitting requirements and building codes, but nonetheless with expertise on safety, would end up in the unfamiliar role of providing on-the-spot advice on how to improve scaffolding or strengthen temporary retaining walls built on demolition jobs. "'A lot of contractors will put their employees in positions that make us cringe,' said one inspector, 'and that is when L&I will issue stop work orders to get people out for their own safety.'"

¹ Natasha Iskander and Nichola Lowe, "The Transformers: Immigration and Tacit Knowledge Development," NYU Wagner Research Paper No. 2011-01, p. 17. See also Natasha Iskander and Nichola Lowe, "Building Job Quality from the Inside-Out: Mexican Immigrants, Skills, and Jobs in the Construction Industry," *Industrial and Labor Relations Review*, Vol. 66, No. 4, Special Issue on Job Quality (July 2013), pp. 785-807.

² The rest of this paragraph is based on Natasha Iskander and Nichola Lowe, "Turning rules into resources: Worker enactment of labor standards and why it matters for regulatory enforcement," paper prepared for the Cornell ILR/Rutgers SMLR symposium on Federalism in U.S. Work Regulation, November 8-9th, 2018. The quote from an inspector at the end of the paragraph is on page 26.

Wage theft because of failure to pay overtime. In a series of class-action suits filed over the past dozen years, a Montgomery County law firm, Winebrake & Santillo, LLC (previously the Winebrake Law Firm, LLC), sometimes in collaboration with other law firms, has documented pervasive wage theft in the Philadelphia regional construction industry as a result of overtime violations (and, in some cases, failure to pay prevailing wage and benefit rates on public construction jobs). The settled cases below all concerned the construction industry in the five-county SE Pennsylvania region. They are described based on the complaints filed (and cited in the footnotes). In each case, the complaint describes violations of the Pennsylvania Minimum Wage Act (PMWA), Pennsylvania Wage Payment and Collection Law (PWPCCL), and/or the federal Fair Labor Standards Act.

Three Philadelphians worked as laborers for Joseph E. Sucher & Sons Inc., a roadwork and road paving contractor with offices in Delaware County. The complaint described the company's failure to compensate the plaintiffs for all hours worked, to pay overtime premiums, and to maintain time and payroll data.³

A Delaware County resident, Joseph Fasciocco, was employed as a "Shop Foreman" in Philadelphia. He was paid approximately \$15 per hour and "...regularly worked in excess of 40 hours per week." He received no overtime pay premium.⁴

A Philadelphia electrician worked for about 10 years starting in 2001 for Bucks County-based Neshaminy Electrical Contractors, Inc. an employer of, "at any given time,...at least 50 individuals paid on an hourly basis...throughout the region."⁵ The electrician reported with other hourly employees to a Bensalem shop with a posted monthly schedule for each worker. Employees would perform tasks in Bensalem (e.g., loading trucks and gathering materials for the day) then go to the project site before returning to Bensalem to finish up for the day. Workers were generally paid based on the scheduled hours. They generally did not get paid for the time elapsed between (i) their first compensable activity in Bensalem and their arrival at the project site and (ii) their departure from the project site and their last compensable activity in Bensalem. Depending on project site location, this uncompensated time amounted to five to 15 hours per week.

A resident of Folcroft in Delaware County installed, finished, and/or maintained flooring products for a flooring construction and installation business from about August 2001 to March 2015.⁶ The plaintiff (and hundreds of other hourly employees in the "class") worked for rates that varied by customer, equaling \$22.50 and \$27.57 in one week cited. Hourly employees were not paid for some of the total hours worked (e.g., they worked 52 hours but were paid for only 46.25). In addition, overtime if paid was based on 1.5 times the *lower* of the two hourly rates worked that week.

Electricians at Brothers Electric (including one interviewed for this project), an electrical contractor with a staff of over 180 electricians and administrative employees, "consistently and openly" worked during and/or through meal breaks but had their work hours reduced by the purported meal break.⁷ In addition, electricians often worked more than 40 hours so unpaid meal time should have been compensated at time-and-a-half.

³ Pedro Rivera, Towaldo Rivera, and Florencio Rosado, Plaintiffs, v. Joseph E. Sucher & Sons, Inc., Defendant, April 30, 2007; Case 2:07-cv-01771-RK Document 1 Filed 05/02/07, US District Court for the Eastern District of Pennsylvania,

⁴ Joseph Fasciocco, Plaintiff, v. Unique Designs by Michael A. Del Bonifro, Inc. Defendant, July 17, 2008; Case 2:08-cv-03407-RBS Document 1 Filed 07/21/2008, US District Court for the Eastern District of Pennsylvania,

⁵ Daniel Ciarrocchi, Plaintiff, v. Neshaminy Electrical Contractors, Inc. Defendant, November 12, 2012; Case 2:12-cv-06419-JHS Document 1 Filed 11/14/12, US District Court for the Eastern District of Pennsylvania,

⁶ Marcellus Smith, Plaintiff, v. Miller Flooring Company, Inc. Defendant, January 27, 2016; Case 2:16-cv-00330-NIQA Document 1 Filed 01/27/16, US District Court for the Eastern District of Pennsylvania,

⁷ Allan Gauger, Plaintiff, v. Brothers, Inc. Defendant, February 2, 2016; Case 2:16-cv-00603-MMB Document 1 Filed 02/05/16, US District Court for the Eastern District of Pennsylvania,

A Malvern, Chester County, “mechanic” performed “manual labor” for a lighting and design company that serves the commercial and residential sectors in the Greater Philadelphia Region, with offices also in Malvern.⁸ He generally worked about 55 hours per week but received no overtime pay.

