



CURRENT IMPACT OF THE UNDERGROUND ECONOMY

Residential Construction Sector in Nova Scotia

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1.0 Summary of Findings and Conclusions

1.1 Findings

There are many different terms for, and ways of defining and measuring, the underground economy. For the purposes of this study the underground economy is defined as business activity that generates unreported revenues and takes place outside of, or in contravention of, the established laws, regulations and other legal and financial obligations that apply to the industry.

In essence, the underground economy creates an uneven playing field in which business enterprises that obey the law operate at a significant market disadvantage compared to companies that break the law.

This project involved three areas of research on underground economic activity:

1. A review of the research literature in Canada and other industrialized nations.
2. A survey of professional home builders and renovators in Nova Scotia.
3. Focus group research and consultations with stakeholders in Nova Scotia.

In most instances the findings presented in this summary are derived from, and supported by, evidence from all three areas of research.

The research produced evidence that underground economy activities in the residential construction industry have significant negative impacts in the following areas:

- ▲ The ability to develop and maintain a labour force geared to continually advancing production methods, materials and tools;
- ▲ The ability to attract and maintain a skilled and committed workforce in a much more competitive labour market environment;
- ▲ Workplace health and safety;
- ▲ Product safety and reliability;
- ▲ Liability issues with regard to workplace safety and consumer protection;
- ▲ Government tax revenues;
- ▲ The credibility of regulatory, inspection and/or enforcement systems in the areas of taxation, the Building Code, Workers' Compensation and Employment Insurance.

These impacts are found to occur throughout the economy generally, but to be particularly evident in the residential construction field, in Canada and in other industrialized nations. The following findings

from this project regarding underground activity in the residential construction field in Nova Scotia are consistent with research findings in other parts of Canada and in other countries.

- ▲ Approximately 25% of business activity in the residential construction sector takes place underground. Within this overall proportion, an estimated 21% of new home construction and 36% of home renovation and repair take place underground.
 - In Nova Scotia this represents approximately \$350 million in new home construction and renovation activity that is in various ways unregulated and untaxed.
- ▲ There is strong agreement among professional business operators in Nova Scotia that underground activity distorts the market through unfair price competition.
 - New home builders report that, on average, their pricing proposals to customers can be as much as 19% lower, and their total sales revenues 24% lower, because of competition from the underground sector.
 - Home renovators report that, on average, their pricing proposals to customers can be as much as 26% lower, and their total sales revenues 28% lower, because of competition from the underground sector.
- ▲ Roughly half of professional business operators in the industry in Nova Scotia feel that the underground sector has remained the same in scale over the past two years, while 28% of new home builders and 44% of renovators feel it has increased. The principal drivers for underground activity are seen to be consumer demand (lower prices, avoidance of HST), the continuing growth in self-employment, and the sustained high levels of business activity and demand for labour.
- ▲ Professional business operators in the industry in Nova Scotia indicate that the most frequent forms of underground activity in the new home construction field are:
 - i. Theft of materials and tools from building sites.
 - ii. People with full-time jobs in other industries “moonlighting” as home builders.
 - iii. Disregard to workplace health and safety rules and failure to provide Workers’ Compensation coverage.
 - iv. Failure to charge and remit HST.
- ▲ The most frequent forms of underground activity in the new home renovation and repair field are seen to be:
 - i. People with full-time jobs in other industries who “moonlight”.

- ii. Failure to charge and remit HST.
 - iii. Disregard for workplace health and safety rules and failure to provide Workers' Compensation coverage.
 - iv. People doing business "under the table" while receiving EI benefits.
- ▲ Underground activity has serious negative impacts on efforts to develop and maintain a skilled and committed labour force in the sector.
 - 46% of professional new home builders and 57% of renovators feel that competition from the underground sector holds down wage levels in the industry.
 - Approximately 75% of all professional business operators feel that underground activity gives the industry a bad image for young people making career choices.
 - Close to 50% of all employers feel that competition from the underground means that employers cannot afford to train their workers to higher standards.

On the more positive side, the international literature and the research and consultations with professional builders and renovators in Nova Scotia indicate that there are means available to reduce or control underground activity, and that industry supports such measures. The principal findings are:

- ▲ Consumer education is effective in influencing consumer behaviour:
 - Consumers make different choices when they become aware of the legal liability and product safety implications of doing business with underground operators.
 - Consumers will make informed choices to employ qualified professional builders when they are aware of the options.
- ▲ Licensing of professional builders and renovators and certification of trades people contribute to improved regulation of residential construction activity.
 - 86% of professional builders and renovators support mandatory licensing for business operators.
 - The same proportion supports compulsory certification for carpenter tradespersons.
 - Important gains have been made in controlling underground activity when licensing of contractors and trades people is integrated with building permit and inspection systems.
- ▲ There are a variety of options, some well proven in other jurisdictions, to improve the regulation of the home building and renovation industry.
 - Innovations in building inspection systems, including professionalization of inspectors,

participation by private inspection services, integration of contractor licensing with the building permit system, and expanded self-regulation for licensed professional builders.

- Innovation in tax regulation and enforcement, including public awareness initiatives, increased penalties, “pay as you go systems” and integration of information systems across agencies and levels of government.
- ▲ There is growing interest in many jurisdictions, and among industry leaders, in partnering with the financial and insurance institutions to make access to mortgages and insurance dependent on legitimate, above board business practices.

1.2 Public Policy Implications

The underground economy in the residential construction industry in Nova Scotia represents a significant public policy challenge.

The home building and renovation sector is a critically important component of the economy and makes an essential contribution to individual and community well-being in Nova Scotia. It employs some 25,000 people in the province and generates approximately \$1.4 billion in gross domestic product. Residential construction has seen steady expansion since the late 1990s and continues to be a key economic driver in a period of general economic instability at both the regional and national levels.

The survey and focus group research with professional home builders over the past three years has made clear that the underground economy is the single greatest constraint on business viability and human resource development in the sector. Legitimate builders see no way to stabilize the labour supply situation, and to address the problem of skills shortages, unless the underground economy is brought under control. Without a more stable business environment in terms of fair competition and reasonable returns on investment for builders and renovators who operate above board, the industry will not sustain the necessary investment levels in productivity and human resources.

There are critically important public interest issues on the table:

1. The integrity of the harmonized sales tax system and the adequacy of government revenue flows.
2. Worker health and safety.
3. Consumer safety and protection for their greatest investments.
4. The future viability of hundreds of small and medium sized businesses employing thousands of people in every corner of the province.

The research indicates that, while the problem is complex and there are no perfect or easy solutions, there are policy and program approaches that are supported by industry and that have been proven to be effective in other sectors or other jurisdictions. The measures will be controversial in some areas, and will challenge traditional patterns of economic and social activity at the community level. It will be necessary to respect and accommodate the interests of the self-builder, but these concerns do not gainsay the major public interest advances to be made by the reduction of underground activity in home building and renovation.

In conclusion, there would appear to be every reason for governments at all three levels to act in a concerted and expedient manner to control and reduce underground activity in the residential construction industry. Through this study and other means the industry has made clear where it stands. The challenge now is to take the issue to the public and to build a partnership with government and other stakeholders to develop and implement a comprehensive strategy.

1.3 Strategic Priorities for the AHB&RSC

The findings of this research point to three critical areas of intervention to reduce the negative impacts of underground activity in the home building and renovation sector:

- ▲ Public and consumer education;
- ▲ Licensing of professional builders and renovators and certification of trades people; and
- ▲ Improved regulation and enforcement.

