The Underground Economy in the New York City Affordable Housing Construction Industry

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Preface

FPI's recent report, *One New York: An Agenda for Shared Prosperity*, outlines policies to help the state's diverse regions and populations grow together and to strengthen and expand the middle class. Enforcing labor standards and leveling the playing field among businesses are key elements of FPI's One New York agenda and should be major public policy priorities in New York City's booming housing construction industry.

This report lends detail to the vision in One New York and builds on FPI's previous research reports on New York's labor market, economic trends, social insurance programs, and the minimum wage. FPI has done a number of studies dealing with New York's construction industry. In 2004, in conjunction with the Building Trades Employers' Association and the Consortium for Worker Education, FPI published *Building Jobs: A Blueprint for the "New" New York*, a study of the "white collar" segment of the construction employment market. In April 2006, the New York City Employment and Training Coalition and the New York City Workforce Investment Board published a profile of the New York City construction labor market prepared by FPI. A brief literature survey, "The Economic Development Benefits of Prevailing Wage," was released in May 2006. These and other FPI reports can be found at: www.fiscalpolicy.org.

This report is a companion to one released in January of this year, *New York State Workers' Compensation: How Big Is the Coverage Shortfall?* That report demonstrated the need for New York State to undertake a concerted enforcement commitment and strategy to ensure compliance with the state workers' comp laws. The January report also examined the issue of the misclassification of workers as independent contractors by employers seeking to shirk their responsibility for payment of payroll taxes, social insurance premiums and employee fringe benefits.

Comments and questions on this report should be directed to FPI's Deputy Director and Chief Economist, James Parrott, Ph.D., who can be reached at 212-721-5624 or parrott@fiscalpolicy.org.

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Executive Summary

This study uncovers a significant underground economy in affordable housing construction. Illegal employment practices are rampant. The size of the underground economy is estimated using the Current Population Survey and by comparing Labor Department payroll data to figures on new construction permits and awards.

Despite the dangerous working conditions in the affordable housing construction industry, most workers earn very low pay and few benefits. Few workers have health insurance. For most workers, employers are not paying premiums for workers compensation or unemployment insurance. For a significant number of workers, no payments are made into the social security or Medicare systems.

These practices have a broad fiscal impact on the city, state and national economies. When employers do not meet their legal responsibility for social insurance premiums, costs are shifted—onto employers that do. Similarly, when employers don't provide health insurance for employees, health care providers give uncompensated care, and costs are passed on to other consumers. Taxpayers in general suffer too, because the government picks up the tab for Medicaid and basic payments for social security and Medicare.

One third of New York City's residential construction is underground:

- New York City has been experiencing a tremendous boom in residential construction since 2000. New residential construction permits and construction awards have more than doubled. Yet there has been only a very slight increase in the Labor Department's official count of New York City residential construction workers.
- Conservatively, it is estimated that the current level of construction activity employs 82,000 New York City residential construction workers, and that construction contractors employ more than one third (30,000) of this number on an illegal basis.
- As many as 17,000 workers may be paid off the books and so do not show up in the official employment numbers. Also, 13,000 of those identified as self-employed in Census Bureau data may be employees who are misclassified as independent contractors by their employers.

In affordable housing construction, two-thirds is underground:

- It is estimated that the New York City affordable housing construction workforce numbers 13,350 workers. Of this number, about two thirds, or 9,000 workers, are illegally employed, either as independent contractors or employed off the books.

Most affordable housing construction workers receive very low pay, and few receive benefits:

- Many workers are paid $10 an hour, an amount that has changed little over the past decade. The low wages paid in affordable housing construction contribute to the 30 percent decline in inflation-adjusted wages for New York City construction workers since 1990.

- Not only do construction contractors pay low wages, they also:
    - Illegally skirt responsibility for the payment of payroll taxes and social insurance premiums for their workers.
    - Deprive their workers of basic employment rights and opportunities for skill development and career advancement.
    - Shift the costs of employee health care onto the workers themselves, taxpayers and other employers that pay taxes and operate within legal requirements regarding payroll taxes and social insurance protections.

Employment practices in the affordable housing construction industry have sizable fiscal costs:

- Together, the shifted costs are estimated to range from $85 million to $126 million. The low end of the range represents strictly the costs of employer non-compliance with legal requirements given the wage rates currently paid.
- Current wages are unusually low for most affordable housing construction workers. Thus, the high end of the range of fiscal effects is based on the assumption of a $14 an hour minimal wage standard. This wage standard equals the hourly equivalent (based on 1,840 annual hours) of 150 percent of the three-person 2007 federal poverty guideline.

The City heavily subsidizes the affordable housing industry and plans to sharply increase the number of subsidized housing starts:

- Under Mayor Michael Bloomberg, the City of New York justifiably has undertaken an ambitious ten-year plan to preserve or create 165,000 units of affordable housing. The ten-year goal includes preserving 73,000 units and building 92,000 new affordable housing units. Through the plan's first four years, the City subsidized about 6,000 new affordable starts per year. This number will have to almost double to 11,373 per year through the remaining six years of the plan to meet the 92,000-unit new construction goal. As the City sharply increases the number of City-subsidized housing starts over the next few years, the affordable housing share of new residential construction likely will increase.

Recommendations:

- New York City government should work with the State of New York to improve working conditions and the poor pay and benefit practices that exist in the affordable housing construction sector. The City has moved aggressively to address hazardous scaffold safety problems in construction. The logical next step is to recognize and begin addressing, together with the State, pervasive noncompliant labor practices. With the passage of several anti-fraud enforcement provisions in the historic workers' compensation reform legislation signed into law in mid-March, the State is also poised to dramatically improve labor standards enforcement.
- Enforcement efforts should be pursued in a fashion that benefits an often vulnerable workforce that includes many minority workers long shut out of opportunities for good-paying jobs, skill development and advancement, and workers who are recent immigrants.

Introduction

Affordability is one of the major challenges facing the New York City economy. The concept of "affordable" relates the cost of something to the income of the consumer of that good or service. Almost everyone acknowledges that New York City has a serious lack of affordable housing. Less well appreciated is the fact that the inflation-adjusted wage earnings of most workers generally have fallen compared to a decade and a half ago. This has contributed to the rise in the ranks of the working poor and to the tremendous increase in the gap between the rich and the poor and between the rich and those in the middle.[1]

The eight percent decline in the real median hourly wage in New York City, across all industries, from 1990 to 2006, results from several factors. The decline in middle-income paying employment opportunities and the disproportionate growth in jobs paying low wages have been major contributors to this trend. This trend is also evident within industries as certain employment practices have put downward pressure on wages. Within New York City's construction industry, where the real median hourly wage has fallen by 28 percent from 1990 to 2006,[2] the practice of misclassifying workers as independent contractors and the growing prevalence of off-the-books activity (the so-called underground economy) have been among the chief causes of wage erosion. These problems appear particularly acute within the affordable housing segment of residential construction.

In industries such as residential construction where wages have eroded substantially, the broader terms and conditions of employment have been transformed in a way that undermines many of the worker protections, benefits and opportunities that evolved over the course of several decades. Many residential construction workers are not covered by basic social insurance protections (unemployment insurance, workers' compensation, temporary disability insurance), they do not have employer-provided health insurance or pension coverage, and, often, they do not have any paid leave time (vacation, holidays or sick pay). And without access to the apprenticeship system that exists in the unionized part of the construction industry in New York, they have limited opportunities to acquire new skills or to move up a career ladder. Such workers are consigned to a secondary tier of the labor market.

This report examines the growth in New York City's residential construction sector, and the fiscal and economic costs associated with the apparent substandard employment practices characteristic of the affordable housing segment of that market. The report

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[1] For a discussion of the rise in the ranks of the working poor in New York City, see the Report of the Mayor's Commission on Economic Opportunity , http://www.nyc.gov/html/om/pdf/ceo_report2006.pdf. For a discussion of the widening income gap in New York State and New York City, see Fiscal Policy Institute, *Pulling Apart in New York: An Analysis of Income Trends,* http://www.fiscalpolicy.org/PullingApartNY2006.pdf, January 2006.

[2] The hourly wage changes reported in this paragraph are based on data from the Current Population Survey Outgoing Rotation Group (CPS-ORG) file, deflated using the Consumer Price Index for the New York metropolitan area.

identifies several factors that all point in the same direction, namely, that the housing construction boom in New York City has been accompanied by an increase in illegal employment practices.

