

1. How do the Labor Enforcement Task Force (LETF), the Joint Enforcement Task Force (JESF), and the Revenue Recovery and Collaborative Enforcement Team (RRCE) differ?

Response:

Under the direction of Governor Brown, and the Labor and Workforce Development Agency, California is initiating a collaborative agreement between LETF, JESF, and RRCE. The goal of this collaboration is to fight the underground economy and to make sure that businesses compete on a level playing field, workers have a safe and just work environment, appropriate taxes are collected, and California's economy can thrive. The focus of the RRCE as opposed to the LETF and the JESF will be on recovering lost taxes and investigating criminal-level violations.

Earlier this year, Director Christine Baker of the Department of Industrial Relations (DIR) and Chief Deputy Director Sharon Hilliard of the Employment Development Department (EDD) initiated an effort to consolidate the departments' respective multi-agency underground economy programs (LETF and JESF) and streamline administration of the two teams. The resulting joint effort will be called the LETF/JESF Collaborative Enforcement Partnership (CEP).

The Revenue Recovery and Collaborative Enforcement Team (RRCE) became statute on October 7, 2013. The signing letter from the Governor named DIR to lead the effort to ensure collaboration between the LETF/JESF Collaborative Enforcement Partnership and other partners and to eliminate duplicative efforts. To date, DIR has held individual meetings with the primary partners, the State Board of Equalization (BOE), the Franchise Tax Board (FTB), EDD, and the Department of Justice (DOJ), as well as a planning meeting for all the agencies involved. A series of working meetings are planned for early 2014.

Each task force has a slightly different focus that complements the strengths of the other partners. When they all work together, their combined effort will be far more comprehensive and robust. LETF expertise brings organization, oversight, and accountability through statistical tracking, as well as its successful, empirically-based method of targeting business in low-wage and high hazard sectors. LETF and JESF both concentrate on enforcing tax laws and other civil laws, and they refer criminal-level violations to their respective criminal investigative units, to, the District Attorney, or to the Department of Justice. RRCE will begin its work January 1, 2014, and it will be able to enforce *both* civil and criminal law, as well as share information and coordinate investigations of criminal-level violations in the underground economy.

2. What do the two newer organizations, the LETF and RRCE, bring to the effort that was missing prior to their creation?

Response:

LETF, JESF, and RRCE were each created at different points in time, each with a unique focus.

LETF is the updated and greatly improved version of the Targeted Industries Partnership Program (TIPP), established in November of 1992 at the recommendation of the Governor's Farm Workers Services Coordinating Council. The council's recommendations included a targeted multi-agency approach to the enforcement of labor laws and health and safety requirements. The DIR's Division of Labor Standards Enforcement (DLSE) and Division of Occupational Safety and Health (DOSH) initiated the two-year pilot program with the US Department of Labor (DOL). In 1994, TIPP became permanent, through a Memorandum of Understanding (MOU) that broadened the program to include EDD as a partner. The MOU also expanded TIPP's coverage to industries, such as the garment industry, that fit the targeted low-wage, high-hazard criteria. The program used a sweep model of enforcement, sending multi-agency teams to randomly visit businesses and concentrating on a specific region for each sweep. The program experienced some success.

Several years later, in 2005, the LWDA created the Economic Enforcement and Education Coalition (EEEC), which then took the place of TIPP in the fight against the underground economy. The Legislature made EEEC a permanent program in 2009. Like its predecessor TIPP, EEEC used a sweep model of enforcement. In 2012, Governor Jerry Brown moved the administration of the EEEC from LWDA to DIR. The Governor also changed the name from "Economic Enforcement and Education Coalition" to "*Labor Enforcement Task Force*," the LETF, to emphasize the importance of labor enforcement in the fight against the underground economy.

The Brown administration studied the lessons learned from the EEEC effort and listened to stakeholders who found the enforcement model of sweeping an area randomly to be ineffective. As a result, the LETF administration developed an empirically-based methodology of targeting businesses in key, low-wage, high-hazard industries, an approach that has proven very successful. DIR has devoted resources to developing a central control to assist the agencies with data analysis. The central control includes an LETF hotline and email that both take in lead referrals from the public. LETF has also carefully developed protocols with all partner agencies to ensure all processes are clear. As a result, communication is constant between the LETF partner agencies and plays a key role in the success of its operations. In addition, DIR maintains a database to track results and create reports that allow for analysis of operations and outcomes. LETF has also forged partnerships with labor, management, and the insurance industry to identify non-compliance. Because of this proven track record, the Governor signed AB 576 and directed DIR to lead the new joint task force.