The AHB&RSC is in a unique position to facilitate industry leadership and partnerships with government and the education and training systems to address these challenges. The Council should build on work already accomplished in the areas of professionalization (licensing, certification and new education and training models) and public education. It can also represent industry in multi-stakeholder initiatives to improve regulation and enforcement related to the Building Code, taxation systems, Employment Insurance and other fields. Building linkages with banks and insurance interests is also a strategic priority.

With regard to the underground economy itself, this study suggests the need for follow-up research and consultation. It is a strategic priority of the highest importance to know more about how underground activity takes place, the attitudes of participants and the possible reactions to new efforts to control underground activity.

It is possible that many trades people who do underground activity would change their behaviour if they

had greater awareness of its consequences and risks, and if there were practical ways for them to acquire the knowledge and skills to manage their businesses in more conventional ways.

It is also predictable that efforts to limit underground activity will meet with a significant backlash from certain elements in the industry and the wider community. It will be important to anticipate this reaction, to understand the interests at stake, and to plan effective means to manage the political process that will likely unfold. For example, it will be essential to respect traditional patterns of sweat equity and self-building so that these issues are not confused with the more negative aspects of underground construction activity.

In short, this study provides solid evidence that the AHB&RSC has been pursuing issues of great importance to the residential construction industry in Nova Scotia through its research projects and the ongoing professionalization initiative. The Council should continue these efforts and focus even more intently on human resource development activities to mobilize, modernize and educate the sector.

2.0 Project Overview

The primary objective of this project is to provide the Atlantic Home Building & Renovation Sector Council (AHB&RSC) with a deeper understanding of the current impacts of the underground economy on labour market operations and human resource development in the residential construction sector in Nova Scotia.

The research activities of this project are focused on two areas:

1. The influence of the underground economy on labour market operations and human resource development in the sector; and
2. The need to find ways to mitigate the negative impacts of the underground economy.

With this information, the AHB&R Sector Council and its partners in government and industry will be better positioned to address the long-term issue of recruitment and professional preparation for the residential construction sector in Nova Scotia.

The project involved three principal components: a literature review, a survey of professional home builders and renovators in Nova Scotia, and industry consultations.

The literature review focuses on the most recent Canadian and international policy and research information on the size and significance of the underground economy and its impact on labour markets and human resource development. There is a significant amount of research and policy analysis that addresses underground economy issues generally: the challenge is to find material that is specific to the residential construction sector.

As part of this project PRAXIS Research carried out a survey of professional home builders and renovators in Nova Scotia in July 2003 with the services of Vision Research, a survey company based in Charlottetown, Prince Edward Island. The sampling frame for the survey comprised of active members of builder associations and warranty programs in Nova Scotia.

In addition, PRAXIS conducted two industry consultation sessions to review the outputs from the survey research with builders and renovators and to seek their advice on the interpretation of key issues and findings.

Human Resources Development Canada-Nova Scotia Region provided funding resources to the AHB&R Sector Council for this project.

3.0 Literature Review

3.1 Perspectives on the Underground Economy in General

3.1.1 Definition of the Underground Economy

In the research literature there is a wide range of terms that are used more or less synonymously with “underground economy”:

Cash economy	Informal economy	Shadow economy
Clandestine economy	Invisible economy	Subterranean economy
Concealed economy	Irregular economy	Unofficial economy
Dual economy	Moonlight economy	Unmeasured economy
Grey market	Parallel economy	Unrecorded economy
Hidden economy	Second economy	

This report will, for the most part, use the term “underground economy” to describe economic activities that are considered to be irregular or illegal. An essential characteristic of underground activity is the failure to declare income to a revenue-gathering authority. The following grid defines underground activity in terms of four classes of activity, namely market versus non-market and legal versus illegal:

Table 1: Classifications of Underground Economic Activities¹

	Underground Activities based on Market Activities	Underground Activities based on Non-Market Activities
Underground Activities based on Legal activities	A) Failure to report income from wages, self-employment, benefits, profits, capital gains, and dividends, unreported sales, etc.	B) Barter of legal goods and services
Underground Activities based on Illegal activities	C) Sale of stolen goods, drugs, smuggled tobacco, alcohol, prostitution, fraud, etc.	D) Barter of stolen goods, production of illegal drugs for self-use, extortion for own benefit, etc.

This study will focus primarily on category A, i.e., underground market activities based on legal activities in the home building and renovation industry.

¹ Giles, David E.A. and Tedds, Lindsay M., *Taxes and the Canadian Underground Economy*, Canadian Tax Paper 106, Canadian Tax Foundation (2002) p.88.

3.1.2 Measuring the Underground Economy

Given the uncertainties associated with identifying and tracking hidden transactions, the size of the underground economy is very difficult to measure. In Canada and internationally, different measures have generated wide variations in the estimated size of the underground economy. To date, the most commonly used measures by economists include:²

- ▲ Latent-Variable Structural Model – also called Multiple Indicators, Multiple Causes (MIMIC) Model
- ▲ The Currency-Ratio Approach
- ▲ The Monetary-Transactions Approach
- ▲ Discrepancy Measures
 - Macroeconomic Measures
 - National Income Accounts Method
 - Tax-Evasion Method
 - Physical-Input Method
- ▲ Microeconomic Measures
 - Voluntary Survey Results
 - Labour Market Statistics

Over the last decade or so, there has been considerable debate concerning the underground economy and how to measure its size in Canada. A major contribution to this debate is a book entitled *Taxes and the Canadian Underground Economy* authored by David Giles and Lindsay Tedds. They state that:³

“... the MIMIC method is more attractive than any of the alternatives. For one thing, it can capture most of the significant features of the underground economy on the basis of readily available data. For another, it can take explicit account of a wide range of indicators and causes simultaneously. Finally, it involves a structural modelling approach that lends itself to desirable estimation procedures – notably the method of maximum likelihood.”

2 Giles, David E.A. and Tedds, Lindsay M., *Taxes and the Canadian Underground Economy*, Canadian Tax Paper 106, Canadian Tax Foundation (2002) Chapter 3.

3 Giles, David E.A. and Tedds, Lindsay M., *Taxes and the Canadian Underground Economy*, Canadian Tax Paper 106, Canadian Tax Foundation (2002) Page 51.

The major pitfall of the other methods is that they consider only one indicator and one cause of underground activity. Nevertheless, results from the MIMIC, as well as from the other methods, should be treated with considerable caution. The economists, Schneider and Enste, report that, “*there is no ‘best’ or commonly accepted method. Each approach has its strengths and weaknesses and can provide specific insights and results*”.⁴

3.1.3 Size of the Underground Economy in Canada

Using the MIMIC approach, Giles and Tedds estimate that the underground economy in Canada, defined as unreported legal plus illegal activities, increased from \$13 billion in 1976 to \$95 billion in 1995 in real (1986) dollars. As a percentage of gross domestic product (GDP), the underground economy is estimated to have increased from 3.5 percent of GDP in 1976 to almost 16 percent of GDP in 1995.