1. The Bottom Tier of the New York City Construction Labor Market

Construction work is often dangerous. In the last full federal fiscal year, through September 30 2006, there were 28 deaths on New York City construction sites. Over two thirds of the construction workers killed on the job worked for employers with fewer than 10 employees.[3] Overall, the city's construction industry offers some of the highest wages available for workers with limited formal education.[4] However, wages, working conditions and employment practices are much different between the residential and non-residential segments of the industry. In 2005, the latest full year for which total wage data are available from payroll records, the average wage across all occupations within the residential construction industry was only 60 percent of the average wage in non-residential construction.[5]

Wages are higher in non-residential construction because the construction companies tend to be much larger and the workforce much more highly unionized. Annual pay for unionized journeypersons—workers who have completed an extensive apprenticeship program—can range as high as $60,000 to $85,000, along with family health insurance and pension benefits. The apprenticeship system, which combines actual work experience with extensive classroom instruction in craft skills and safety training, is well established in the city's non-residential construction sector and provides clear career ladders with significant pay progression.[6]

Much, but not all, of non-residential construction of commercial buildings and public infrastructure is by unionized employers in New York City. Much of the low- and mid-rise residential construction in the city, however, is not union and union conditions are not followed, contractors do not utilize or support the apprenticeship system and worker safety problems are much worse than on union worksites. Except for a portion of the affordable 20 percent component of high-end, high-rise residential construction under the

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[3] Richard Mendelson, Area Director, OSHA Manhattan, "2006 New York City Construction Safety Report Card," Presentation at BTEA Safety Conference, November 21, 2006.

[4] Fiscal Policy Institute, "The New York City Construction Labor Market: A Labor Market Profile Prepared for the NYC Employment and Training Coalition and the NYC Workforce Investment Board," April 2006, http://www.fiscalpolicy.org/publications2006/Construction_LMP_April2006.pdf.

[5] Data on average annual wages are from the New York State Department of Labor's Quarterly Census of Employment and Wages (QCEW) series and are different than the hourly wage data cited elsewhere in the Introduction, which are from the Current Population Survey (CPS). One difference is that the QCEW data are for construction workers employed in New York City while the CPS data are for NYC resident construction workers. Another major difference that is particularly significant in the construction industry is that the CPS data include some workers who are misclassified as independent contractors or who may be paid on a cash basis. These two categories of workers would not appear on the payrolls of construction companies and would not be counted in the QCEW series.

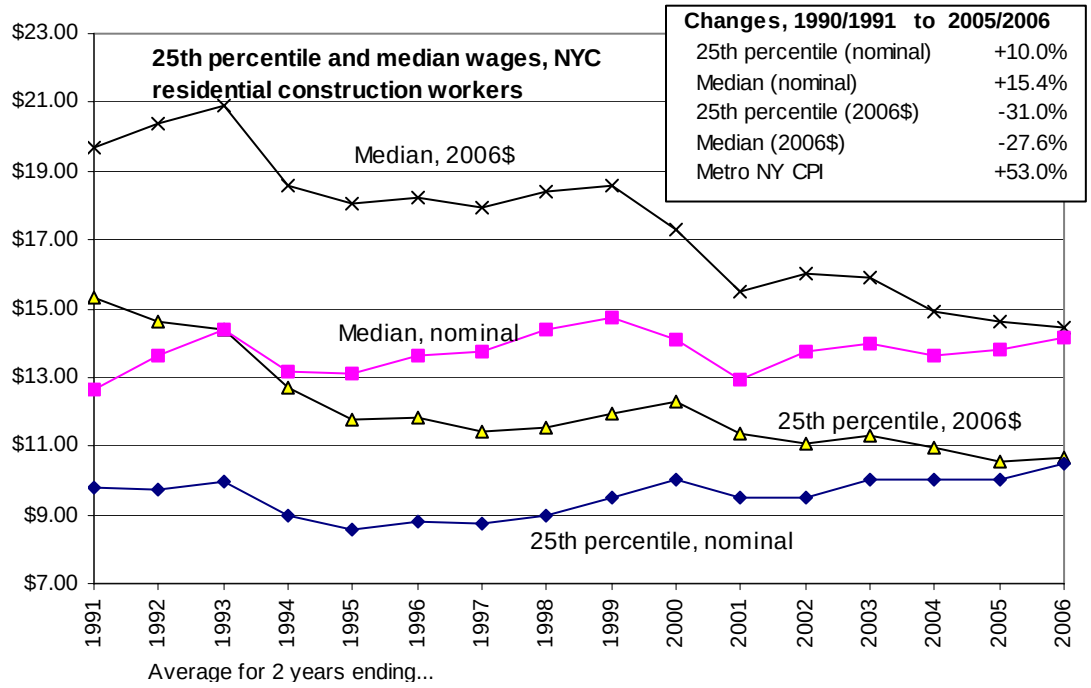
[6] Fiscal Policy Institute, "The New York City Construction Labor Market." (See note 4.)

80-20 program, almost all affordable housing construction in New York City is non-union.

Of the roughly 112,000 resident non-union New York City construction trades workers in 2006, 26.4 percent (nearly 30,000) were paid $10 an hour or less. While the Current Population Survey data on hourly construction wages does not permit disaggregation by residential or non-residential construction, it seems fairly certain from all information sources that workers in non-union residential construction receive wages at the low end of the construction wage spectrum.

The 25th percentile wage for all resident construction workers (union and non-union) increased to $11.00 in 2006. But this increase is a recent development. In nominal terms (that is, before adjusting for inflation) $10.00 an hour was the 25th percentile wage for most years between 1990 and 2005. (See Chart 1.) That is, there was virtually no change in the nominal wages paid at the low end of the construction industry for the prior 15 years. This astounding trend is probably unique among all industries in New York City over the past 15 years. While the wages that many New York City workers receive have failed to keep pace with the increase in consumer prices, it is highly unusual to see no increase whatsoever in the nominal wage for a sizable group of workers over such a span of time. This is particularly puzzling given the tremendous boom in residential construction since 2000.

Chart 1: Nominal wages for NYC construction workers stagnant since 1990, while real wages fell 30 percent



Changes, 1990/1991 to 2005/2006	
25th percentile (nominal)	+10.0%
Median (nominal)	+15.4%
25th percentile (2006$)	-31.0%
Median (2006$)	-27.6%
Metro NY CPI	+53.0%

Source: Fiscal Policy Institute analysis of CPS ORG files. Metro NY CPI used as deflator.

The picture is even more pronounced once one adjusts for inflation. The purchasing power of the 25th percentile wage in construction declined by 31 percent from 1990 to 2006. As noted earlier, the real median hourly wage in New York City construction fell by 28 percent over this period.

The wage erosion of the last decade and a half has been accompanied by a broader marginalization process that leaves many construction workers without social insurance protections, health or pension benefits, paid leave time or access to skill development opportunities or even rudimentary safety training so critical for survival in a dangerous occupation.

Given the seasonal nature of construction work and the vagaries of weather conditions affecting largely outdoor work, the typical construction worker works about 1,840 hours per year, the equivalent of 46 weeks at 40 hours per week.[7] At $10 an hour, a construction worker stands to make about $18,400 a year. This is only a little above the three-person federal poverty level guideline for 2007 of $17,170.[8]

While a "self-sufficiency" household income in New York City is two to three times the poverty level, a minimal standard for a wage earner should be at least 150 percent of the federal poverty level.[9] For a three-person household, 150 percent of the 2007 poverty guideline equals $25,755. A construction worker working the industry average of 1,840 hours per year would need an hourly wage of $14.00 to reach this level. This is not an unrealistic minimum standard for construction in New York City. According to data from the Current Population Survey, $14.00 an hour is the median hourly wage for non-union construction workers in New York City. Health insurance coverage, paid time off, and regular training in construction safety should also be considered part of a minimal construction standard. Legal requirements already exist for employers to pay payroll taxes covering Social Security and Medicare and to pay social insurance premiums for unemployment insurance, workers' compensation, and state temporary disability insurance.

2. The Boom in New York City's Residential Construction since 2000

New York City has been experiencing a tremendous housing boom since 2000. Initially fueled by the rapid income growth of the late 1990s, then by low and falling interest rates, the growth in New York City housing permits continues at a high level even though

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[7] According to the CPS, the average hours worked annually for resident New York City construction workers over the 2003-to-2005 period was 1,840 hours.

[8] The federal poverty measure is widely seen as limited since it is not adjusted for regional cost of living differences. Various researchers have sought to develop a more appropriate methodology to reflect a basic family standard of need. For example, the "self-sufficiency standard" is designed to reflect the income level necessary to meet basic family needs without public or private subsidy. The standard, which varies depending on family size and structure, generally ranges from two to three times the federal poverty threshold. See http://www.wceca.org/publications/NYC_Standard.pdf.

[9] This is net of child care and health care expenses. See Working Group on New York City's Low-Wage Labor Market, *Building a Ladder to Jobs and Higher Wages*, October 2000, pp. 135-136.

interest rates have risen from the low levels reached in late 2004. In 2004 and 2005, Mayor Bloomberg dramatically stepped up City financial support for affordable housing construction and set ambitious goals for the next few years.

The New York Building Congress projects that residential construction activity in New York City will continue in the $5 billion annual range, representing roughly 30,000 housing units per year, from 2006 through 2008.[10] This suggests that the New York City residential construction employment levels suggested above likely will continue through, at least, 2007 and 2008.

According to the Federal Occupational Safety and Health Administration (OSHA), there were 28 deaths on NYC construction sites in the federal fiscal year from Oct. 1, 2005 to Sept. 30, 2006. This was a 40 percent increase over the average level of 20 construction deaths a year from 2002 through 2005. Most of the deaths (17 of 28) resulted from falls. Over two-thirds (68 percent) of the construction workers killed on the job worked for very small employers (fewer than 10 employees). Most of the construction deaths (86 percent) occurred on the job sites of non-union employers.[11] The day following the death of a construction worker who fell off a scaffold in early November, Mayor Bloomberg established a task force on construction scaffold safety.