JESF has distinct origins, as it was created in 1993 at the recommendation of the 1985 Little Hoover Commission in its report, *A Review of Selected Taxing and Enforcing Agencies' Programs to Control the Underground Economy*. In 1994, JESF created a joint enforcement effort called the Employment Enforcement Task Force (EETF) to perform its field operations. EETF partners include DIR, DLSE, CSLB, Department of Insurance, and others. In 2005, the LWDA acknowledged that EETF's labor enforcement was not living up to expectations, primarily because EETF did not include enforcement of health and safety laws, and because it was neither robust nor equal to the need of California's workers and employers in low-wage, high-hazard industries.

Assembly Bill 576 created RRCE to become effective January 1, 2014. While the RRCE is still in the early stages, it is being developed with a watchful eye to ensure collaboration with LETF and JESF. Analysis of the bill estimates that \$9 billion dollars in corporate, personal, and sales and use taxes go uncollected in California each year due to unreported and under-reported economic activity. The analysis also states that criminal tax evasion is hurting Californians and not getting enough attention by law enforcement. As a result, RRCE has focused discussion on illicit operations as well as criminal level tax violations found in the underground economy. This focus will allow LETF and JESF to work even more efficiently and effectively on civil violations, catching the non-compliant employers before their actions become more egregious, as well as giving them the ability to provide criminal-level leads to RRCE.

3. How will you set performance metrics as a leader in these efforts and use them to determine progress?

Response:

Multi-agency task forces targeting employers that do business underground and compete unfairly with legitimate businesses will recover significant amounts in taxes for California every year. Estimates of the size of the underground economy vary widely since, by its very nature, an underground business leaves no paper trail. Nonetheless, using two separate estimation methods, we were able to project increases of between \$840 million and \$2.8 billion per year in state taxes collected.

The underground economy is a moving target. By definition, it involves business conducted covertly, without a paper trail, using resources such as vulnerable workers who do not know their rights or feel powerless to exert them. The combined efforts of all three teams will make a significant and measureable impact.

As a leader in the effort to fight the underground economy successfully and ensure collaboration among LETF, JESF, and RRCE, DIR will use metrics similar to those used to develop and guide LETF. Development of the metrics will include the following steps: (1) establishing the mission, vision, goals, and objectives; (2) determining what to measure and how; (3) tracking and analyzing the resulting data; and (4) looking for opportunities to make continuous improvement. Ultimately, the goal will be for legitimate businesses to be able to grow and for employees to receive their full wages, be covered by workers' compensation insurance in case of injury, and work in productive, rewarding, safe, and healthy jobs. Just as important, the State of California will see increased tax revenues generated from business income, personal income, insurance premiums, sales taxes, and the use of and proper sales of goods. As a result, our economy will thrive and grow.

The LETF model will help us to describe how we determine success. Its goals include the judicious use of resources necessary to carry out these goals efficiently. To achieve this goal, we applied lessons learned from the Economic Employment and Enforcement Coalition (EEEC), in particular, that interruptions from site visits caused by the random sweeps method were a heavy

burden on compliant businesses. For this reason, we abandoned the random sweeps in favor of targeted inspections.

Taking these goals and priorities into consideration, the RRCE leadership will identify key indicators to measure enforcement results for each agency. To determine the new program's effectiveness, DIR will collect and compile all violations identified and will then track and measure all violations, referrals, and outcomes. With empirically-based targeting methods, we will measure the percentage of businesses found to be out of compliance. DIR will also track individual investigator performance and measure outcomes. When results in any of these areas fall below the standard, the strategic operations team will deliberate and decide whether to change the protocol or to provide further training. Investigators will make informed judgment calls and choose their targets based on evidence indicating a likelihood of non-compliance.

Strategic use of resources is important for California's economy. LETF's administration chose to concentrate resources on industries that employ the highest population of California's workers in low-wage, high-hazard occupations. These industries also have a reputation for employing the business practices of the underground economy, so LETF matched that apparent demand to enforcement resources. Initial 2012 efforts focused on the following industry sectors: construction, restaurant, agriculture, garment, and automotive. However, this focus also left room to explore other industries that might warrant attention.

To track efforts and results, the LETF administration created a relational database, in which the details of every business inspected by each enforcing agency are recorded in separate, related tables. In this way, LETF is able to track and tabulate how many agencies find a given targeted business out of compliance, and LETF can also track individual violations. Reports created from this database allow management to make continual improvements by analyzing operations and individual investigator performance. In addition, regularly generated external reports keep stakeholders well informed of LETF activities.

To meet the needs of stakeholders and to strengthen its enforcement efforts, LETF has developed and implemented a robust communications plan, which is now undergoing further expansion, including outreach and education for both workers and employers. These efforts will occur via the LETF website and distribution of printed materials at training sessions for worker advocates and at in-person presentations for employer organizations.

In summary, DIR will apply the principles of LETF's methodology to establish performance metrics for the newest task force and the collaboration effort as a whole: (1) establish goals and objectives, (2) determine how and what needs to be measured, (3) understand performance and determine set metrics, (4) track and analyze data, and (5) continually look for opportunities to improve operations.