Worker misclassification. Recognizing the potential problem of worker misclassification in the Pennsylvania construction industry, the Pennsylvania legislature enacted the “Construction Worker Misclassification Act,” or “Act 72,” which went into effect February 10, 2011. In testimony leading up to the passage of Act 72, a Masonry Contractors Association representing 25 contractors noted that

“...the construction marketplace has recently [become] beleaguered by the ‘1099ing’ of the construction workforce. Contractors looking to take advantage of employees, law abiding contractors and government are illegally hiring employees under 1099 Independent Contractor rules. This intentional and illegal practice takes away the ability of our contractors to fairly compete on job bids, takes jobs away from trained and qualified craftsmen and contributes to substandard construction practice. Workers under the illegal 1099 application miss out on wages, overtime pay, Workmen's Compensation, health insurance, unemployment insurance and social security benefits. Meanwhile our contractors can only stand and watch as their businesses lose the economic activity they helped create by supporting good paying jobs.

Make no mistake, this practice is alive and well within Pennsylvania. Our contractors and employees have witnessed this exploitation.”⁹

The testimony details a case of a masonry contractor on a public middle school project found guilty of hiring misclassified independent contractors. In a second case, a specialty caulking, waterproofing, and fire safety subcontractor that primarily performs school, college, municipal and other public construction reported having shrunk from 18-25 employees to nine employees, not all full time, because “...many subcontractors we compete with are taking advantage of the system...paying cash, cheating on labor classifications, using workers as subcontractors, or just not paying the rate or health and welfare monies.” The testimony cited the State Judicial Center two blocks from the Pennsylvania State Capitol as a specific example. One of the three testifiers was hired without any background check or other clearances and offered a base pay of at most \$17.68 per hour for a caulker classification with a total prevailing wage and benefit package of \$40 per hour.

“This company is still in business doing prevailing wage work and still is beating the system...The state is losing taxable income from incorrect wages. The workers are losing income. The government is losing social security taxes, unemployment taxes, federal taxes, and workers compensation premiums if a contractor is with the S.W.I.F. [State Workers’ Insurance Fund] ... The honest contractors will just fade away.”

Over time, enforcement of Act 72 could provide more substantial information on misclassification within the construction industry. Since the act was only implemented recently, however, the body of evidence it provides is still building. In addition, as with other labor-standards enforcement, many cases pursued are “complaint driven.” If, as is likely, worker misclassification is more prevalent among more vulnerable workers

⁸ John Hee, Plaintiff, v. First Electric Lighting and Design, LLC, January 31, 2018; Case 2:18-cv-00471-GEKP Document 1 Filed 02/05/18, US District Court for the Eastern District of Pennsylvania,

⁹ This quote and the quotes in the next paragraph and the next indented text come from “Testimony of David Crowl, Masonry Contractors Association of Central Pennsylvania and Tony Cicero and Dave Gibble, Gibble Construction, on HB 400, the Construction Industry Independent Contractor Act,” April 2, 2009.

and the more informal parts of the labor market, including subcontractors, these cases of misclassification may not come to the attention of state enforcement agencies.

Act 72 provides for the imposition of criminal and administrative penalties against employers found to have committed violations. The Act also empowers the Secretary of the Department of Labor & Industry to petition a court to issue a stop-work order mandating the partial or complete cessation of work at the site of an ongoing intentional misclassification. From 2011 to 2014, the Department pursued only nine to 50 cases annually under the Act.¹⁰ Since Governor Wolf took office, the number of cases pursued under the Act each year has ranged from 185 to 297 cases, including 46 cases in metropolitan Philadelphia in 2017. Administrative penalties collected under the Act have risen a factor 30: from \$12,700 in 2014 to \$383,000 in 2016 (and half a million dollars or more in 2018).

Worker Interviews Also Reveal Labor Standards Violations in PA Construction

We conducted open-ended interviews with a dozen electricians who had worked in the non-union sector for significant periods of time and/or recently. As with open-ended interviews generally, even with a larger sample, the goal was not to gauge the quantitative frequency of different practices. It was, instead, to evaluate whether unscrupulous practices of the kind reported in research across the country also exist in the Philadelphia area. The findings corroborate that some unscrupulous contractors do operate in the Philadelphia region.

Wage theft due to underpayment of overtime pay. Several of the workers interviewed reported wage theft through underpayment of overtime among non-union contractors. One of the workers interviewed was a victim of wage theft when he worked for Brothers Electric, which operates in Pennsylvania, Delaware, and New Jersey. At the company, it was “...just go, go, go. There was no stopping for a break or a lunch. You got yelled at for going to the bathroom. I worked on housing construction, but the company also had an industrial and commercial side.”

This worker was a plaintiff in the class action suit against Brothers for violation of overtime rules summarized and cited above. “We weren’t getting time for breaks or lunch, but they weren’t paying us for working through it: we had 45-hour weeks, but they paid us for 40.” Sixty former or current employees signed onto a suit that was ultimately settled.

Another worker interviewed reported that charges had been filed against his contractor for failure to pay time-and-a-half for hours worked over 40. Some of the workers named in that filing were then fired. Ultimately, those workers were awarded back pay for a year because the firing was illegal—more than \$30,000 per worker.