While the City has stepped up building safety enforcement in the wake of the scaffold task force, the *New York Post* reported on December 27, 2006, that a worker died when an apartment building undergoing renovation collapsed in Harlem. According to the article, the City Buildings Department stopped work on the site and planned to charge the contractor with four violations. The apartment building, which had been abandoned and was taken over by the City, had been sold by the City in 2003 to a developer, and was in a City housing rehabilitation program under the Department of Housing Preservation and Development.[12]

In examining the safety of working conditions in the New York City construction industry, the Mayor's Scaffold Worker Safety Task Force found extensive noncompliance with safety and health and Buildings Department regulations. Few workers are aware of existing safety and training requirements. The Task Force report stated: "Some workers may be reticent to demand safe job conditions for fear of retaliation by an employer." The Task Force report also noted that many workers have limited English proficiency and undocumented workers may be fearful of deportation. To improve construction safety, the critical Task Force recommendation was the establishment of a Scaffold Enforcement Unit within the Department of Buildings to conduct proactive inspections. The Task Force also

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[10] New York Building Congress, *Construction Outlook 2006-2008,* http://www.buildingcongress.com/code/outlook/2006-2008-outlook.htm.

[11] Richard Mendelson, Area Director, OSHA Manhattan, "2006 New York City Construction Safety Report Card," Presentation at BTEA Safety Conference, November 21, 2006.

[12] John Mazor, C.J. Sullivan and Ed Robinson, "Collapse Horror," *New York Post*, December 27, 2006. According to this story, the construction worker who died had been worried about the lack of safety protections on that job and had told family members two days before his death that he feared he was going to die on the job.

recommended that all scaffold workers, riggers and foreman comply with the safety training requirement, and that fines and penalties be increased.[13]

For an article in the May 2003 issue of *City Limits* magazine, Annia Ciezadlo interviewed several workers, contractors and others involved in NYC's affordable housing construction industry. Referring to a construction worker paid $10 an hour, often in cash, Ciezadlo wrote:

> Ramos is part of an underground workforce that builds New York City's affordable housing. … Their cheap, sometimes off-the-books labor is what puts the "affordable" in affordable housing. Most of them are working for subcontractors, or even sub-subcontractors, at the bottom of a contracting chain. At or near the top of this chain are nonprofit community development groups, organizations that exist to make life better for poor people. But for the poor people at the bottom of this chain, their pay and treatment are the dirty little secret of the housing world.[14]

Ciezadlo's article described dangerous working conditions and noted that most workers on affordable housing construction sites do not receive safety training, do not have health insurance, and often are not covered by workers' compensation. When a worker gets injured on the job, employers never call an ambulance because to do so would mean there would be a record of the accident at the work site that could lead to "OSHA inspections, lawsuits, higher workers' compensation rates and higher insurance costs." Ciezadlo wrote that in order to circumvent workers' compensation. employers pay workers in cash or pay them as so-called independent contractors.[15]

3. The Bloomberg Administration and Affordable Housing

As residential construction activity flourished and housing prices soared early in this decade, Mayor Bloomberg has dramatically stepped up the City's commitment to build and preserve affordable housing. When first announced at the end of 2002, the Mayor's New Housing Marketplace Plan set a five-year goal of creating or preserving 65,000 units of affordable housing by 2008. In April of 2005 that was increased to 68,000 and in the fall of 2005, the New Housing Marketplace Plan was extended from five years to 10 years and the goal raised to 165,000 units of affordable housing. According to the Mayor,

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[13] Mayor Bloomberg's Scaffold Task Force Report, *Steps to Safety: Recommendations for Improving the Safety of Workers on Suspended Scaffolds*, December 2006. The Task Force Report was released on February 2, 2007.

[14] Annia Ciezadlo, "Invisible Men," *City Limits*, May 2003.

[15] Ibid. On November 2, 2006, Channel 4 television news aired the first segment from a six-month investigation into New York City's affordable housing program. This segment focused on shoddy construction quality problems that have plagued several affordable housing projects. See http://www.wnbc.com/print/10224364/detail.html.

the $7.5 billion plan is the largest municipal affordable housing effort in the nation's history and will provide housing to 500,000 City residents by 2013.[16]

City funding support for affordable housing is primarily provided through the Department of Housing Preservation and Development (HPD) and the New York City Housing Development Corporation. The goal of 165,000 affordable housing units included preserving 73,000 units and building 92,000 units. Through the first four years (FY 2004-2007) of the ten-year plan, HPD reports that the City funded 23,765 new affordable housing starts. This amounts to about 6,000 new affordable starts per year. This number will need to almost double to 11,373 through the remaining six years of the plan to meet the 92,000-unit goal for new affordable units. In 2005 and 2006, the number of affordable housing units the City funded amounted to about 20 percent of the total number of New York City new residential permits. As the City sharply increases the number of City-funded housing starts over the next few years, the affordable housing share of new residential construction likely will increase.

4. Where Are the Workers Who Are Building All This Housing?

A careful look at the numbers supports the existence of what Ciezadlo called the "dirty little secret" of an "underground workforce." Measures of construction activity—permits, the value of permits and construction awards—have all more than doubled, while payroll employment has risen an anemic 16 percent. This implies that a considerable volume of NYC residential construction activity in recent years involves the misclassification of workers or some portion of off-the-books activity.

According to official U.S. Census Bureau data for new residential construction permits, the number of residential permits issued in NYC increased by 110 percent from 2000 to 2005, and the value of permits rose by an even greater 143 percent, increasing from $1.1 billion to $2.6 billion. F.W. Dodge data on residential construction contract awards show an increase of 130 percent over the 2000 to 2005 period, rising from $2.2 billion to $5.1 billion. (See Table 1.)

On the other hand, state labor department data on employment in NYC residential construction companies grew by 16 percent, rising from 32,750 to 38,113 over the same period. The residential permit data and the F.W. Dodge data are both widely used and highly regarded data sources for assessing residential construction trends. These data show increases from 110 percent to 143 percent. If residential construction employment had increased by 100 percent, there would have been an additional 38,000 residential construction jobs in NYC in 2005 than in 2000, a much greater increase than the 5,400 increase registered by the state labor department. It strains credulity to believe that the labor department employment numbers accurately reflect NYC residential construction activity. (See Table 1.)

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[16] New York City Mayor's Office and Department of Housing Preservation and Development, *The New Housing Marketplace: Creating Housing for the Next Generation, 2004-2013*, http://www.nyc.gov/html/hpd/downloads/pdf/10yearHMplan.pdf.

A large part of the under-reported number of residential construction workers is probably made up of of workers misclassified as independent contractors. Such workers appear in the Current Population Survey (CPS) as self-employed. The number of construction workers identified as self-employed in the CPS increased from 18,000 in 2000 to 33,000 in 2005. These data strongly suggest a sharp increase in the number of construction workers misclassified as independent contractors during a period when residential construction activity was booming and non-residential construction activity declined. The CPS self-employed data cover both the residential and non-residential sides of the construction industry. Since the majority of self-employed workers likely work in the residential sector, it is estimated that residential self-employment increased from 10,800 in 2000 to 26,500 in 2005.[17] If one assumes that half of the number of reported self-employed residential construction workers in 2005 are truly self-employed, that would mean that the other half, 13,251, are misclassified as independent contractors by employers.[18]

Adding together the residential construction payroll employment data and this estimated CPS self-employed data would show an increase of 48 percent from a combined total of 43,528 in 2000 to 64,616 in 2005. However, calculations show that the 2005 figure may well be an understatement. Starting from the 110 percent growth in the number of residential building permits from 2000 to 2005, and assuming moderately high annual productivity growth generates a projected 88 percent growth rate for residential construction employment over the five-year span. Applying the 88 percent growth rate projection to the 2000 level of residential construction employment (payroll plus self-employment) of 43,528 would mean a projected 2005 employment level of 81,668 for residential employment. The resulting net growth of 38,140 is 17,052 greater than the 21,088 increase resulting from official government payroll employment and CPS self-employment data.

This analysis suggests that there has been a substantial growth in off-the-books employment in New York City's residential construction sector. Given the increase in residential construction activity as measured credibly by the Census Bureau data on the number of permits and corroborated by the F.W. Dodge construction data, there should have been something like at least a projected 88 percent increase in residential construction employment, an increase much greater than the 48 percent increase based on the growth in residential construction employment from official government data sources. The employment increase should have been a projected 38,140 instead of the reported

[17] A majority of self–employed workers are assumed to work on the residential sector because the employers in the commercial construction sector are primarily large firms with expertise on staff. Also, the proportion of self-employed workers in the residential sector is likely to have increased over time. FPI assumed that 40 percent was non-residential self-employment in 2000 and that this number (7,186) declined by 10 percent from 2000 to 2005 along with the broader decline in non-residential construction activity in New York City during this period.