As discussed, there are a number of alternative approaches to measuring the underground economy. Over the last decade or so, analyses of the Canadian underground economy have yielded the following estimates:

Table 2: Empirical Measures of the Canadian Economy⁵

Study	Method	Size as a % of GDP	Year	Definition
Karoleff et al.	Currency-ratio	21.6	1990	Legal and illegal market transactions that are missing from measured GDP
Mirus et al.	Currency-ratio	27.6	1990	
Mirus	Adjusted currency-ratio	5.1	1990	
Pouftis	Adjusted currency-ratio	7.4 – 13.0	1990	
Gervais & Smith	National accounts ⁶	3.7	1992	
Drummond et al.	Judgement	4.5	1993	
Spiro	Adjusted currency-ratio	8.0 – 11.0	1993	Legal and illegal market transactions that are not reported to the revenue-gathering authority.
Schneider	MIMIC	15.0	1994	
Tedds	MIMIC	14.7	1995	
Giles and Tedds	MIMIC	15.6	1995	

⁴ Smith, Roger S., *The Underground Economy: Guidance for Policy Makers?* Canadian Tax Journal. (2002) Vol. 50. No 5. Page 1656.

⁵ Business Council of British Columbia, *How Big is the “Hidden” Economy?*, Policy Perspectives. Vol. 9, No. 3, June 2002. The table is adapted from Giles and Tedds, p 90. Only estimates for the 1990s are shown.

⁶ Study used the GDP approach.

The table reveals that there is a variation in recent estimates of the size of the Canadian underground economy. Due to the complexity of the problem and the limitations of data sources and estimation techniques, these estimates should again be treated with caution. The two things we can say for sure about the underground economy in Canada are that it exists and that accurate estimates of size are difficult to ascertain.

It should be noted that these estimates of the value of the underground economy are not adjusted for any double counting. These figures, therefore, do not mean that the “official” GDP is understated by these amounts. Measured in GDP terms, the size of the underground economy would be significantly smaller because GDP is a value-added measure. Only the final value of a product or service is included in GDP, to avoid double counting intermediate inputs.

3.1.4 The Underground Economy in Other Countries

There is extensive international research focusing on the underground economy, and while the types and the relative scale of underground activities vary from country to country there is some consistency in overall trends.

Using a variety of approaches, Schneider and Enste recently conducted a study of 67 developing, transitional, and the Organization for Economic Co-operation Development (OECD) countries. Over the period 1989 to 1993, the hidden economy averaged as follows:⁷

Table 3: Hidden Economy by Type of Country

Type of Country	% of Measured GDP
Developing Countries	39.2
Transitional Countries	23.2
OECD Countries	14.2

In separate studies, Schneider reported the following:⁸

- ▲ The average estimate for OECD countries in 1998 is 17% of GDP; and

7 Giles, David E.A. and Tedds, Lindsay M., *Taxes and the Canadian Underground Economy*, Canadian Tax Paper 106, Canadian Tax Foundation (2002) Page 65.

8 Giles, David E.A. and Tedds, Lindsay M., *Taxes and the Canadian Underground Economy*, Canadian Tax Paper 106, Canadian Tax Foundation (2002) Page 59.

- ▲ The estimate for 21 OECD countries grew from 13.2% of measured GDP in 1989-90 to 16.8% in 1997-98.

A review of these estimates, together with those determined by other economists, initially reveals little consensus about the size of the underground economy in any particular country. Allowing, however, for differences in definitions and concentrating only on the more reliable data and statistical techniques, there appear to be some consistencies. In particular, Giles and Tedds state that:⁹

“... there is a consensus that in almost every country that has been studied the underground economy has been growing relative to measured GDP or GNP over the past two or three decades. There is also a general agreement about the size of the underground economy in most developed western countries. If one adopts a relatively broad definition of the underground economy ...then in the late 1990s underground activity in western countries equalled between 9 and 25 percent of measured GDP; for most countries, the figure was between 14 and 20 percent.”

3.1.5 Causes and Effects

The research indicates that in Canada and internationally the major factors contributing to growth of the underground economy include:¹⁰

- | | |
|---------------------------------|---|
| ▲ Tax rates and tax complexity; | ▲ Frequency of employment in more than one job; |
| ▲ The burden of regulations; | ▲ Immigration levels; |
| ▲ Unemployment levels; | ▲ Confidence in government; |
| ▲ Levels of disposable income; | ▲ Level of economic and political development; |
| ▲ The inflation rate; | ▲ Technological and financial sophistication; and |
| ▲ The age-gender profile; | ▲ People’s attitudes about the morality of cheating on their taxes. |
| ▲ Incidence of self-employment; | |

9 Giles, David E.A. and Tedds, Lindsay M., *Taxes and the Canadian Underground Economy*, Canadian Tax Paper 106, Canadian Tax Foundation (2002) Page 66.

10 Smith, Roger S., *The Underground Economy: Guidance for Policy Makers?* Canadian Tax Journal (2002) Vol. 50, No 5 Page 1655.

Estimates of the relative influence of these factors vary depending on the accuracy of the data and the measurement techniques employed. For instance, economists in different countries have drawn the following conclusions about the implications of the growing trend to self-employment:

- ▲ In the United Kingdom, individuals with a significant amount of self-employment income did not report 35% of total income.¹¹
- ▲ In Sweden, an estimated 26% of self-employed income was unreported.¹²
- ▲ Based on the 1990 Survey of Family Expenditures, an estimated 11 to 16% of income from self-employment was not reported in Canada.¹³
- ▲ Between 12 and 24 % of self-employment income was unreported in 1990 in Canada.¹⁴

Given such variations in research findings, few conclusions can be made other than that the rapid growth in self-employment appears to have increased opportunities for under-reporting income.

The influence of the underground economy is widespread and generates both economic and social costs. Giles and Tedds suggest that the existence of the underground economy:¹⁵

- ▲ Distorts economic information (employment, personal income and GDP output data) for the country;
- ▲ Redistributes income from those who comply to those who do not;
- ▲ Reduces the efficiency of the economy;
- ▲ Discourages economic growth by reducing government expenditures due to a smaller tax base; and
- ▲ Increases costs of enforcement of the tax system.

11 Pissarides, Christopher A. and Weber, Guglielmo, *An Expenditure-Based Estimate of Britain's Black Economy* (1989) Vol 39, No.1 Journal of Public Economics 17-32.

12 Apel, Mikael, *An Expenditure-Based Estimate of Tax Evasion in Sweden*, Working Paper 1994:1 (Uppsala: Uppsala University, Department of Economics, 1994).

13 Mirus, Rolf and Smith, Roger S., *Self-Employment, Tax Evasion, and the Underground Economy: Micro-Based Estimates for Canada*, Working Paper no.1002 (Cambridge, MA: Harvard Law School, International Tax Program, October 1997).

14 Schuetze, Herb J., *Profiles of Tax Non-Compliance Among the Self-Employed in Canada: 1969 to 1992* (2002) Vol. 28, No 2 Canadian Public Policy 220-23.

15 Giles, David E.A. and Tedds, Lindsay M., *Taxes and the Canadian Underground Economy*, Canadian Tax Paper 106, Canadian Tax Foundation (2002) Pages 31 to 35.