A third worker interviewed said: “What I didn’t agree with is that they expected you to show up half an hour early to load the trucks, on your own time. An employee sued them for all that back time. A few years later I started showing up only on time. I was surprised he kept me for 11 years.”

A fourth worker said: “They based bonuses on overtime. But while I got switched to a higher wage, I think I got cheated on overtime.”

Wage theft on prevailing wage jobs. The workers interviewed also said that non-union contractors sometimes failed to pay prevailing wages and benefits on state or federal construction jobs. One said, “my employer

¹⁰ <https://www.dli.pa.gov/Individuals/Labor-Management-Relations/llc/act72/Pages/default.aspx>

would sub me out to other contractors. Not knowing any different I would do prevailing wage rate work. But I never got the rate. One job was Spring Ford School District in the town of Royersford.”

Another said, “On prevailing wage work, I was not paid proper wages. But you made more money than you made on non-prevailing wage work, so guys wouldn’t speak up about it.” A third worker said simply “they cooked the books when it comes to prevailing rate work. They had two sets of books.” A fourth worker said his contractor underbid on a school-district prevailing wage job. When he won the job, to make it possible to complete the project for the low-price bid, the contractor had employees work for 40 hours; he billed the school district, and paid the workers, for only 32 hours.

Safety problems and lack of training. A third common theme in the interviews related to the lack of training among non-union contractors. One said, “I was hired with no experience. I started with installing receptacles; after a couple of weeks I moved on to lights and switches; after a couple of months they had me pulling wire before the dry wall went up. Some of the guys were a lot better at what they did than others; some people let things fly that were against code or not good workmanship. We were building an apartment complex, the big feeder wires were just flying through the air and not supported.”

Three different electricians talked about dangerous situations at non-union electrical contractors. One said, “you got put in dangerous situations. One time I was working on a live 480-volt panel, that could kill you. They said, ‘just go in there.’ I did it. If I don’t do it, I’m going to lose my job.” Another said, “they would put me and some of the other inexperienced guys to work in office buildings by ourselves on hot circuits.” A third said that, on a job at a pig slaughterhouse, the owner, an engineer by training, tried to make the buses [device for distributing electrical power] smaller in the power line from the building to the transformer. We flipped the switch and it blew the whole thing up. That’s the closest to fatal I’ve ever seen.”

Two other workers echoed the view that safety standards are higher at unionized companies. One of them said, “There was a lot of sloppy, horrible craftsmanship at my non-union contractor. In a union company that stuff wouldn’t fly. There’s a higher standard.” The second said, “non-union, it’s nothing to stand on the very top of a ladder. Safety’s a concern at all the non-union contractors.” This worker added that “At the unionized contractor where I am an apprentice, it’s been a lot different. The union is about the safety of the workers. And the knowledge the school has given us, we’re not just throwing things together.”

Interviews did not suggest that lack of concern for safety is a universal problem among non-union contractors. One worker said that, at his heavy industrial non-union construction contractor, “the safety culture matched unionized contractors; the contractor didn’t fool around. Other non-union contractors would hire any knucklehead off the street.”

Several workers also pointed to an unwillingness to invest in training among non-union contractors. One said simply “Out of the hiring hall everyone is trained. On the non-union side, contractors hire people with no experience.” Three others said they had sought to become apprentices through the Associated Builders and Contractors (ABC) while at a non-union company, but their employer failed to process the paperwork either to initiate the program or to get recognition and a required raise at the end. One said, “my second year with this outfit, I knew I wasn’t qualified, but they still made me run work. That’s why I wanted to go to the ABC apprenticeship.”

Government Data Confirm Workers' Perception That PA Non-Union Companies Do Little Training

The official U.S. apprenticeship data base—the Registered Apprenticeship Partners Information Management Data System (RAPIDS)—buttresses the perceptions of workers interviewed that non-union contractors in Pennsylvania's construction industry invest little in training their workers:¹¹

- Non-union companies account for only 15% of construction apprentices in Pennsylvania versus 85% for joint labor-management programs.¹² Union construction apprenticeships account for a similar share of veterans in apprenticeship (84%) and an even bigger share of minority apprentices (nine of 10) and female apprentices (13 of every 14, albeit still a small number).
- Overall, and for minorities, women, and veterans considered separately, graduation rates for the small number of non-union apprentices are about 20% lower than for apprentices in joint labor-management programs.
- Union apprentices' wages are also higher than non-union: 36% higher at entry and 60% higher than non-union apprentices upon completion. Higher wages contribute to higher graduation rates, and to higher retention of apprentices and of their skills, once they complete their program.
- In another indicator of the higher skills of unionized trades workers, the share of unionized blue-collar trades that have a two-year or four-year college degree has more than doubled since the 1990s, to just over 25%. This rise partly reflects the growing number of union apprenticeship programs in the Pennsylvania construction sector that provide college credit, and in some cases lead to an Associate Degree (for one example, see Box 1). The share of non-union trades that have a college degree is 10 percentage points below the share among unionized trades.

Box 1: The Finishing Trades Institute of the Mid-Atlantic Region—a Model Joint Apprenticeship

The Finishing Trades Institute (FTI) of the Mid-Atlantic Region illustrates the role of joint labor-management construction apprenticeship programs in lifting the skill levels of Southeast Pennsylvania construction workers.¹³ Starting in 2009, the Institute has itself become an accredited post-secondary school. The formal requirements for accreditation as a college have helped make the Institute a leader in curriculum development grounded in a deep understanding of skills required on the job, and in the incorporation of assessment into its training programs. The Finishing Institute has taken the tried-and-true apprenticeship learning model, with its rich mix of learning-by-doing, mentoring, peer learning, and classroom instruction, to the next level.