[18] The next section of this report discusses a Cornell University study that estimates that 14.8 percent of the construction workforce in New York State is misclassified as independent contractors. Applying this 14.8 percent rate to New York City's 2005 total construction payroll employment of 110,000 would yield an estimated 19,100 misclassified workers (the misclassification rate is applied to the sum of the payroll employment plus the number of misclassified workers).

increase of 21,088. Thus, reasonably it might be presumed that the magnitude of the off-the-books construction worker employment in 2005 was at least 17,100, the difference between the projected employment growth and the reported employment gain. This estimate of off-the-books employment is conservative, in part because it is based only on the projected growth from 2000 to 2005, without allowing for some portion of 2000 employment to be off the books.

Table 1: Residential construction activity and employment in New York City, 2000 - 2005

	2000	2005	change	% change
Construction activity measures				
Number of residential units given building permits (1)	15,050	31,599	16,549	110%
Value of residential building permits given ($millions, nominal) (1)	$1,064	$2,588	$1,524	143%
Residential construction contracts ($millions, nominal) (2)	$2,221	$5,119	$2,898	130%
Employment measures				
Residential construction payroll employment (3)	32,750	38,113	5,363	16%
Residential construction self-employment (4)	10,778	26,503	15,725	146%
Residential payroll employment + self-employment	43,528	64,616	21,088	48%
Projected FPI residential construction employ- ment (including self employment, independent contractors and off-the-books employment) (5)	43,528	81,668	38,140	88%

Sources

(1) U.S. Census Bureau, http://censtats.census.gov/bldg/bldgprmt.shtml

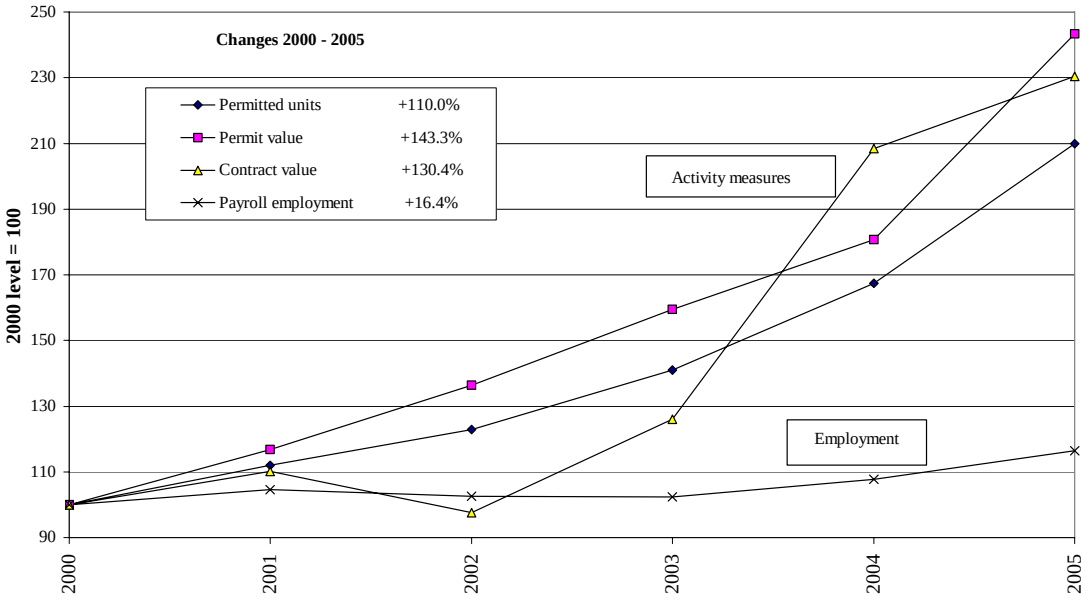
(2) F.W. Dodge Construction Awards, http://www.empire.state.ny.us/nysdc/Economic/Bus_Fact_Book_home.asp

(3) New York State Dept. of Labor, Quarterly Census of Employment and Wages (annual averages)

(4) FPI analysis of Current Population Survey (CPS) data. CPS self-employment data includes non-residential construction. FPI assumed that 40 percent was non-residential self-employment in 2000 and that this number (7,186) declined by 10 percent from 2000 to 2005 along with the broader decline in non-residential construction activity in New York City during this period. Thus, residential self-employment grew by an estimated 146 percent as shown above.

(5) See text.

Chart 2: Since 2000, New York City residential construction activity has grown much faster than employment



Sources: Building Permits, U.S. Census Bureau. Construction contracts, F.W.Dodge Construction Awards. Payroll employment, NYS DOL (QCEW).

And as noted before, 13,251 of the 21,100 increase in construction workers reflected in the government self-employment data between 2000 and 2005 might reflect misclassified workers, workers who are not really independent contractors and should be considered employees under New York State law. Putting the estimated 17,100 off-the-books workers together with the 13,251 misclassified workers equals over 30,000 workers illegally employed in residential construction, 37.1 percent of the projected 2005 employment level of 81,668.

5. The Underground Labor Market Begins with Employee Misclassification

Employee misclassification and off-the-books activity not only drive down the wages of workers but also lead to several other adverse fiscal and economic effects.[19] Employers that misclassify workers or employ workers off the books may shave their costs but only at the expense of government which loses tax revenue and sees increased demands made on various government programs, and at the expense of other employers who operate within legal requirements and institutions providing labor protections (unemployment

[19] In this report, employee misclassification refers to the practice of considering workers who are really employees as independent contractors. In the workers' compensation field, occupational misclassification has a different meaning: when an employee is considered as belonging to a different occupation that has a lower workers' compensation premium rate than the occupational class to which the worker should be assigned.

insurance and workers' compensation). These illegal activities also contribute to wage and income inequality through generalized pressure on less-educated workers. Employers engaging in misclassification and off-the-books activity do not really save costs; they just shift them onto workers, other businesses, government and society at large.

There is growing evidence that the misclassification of workers is on the rise. A February 2000 report prepared for the U.S. Department of Labor stated that:

> The number one reason employers use independent contractors and/or misclassify employees is the savings in not paying workers' compensation premiums and not being subject to workplace injury and disability-related disputes.[20]

The Planmatics study for the USDOL examined unemployment insurance employer audit data from nine states to gauge the extent of employee misclassification.[21] Reflecting practices and perceptions regarding employee misclassification from the late 1990s, the report concluded: "The percentage of audited employers (across all industries) with misclassified workers ranged from approximately 10 percent to 30 percent."[22] According to the interviews conducted by Planmatics researchers for this study, the construction industry was the industry in which the improper use of independent contractors was most widespread.[23] According to the U.S. General Accounting Office in a 1996 report, 20 percent of workers in the construction industry were misclassified.[24]

Four studies conducted since 2000 show continued growth in misclassification. Researchers at the University of Massachusetts and Harvard University examined unemployment insurance audits in Massachusetts and Maine and reached similar conclusions for the two states. The Massachusetts study, for example, stated:

> Across all industries, [at least] 13 percent of employers were found to underreport worker wages and unemployment insurance tax liability to the Commonwealth and thus to have misclassified workers.[25]

In both the Massachusetts and the Maine studies, the incidence of employee misclassification was greater in construction than in other industries. In the

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[20] Planmatics, Inc. "Independent Contractors: Prevalence and Implications for Unemployment Insurance Programs," p. iii. Prepared for the U.S. Department of Labor, Employment and Training Administration, February 2000. See http://wdr.doleta.gov/owsdrr/00-5/00-5.pdf.

[21] The states included in the Planmatics study were California, Colorado, Connecticut, Maryland, Minnesota, Nebraska, New Jersey, Washington, and Wisconsin.

[22] Planmatics, p. iii.

[23] Planmatics, pp. 41-44.

[24] U.S. General Accounting Office, "Tax Administration: Issues in Classifying Workers as Employees or Independent Contractors," GAO/T-GGD-96-130.

[25] Francois Carre and Randall Wilson, "The Social and Economic Costs of Employee Misclassification in Construction," December 17, 2004, (http://www.law.harvard.edu/programs/lwp/Misclassification%20Report%20Mass.pdf). Carre and Wilson, "The Social and Economic Costs of Employee Misclassification in the Maine Construction Industry," April 25, 2005 (http://www.law.harvard.edu/programs/lwp/Maine%20Misclassification%20Maine.pdf).

Massachusetts construction industry, for example, an estimated 14 to 24 percent of employers misclassified workers.