3.2 Residential Construction in the United Kingdom

3.2.1 Economic Contribution

In the United Kingdom, overall construction activity contributed £83.6 billion to the country's economy in 2002. The industry is segmented into two major sectors: (1) new work and (2) repair and maintenance. The level of activity in each of these sectors was as follows in 2002:

Table 4: United Kingdom, Construction Output¹⁶ in Current Prices (£ current dollars), 2002

Construction Segment	£	% of Total
New Work		
New Housing		14%
Public ¹⁷	1,713	
Private ¹⁸	10,357	
Other New Work Non-Housing		40%
Infrastructure	8,085	
Public	6,870	
Private Industrial	3,374	
Private Commercial	14,968	
<i>Sub-Total New Work</i>	<i>45,370</i>	<i>54%</i>
Repair & Maintenance		
Housing		23%
Public	6,412	
Private	12,758	
Other Work		23%
Public	6,712	
Private	12,340	
<i>Sub-Total Repair and Maintenance</i>	<i>38,222</i>	<i>46%</i>
Total Construction	83,592	100%

¹⁶ Department of Trade and Industry (DTI), *Construction Statistics Annual 2003 Edition*, September 2003. Table 2.1 Output. Page 33. Output estimates include estimates of unrecorded output by small firms and self-employed workers.

¹⁷ Local authority housing schemes, hostels (except youth hostels), married quarters for the services and police; old peoples' homes; and the provision within housing sites of roads and services for gases, water, electricity, sewage and drainage.

¹⁸ All privately owned buildings for residential use, such as houses, flats, maisonettes, bungalows, cottages, vicarages, and provision of services to new developments.

As presented in the table, the construction of private new housing was worth an estimated £10.4 billion in current prices. The value of repair, maintenance, and improvement (RMI) of the private housing stock was £12.8 billion in current prices. Overall, the private sector housing construction and RMI sectors accounted for an estimated 2.2% of GDP in 2002.

A total of roughly 1.6 million people¹⁹ are involved in the overall construction sector. One-third are self employed and the remaining two-thirds are employees.

3.2.2 The Impact of the Underground Economy

In the construction sector, builders operating in the underground economy are commonly known as “rogue traders” or “cowboy builders”. Consumers are complaining of cowboy builders in the RMI sector. According to Britain's Trading Standards, there were 106,000 complaints in 2002.²⁰ These complaints are expected to rise at 5% a year.

The Department of Trade and Industry (DTI) estimates the size of the underground economy in 2002 to be:²¹

- ▲ £7 billion in the RMI sector (residential and non-residential); and
- ▲ 282,000 construction workers, of which practically all are working in the RMI sector.

To estimate the underground employment figure, the DTI use the discrepancy between the number of people that claim they are employed in the construction industry according to the Labour Force Survey and the number of people construction firms are reported to employ.

In 2000, the Construction Confederation together with the Department of Trade and Industry estimated the value of the construction underground economy to be roughly £4.5 billion.²² The figure is not further disaggregated for the new housing and repair, maintenance, and improvement sectors. Information is not readily available as to how this estimate was derived.

19 Department of Trade and Industry (DTI), *Construction Statistics Annual 2003 Edition*, September 2003. Table 12.1 Manpower – Seasonally Adjusted. Page 145.

20 BBC News, Thursday, January 16th, 2003.

21 Capital Economics Ltd., *VAT and the Construction Industry*, August 22, 2003.

22 <http://www.constructionconfederation.co.uk>

The most common underground activities include:²³

- ▲ workers treated as self-employed rather than employed;
- ▲ fragmentation of businesses to avoid the value added tax (VAT)²⁴ thresholds;
- ▲ staff form their own management companies and provide services to contractors through their company, thereby avoiding paying National Insurance Contributions;
- ▲ smaller companies become insolvent;
- ▲ VAT and Corporation Tax²⁵ are avoided by operating two books of account; and
- ▲ avoidance of VAT in the domestic sector.

Almost a decade ago, the government launched a "Beat the Cowboys" initiative. There was little impact on reducing the incidence of underground activity.²⁶ On April 6, 2002, the Department of Trade and Industry published a consultation paper on Combating Cowboy Builders. The paper proposed two initiatives:

- ▲ development of a list of approved builders; and
- ▲ a quality mark indicating that a trader subscribed to agreed standards of quality backed by a mandatory warranty and an effective dispute process.

The initiatives are intended to seek to improve service to consumers and raise standards. At present, there are no regulations governing entry into the sector and therefore consumers cannot distinguish between a good and a bad builder. As an incentive for builders to join the Quality Mark Scheme, the working group also recommended that the value added tax on domestic RMI be reduced to 5% (from 17.5%) and the threshold reduced to £20,000.

In response to these proposed initiatives, the government is currently pursuing the Quality Mark Scheme. Originally piloted in Birmingham and Somerset, the Quality Mark Scheme has been fully launched. The scheme is a national register of reputable firms and will enable consumers to identify those builders

²³ KPMG Consulting, Revay and Associates, Marc Denhez and Bridges/A.G.T. Consulting, *Strategic Analysis of Underground Employment in the Construction Industry*. December 1997.

²⁴ VAT (17.5%) is levied by companies/individuals in the RMI sector with more than £50,000 in sales per annum. The tax is not imposed on new house building.

²⁵ Main corporation tax rate is 30% and the rate for many small companies is 20%.

²⁶ Department of Trade and Industry (DTI), *Combating Cowboy Builders: A Consultation Paper*, Published April 22, 1998/Updated December 4, 2002.

who have committed to operating within a minimum set of standards and a code of fair trading.

Quality Mark builders and trades people are assessed for workmanship, proper insurance coverage, management practices, financial probity by independent certification bodies, licensed by the DTI, including a simple site-based audit. Firms also follow a code of practice governing relations with clients. There is a complaints system to address concerns regarding workmanship or the conduct of the firm. The complaints system is linked to a scheme warranty. The Quality Mark tradesperson offers the warranty to every consumer, as part of the quotation and before starting the job. This provides financial protection against insolvency, poor workmanship, or major defects, for up to six years.

3.3 Residential Construction in Australia

3.3.1 Economic Contribution

The housing construction renovation, and improvements sector²⁷ contributed A\$45 billion or 3.6% of Australia's GDP, to the country's economy in 2002/03. An estimated 63,000 housing firms provided employment for 391,000 Australians.

In 2002/03, roughly 160,000 new homes were constructed with a value of A\$26 billion. Over the last ten years, the trend in residential building activity has fluctuated. Activity declined in the mid 1990s and then steadily grew to record levels in 1999/2000. The introduction of the '*New Tax System*' in July 2000, however, resulted in a significant downturn in 2000/01.

3.3.2 Impacts of New Taxation System

In 2000, the Australian government introduced major tax reforms with the hope of more robust government finances and substantial efficiency gains throughout the economy. The main components of the new tax system were the elimination of a range of inefficient indirect taxes and the introduction of a goods and services tax (GST), significant personal income tax cuts, reforms to social security benefits and reforms to Commonwealth-State financial relations.²⁸

Specifically, the new tax system centred on the interaction of the following:²⁹

27 Housing Industry Association Ltd. Restoring Housing Affordability – The Housing Industry's Perspective. July 2003.

28 Commonwealth Budget, 2000/01 website - http://www.budget.gov.au/2000-01/papers/bp1/html/bs3-01.htm#P33_3068

29 Cash Economy Task Force, The Cash Economy under the New Tax System. September 2003. Executive Summary. Page viii.

- ▲ the Australian business number (ABN) – a unique identifier for businesses;
- ▲ Australian Business Register (ABR) – a public register for checking GST registration and ABN validity;
- ▲ a broad-based goods and service tax (GST) for businesses with more than A\$50,000 in annual sales;
- ▲ withholding 48.5% from business-to-business payments where no ABN is quoted;
- ▲ pay as you go (PAYG) – collection system for income tax;
- ▲ an activity statement reporting regime; and
- ▲ a broad field presence by tax officers.