The institute registered its first apprenticeship in 1946, for Painters and Decorators. Today, the Finishing Trades Institute runs apprenticeship programs from facilities throughout eastern Pennsylvania for drywall

¹¹ Stephen Herzenberg, Diana Polson, and Mark Price, "Construction Apprenticeship in Pennsylvania 2018," Capital Area Labor-Management Council, Harrisburg, Pennsylvania, June 2018.

¹² According to <http://www.unionstats.com/>, union density in the construction industry in Pennsylvania in 2017 was 22%. If non-trades workers make up 80% of the workforce and the other fifth of the workforce (consisting of managers, administrative workers, and professionals primarily) is 0% union, union density among trades workers is 28%. This means the ratio of apprentices to employment among trades workers in unionized construction is over 17:1. Since union density is very low in residential construction, union density among trades in non-residential construction is likely about 50%--and higher in the Philadelphia region.

¹³ This box is adapted from the profile of the Finishing Trades Institute in Herzenberg et al., "Construction Apprenticeship in Pennsylvania 2018," Box 1, p. 4.

finisher, glaziers and glassworkers, industrial coating and lining application specialists, and painters and decorators.

Thanks to the Finishing Trades Institute’s accreditation as a post-secondary school, apprentices now leave with their Associates degree in hand—and without any college debt. Becoming an accredited post-secondary school has begun to change the perceptions of apprenticeship as a career, facilitating recruitment. High school guidance counselors that once saw a traditional college route as the only viable route, ignoring apprenticeship, have now started sharing the program’s information with students. FTI has also established partnerships with some high schools through which students in the 11th and 12th grade spend time at the FTI to learn about the building trades and the skills required for such a career. Since accreditation, FTI has seen an improvement in the quality of applicants. While the average age of apprentices was 27, the program is starting to get qualified younger applicants who are coming straight out of high school. Becoming accredited also makes it easier for apprentices in their early years to access student aid such as federal Pell grants. This allows income-eligible students to access grants and loans for tools, housing and transportation, and to make ends meet in the first few years of an apprenticeship.

Terry Webb, President of Eureka Metal and Glass, learned glazing through an apprenticeship in the 1980s. Today he employs FTI apprentices. “This local arm of the Finishing Trades Institute is the most sophisticated of all the locals because of the rigorous accreditation process it went through,” Terry says. “Apprentices not only learn from trained and experienced journey-workers; journey-workers also stay current and learn new approaches and practices from apprentices. This makes our state more competitive in construction than neighboring states of Ohio, Maryland and New Jersey.”

Conclusion and Recommendations

When it comes to the economy, Americans and Pennsylvanians sometimes look at competition as monolithic or “all or nothing”: we either have the “market” or we have government delivery—or, at best, a hampered and inferior regulated competition. Anyone who follows sports, however, knows that competition is not “all or nothing.” In fact, virtually every sport has something akin to the National Basketball’s “competition committee,” the express purpose of which is to shape competition—to reward athletic fluidity and skill, and to ensure that the game is attractive to watch, which maximizes revenues from television contracts and ticket sales. Competition committees in sports also try to ensure that the game does not endanger the short-term (think of flagrant fouls in basketball) and long-term (brain damage from playing American football) health of players. Competition committees, in sum, make nuanced changes to ensure that competition is more “constructive” and less “destructive.”

The evidence reviewed in this brief is overwhelming: irresponsible contractors have brought “destructive” competition to part of the regional Philadelphia construction industry—competition based on stealing a portion of workers’ wages, investing little in worker skills, and in some cases operating unsafely. What is less well known is the scope of the irresponsible contractor and destructive competition problems in the SE Pennsylvania construction industry. We conclude therefore, with two recommendations.

1. The Pennsylvania Department of Labor & Industry and the Office of the Attorney General, and localities in SE Pennsylvania, should partner with industry stakeholders (including workers’ compensation insurers and regulators) and philanthropy to finance and conduct a comprehensive research program to better understand the extent, severity, and consequences of labor standards violations. Statewide and local government entities should also develop an enforcement and technical assistance plan that can drive compliance with the law close to 100%. The research should include:

- a study like those conducted in other states, but using the most up-to-date methods and data sources (thereby combining information from state UI audits and Internal Revenue Service data), on the extent of worker misclassification in construction;
 - a comprehensive analysis of data extracted to date through enforcement of Act 72, and of OSHA data on injuries and fatalities in the regional construction industry for what they reveal about their relative prevalence among irresponsible contractors and/or misclassified workers;
 - a large-sample and in-depth survey of construction workers that uses innovative methods to ensure adequate sampling of vulnerable workers likely to be victimized by irresponsible contractors;
 - qualitative research on the “business strategies” of law-abiding non-union and union contractors, to glean lessons for how to use carrot and stick to get more contractors to follow such strategies and comply with the law; and
 - a survey of innovative construction industry labor standards enforcement efforts in other states and localities, to identify cost-effective and strategic approaches that Pennsylvania and its municipalities might adopt.
2. Local authorities in Southeast Pennsylvania should act immediately to ensure that projects financed by local and state government do not contribute to the growth of unscrupulous contractors’ market share. One way to do this would be through the use Project Labor Agreements (PLAs) on public construction projects. On construction projects, PLAs standardize and spell out clearly wages, benefits and work rules (e.g., hours of work, holidays, overtime pay) for trades employees. They also establish common dispute resolution procedures and require winning contractors and subcontractors to access trades labor from union referral services for each craft. These features reduce to almost zero the chance of labor standards violations on projects governed by a PLA. In the Philadelphia region over the past three decades, PLAs have been used on over 70 construction projects with a combined value of over \$25 billion, including by bottom-line-focused private sector owners on huge refinery projects.¹⁴ PLAs can also be an effective tool for (a) increasing the amount of labor on public projects that comes from the geographical area of the project (or of the entity financing the project—e.g., the school district or municipality); and (b) negotiating and implementing “economic opportunity provisions,” which set—and then meet—ambitious goals for diversifying the workforce.

In sum, PLAs on public projects are one tool that could begin a longer-term effort to systematically reshape competition in the regional construction industry in more constructive directions. To return to the analogy with sports, in this case with the National Football League, the goal should be competition shaped deliberately so that it does not give typical trades workers a concussion—and so that it also benefits construction customers, taxpayers, local businesses (that cater to local construction workers), and workers’ families.

¹⁴ BUILT-RITE Construction Industry Program, “Philadelphia Area Labor Management Committee,” no date.

Illegal Labor Practices in the US Construction Industry: A Research Overview

Russell Ormiston, Ph.D.

Introduction

The construction industry represents one of the few remaining options for blue-collar Americans to find a job that pays well, offers health insurance, and provides on-the-job training to develop one's skills. These types of "good" blue-collar jobs have been the backbone of healthy middle-class families and communities for generations. While employment in other traditional blue-collar fields (e.g., manufacturing) have been on the decline for decades due to automation and global competition, the pathway to the middle class has remained available and viable for blue-collar workers interested in construction. However, these good, middle-class jobs have been under siege in recent years by a growing competitive menace: contractors engaging in rampant illegal, cost-saving labor practices that have driven honest, law-abiding employers out of business.

As part of a broader analysis of potential illegal labor practices in Philadelphia's regional construction industry, this report summarizes the research on these practices throughout the United States. To be clear, the literature is not extensive, as these illegalities often occur in the shadows of the industry, hidden from government regulators and data collectors. But the research that has been published paints a harrowing picture: some subsectors of construction are completely awash in illegal behavior by employers, including rampant wage theft and near-universal misclassification of employees. These reports indicate extensive illegal behavior disrupting labor markets in all corners of the United States, from small towns in New England to the biggest cities of California; given the research, it is inconceivable that these same activities are not also occurring in the Greater Philadelphia area.

Illegal labor practices have historically been more heavily concentrated in residential construction, where illegalities are so widespread that some analysts have referred to it as the "Wild West" (Juravich et al., 2015; p. 37). Fault lines that have long separated residential and non-residential construction—specifically higher worker skill demands and greater capital requirements for contractors working on industrial, institutional and commercial projects—have historically kept the non-residential sector *relatively* immune from these low-road labor practices. But those barriers have eroded in recent years, and the encroachment of unscrupulous contractors—who rely on less-skilled, lower-paid laborers and reduce labor costs via illegal means—has made it more and more difficult for honest, law-abiding contractors to win project bids in all sectors of the construction industry (e.g., Davidson, 2018).

The fault lines separating the practices of residential and non-residential contractors have eroded for several reasons. Among other factors, many commercial projects such as big box retailers and fast-food restaurants have increasingly featured similar characteristics with single-family homes: simple construction demands and oft-used, cookie-cutter designs. This has opened the door for unscrupulous contractors—either from the residential sector or new, often undercapitalized firms—to underbid long-established contractors in the commercial sector. This disruption has put competitive pressure on many non-residential contractors to either adopt these illegal, cost-saving labor practices or exit the industry. The result is a "race to the bottom" that costs regional Philadelphia taxpayers tens, if not hundreds, of millions of dollars annually and degrades working conditions in non-residential construction, thereby undermining one of the last remaining avenues to the middle-class for Greater Philadelphia's blue-collar workers.

Overview of Illegal Labor Practices

Introduction

While illegal labor practices may take on many forms, academic-level research and government-issued reports offer the most insight on five specific areas in the construction industry: wage theft, employee misclassification, workplace violations of safety and health regulations, the hiring of unauthorized laborers, and workers' compensation fraud. As a reminder, the literature on illegal labor practices in construction is unusually thin given that these actions typically occur outside the usual purview of government regulators and data collectors. While none of these studies explicitly examine the incidence of illegal labor practices among construction employers in Philadelphia, its pervasiveness in every region of the country—from small towns to big cities from coast to coast—would suggest that these findings have considerable relevance in understanding the local construction environment.

Wage Theft

Wage theft is pervasive in the construction industry, an unsurprising outcome considering the incidence of under-the-table, cash-only employment arrangements in some trades and sectors (e.g., residential construction). The most comprehensive study of wage theft in the United States was conducted by Bernhardt et al. (2009). In an analysis of the residential construction sector in Chicago, Los Angeles and New York, the authors found that 70.5% of workers reported experiencing nonpayment of overtime while 72.2 reported "off-the-clock" violations (i.e., nonpayment for work). But not getting paid was not the only problem; getting paid enough was also an issue: 12.7% of residential construction workers in those three cities reported violations of minimum wage laws. This study's concentration on large urban labor markets makes the findings especially relevant to understand Philadelphia's construction sector, even if the report was limited to residential construction.