A recent study found that the practice of employee misclassification has grown rapidly since 2000.[26] Using audit data provided by the Illinois Department of Employment Security, a December 2006 study by researchers at the University of Missouri-Kansas City estimated that 8.5 percent of all employees in Illinois were misclassified as independent contractors in 2005, representing a 55 percent increase in the misclassification rate in Illinois from 2001 to 2005. This put the estimated number of misclassified workers in Illinois at 418,870 for 2005. The Illinois study found that misclassification was a significant factor for all employers found to have been misclassifying workers. For employers found to have misclassified workers, on average, well over one quarter (28 percent) of workers for such employers were misclassified. For the construction industry, the Illinois study estimated that one in five employers (19.5 percent) misclassified workers.[27]

Using a methodology similar to the studies for Massachusetts, Maine and Illinois, Cornell University researchers recently conducted an analysis of New York State unemployment insurance audits for the years 2002 to 2005. The Cornell researchers estimated that 704,785 New York workers, or 10.3 percent of the workforce, were misclassifed each year. In the construction industry, the study found that an estimated 45,474 workers—or 14.8 percent of the workforce—were misclassified as independent contractors in New York. For the industries included in the Cornell study for New York State, the average annual unemployment insurance tax underreported for misclassified workers amounted to $175.7 million.[28]

Employee misclassification creates significant problems for workers. Misclassified workers are not covered by workers' compensation or unemployment insurance and are liable for the full Social Security and Medicare payroll taxes (15.3 percent). They also lose access to employer-provided health and other benefits, such as retirement benefits and paid time off. Since misclassified workers are not considered employees, they lose protection against employment-related discrimination and do not have the right to form a union or bargain collectively. In the construction industry, independent contractor status precludes a worker's access to apprenticeship training opportunities.

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[26] This confirms the preliminary analysis of U.S. Census Bureau non-employer data by the Fiscal Policy Institute. From 2000 to 2004, the number of non-employers in the U.S. grew by 3 million during a period when reported payroll employment declined by 1.2 million. In New York State, the number of non-employers increased 207,000 while payroll employment declined by 194,000 from 2000 to 2004. And within the construction industry in New York State, the number of non-employers increased by 13,400 while payroll employment declined by 5,100.

[27] Michael P. Kelsay, James I. Sturgeon, and Kelly D. Pinkham, "The Economic Costs of Employee Misclassification in the State of Illinois," A Report by the Department of Economics, University of Missouri-Kansas City, December 6, 2006.

[28] Linda H. Donahue, James Ryan Lamare, and Fred B. Kotler, "The Cost of Worker Misclassification in New York State," Cornell University ILR School, February 2007.

Employers who misclassify workers often gain an unfair cost advantage over employers who comply with legal requirements. This unfair cost advantage can be critical for construction contracts awarded to the lowest bidder. A low bidder who misclassifies workers as independent contractors is usually able to secure contracts only because they succeed in shifting their costs onto others, whether the workers, taxpayers, or law-abiding employers.

While the studies of misclassification are usually based on unemployment insurance audits, misclassification for unemployment insurance purposes almost always extends as well to the workers' compensation system. Workers compensation costs in construction are much higher than unemployment insurance premiums, and are paid on the full amount of payroll, not just the first $8,500 of wages as is the case with New York's unemployment insurance program.

Since workers misclassified as independent contractors are known to underreport their personal income for tax purposes, the Illinois study estimated that the state lost from $150 million to $250 million in personal income tax collections in 2005 related to employee misclassification.[29]

In addition to the growing problem of employee misclassification, it is likely that there has been a growth in off-the-books, underground economic activity in which transactions are performed on a cash basis and not easy to track or audit. By misclassifying employees as independent contractors, employers evade payroll costs and social insurance premiums and avoid responsibility for providing paid time off or any health or retirement benefits. Such employers thus have employee compensation costs that can range from one quarter to one third less than employers who properly classify their workers and who comply with legal requirements. Contractors who employ workers off the books also illegally save considerably on compensation costs, as well as further minimizing any associated paper trail regarding their illegal practices.

6. Labor Standards Enforcement Should Be a Check on the Underground Economy

Government in New York in recent years generally has done very little to enforce adequate labor standards. A recent report by the Fiscal Policy Institute on New York's workers compensation system identified two substantial state enforcement gaps: (1) with limited exceptions, all workers covered by the state's unemployment insurance system should also be covered by workers compensation yet an estimated 500,000 to 1 million workers in the unemployment system are not covered by workers compensation; and (2) tens of thousands of workers are illegally classified as independent contractors when they are in fact employees and their employers should be paying payroll taxes and social

[29] Michael P. Kelsay, James I. Sturgeon, and Kelly D. Pinkham, "The Economic Costs of Employee Misclassification in the State of Illinois," Department of Economics, University of Missouri-Kansas City, December 6, 2006.

insurance premiums.[30] The failure on the part of New York State government—particularly the State Labor Department and the Workers' Compensation Board—to adequately ensure compliance with state labor laws has eroded labor standards and has permitted the underground economy to proliferate.

Former Attorney General Eliot Spitzer brought several high profile enforcement cases involving workers paid less than the minimum wage or not paid adequately for overtime work. Under Spitzer, the Attorney General's office also brought some prevailing wage enforcement cases in the New York City construction industry. The prevailing wage cases involved publicly funded construction at the New York City Housing Authority or the New York City public school system.[31] In late January 2007, Attorney General Andrew Cuomo and City Department of Investigations Commissioner Rose Gill Hearn announced guilty pleas by three construction contractors in a case involving renovation work for the Housing Authority taking place over a four-year period and involving underpayment of wages for 400 workers. The contractors were ordered to pay $6.5 million in back wages and $10.2 million in penalties.[32]

In October 2005, Mayor Bloomberg's Commission on Construction Opportunity announced several recommendations to expand job opportunities in the New York construction industry. The Commission also recommended that the City ensure greater compliance with prevailing wage laws as they apply to the construction industry.[33] The Mayor issued Executive Order #73, Prevailing Wage Requirements in City Contracts, to implement this recommendation. Among other things, the executive order was intended to ensure that successful bidders on City contracts, and their subcontractors, prove that they will pay prevailing wages.[34] The Mayor's Office of Contract Services also issued a directive requiring bidders on City construction contracts to have appropriate apprenticeship systems in place.[35] However, in applying the directive regarding apprenticeship systems, the Mayor's Office has exempted the Department of Housing Preservation and Development (HPD), the main City agency subsidizing affordable housing.

Under New York State law, the City Comptroller in New York City has responsibility for enforcing State prevailing wage requirements within New York City.[36] However, HPD contends that many of the City's affordable housing programs are not subject to State

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[30] Fiscal Policy Institute, *New York State Workers' Compensation: How Big Is the Coverage Shortfall?*, January 25, 2007. http://www.fiscalpolicy.org/publications2007/FPI_WorkersCompShortfall_Jan2007.pdf.

[31] See the Office of the Attorney General website, various press releases announcing enforcement actions.

[32] Office of the New York State Attorney General, "Contractors Admit Stealing More than $6.5 Million in Wages from over 400 Workers on NYC Housing Authority Contracts," Press Release, January 26, 2007.

[33] See the Commission's recommendations, http://www.nyc.gov/html/sbs/html/press/pressrelease_100505.html.

[34] New York City Comptroller, Bureau of Labor Law, *Prevailing News*, May 2006, p. 4, Fall 2006, p. 3.

[35] Memo from Marla G. Simpson, Director, Mayor's Office of Contract Services, "Apprenticeship Program Requirements for Certain Construction Contracts," July 20, 2006.

[36] In 2006, City Comptroller William C. Thompson, Jr.'s office collected more than $5 million in back wages for workers not paid in accordance with State prevailing wage law or New York City's living wage law. New York City Comptroller's Office, "Thompson Wins $5 Million from City Contractors Who Cheated Workers," Press Release, January 29, 2007.

prevailing wage regulation by the City Comptroller.[37] While many of the City's affordable housing programs are subject to federal prevailing wage regulation according to HPD, the federal Labor Department, which enforces federal prevailing wage law, has done very little to enforce compliance. Thus, there have not been many prevailing wage enforcement cases brought involving publicly-subsidized affordable housing projects in New York City. Reportedly, the Comptroller's office has begun to investigate prevailing wage compliance at a number of HPD-funded construction sites in upper Manhattan and the Bronx. These sites are part of HPD's Tenant Interim Lease program, which is covered by the State prevailing wage law according to HPD.

But considering the likely scale of noncompliance with workers' compensation and unemployment insurance and of employers illegally misclassifying workers as independent contractors, there have been extremely limited enforcement efforts.

It does appear that New York State's enforcement of social insurance requirements and labor standards will improve markedly under Governor Spitzer. The landmark workers' compensation legislation signed by Governor Spitzer on March 13, 2007, added several enforcement measures intended to increase employer compliance with the state requirement to provide workers' compensation coverage. Failure to secure coverage is elevated to a felony violation and the maximum fine for a first offense was increased from $2,000 to $50,000. The chair of the state Workers' Compensation Board was given various explicit powers to aid in civil enforcement, including the power to subpoena business records and the power to issue stop work orders for failure to secure coverage or to pay penalties assessed. The legislation also called for greater coordination between the Workers' Compensation Board and state agencies, particularly Taxation and Finance, Insurance, and Labor, to ensure more effective enforcement.[38]

New York can continue to learn from other states with aggressive strategies for identifying misclassified workers. In New Jersey, Governor Corzine has directed the Department of Labor and Workforce Development and the Department of the Treasury "to work together to ensure that employers don't misclassify their employees as independent contractors …" and in 2005, more than 26,000 workers were found to be misclassified as independent contractors.[39] California has mounted an aggressive effort to curb the misclassification of workers as independent contractors and in order to identify potential noncompliance, the State of California requires businesses to provide all IRS form 1099s to the State.[40]

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[37] See "Labor Standards on HPD Construction Projects," in *Prevailing News*, Fall 2006, p. 3. See http://www.comptroller.nyc.gov/bureaus/bll/newsletter/Dec06PrevailingNews.pdf.