Created in 1996, the Cash Economy Task Force has been involved in examining the development and implementation of the Tax Office’s cash economy³⁰ strategies, their effect on the cash economy and the extent of risk the cash economy poses in Australia. In its third and most recent report (September 2003), the Task Force concluded that the new tax system measures are having a significant impact on the cash economy – “*the design features of the reformed tax system are working together to produce a more robust tax system that is harder to evade*”.³¹ The Task Force also put forth the following recommendations:³²

- ▲ focus compliance activities on transactions between consumers and businesses (rather than just business to business);
- ▲ encourage the community to play a greater role in ensuring the integrity of their tax system;
- ▲ implement new strategies to encourage self-regulation within industries;
- ▲ work with other agencies to help educate new businesses about their taxation obligations;
- ▲ simplify tax payment process;
- ▲ expand the use of the Australian Business Register;
- ▲ trial new data matching initiatives, such as building approval information with registration lists; and
- ▲ relax reporting requirements for businesses with good tax records and tighten reporting obligations

³⁰ The task force focuses on cash economy as defined as economic activity that is not accounted for as required by law.

³¹ Cash Economy Task Force, *The Cash Economy under the New Tax System*. September 2003. Executive Summary. Page viii.

³² Cash Economy Task Force, *The Cash Economy under the New Tax System*. September 2003. Executive Summary. Page vii.

for those businesses with bad tax records.

To deal specifically with the issue of business-to-consumer transactions, the Task Force recommended a number of initiatives, including:

- ▲ a ‘get it in writing’ campaign designed to inform consumers on their rights and obligations and initially targeting householder building projects;
- ▲ conduct research and analysis on the risks of business-to-consumer dealings – such as moonlighting;
- ▲ Tax Office reviews with consumers the accuracy of information provided by businesses;
- ▲ encourage community to play a greater role in identifying and reporting underground operators;
- ▲ improve provision of data by third parties such as local councils reporting building approvals; and
- ▲ negotiate with businesses such as insurance companies to require work to be completed by an ABN-registered business.

In their recent report, the Task Force highlights the importance of research conducted by the Centre for Tax System Integrity (CTSI). The CTSI focuses on researching community attitudes towards the cash economy. *“Its research reveals an unreconciled gap between people’s personal beliefs of the right thing to do and what they think others believe. For example, while 72% believe that they are personally honest, paradoxically, about the same number also believe that others are not.”*³³

The centre’s research has also revealed the following:

- ▲ the most visible cash economy activity involves home maintenance, home-based services, teaching and entertainment;
- ▲ one-fifth of the survey population³⁴ are involved in either purchasing or providing cash economy work, though the amounts were small;
- ▲ individuals/businesses move in and out of the cash economy activity from year to year;
- ▲ purchasers of cash economy labour are likely to be high income earners, well-educated, married and have high status occupations; and

³³ Cash Economy Task Force, *The Cash Economy under the New Tax System*. September 2003. Executive Summary. Page 2.

³⁴ In May 2000, the “Community, Hopes, Fears and Actions Survey” was sent to 7,004 Australian households. The response rate was 29% or 2,040 households.

- ▲ suppliers of cash economy labour are young business owners who distance themselves from the tax system.

The research of the CTSI underscores the importance of social norms in relation to the cash economy. The task force emphasizes that understanding community norms can assist with developing and tracking the effectiveness of programs. To that end, the task force also recommends a series of community consultations geared to further analyze the role of norms.

3.3.3 The Cash Economy in the Housing Sector

According to research conducted for the Australian Tax Research Foundation, the estimated size of the cash economy varies between 3% and 15% of GDP.³⁵ There does not appear to be data available on the estimated size of underground activity in the residential construction, renovation, and improvement sector in Australia.

Within this sector, cash economy activities centre on cash payments to reduce the tax burden and arrangements to reduce the cost of labour. The specific activities include:

- ▲ payment of undisclosed cash wages – by using fabricated invoices to disguise cash wages as payments for materials or equipment;
- ▲ unreported cash payments to contractors and sub-contractors;
- ▲ fraudulent claims for GST credits;
- ▲ ‘bodgies’ – undeclared cash payments to bogus labour hire companies;
- ▲ phoenix arrangements – evade tax liabilities through deliberate and systematic liquidation of companies;
- ▲ poor record keeping leading to understated supplies and overstated acquisitions; and
- ▲ failure to lodge or submission of incorrect business activity statements.

As part of its efforts, the Tax Office recently (2002) revived its field efforts within the building and construction sector. To improve compliance within this targeted sector, the Tax Office is building relationships with stakeholders and expanding its understanding of underground economy practices.

³⁵ Carter, M., *The Size of the Underground Economy: Problems and Evidence* Australian Tax Research Foundation, Sydney. 1987.

The elements of the initiative include:³⁶

- ▲ risk scoping - visiting 800 sites to identify risks of non-compliance;
- ▲ outliers- visiting 2,000 building and construction businesses whose activities are outside industry norms;
- ▲ display homes – visiting 400 sites to address compliance issues related to incorrect GST input tax credits for the purchase or construction of a dwelling and its lease to an investor for use as a display home;
- ▲ top down approach – for selected major infrastructure projects and small and medium businesses in each state, monitor compliance levels at each stage of construction; and
- ▲ special focus on tax evasion arrangements such as phoenix and ‘bodgies’ activities – collected over A\$90 million in tax and penalties over the past four years.

3.4 Residential Construction in Canada

3.4.1 The Extent and Influence of the Underground Economy

The policy and research literature on the underground economy within the Canadian residential construction sector is limited in scope. The following six reports represent the most substantive and current research available in the Canadian context:

- ▲ A report entitled “Strategic Analysis of Underground Employment in the Construction Industry” by KPMG, 1997
- ▲ A 1998 study for the Ontario Construction Secretariat on underground activity in the Ontario residential and non-residential construction sector, by Prism Economics and Analysis. Prism updated its 1998 estimates in a follow-up study in August 2001.
- ▲ A 1994 Statistics Canada published report entitled “The Size of the Underground Economy in Canada”.
- ▲ A report entitled “The Underground Economy in Residential Construction” by the Nova Scotia Department of Finance, 1997.
- ▲ Two 1996 reports by Luigi Zanasi: “The Underground Economy in Construction in Saskatchewan”

³⁶ Cash Economy Task Force, *The Cash Economy under the New Tax System*. September 2003. Page 42.

and “The Underground Economy in Construction in the Yukon”.³⁷

The following section will briefly summarize the key findings from each of these documents. The focus will be on the size, significance, and labour market impacts of the underground economy.

Strategic Analysis of Underground Employment in the Construction Industry. KPMG Consulting, Revay and Associates, Marc Denhez and Bridges/A.G.T. Consulting. December 1997

The principal purpose of this study was to identify specific ways to combat underground employment. Among the specific objectives of the study were:

- ▲ To provide a comprehensive overview of the types of underground activity by sector, the mechanisms by which these activities take place, and elements in the current system that may contribute to the problem;
- ▲ To describe the types of firms and individuals most likely to be engaged in underground activities;
- ▲ To identify factors contributing to the supply and demand for underground work arrangements;
- ▲ To assess implications of underground employment on the work force and the industry, in terms of employment levels, skills, recruitment difficulties, quality of work, worker mobility, labour supply, wages, and industry image;
- ▲ To provide an overview of strategies that have already been adopted in Canada and in other countries to combat the problem; and
- ▲ To make specific recommendations on ways to reduce unreported construction employment.³⁸

The study defined underground employment as any transaction that conceals and/or misrepresents employment in the construction sector. The methodology included an in-depth literature review and consultations with nearly 200 stakeholders.