Wage theft is certainly not limited to residential construction, large urban areas, or even private-sector projects. The Workers Defense Project (2013) surveyed 1,194 construction workers on building construction sites in five of the largest cities in Texas. They found that 22% of workers reported experiencing nonpayment for work while 50% reported that they had not been paid for earned overtime.¹⁵ Juravich et al. (2015) chronicled rampant wage theft in residential construction in small towns in Western Massachusetts, including the regularity of unscrupulous contractors refusing to pay workers *at all* for time worked. Finally, the Brennan Center for Justice (2007) outlined the pervasiveness of wage theft on public and quasi-public affordable housing projects. Taken together, the studies above demonstrate the pervasiveness of wage theft in all corners of the construction industry.

Worker Misclassification

The most pervasive form of wage theft in the residential construction industry may come in the form of worker misclassification. Perhaps more than any other practice, construction employers regularly misclassify employees as independent contractors—or simply pay workers "under the table"—as a means of illegally avoiding required employee compensation (overtime pay) and state and federal taxes (e.g., Social Security, Medicare, unemployment insurance). Employer liability for safety and health regulations is lessened when employing independent contractors; these workers are also not covered by an employer's workers'

¹⁵ Of the 1,194 construction workers surveyed, the Workers Defense Project (2013) reported that wage theft was not the only compensation-related issue that workers faced, as 52% reported wages below the federal poverty limit.

compensation insurance plan. Congressional testimony in 2010 suggested that misclassification can lower labor costs by as much as 30%.¹⁶

To be clear, the construction industry features extensive contracting and subcontracting and there are situations where the hiring of an independent contractor is legitimate. But the misclassification of regular employees as independent contractors to lower labor costs has become *modus operandi* in some trades and sectors of the construction industry. This not only drives law-abiding firms out of business—a 30% labor cost differential is too substantial for “good” employers to overcome—but it defunds vital government programs and deprives workers of critically important benefits: Social Security, unemployment insurance, and workers’ compensation benefits. In an inherently dangerous industry wrought with unstable employment—workers’ jobs often last only as long as the project they are working on—the denial of legally-earned benefits such as unemployment insurance undermines the financial and emotional well-being of workers and their families.

The prevalence of employee misclassification in the construction industry is substantial and, unlike other illegal labor practices, well-documented by researchers and government agencies. The predominant method of identifying misclassification has been through audits of state unemployment insurance forms. For example, Donahue, Lamare and Kotler (2007) estimated that 14.8% of construction employees in New York—nearly 50,000 workers annually—were misclassified as independent contractors between 2002 and 2005. Virginia’s Joint Legislative Audit and Review Commission (2012) found that 33% of construction employers misclassified workers in the state in 2010, accounting for 30% of all employees in the industry (JLARC, 2012). A similar study in Minnesota found that 20% of construction employers misclassified workers in 2004-2005, with substantially higher rates in the subsectors of roofing (38%) and drywall installation (31%) (Office of the Legislative Auditor, 2007).¹⁷

But a second approach to estimating worker misclassification—interviewing workers on construction job sites—offers evidence that UI audits may underreport the amount of worker misclassification in the industry. In its survey of over a thousand workers at Texas job sites, the Workers Defense Project (2013) found that 41% of workers were victims of payroll fraud, misclassified as independent contractors, or paid off the books in cash. Ormiston et al. (2018) describes the findings of a multi-year research effort by a team of staff members at Local 525 of the Michigan Regional Council of Carpenters. In a census of as much of the drywall industry in Southwest Michigan that the project could identify, researchers visited job sites of 71 contractors and discovered that 67 of them—or 94.4% of employers—misclassified at least one employee as an independent contractor. Among violating contractors, 66 of 67 engaged in these practices with more than half of their employees; this included 45 firms who were violating the law with their *entire* workforce. In sum, of the 1,840 workers studied across these 71 contractors, researchers estimated that 1,345 (73%) were either misclassified as independent contractors and/or paid off the books.¹⁸ When combined with the findings of the Minnesota UI audit, the analysis of the drywall industry in Southwest Michigan suggests that misclassification is a more pronounced problem in trades featuring lower barriers to entry for firms and fewer skill requirements for workers.

¹⁶ <https://www.help.senate.gov/imo/media/doc/Ruckelshaus1.pdf>; This 30% estimate is consistent with published studies. For instance, the Joint Legislative Audit and Review Commission in Virginia estimated that a construction employer that paid state-average wages would save 26% by misclassifying a worker as an independent contractor (JLARC, 2012; p. iii).

¹⁷ For a more complete review of misclassification studies, see <http://www.nelp.org/content/uploads/NELP-independent-contractors-cost-2017.pdf>

¹⁸ While 94% of contractors were deemed to misclassify workers, the percentage of total workers misclassified (73%) is substantially less because the region’s largest drywall contractor—by a wide margin—was deemed to be operating above-board, designating all 200 of its workers as employees.