[38] For the New York State workers' compensation legislation, see http://assembly.state.ny.us/leg/?bn=A06163. For the Governor's press release regarding his signing the legislation into law, see http://www.ny.gov/governor/press/0313071.html.

[39] New Jersey Department of Labor and Workforce Development, "Update on Governor Corzine's Worker Misclassification Initiative," www.state.njk.us/labor/press/2006/0719WorkerMisclassification.htm.

[40] For example, see the notice by the California Division of Labor Standards, "Misclassification of workers as 'independent contractors' rebuffed by the California Court of Appeal," http://www.dir.ca.gov/dlse/MisclassificationOfWorkers.htm, downloaded February 12, 2007.
In the midst of a housing construction boom in 2003, the State of Florida reformed its workers' compensation system and launched an aggressive program to combat workers' compensation fraud. Florida

7. Estimating the Fiscal Impacts of the Underground Economy in New York City's Affordable Housing Construction Industry

This report has identified several factors that all point in the same direction, namely, that the housing construction boom in New York City has been accompanied by an increase in illegal employment practices. The discussion of employment trends presented earlier suggested that well over one third of the local residential construction workforce was misclassified as independent contractors or employed off the books. There are several indications that such illegally employed workers are concentrated in the residential, as opposed to non-residential, portion of the construction industry. And within the residential segment, such employment practices are most likely to occur in the affordable housing construction segment. Affordable housing units tend to be built by smaller contractors or to use small subcontractors. Up to now, however, there has been little indication of the significant enforcement of labor protections and standards in residential construction. Building safety enforcement likely will improve in the wake of the Mayor's Scaffold Worker Safety Task Force and enforcement to ensure social insurance compliance likely will improve under Governor Spitzer, particularly in light of the workers' compensation reform legislation.

The increase in illegal employment practices has been accompanied by considerable pressure to hold down the wages of many construction workers. As the first section of this report discussed, there has been a 30 percent decline in the inflation-adjusted wages of New York City construction workers since 1990. Only recently has there been any increase at all in the nominal wage paid workers at the 25th percentile level.

From the point of view of labor protections and wage levels, there is not a huge difference between employers who misclassify workers as independent contractors and those who employ workers off the books. Neither makes payroll tax payments or social insurance premium payments on behalf of such workers. Social insurance programs include unemployment compensation, workers' compensation and disability insurance. In New York State, private employers are required to provide coverage for all three social insurance programs. Generally, employers who do not make payroll tax or social insurance premium payments deprive workers of coverage under these programs. Since Social Security and Medicare are general safety net programs, most workers will be eligible for at least minimum benefits, regardless of the payroll taxes paid in on their behalf. Workers injured on the job can qualify for workers' compensation benefits even if their employer has not made premium payments on their behalf. Such workers are paid out of a special fund financed through an assessment on premiums paid by employers providing regular workers' compensation coverage. In any case, there is a fiscal cost, or

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now has nearly 100 investigators in its anti-fraud campaign that targets employers who attempt to evade the legal mandate to provide their employees with workers' compensation coverage, including those who claim their workers are independent contractors. Florida Department of Financial Services, Division of Insurance Fraud and Division of Workers' Compensation, "Joint Report to the President of the Florida Senate and the Speaker of the Florida House of Representatives," January 1, 2007, http://www.fldfs.com/WC/pdf/01-01-07_Joint_report.pdf.

revenue loss, to government that results from employers not making payroll tax or social insurance premium payments.

There is also likely to be cost-shifting involving health care costs that results from employers who illegally employ workers. Since the affected workers will not have employer-provided health insurance, the workers are left to fend for themselves. Given their low wages, such workers likely would qualify for Medicaid coverage; however, many will not avail themselves of that. If they cannot qualify for Medicaid, and they are injured on the job or otherwise require medical assistance, emergency rooms will provide uncompensated health care services. Medicaid and uncompensated care both involve the shifting of costs from employers illegally employing workers to taxpayers and employers providing health coverage to their employees.

This final section of this report develops estimates of the fiscal impacts of the underground economy in New York City's affordable housing construction industry. Five steps are involved in estimating the fiscal impacts. First, drawing on the discussion of residential construction employment trends presented earlier in this report, an estimate of the number of workers engaged in the affordable housing construction segment of the industry is developed, including a distribution for five categories of wage and tax compliance status. Second, per worker payroll taxes and social insurance premiums are calculated for workers at the three different hourly wage levels used in this analysis. Third, industry-wide estimates are made of the payroll taxes and social insurance premiums lost due to employer noncompliance with applicable employment laws. Fourth, since most of the workers involved in this industry do not have employer-provided health insurance, estimates are made of the health care costs shifted to Medicaid and other payers. Fifth and finally, the amount of personal income tax liability is estimated for workers at different hourly wage levels and estimates are made of the lost personal income taxes for a portion of workers who are assumed to be noncompliant in paying income taxes.

The calculations for lost payroll taxes, social insurance premiums, and personal income taxes are made in relation to both current wage rates and against a minimal $14.00 an hour wage standard applied to workers making below that at present.

Table 2 shows the estimated number of workers in the New York City affordable housing sector and the distribution of workers by employment and tax status. These estimates are based on FPI's examination of several government data sources.

Table 2: Estimates of NYC Affordable Housing Workforce, by Category of Worker

category of worker	share of workforce	# of workers	hourly wage *
Union worker	5.1%	675	$24.70
Non-union employee	27.5%	3,675	$14.00
Misclassified "independent contractor" paying own payroll taxes	17.8%	2,375	$10.00
Misclassified "independent contractor" not paying payroll taxes	17.8%	2,375	$10.00
"Off-the-books" worker	31.8%	4,250	$10.00
Total, all workers	**100%**	**13,350**	**$11.84**

* Hourly wage rates are detailed in the text and the notes to Table 3.
Source: Estimates by Fiscal Policy Institute, March 2007.

As discussed earlier, based on measures of construction activity, total residential construction employment was estimated to be slightly less than 82,000 in 2005 (although payroll data show much lower figures). It was assumed that renovation work accounts for one third of residential construction activity, and that it has grown along with new construction since 2000. Of the 54,500 construction workers needed for new residential construction, roughly one quarter were assumed to constitute the new affordable housing construction sector. (See Appendix Table 1.)

This calculation yields an estimate of 13,350 workers needed to construct the volume of new affordable housing built in 2005. This includes workers misclassified as independent contractors and workers paid off the books. Recall that the estimated number of residential construction workers paid off the books was derived as the difference between the projected employment needed to build the amount of residential units indicated by the permit data and the official payroll employment and self-employment data. The number of workers misclassified as independent contractors was assumed to be half of the reported self-employment level in residential construction. The distribution of the 13,350 construction workers building affordable housing by category of worker was estimated using all the available data and making plausible assumptions about the magnitude of employment in each category.

Fiscal estimates are made for workers at three possible wage levels applicable to the residential construction industry.

- $10.00 an hour. Worker misclassified as an independent contractor or simply paid off the books. This wage level is deemed the customary rate for many such workers in the affordable housing segment of the residential construction industry according to several industry observers and journalists who have interviewed workers and is consistent with the CPS wage data. In this analysis, it is assumed that two-thirds (67.4 percent) of affordable housing construction workers are paid $10.00 an hour.
- $14.00 an hour. Typical non-union worker paid on the books by an employer as an employee. This is the median hourly wage for non-union New York City construction workers according to the Current Population Survey data, 2006. It is assumed that slightly more than a quarter (27.5 percent) of workers are paid $14.00 an hour.
- $24.70 an hour. Union worker paid at a market recovery wage rate reflecting a 5-2 blend of the wage rates paid to journey persons and apprentices (a 5-2 blend means 2 apprentices can work on a job for every 5 journey persons).[41] Union sources indicate that fewer than 1,000 union workers are employed on projects building affordable housing in New York City. For this analysis, it is assumed that 5.1 percent of affordable housing construction workers are union.

For each category of worker, Table 3 shows the total annual amount of payroll taxes and social insurance premiums that should be paid, given the wage rate involved. Workers' compensation premiums represent the single largest component. According to the New York Compensation Insurance Rating Board, the premium rate, including assessments, is $14.67 dollars per $100 dollars of payroll in residential construction. At a wage level of $10 an hour, an employer should be paying a workers' compensation premium of $2,699 per year. At the union market recovery average hourly rate of $24.70, the workers' compensation premium totals nearly $6,677. Including all payroll tax and social insurance premium payments produce a total of about $6,007 for a $10 an hour construction worker, ranging up to $14,113 annually for a union construction worker.

