

Report: State's 'underground economy' thrives, enforcement lags

Little Hoover Commission details \$170 billion off-the-books system

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It's a complicated system that cheats the state out of tax revenue, robs workers of their legal due, hurts law-abiding businesses and erodes public trust in government - and in 30 years, the state hasn't done much to fix it.

The network in question: California's underground economy.

In its first report on the subject since 1985, the Milton Marks Little Hoover Commission on California State Government Organization and Economy is reporting today that California's underground economy is costing the state as much as \$10 billion per year in lost tax revenue, while threatening workers and businesses and undermining governmental authority.

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Little Hoover Commission chair Pedro Nava gestures during a meeting in 2014. The commission has issued a report stating that California's underground economy may be costing the state as much as \$10 billion a year in lost tax revenue.

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"(T)he tentacles of the underground economy reach deep in California and ... it plagues both businesses and workers," the report stated.

Roughly \$170 billion in off-the-books activity - the commission's definition of underground economy - permeates California's \$2 trillion economy. The illicit activities run the gamut from under-the-table pay to disregarding of safety rules and tax evasion.

A major part of the problem is the fact that rules are sometimes unclear and penalties for violating them too lax - if an offender can even be caught in the first place.

Pedro Nava, chair of the Little Hoover Commission and former representative of Santa Barbara in the state Assembly, told the News-Press the report highlights the fact that California hasn't taken the underground economy seriously in the three decades since the first report.

So little has changed because the state of California has not invested in enforcement when providing funding for the agencies/departments that have the responsibility of prosecuting the wrongdoers, Mr. Nava said.

Inadequate enforcement was cited in the 1985 report, as were problems with a multitude of taxing and enforcement agencies not working together, problems also cited in the latest report.

In the 1985 report, the commission estimated the size of the underground economy to be \$40 billion.

The fact that so many businesses are skirting California's laws may not come as a surprise, since the Golden State is notorious for onerous regulations and high tax rates.

In the non-partisan Tax Foundation's 2015 State Business Tax Climate Index, California ranked 48 in the nation with regard to high personal, corporate and sales tax rates, and in the inaugural First in Freedom Index released last month by the conservative think tank the John Locke Foundation, California ranked dead last nationally in regulatory freedom.

But according to Mr. Nava, most business owners weren't complaining of taxes and regulations: they were lamenting the fact that the other guy could get away with cheating.

"Interestingly, many of the businesses said that it wasn't the complexity (of regulations) that cause them so much frustration as their consternation that enforcement wasn't being conducted," Mr. Nava told the News-Press. "Granted, there are many rules and regulations of which a business owner must be mindful, and our report makes recommendations that would assist business owners in meeting the rules, but overwhelmingly, business owners complained that their competitors who either skirted the rules or ignored them and were not being prosecuted caused

them the most heartburn."

That heartburn, Mr. Nava said, has harmed law-abiding businesses that cannot match the prices of rule-breaking competitors, and the whole situation is perverse because the state continues to ignore a problem draining its coffers.

If the legislature wants to fund the testing of DNA kits so rapists can be caught and put in prison- as the kits sit in a locked room because there hasn't been enough money to test them - that gets a lot of support and attention, Mr. Nava said, but asking for an investigator to catch tax cheats gets no applause, even though if the tax cheats had been prosecuted earlier, the money recovered would have allowed testing of the DNA kits all along.

Some good work is being done, Mr. Nava noted, pointing to the nearly \$273,000 in special monies Santa Barbara receives to prosecute workers compensation fraud.

An example of such prosecution are the charges filed in January against United Seal Coating owner Alberto Rodriguez, who with two associates faces 42 felony counts of Worker's Compensation premium fraud, wage theft, and California Unemployment Insurance Code violations.

The investigation is a joint project of the Santa Barbara County District Attorney's Office, state

Department of Insurance Fraud, the Franchise Tax Board, the Employment Development Department and the Division of Labor Standards Enforcement.

The special funds that pay for this kind of prosecution are an example of what can be done to pierce the underground economy so that crime doesn't pay, Mr. Nava said.

All told, the Little Hoover Commissions report includes 15 recommendations for combating the underground economy - many focused on improving education and enforcement and enabling a cacophony of government agencies to work together to prosecute wrongdoers.

The commission also recommends more basic fixes like nailing down the meaning of independent contractor, a term the state government has bafflingly never defined despite using it in labor rules.

But will Sacramento take the advice?

The last report went largely unheeded.

Thirty years ago, the Little Hoover Commission reviewed the underground economy and concluded the state can and must do more to deter the growth of the underground economy and eliminate its activity in many areas, today's report notes.

But little has changed in this arena since 1985.

Whether the new report spurs Sacramento to action

remains to be seen, but until enforcement of the law is more consistent and both businesses and workers face stiffer penalties for breaking the law, the problem of the underground economy will likely grow.