The public policy implications of worker misclassification in the construction industry are enormous, with substantial costs to workers and taxpayers. In their analysis of the Southwest Michigan drywall industry, researchers at Local 525 estimated that misclassification among these 71 drywall contractors—which do not represent the entirety of the region’s industry—reduced worker incomes by \$7.9 million annually, or \$6,000 per worker, due to the absence of overtime pay. Union researchers also projected an \$8.8 million loss in federal Social Security and Medicare taxes, with an additional loss of \$9.5 million for state workers’ compensation and unemployment insurance programs. Including the additional loss in state and federal income tax, researchers estimated that worker misclassification represented approximately \$20 million in lost tax revenue to the region, an unwelcome public subsidy paid to industry actors whose business is built upon the violation of state and federal labor laws. Considering that this \$20 million represents just one industry subsector in a small corner of Michigan, the annual cost of employee misclassification in the residential construction industry to workers and taxpayers in Greater Philadelphia and across the country is likely to be staggering.¹⁹

Workplace Safety

Construction is one of the most dangerous industries in the United States. In 2016, the construction industry employed just 4.7% of the US labor force but accounted for 19.1% of workplace fatalities.²⁰ While the inherent nature of construction work may make some injuries unavoidable, there are countless anecdotes—including those presented by Juravich et al. (2015)—of low-road employers ignoring state and federal safety regulations on construction job sites. These anecdotes are consistent with the findings of the empirical research indicating that union job sites—where contractors are much more often engaged in high-road labor practices such as worker training—are substantially safer than non-union job sites. For example, Zullo (2011) found that construction fatalities were lower in states with greater union density while Miller et al. (2013) demonstrated that non-union contractors commit significantly more OSHA violations than their union counterparts. Better safety records among union contractors is the result of several factors, including better worker training (Bilginsoy, 2005), more stringent awareness and enforcement of OSHA requirements at union sites (Weil, 1992) and a workplace culture that more substantially emphasizes safety (Gillen et al., 2002).

Unauthorized Laborers

The pervasiveness of illegal labor practices by low-road employers in the construction industry has been fueled, in part, by the widespread employ of unauthorized immigrant laborers. These workers’ concerns about alerting immigration authorities to their presence makes them more likely to accept off-the-books payment for their work and classification as independent contractors (to avoid work status verification), and more reluctant to report workplace violations to government regulators. These factors make unauthorized immigrant workers especially vulnerable to exploitation. Among others, Juravich et al. (2015) offers evidence of the illegal labor practices that these workers face regularly, including persistent wage theft and contractors’ willful ignorance of health and safety regulations.

The presence of immigrant laborers in construction labor markets is substantial and is not restricted by geography. The influence of unauthorized immigrant laborers is prevalent from coast-to-coast, in the country’s biggest cities and small Northeastern towns (Bernhardt, Spiller, and Polson 2013; Juravich et al.,

¹⁹ In a study of misclassification in California’s construction industry, Liu and Flaming (2014) estimated that one in six of the state’s construction workers were either misclassified as independent contractors or not reported by their employers, amounting to \$774 million in lost tax revenue for federal, state and local governments. That included \$264 million in lost funding for workers’ compensation, \$146 million for state disability funds, and \$63 million for state unemployment insurance.

²⁰ <https://www.bls.gov/iif/oshcfoi1.htm>

2015; Milkman, Gonzalez, and Ikeler 2012; Theodore, Valenzuela, and Melendez 2006). As of 2014, immigrant laborers accounted for 24% of the construction industry's workforce nationally; unauthorized immigrant workers comprised 13% (Passel and Cohn, 2016). These workers are especially concentrated in the residential sector and among specific trades (e.g., drywall installation, roofing, painting).²¹

Workers' Compensation Fraud

While the four illegal labor practices described above are well-established in the academic literature and/or the public consciousness, an emerging practice in some corners of the industry has largely remained out of view: the use of shell companies to defraud state workers' compensation funds. While there are indications that this scheme has been employed across the United States, a number of high-profile criminal indictments suggest that it has especially taken root in Florida.²² Perhaps not coincidentally, a Florida task force of government agencies, insurance companies, construction unions and employers estimated that the scheme could be defrauding the state upwards of \$1 billion annually (Money Service Business Facilitated-Workers' compensation Fraud Work Group, 2011).²³ While there is no clear evidence that this is—or is not—an active problem in Philadelphia, the evidence from Florida reflects the lengths to which some contractors will go to gain a competitive advantage.

To understand how the scheme works, it is first important to note that any contractor or subcontractor working on a job site is legally required to purchase a workers' compensation insurance policy to cover costs in case of a workplace injury. General contractors and construction managers that oversee a project will—for their own liability—mandate that all subcontractors working on a job site present them with a valid certificate of insurance (COI) before allowing them to secure a project bid and begin work. This can be rather expensive for contractors, as premiums typically cost between 5 and 25% of a firm's annual payroll, with higher rates for more dangerous trades.

To reduce these costs for contractors, a "facilitator" will create a shell company. Once this company is in operation, the facilitator will obtain a minimal workers' compensation policy from an insurance agent. To minimize the annual premiums, the facilitator will list the company as a small, two-to-four employee enterprise working in a low-risk construction trade (e.g., drywall installation). With the inexpensive workers' compensation policy in place, the facilitator can offer to let subcontractors "rent" his company for a fee. When such subcontractors are asked by a project's general contractor or construction manager for documentation, they will use the name of the shell company and present its valid COI. Payment for the work performed by subcontractors will typically produce a check made out to the shell company; those funds are

²¹ The National Association of Home Builders (2015) estimate that immigrant laborers account for 28% of construction *occupations* (which spans all industries), with the largest numbers employed as construction laborers (1.8 million), carpenters (1.1 million), first-line construction supervisors (669,579) and painters and paperhangers (575,490). In terms of share of the industry, the NAHB estimates that the largest proportions of immigrant laborers are among plasterers and stucco masons (59%), drywall installers (49), hazardous material removal (43), and painters and paperhangers (43). Passel and Cohn (2016) estimate that *unauthorized* immigrant laborers comprise 31% of drywall installers, 29% of roofers and 26% of construction painters.