[41] The "market-recovery" contract rates are below standard New York City non-residential construction contract rates and represent an effort by building trades unions to recapture market share. The market-recovery rate used here is a blended hourly rate based on the carpenters' pay scale which is in the middle range among construction trades, higher than laborers and painters, but lower than electricians and plumbers. The journeyperson-to-apprentice ratio is established by the New York State Department of Labor. Most union workers building affordable housing in recent years have been paid at rates above the market-recovery rates.

Table 3: Per Worker Payroll Taxes and Social Insurance Premiums, NYC Affordable Housing Construction Sector

		Union worker (a)	**Non-union construction employee** (b)	**Misclassified independent contractor or off-the-books worker**
Hourly wage		$24.70	$14.00	$10.00
Per year, 1840 hours		1,840	1,840	1,840
Annual wages		**$45,448**	**$25,760**	**$18,400**
	payroll rate (c)			
FICA	0.1240	$5,635.55	$3,194.24	$2,281.60
Medicare	0.0290	$1,317.99	$747.04	$533.60
Unemployment insurance (d)	0.0480	$408.00	$408.00	$408.00
Federal Unemployment Tax (e)	0.0080	$56.00	$56.00	$56.00
Disability (f)	0.0016	$28.29	$28.29	$28.29
Workers' compensation (g)	0.1467	$6,667.22	$3,778.99	$2,699.28
Annual payroll taxes and social insurance premiums if employers comply with NYS law (h)		**$14,113.05**	**$8,212.56**	**$6,006.77**
Annual payroll taxes if paid by misclassified independent contractor				**$2,815.20**

Notes:

(a) The $24.70 hourly rate is a "market recovery" union wage rate that blends rates for journey persons and apprentices, and is based on the Carpenters pay scale which is in the middle range among construction trades. In the affordable housing sector, the small number of union workers typically work on 80-20 projects and earn a standard union contract rate, not the lower market recovery rate.

(b) Median non-union hourly wage in construction, 2006, Current Population Survey, FPI analysis.

(c) Payroll rates for FICA and Medicare are evenly shared between employer and employee, except in the case of a misclassified independent contractor.

(d) According to the NYS Department of Labor, the average unemployment premium rate for NYC residential construction employers in 2006 was 4.8%. Unemployment insurance premiums are paid only on first $8500 of annual wages.

(e) FUTA is paid only on the first $7000 of annual wages.

(f) Under the NY State Insurance Fund, disability premiums for men are 16 cents per $100 of wages, and are payable up to a maximum annual wage of $17,680.

(g) According to the New York Compensation Insurance Rating Board, the premium rate, including assessments, in residential construction is $14.67 per $100 of wages.

(h) This calculation is before application of federal or NYS prevailing wage requirment, if applicable.

Source: Estimates by Fiscal Policy Institute, March 2007.

Table 4: Lost Payroll Taxes and Social Insurance Premiums Due to Construction Employer Non-Compliance, NYC Affordable Housing Sector

($ millions)			**Lost Payroll Taxes and Social Insurance Pemiums**	
category of worker	share of workforce	# of workers	**vs. employers paying payroll taxes at current wage rates**	**vs. all workers at least 150% of poverty wage level ($14.00)**
Union worker	5.1%	675	$0.0	$0.0
Non-union employee	27.5%	3,675	$0.0	$0.0
Misclassified "independent contractor" paying own payroll taxes	17.8%	2,375	$12.8	$26.8
Misclassified "independent contractor" not paying payroll taxes	17.8%	2,375	$19.5	$33.5
"Off-the-books" worker	31.8%	4,250	$34.9	$60.0
Total, all workers	**100%**	**13,350**	**$67.2**	**$120.3**

Source: Estimates by Fiscal Policy Institute, March 2007. See Table 2 for per worker estimates.

Table 4 uses the per worker payroll tax and social insurance premium data from Table 3 to estimate the public costs in lost payroll taxes and lost social insurance premium payments. At current wage rates, lost payroll taxes and social insurance premium payments for misclassified independent contractors and off-the-books workers total $47.4 million per year. In relation to the $14.00 an hour minimal standard, that is, assuming all affordable housing construction workers make at least that wage and that all employer legal obligations are met, the estimate of lost payroll taxes and social insurance premiums rises to $67.2 million.

The low wages paid to many workers in affordable housing construction, particularly given the hazardous nature of construction work, also imply public costs in other ways. Such low paid workers may qualify for food stamps or other forms of public assistance. Arguably, these workers should be paid at least an hourly wage of $14.00. This would bring them to 150 percent of the federal three-person poverty level ($14 an hour times 1840 hours per year equals $25,760).

The public also bears the cost of providing health coverage to the non-union affordable housing construction workforce. Generally, in New York City's construction industry, only unionized workers have employer-provided health insurance.[42] U.S. Labor

[42] A recent United Hospital Fund report that provides the most detailed data on health insurance coverage in New York does not provide data on coverage by industry for New York City. In New York State, 33.9 percent of construction workers were uninsured in 2003-2004. This is the highest for the nine industry

Department data indicate that construction industry in New York City has a much higher than average incidence of occupational injuries than other industries. In 2004, male construction workers accounted for 13.9 percent of occupational injuries and illnesses suffered by male New York City private sector workers, nearly four times the construction share of NYC private employment (3.7 percent). In 2005, construction accounted for 28 percent of fatal occupational injuries among New York City males.[43]

Table 5 provides estimates of the health care costs shifted to other payors by construction employers not providing health insurance. For the roughly 95 percent of affordable housing construction workers without employer health insurance, it is assumed that one fourth receive coverage under Medicaid and a slightly lower portion, one fifth, receive uncompensated health care services.[44] Thus, the estimated cost to taxpayers of providing Medicaid coverage to roughly 3,200 construction workers in the affordable housing sector is $19 million annually, and the cost of providing uncompensated health care services to 2,500 workers is $6.3 million annually.

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groupings presented. Very few New York City adults with incomes below 200 percent of poverty have employer-provided health insurance: 39 percent are uninsured and 33 percent have Medicaid. United Hospital Fund, "Health Insurance Coverage in New York, 2003-2004," November 2006.

[43] U.S. Department of Labor, Bureau of Labor Statistics.

[44] Medicaid costs per non-elderly adult average $6,000 annually in New York City. The cost of uncompensated health care services provided affordable housing construction workers was estimated by FPI at $2,500 per worker receiving uncompensated care. Articles consulted in developing this estimate include: Randall R. Bovbjerg, et.al., "Caring for the Uninsured in New York," Urban Institute, October 2006, and C. Jeffrey Waddoups, "Employer Sponsored Health Insurance and Uncompensated Care: An Updated Study of the University Medical Center in Clark County (Las Vegas)," July 2001.

Table 5: Health Care Costs Shifted to Medicaid and Other Payors by Non-Compliant Construction Employers, NYC Affordable Housing Sector

($ millions)

category of worker	share of workforce	# of workers	**Public cost of Medicaid coverage for 1/4 of workers without health insurance** (a)	**Cost of uncompensated health care shifted to other payors for 1/5 of workers without health insurance** (b)
Union worker	5.1%	675	$0.0	$0.0
Non-union employee	27.5%	3,675	$5.5	$1.8
Misclassified "independent contractor" paying own payroll taxes	17.8%	2,375	$3.6	$1.2
Misclassified "independent contractor" not paying payroll taxes	17.8%	2,375	$3.6	$1.2
"Off-the-books" worker	31.8%	4,250	$6.4	$2.1
Total, all affordable housing construction workers	**100%**	**13,350**	$19.0	$6.3

(a) Assumes that a quarter of workers without employer-provided health insurance sign up for Medicaid and that the annual cost of Medicaid-covered health care they receive is $6,000.

(b) Assumes a fifth of workers without employer-provided health insurance receive health care services that fall into the "uncompensated care" category. In New York, the costs for uncompensated care are borne by health care providers (hospitals and clinics) and, through the Health Care Reform Act's uncompensated care surcharge, by employers that provide health insurance to their workers. Given the high incidence of construction accidents, this cost was estimated at $2,500 per worker receiving uncompensated care.

Source: Estimates by Fiscal Policy Institute, March 2007.

Under New York State's Health Care Reform Act (HCRA), employers providing health insurance to their employees, such as union construction employers, are mandated to pay a surcharge on certain medical expenses to help cover the cost of uncompensated health care, including the health care for employees of employers not providing health insurance. Thus, under this perverse state provision, responsible employers providing health insurance to their employees, in effect, pay several hundred dollars per worker to cover medical costs for the employees of their competitors who do not provide health coverage.

The high incidence of illegal employment practices in affordable housing construction also suggests the likelihood of lost personal income tax payments. Workers paid on a

cash basis, off the books, are unlikely to pay personal income taxes and many workers misclassified as independent contractors probably fail to report all of their earnings. Only workers officially on a business's payroll records have federal, state and local income taxes withheld from their pay. Table 6 presents estimates of the additional personal income taxes that would be paid, or owed, by affordable housing construction workers if all were legally employed on a payroll employment basis and were, thereby, subject to withholding. The estimates in Table 6 assume that all workers currently subject to withholding pay income taxes and that one half of the workers misclassified as independent contractors pay income tax.[45] (Appendix Table 2 provides estimates of the income taxes paid by these workers.)