4. What additional reforms are needed to aid in the groups' work?

Response:

As designated leader of the three task forces, I'm in the process of evaluating this key question. Among the issues we're looking at are the following:

- 1) Removing barriers to interagency information sharing.
- 2) Improving coordination with local and state criminal prosecutors.
- 3) Improving collection of unpaid wages and penalties.
- 4) Improving payroll reporting and insurance classification reporting.

5. What are the ways in which the underground economy has evolved?

Response:

The underground economy evolves in part as a reaction to changes in the overall economy and changes in the employment relationship, such as the increasing reliance on temporary workers. Most noteworthy in the past decade was the Great Recession that ran from December 2007 until June 2009.¹ The resulting high unemployment rate has been unusually slow to fall back down.² And the unusually large income gap that California has seen since the recession began is unlikely to narrow anytime soon, if previous recovery patterns are any indicator.³

Another important factor contributing to the recent growth of the underground economy in California was the \$42 billion dollars of infrastructure bonds that the state's voters passed in 2007. The construction industry was preparing for a boom in the public works sector; however, within a year, the housing crisis that helped spur the recession dried up construction jobs in the residential and public works markets. To remain viable, more contractors adopted the "cheat to eat" philosophy, lowering bids to get the jobs. Since the cost of hard goods is fixed, many previously compliant contractors ended up cutting corners and cheating in the area of labor, which helped keep their taxes down and reduced their expenditures for associated social insurances.

These economic factors, among others, created conditions highly conducive to the growth of the underground economy. Because of the stubbornly high unemployment rate, workers

¹See "The Great Recession and Distribution of Income in California," Public Policy Institute of California, Sarah Bohn and Eric Schiff, 2011, p. 1. http://www.ppic.org/content/pubs/report/R_1211SBR.pdf

² Silver, Drew. "At 42 Months and counting, current job "recovery" is slowest since Truman was president." Pew Research Center, 25 of September, 2013. Web, 30 December, 2013. <http://www.pewresearch.org/fact-tank/2013/09/25/at-42-months-and-counting-current-job-recovery-is-slowest-since-truman-was-president/>.

³ "If previous recovery patterns repeat themselves, it is likely that the lower half of the income distribution will recover much more slowly than the upper half, potentially allowing already record-high income inequality to persist." Sarah Bohn and Eric Schiff, 2011, p. 2 (same source as above).

desperate for any income are now more than ever willing to work for an employer who is violating their rights, including paying them in cash, misclassifying them as independent contractors, and failing to carrying workers' compensation insurance. In addition, we see the flourishing of illegitimate forms of commerce, such as residential work conducted without required permits, pirated commercial goods, counterfeit products, and we also see an increase in organized crime.

There are many ways in which the underground economy currently thrives:

- Cash payment to workers (under the table).
- Non-payment of wages for time owed (falsifying records)
- Misclassification of employees as independent contractor
- Payment of less-than-minimum wage
- Non-payment of overtime for hours worked over 8 in a day or 40 in a week
- All forms of wage theft
- Non-compliance with health and safety laws
- Illegally charging employees for uniforms, tools, etc.

Insurance

- Lack of workers' compensation insurance for employees
- Insurance fraud—all types
 - Workers' compensation fraud (worker, employer, insurer, provider).
 - Misclassifying employee class code for workers' compensation
 - Under-reporting employees on workers' compensation
 - Unemployment Insurance fraud (individuals receiving unreported income while collecting unemployment insurance)

Taxes

- Unreported or under-reported payroll
- Unreported or under-reported corporate, business, or personal income
- Unreported or under-reported sales, use, or excise tax

Consumer/Licensing/Other

- Unregistered/Unlicensed contractors or other practitioners under the DCA (Department of Consumer Affairs)
- Cash-based sales of goods and services
- Inflated billing
- Cash from illegal activities such as drug sales and prostitution
- Embezzlement
- Human trafficking

6. Are there areas that warrant additional attention from the state's top policymakers?

Response:

As we move into the integration of the three task forces we will become better equipped to provide recommendations. We intend to report on this soon.

7. What barriers exist that prevent successful enforcement of current laws?

Response:

DIR is currently meeting with all of the integrated team members to determine what barriers will hinder the joint efforts in the successful enforcement of the underground economy. AB 576 requires DIR to file a report to the legislature by December 1, 2017. In his signature letter of AB 576, the Governor also tasked DIR with reporting to him on "recommendations on ways to improve the effectiveness in attacking the underground economy." As collaborative efforts continue to develop, DIR will identify and evaluate any barriers that prevent effective enforcement and will provide recommendations to the legislature and governor on how to overcome these barriers. We anticipate that the RRCE may encounter barriers in the area of information sharing and resources.

8. Are there additional opportunities to improve coordination among state entities?

Response:

Yes, consolidating the administration of these efforts is a positive step toward ensuring efficient use of existing resources and avoiding duplicative enforcement efforts. Communication between agencies will be critical, in particular, information sharing.