Characteristics of Underground Employment Activity

Within the residential sector, the areas found to be most vulnerable to underground activities were:

³⁷ Note that the study team was unable to locate a copy of this report. Nevertheless, it is known that the study employs similar methodologies to those used in the Saskatchewan study.

³⁸ Page 14.

- ▲ Low-skilled occupations;
- ▲ One-person operations;
- ▲ Smaller-size projects;
- ▲ Short-term projects; and
- ▲ Workers paid by the job or piecework.

A number of specific construction activities were found to be conducive to underground practices. These included drywall and taping, concrete work, driveway paving, painting, roofing, excavating, acoustic tiling, flooring, landscaping and pool maintenance, wallpapering, independent truckers and equipment owner-operators, and snow clearing.

The research generated divergent views on whether the incidence of underground activity differs between non-certified and certified trades.

Motivating Factors of Underground Operators

The major motivating factor contributing to underground practices was found to be the pursuit of economic rewards or competitive advantages. This factor included the desire to reduce costs and save money, the wish to generate discretionary funds, the fear of retroactivity, and the drive to succeed in a highly competitive environment.

Consumer Demand

Among the builders who participated in the study there was consensus that consumer demands are the primary cause of underground activity. Again, the main motivation was seen to be the desire to save money or to get “more for less”.

The issue of consumer expectations is seen to be critical to any effort to combat underground activity. The study concluded that changing consumer attitudes and behaviour should be a goal of any strategy to mitigate the effects of underground activity.

Impacts on the Labour Market and Social Programs

Though the study was conducted during a recession period and skilled labour was in good supply, there were still concerns voiced about the aging workforce and looming shortages. The study identified the following impacts of underground activity on labour markets and social programs:

- ▲ The growth in the number of independent contractors means fewer opportunities for on-the-job training by journeypersons;
- ▲ Trades people working in the underground sector rarely take part in formal apprenticeship training;
- ▲ Wages are lower for underground work but net earnings are higher;
- ▲ Sub-contractors working for lump-sum amounts are earning less than minimum wage;
- ▲ Underground activity precipitates a poor public image; and
- ▲ Underground activity places increasing pressure on the funding of Canada's social programs.

Key informants were asked to reflect on the labour market impact of an eight-point “worst-case” growing underground economy scenario. Though views were not homogenous, the perceived impacts of the worst-case underground scenario included:

- ▲ Declining number of apprenticeship entrants;
- ▲ Reduced participation in training programs, particularly for youth;
- ▲ Underground operators not keeping up with latest technological developments; and
- ▲ Increased use of inferior materials.

The largest concern was the cumulative effect of these impacts. Among those who anticipated that the worst-case scenario would become reality, the following indicators were identified:³⁹

- ▲ Quality is already suffering because of undue emphasis on cost consciousness.
- ▲ Everyone wants something for nothing. The underground economy participant just won't invest in training.

For those who believed that the worst-case scenario was exaggerated, the following reasons were given:

- ▲ The continually expanding use of technology will ensure the demand for state-of-the-art materials and people to install them.
- ▲ The consumer savings on underground labour may translate to more money spent on state-of-the-art materials. As a result, the underground economy may not dampen technological demand.

³⁹ Page 110.

- ▲ As long as there is demand for quality and technologically advanced houses, the industry will need to continue to deliver this service.

Despite the differences in opinions, the study found that many contractors believe that the underground economy will likely create a stratification of housing quality. In particular, the most likely scenario is described as follows:⁴⁰

- ▲ There will be ongoing demand for quality by those who can afford the best.
- ▲ The definition of “quality” will be geared to what consumers and their neighbours can see.
- ▲ What they cannot see (i.e., all the features of quality home construction that are not superficially visible) are “out of sight, out of mind.”
- ▲ As far as the rest of the market is concerned (i.e., more affordable homes), quality will be in free-fall.

These perceptions suggest that as the demand for quality deteriorates in certain segments of the housing marketplace, the demand for training and apprenticeship are likely to decline accordingly.

Actions Taken in Canada

The study noted that the federal government has increased its efforts to deal with the underground economy. The actions have included:

- ▲ Recruitment of larger investigative and audit staffs;
- ▲ Imposition of new or increased penalties;
- ▲ Public awareness initiatives; and
- ▲ Movement towards information exchanges between government bodies facing revenue losses and/or incurring additional expenses due to non-reported employment.

The provincial government of Québec is the only jurisdiction with a mandatory licensing system for all contractors and a mandatory certification system for all journeypersons. In other jurisdictions, licensing of contractors is limited to plumbers and electricians.

The study identifies opportunities for the municipal level of government to play a more significant role

⁴⁰ Page 112.

in combating underground activity through the building permit and inspection systems. However municipal officials who participated in the study indicated that they do not have sufficient staff resources to combat the problem.

The introduction of more stringent regulatory systems is generally supported by labour union representatives but not by independent contractors. Most contractors felt that the existing regulatory burden was already contributing to the expansion of underground activity. The key conclusion drawn by the study was that regulations are of little value if not fully enforced.

“In summary, it is too early to assess the effectiveness of the steps taken in Canada to reduce underground construction employment. No doubt various actions have served to ameliorate the problem, especially the increased enforcement of regulations. However, in light of the general consensus among interviewees that the volume of underground activity is increasing, it must be concluded that further efforts are necessary in order to achieve a net decrease.”⁴¹

Measures to Control Underground Activity in Other Countries

The KPMG study identifies steps taken by governments in other countries to address the problem. These include:

- ▲ Development of an integrated approach with participation by government and stakeholder groups;
- ▲ Greater sharing of data among government agencies;
- ▲ Implementation of source deduction schemes whereby assessments are deducted from payments to sub-contractors;
- ▲ Tracking of large or suspicious cash transactions; and
- ▲ More intensive enforcement of existing legislation.

In Australia, for example, the main instrument to reduce underground employment in construction has been the Prescribed Payments System (PPS). Introduced in 1983, the system was designed to prevent avoidance of taxes and superannuation. The PPS involves an at-source withholding rate of 20% of gross at the time of payment. The system applies to anyone who works and earns money under contract, whether the contract is written, verbal or implied.

⁴¹ Page 138.

Over the last twenty years France has undertaken a series of studies on underground employment. A wide range of measures has been pursued as a result,...

"...including publicity campaigns, prison sentences for undergrounders, penalties for employers who misrepresent their employees as independent contractors, banning people from certain occupations or certain marketplaces, etc".⁴²

Recommended Strategies

Based on interviews with industry and government stakeholders, the following general proposals were put forth by the KPMG study on ways to reduce or eliminate underground construction activity in the residential construction sector in Canada:

1. Promote the ongoing development and utilization of construction skill standards.
2. Introduce a formal recognition system of licensed operators.
3. Focus on criteria designed to differentiate between employees and independent contractors.
4. Encourage employment-related information exchanges between government departments.
5. Expand responsibilities and roles of municipal building permit and licensing system.
6. Introduce a point of purchase reporting system for building supply companies.
7. Increase public awareness with a focus on risk.