Given current wages rates, lost income taxes are estimated at $12.5 million, with $4.8 million of that representing New York state and city income taxes. If all workers were paid at the minimal standard level of $14 an hour, the estimate of lost income taxes would rise to $33.2 million. For the latter estimate, New York's share is $12.8 million.

Table 6: Lost Income Tax Collections Given Current Wage Levels and Compared to 3-person Poverty Wage Level

($ millions)

Lost Income Tax Collections Assuming All Workers Paying Income Taxes, Depending on Assumed Wage Level ($millions)	**vs. workers paying income taxes at current wage rates**	**vs. all workers at least 150% of 3-person poverty wage level**
Federal income tax	$7.7	$20.4
New York State income tax	$2.7	$7.7
New York City income tax	$2.1	$5.1
Subtotal, New York income taxes	$4.8	$12.8
Grand Total, All Income Taxes	$12.5	$33.2

See Appendix table for detailed estimates by worker category.
Note: These estimates do not include business income tax payments.

Source: Estimates by Fiscal Policy Institute, March 2007 (based on 2005 tax tables).

[45] The personal income tax calculations assume full-year New York City residency and are based on city, state and income tax liability for a single worker with no dependents.

Table 7 summarizes the three sets of fiscal costs presented in Tables 4, 5 and 6. The total fiscal costs range from $85.3 million to $125.8 million. The lower figure represents the various costs based on current wage levels. The higher figure represents the sum of the costs and foregone taxes and premium payments compared to a scenario where the entire affordable housing workforce is paid based on minimal standard wage of $14 an hour.

Table 7: Summary Table: Lost Payroll Taxes, Social Insurance Premiums, Personal Income Tax Collections, and Health Care Costs Shifted to Others, NYC Affordable Housing Construction

($ millions)	**based on current wage rates**	**based on all workers receiving at least $14/hour (150% of poverty)**
Lost payroll taxes and social insurance premiums	$67.2	$120.3
Health care costs shifted to other payors	$25.4	$25.4
Lost income tax collections	$12.5	$33.2
Grand total, lost payroll taxes, social insurance premiums, and personal income taxes, and health costs shifted to others	**$105.1**	**$178.9**

Source: Estimates by Fiscal Policy Institute, March 2007. See Tables 4, 5 and 6.

Conclusion

In examining all of the published data on activity and employment in the New York City residential construction industry, this report concludes that approximately two thirds of the employment in the city's affordable housing construction industry represents illegal employer practices, either workers misclassified as independent contractors or off-the-books employment. This means that an estimated 9,000 workers are misclassified or employed off the books in the affordable housing construction sector out of a total workforce of about 13,350. Solid data on employment trends in this industry do not exist and these figures are only rough estimates. Many assumptions had to be made to generate these estimates. Readers are encouraged to challenge these assumptions and to provide data that can be used to improve on these estimates.

As the level of activity in the affordable housing construction industry has grown substantially in New York City in recent years, accidents resulting in a growing number of deaths have increased and necessitated a strong response from government. Despite the dangerous working conditions in this industry, wage levels are extremely low, particularly by standards for the construction industry. The low wages paid in the affordable housing construction industry have contributed to the 30 percent decline in inflation-adjusted wages for New York City construction workers since 1990. For the lowest paid quarter of New York City construction workers, nominal wages have barely changed over the past fifteen years.

Beyond the steep decline in real wages, workers in the affordable housing construction industry are consigned to a secondary tier of the labor market with limited opportunities to acquire new skills or to move up a career ladder. Very few workers in this industry have health benefits and, if the estimates in this report are plausible, most workers are not covered by workers' compensation, unemployment insurance or state-mandated disability insurance. Most workers do not have payroll taxes paid on their behalf by their employers, and employers are not withholding income taxes from wages paid. It appears that many contractors may be completely out of compliance with the various labor standards requirements that have existed in New York State for decades.

Just because the wages are low does not mean that costs are low. Contractors pay construction workers low wages and shift substantial economic costs onto workers, and shift considerable fiscal costs to other construction employers and taxpayers generally. These costs may not be reflected in the price of the contract or the cost of the housing unit, but they are certainly real and borne elsewhere in the economy. Workers bear the brunt of these costs through low wages, hazardous working conditions and the lack of social insurance or fringe benefits. But there are also costs that push up workers' compensation premiums for other employers, health care costs are shifted to taxpayers or businesses that provide their employees with health insurance, and tax collections are less because these contractors are evading legal requirements.

Affordable housing construction under these labor conditions entail several economic costs that are not quantified in this report. They are nonetheless real. Unfair competition is created for businesses that comply with the law and pay their workers decent wages with benefits. Employment conditions like those in affordable housing construction put downward pressure on wages for many workers in the New York economy who have limited formal education or limited English language skills.

Part of the construction industry in New York City is linked to an employer-funded apprenticeship training system that provides New York City residents the opportunity to receive valuable vocational skills and safety training that can lead to much better compensated employment opportunities and provides a pathway into the middle class.[46] Almost all of the affordable housing construction activity in New York City is completely outside of this apprenticeship system.

The City of New York plays a major role in the affordable housing construction sector through the subsidies it provides to stimulate the construction of affordable housing for New Yorkers. Affordable housing is justifiably a top priority of City government. (Because their pay is so low, many construction workers building affordable housing would not even qualify under some of the City's affordable housing programs.) Over the past four years, the City has subsidized the construction of 6,000 units of affordable housing a year. The number of housing units the City will support annually will nearly double over the next six years.

New York City government should take responsibility for the working conditions that have been created in this sector and work with the State of New York to begin enforcing labor standards and addressing working conditions and the poor pay and benefit practices that exist in the affordable housing construction sector. The City has moved aggressively to address hazardous scaffold safety problems in construction. The logical next step is to recognize and begin addressing pervasive non-compliant labor practices. With the passage of several anti-fraud enforcement provisions in the historic workers' compensation reform legislation signed into law in mid-March, the State is also poised to dramatically improve labor standards enforcement.

Enforcement efforts should be pursued in a fashion that benefits an often vulnerable workforce that includes many minority workers long shut out of opportunities for good-paying jobs, skill development and advancement, or who are recent immigrants.

[46] For example, under the Carpenters Union contract, union employers contribute 60 cents for every hour worked to fund an extensive apprenticeship training program.

Appendix Table 1: Estimates of NYC residential construction workforce
By industry segment, 2005

		residential construction industry segment			
category of worker	**All residential construction employment**	Residential renovation construction	**New residential construction**	*New affordable housing construction **	*New market rate housing construction*
Payroll employment	38,100	2,550	35,550	4,350	31,200
Self-employment	13,250	11,925	1,325	250	1,075
Misclassified independent contractors	13,250	1,325	11,925	4,750	7,175
Off-the-books workers	17,100	11,400	5,700	4,250	1,450
Total, all workers	**81,700**	**27,200**	**54,500**	**13,600**	**40,900**

** For affordable housing construction, Tables 2 through 7 leave aside the estimated 250 self-employed for a total affordable housing construction workforce of 13,350.*

Source: Estimates by Fiscal Policy Institute, March 2007. Methodology available on request.

Appendix Table 2: Personal Income Taxes, NYC Affordable Housing Construction

Single worker, no dependents, not eligible for EITC

	Non-union construction employee*	Misclassified independent contractor, income tax compliant	Misclassified independent contractor, not tax compliant	"Off-the-books" worker, not tax compliant	Union worker
Gross Wages	$25,760	$18,400	$18,400	$18,400	$45,448
Income Tax Liability, Individual Worker					
Federal income tax	$2,271	$1,169	$0	$0	$5,971
New York State income tax	$851	$407	$0	$0	$2,204
New York City income tax	$571	$318	$0	$0	$1,272
Subtotal, New York income taxes	$1,422	$725	$0	$0	$3,476
Grand Total, All Income Taxes	$3,693	$1,894	$0	$0	$9,447

	Non-union construction employee*	Misclassified independent contractor, income tax compliant	Misclassified independent contractor, not tax compliant	"Off-the-books" worker, not tax compliant	Union worker	Total, all workers, affordable housing construction
Number of workers in each category	3,675	2,375	2,375	4,250	675	13,350
Income Tax Liability, All Workers ($ millions)						
Federal income tax	$8.3	$2.8	$0.0	$0.0	$4.0	$15.2
New York State income tax	$3.1	$1.0	$0.0	$0.0	$1.5	$5.6
New York City income tax	$2.1	$0.8	$0.0	$0.0	$0.9	$3.7
Subtotal, New York income taxes	$5.2	$1.7	$0.0	$0.0	$2.3	$9.3
Grand Total, All Income Taxes	$13.6	$4.5	$0.0	$0.0	$6.4	$24.4

Note: These estimates do not include business income tax payments.

Source: Estimates by Fiscal Policy Institute, March 2007 (based on 2005 tax tables).

The Fiscal Policy Institute is a nonpartisan research and education organization that focuses on tax, budget, and economic issues that affect the quality of life and the economic well being of New York State residents.

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