²² A press release by the Coalition Against Insurance Fraud pointed to its use in Georgia, Tennessee and Colorado (<http://www.insurancefraud.org/IFNS-detail.htm?key=25041>). Regarding criminal indictments in Florida, see the following articles:

<https://www.myfloridacfo.com/sitePages/newsroom/pressRelease.aspx?ID=4835>

<http://www.sun-sentinel.com/news/crime/fl-deerfield-workers-comp-fraud-20160115-story.html>

<http://www.sun-sentinel.com/local/palm-beach/fl-workers-comp-fraud-20141117-story.html>

²³ https://www.myfloridacfo.com/siteDocs/MoneyServiceBusiness/WC_MSBReport-Rec.pdf

then typically funneled through a check-cashing facility that diverts a portion of the funds back to the facilitator before returning the rest to the subcontractor (minus the check-cashing fee).²⁴

This criminally fraudulent scheme can wreak havoc on a state's workers' compensation insurance system. First, the workers' compensation policy taken out by the shell company may severely underrepresent the scope and workplace risk associated with the subcontractor; instead of a two-to-four-person drywall installation firm, it may well be a 50-person employer in a high-risk trade (e.g., roofing). Second, the facilitator is not limited in the number of subcontractors that can rent this COI, meaning that this small workers' compensation policy may, in the end, provide coverage for hundreds of workers across numerous trades. When a severe injury strikes, the shell company's insurance carrier will typically start to process the claim since the policy does not cover individual workers by name but rather the entirety of the shell company's labor force. Even if an insurance company investigation reveals the fraudulent use of a COI, liability for a claim shifts to the general contractor's insurance carrier. Regardless, the outcome remains the same: workers' compensation is paying a worker for whom there was an inadequate premium collected. This subsequently raises the costs of workers' compensation premiums for all firms, including those outside of the construction industry.

Conclusion & Recommendations

Illegal labor practices in the construction industry undermine honest employers, middle-class workers and taxpayers in Greater Philadelphia and across the country. Some of these practices—such as employee misclassification—represent the *modus operandi* in residential construction and have become increasingly commonplace in non-residential construction. This is troubling from a public policy perspective. First, the persistent evasion of state and federal labor standards by unscrupulous contractors represents an enormous drain on taxpayers; consider it a public subsidy for the unscrupulous. Second, these illegal behaviors represent an existential threat to one of the last avenues to the middle-class for blue-collar workers: the skilled construction trades.

To be clear, safeguarding law-abiding contractors, workers and taxpayers from the degrading effect of illegal labor practices in construction will be a challenge. As outlined in Ormiston et al. (2018), the pervasiveness of illegalities in some sectors and trades of construction are the result of the broader economic and legal frameworks of the industry that reward—or, at minimum, fail to punish—those who engage in such unscrupulous behavior. As such, a comprehensive policy solution would require broad, far-reaching efforts—incorporating state and federal policymakers—to change the landscape of the construction industry. Elements of effective policy changes could include more resources for enforcement agencies, stiffer penalties for labor law infractions, better reporting options for vulnerable workers, and the establishment of multiemployer liability given the ease which low-level contractors often evade punitive actions (Weil, 2017).

The policy options offered above either require state or federal involvement and/or require considerable public expenditure. However, municipalities in and around Philadelphia that are concerned about the degradation of labor standards in their communities have reasonable, cost-effective policy options at their disposal. For example, suburban municipalities can follow the lead of the City of Philadelphia (and many other communities across the country) by using project labor agreements (PLAs) on projects supported by local

²⁴ This scheme typically goes through check-cashing services because banking rules typically prohibit third parties from cashing business checks at traditional financial institutions, whereas looser regulations at check-cashing facilities allow business-to-business checks to be cashed by certain individuals related to the payee.

taxpayers.²⁵ These require contractors to access all or most of their trades labor from union referral services (hiring halls). Any concerns that a PLA will increase construction costs are overblown: academic research demonstrates that project labor agreements have little to no effect on public expenditures (e.g., Belman et al., 2010).

Regardless of the policy initiatives pursued, local lawmakers are implored to act to stem the influence of unscrupulous contractors whose profit depends on illegal, cost-saving labor practices that include wage theft and employee misclassification. The pervasiveness of illegalities in the residential construction industry has degraded labor standards to the point where honest, law-abiding contractors find it difficult, if not impossible, to continue operations (Marek, 2015; Davidson, 2018). This “race to the bottom” harms not only fair-minded contractors and defunds vital government programs, but it degrades working conditions and erodes one of the last remaining pathways to the middle class for blue-collar workers across Philadelphia and the United States.

²⁵ For Philadelphia’s Executive Order on project labor agreements, go to:
<http://planphilly.com/articles/2016/10/05/council-eyes-expansion-of-prevailing-wage-law-for-building-service-employees>

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