The study concludes that there is a high level of concern in the industry and a willingness to support concrete steps to combat the underground economy.

The Underground Economy in Ontario's Construction Industry: Estimates of its Size and the Revenue Losses to Government and the WSIB. Ontario Construction Secretariat, November 1998; and Updated Estimates, August 2001

The objective of this study by Prism Economics and Analysis was to generate credible estimates with regard to two critical aspects of the underground economy in Ontario's construction industry: the size of the underground economy, and the resulting losses in tax revenue and Workplace Safety and Insurance Board contributions.

The study generated the following assessment of the size of the underground economy in the Ontario residential construction sector:

⁴² Page 150.

- ▲ Average annual underground income grew 22.4% from \$1.544 billion in the 1995 to 1997 period to \$1.89 billion in the 1998 to 2000 period.
- ▲ Average annual underground employment grew 8.3% from 58,600 in the 1995 to 1997 period to 63,500 in the 1998 to 2000 period.⁴³

The residential construction sector includes new home construction, renovations, and repair. The Prism study generated the following estimates of underground incomes for each of these sectors:

Table 5: Estimates of the Underground Income in the Residential Construction Sector in Ontario (Current \$ millions)

	Average Income 1998-2000	Underground Income	Rate
New Residential			
New Housing	\$4,062	\$518	13%
Renovations	\$2,010	\$957	48%
Total New Residential	\$6,072	\$1,475	24%
Repair – Residential	\$730	\$416	57%
Total Residential Construction	\$6,801	\$1,890	28%

The estimated underground employment by segment is:

Table 6: Estimates of the Underground Employment in the Residential Construction Sector in Ontario

	Average Employment 1998-2000	Underground Employment	Rate
New Residential			
New Housing	106,900	16,000	15%
Renovations	59,100	33,100	56%
Total New Residential	166,000	49,100	30%
Repair – Residential	21,500	14,400	67%
Total Residential Construction	187,500	63,500	34%

⁴³ O'Grady, John, Prism Economics and Analysis, Estimates of Revenue Losses to Governments As a Result of Underground Practices in the Ontario Construction Industry, 1995-1997 Compared to 1998 – 2000 Updated Estimates – August 2001, Ontario Construction Secretariat.

The Prism report identified three major factors that it saw as contributing to the growth of underground activities in the 1990s:

- ▲ Introduction of the GST on January 1st 1991;
- ▲ Declines in new construction spending in both the ICI and residential sectors; and
- ▲ The sharp increase in the incidence of self-employment.

The latter point is seen by Prism as the most significant. The self-employed share of total Ontario construction employment increased from 27% in 1987 to 40% in 1997.

The report identified the following as the most significant impacts of a growing underground economy:⁴⁴

- ▲ Revenue loss to government;
- ▲ Increased tax and contribution burdens for legitimate businesses;
- ▲ Unfair competition for legitimate workers and contractors;
- ▲ Erosion of health and safety and construction standards;
- ▲ Deterioration of labour standards and programs;
- ▲ Reduction of contribution base for benefits plans; and
- ▲ Weakening apprenticeship training and skills development.

Prism's 2001 update report reinforced the conclusion that underground practices and underground income remain a serious problem in Ontario's residential construction industry.

The Size of the Underground Economy in Canada. Statistics Canada, June 1994.

In light of growing attention and interest in the size and growth of the underground economy, Statistics Canada attempted to ascertain whether certain transactions are captured in GDP and, if they are missing, to estimate their size. The study focused on . . .

“the value-added (returns to labour and capital) which is left out of GDP due to underground production, defined as legal economic production hidden from the

⁴⁴ Pages 72 and 73.

authorities in order to avoid taxes and regulations.”⁴⁵

In other words, the focus is primarily on legal market-based economic production.

The Statistics Canada report measures the value of underground production potentially missing from the 1992 GDP. The intent is to provide a broad upper limit estimate for the possible size of the underground economy. These estimates are as follows:

Table 7: Upper Limit of Underground Transactions Potentially Missing from Expenditure-based GDP, 1992

	Underground Transactions (\$Millions)	Expenditure-based Estimates (\$Millions)	% of Official GDP
New Residential Construction	1,883	20,934	9.0%
Single dwellings	1,112		
Semi-detached dwellings and row housing	127		
Apartments	159		
Mobile homes	12		
Cottages	156		
Conversions	206		
Supplementary costs	111		
Alterations and Improvements	1,695	12,153	13.9%
Gross Domestic Product	18,490	688,541	2.7%

Statistics Canada cautions that these estimates of underground transactions should not be seen to represent the total value of underground economic transactions or a comprehensive measure of tax evasion.⁴⁶ They are simply estimates of the maximum value of the portion of underground production potentially missing from the official GDP.

To derive these estimates, the Statistics Canada approach focused on discrepancy measures - national accounts data, judgments, and surveys. The rationale for using the income and expenditure data is that it is available for hundreds of categories and is expressed in volume as well as value.

In the residential construction sector the estimation of the value of new housing construction is based on the number of housing starts, the average value of building permits and allowances for construction

⁴⁵ Page 2.

⁴⁶ Page 35.

lags. The housing start data is provided by the Canada Mortgage and Housing Corporation (CMHC) and is considered reliable. A negligible number of starts are likely missing, but not due to the underground economy. In contrast, the average value of building permits is likely to be understated. According to Statistics Canada . . .

*“builders have a twofold interest in understating the cost of construction: to facilitate hiding of income . . . and (in some cases) to save on the cost of the permit itself, usually proportional to the cost of construction excluding overhead costs and profit”.*⁴⁷

Statistics Canada assumes that the building permit values are underestimated and therefore the values are adjusted to reflect the builder’s margin and any omitted material costs such as landscaping and the likelihood that the cost of construction is underestimated. In the end, Statistics Canada makes the following adjustments for each segment of residential construction:

Table 8: Investment and Estimated Underground Transactions in Several Residential Construction Segments, 1992

	1992 Investment (\$Millions)	Upward Adjustment	Underground Transactions (\$Millions)
Single dwellings	11,115	10%	1,112
Semi-detached dwelling and row housing	2,532	5%	127
Apartments	3,173	5%	159
Mobile homes	116	10%	12
Cottages	622	25%	156
Conversions	103	200%	206
Supplementary costs	1,707	7%	111
Total	19,368	10%	1,883

The estimated spending on ‘alterations and improvements’ is based on two sources: the annual Homeowner Repair and Renovation Expenditure Survey (HRRES)⁴⁸ of 25,000 homeowners and building permit statistics. The likely areas of misreporting include:

- ▲ Hiding any spending made ‘under the table’;

47 Page 13.

48 Statistics Canada. Homeowner Repair and Renovation Expenditure in Canada, Catalogue No. 62-201 1992.

- ▲ Understating spending, even formal transactions, to avoid higher property taxes; and
- ▲ Understating the value of contract work if done ‘under the table’.

Statistics Canada employs several proxies to test the hypothesis that estimated spending is understated. Based on this analysis, Statistics Canada estimates that underground transactions related to home renovations could total \$1.7 billion.

Table 9: Homeowner Expenditures on Alterations and Improvements, 1992

	1992 Expenditure (Millions of \$)⁴⁹	Upward Adjustment	Underground Transactions (Millions of \$)
Owner-occupied housing	9,453	15%	1,438
Cottages	1,153	9%	104
Rented housing	922	16%	153
Total	11,528	15%	1,695

These estimates relate to the unmeasured underground economy. Statistics Canada also attempts to quantify the measured underground production. Based on a comparison of taxation data versus national accounts estimates, it concludes that measured underground production represents, at the most, 1.5% of the official GDP. Again, the reader is cautioned that the 1.5% is an estimate of maximum size of the measured underground economy, not of its actual size.

Statistics Canada concludes that though solid data do not exist on the underground economy . . .

“there are plenty of statistics which do enable the Canadian system of national accounts to determine with some measure of confidence a maximum size of 4.2% for the underground economy as a percentage of GDP, of which about 1.5% would be already measured and the other 2.7%, unmeasured.”⁵⁰

⁴⁹ Note these numbers are estimated given the fact that homeowners account for over 80% of spending, landlords, for over 10%, and cottage owners and tenants for the remainder.

⁵⁰ Page 56.

The Underground Economy in Residential Construction, Nova Scotia Department of Finance, October 1997.

The Department of Finance report was primarily intended for internal reference for government officials in Nova Scotia. Pursuant to the Access to Information Act, a draft version of the report is available to the public. For reasons of confidentiality, certain parts of the report are withheld. The following summarizes the key findings based on the incomplete draft version of the report that is available.

The study briefly reviews approaches to measuring the size of the underground economy, estimates the size of underground activity in the Nova Scotia residential construction sector, and addresses the policy issues facing the provincial government.

The following approaches are discussed:

1. The Discrepancy Method to Estimate Missing Expenditure Data in the Residential Construction Sector
 - a. Compare domestic sales of labour and materials to total output in residential construction;
 - b. Compare value of building permits to output; and
 - c. Compare reported expenditures on repair and renovation (per Annual Homeowners Repair and Renovation Survey, Statistics Canada, Catalogue 62-201 – XPB) to output.
2. The Relationship between Changes in Tax Rates and Currency Holdings

The Nova Scotia Department of Finance roughly estimated that underground activity in residential construction was in the \$100 million to \$120 million range between 1987 and 1995. This estimate was based solely on Statistics Canada's 1994 conclusion that the upper limit of underground transactions potentially missing from expenditure-based GDP in Canada amounted to 9% for new residential construction and 13.9% for repairs and renovations. This approach assumes that the proportion of underground activity for the province is the same as for Canada. In particular, the Department of Finance estimated the size of the underground economy for Nova Scotia as follows:

Table 10: Underground Activity in Residential Construction in Nova Scotia, 1987 – 1995
(\$ millions)

Year	NHC	Under-estimation	HRR	Under-estimation	Total Under-estimation	% of GDP
1987	646.9	58.2	359.1	49.9	108.1	0.76%
1988	606.3	54.6	372.7	51.8	106.4	0.75%
1989	572.8	51.6	353.2	49.1	100.6	0.71%
1990	629.0	56.6	426.0	59.2	115.8	0.81%
1991	571.9	51.5	361.1	50.2	101.7	0.71%
1992	601.9	54.2	380.1	52.8	107.0	0.75%
1993	597.7	53.8	440.3	61.2	115.0	0.81%
1994	690.7	62.2	411.3	57.2	119.3	0.66%
1995	679.0	61.1	401.0	55.7	116.8	0.62%

The section dealing with the policy issues facing the government is excluded from the public version of the report.

The Underground Economy in Construction in Saskatchewan for United Brotherhood of Carpenters and Joiners. Luigi Zanasi June 4, 1996

The study focuses on the value of underground employment income in the construction⁵¹ sector. The report does not isolate the underground employment within the residential construction sector but does compare construction data with and without repair construction figures. Due to a lack of data, the study does not attempt to estimate the value of underground income associated with evading goods and services tax and provincial sales tax.

To derive underground employment estimates Zanasi compared employment income, as declared to Revenue Canada, with total value of construction, and determined whether the ratio of income to value of construction matched industry standards. The data sources included:

- ▲ Statistics Canada, Labour Income Section – total employment (wages and salaries) income for construction;

⁵¹ Includes government, private residential, and non-private residential construction.

- ▲ Revenue Canada, Statistical Services Division, Legislative and Inter-governmental Affairs Branch – self-employment income in construction;
- ▲ Statistics Canada, Provincial Economic Accounts, Annual Estimates – value of construction, GDP based; and
- ▲ Statistics Canada, Construction in Canada – value of construction purchased and percentage of labour in construction contracts.

Based on this approach and the data sources, the study concludes, “less than half of labour income from construction in Saskatchewan was declared to Income Tax authorities between 1989 and 1992.”⁵² In this period, the average ratio of declared employment income to value of construction was 14.8%. The industry standard for Saskatchewan was 33.5% for the same period. Thus, the value of underground employment income equates to 18.7% of the value of construction, including repair construction, or roughly \$654 million.

Based on the derived underground employment income, the study also estimated losses of \$200 million in federal and provincial government income tax and CPP premium contributions.

3.4.2 Policy and Program Responses

The challenge for policy makers is to introduce solutions that effectively and efficiently induce compliance without imposing undue pressure on legitimate businesses. The following is a brief summary of recent measures by government and industry to address the underground economy in Canada.

Canada Customs and Revenue Agency

In 1993 Revenue Canada (now Canada Customs and Revenue Agency) launched an underground economy initiative (UEI). The UEI focused efforts on a number of high-risk areas of activity in which non-compliance with the tax laws is prevalent. These areas include:

- ▲ The “hospitality” sector;
- ▲ Automobile repairs and sales of used vehicles by “curbsiders”;
- ▲ The jewellery trade; and

⁵² Page 5.

- ▲ The construction/renovation industry.

As part of this initiative, CCRA introduced a mandatory contract payment reporting system (CPRS) on January 1st 1999. Originally introduced in 1996 on a voluntary basis, the system had very low participation rates. The government announced in its 1998 federal budget that mandatory reporting requirements for service contracts would be implemented for government departments and agencies in January 1998 and Crown corporations and the construction sector in January 1999.

The CPR system requires that all construction businesses⁵³ report the total of all amounts paid or credited to contractors.⁵⁴ At present, this does not include companies involved in home renovations.

The specific reporting requirements are as follows:

- ▲ Goods-only payments do not have to be reported;
- ▲ Mixed service and goods payments have to be reported if the service component is \$500 or more; and
- ▲ Wages paid to employees do not have to be reported as they are reported on t4 slips.

The objectives of the reporting systems are to:

- ▲ Increase levels of compliance;
- ▲ Improve targeting of compliance and enforcement activities; and
- ▲ Reduce the chance of auditing those who do comply.

CCRA has also released a guide on “Employee or Self-Employed” (RC4110) to provide a clearer definition of independent contractor. A specific section is devoted to the construction sector. If the situation is unclear, workers can request CCRA to make a determination of employee or independent contractor status.

Under the Voluntary Disclosure Program (VDP), CCRA allows individuals to report previously undisclosed information, without penalty or prosecution. The program accepts information that is less than one year overdue, except when disclosures are being made to avoid late filing charges.

⁵³ Construction businesses include those involved in erection, excavation, installation, alteration, modification, repair, improvement, demolition, destruction, dismantling, or removal of any structure or part, including but not limited to buildings, roads, and bridges.

⁵⁴ Individuals, partnership, or corporation that provides construction services.

With the support of CCRA, the Canadian Home Builders' Association (CHBA) has launched a 'Get it in Writing' Campaign. This national consumer awareness campaign is designed to warn consumers of the risks involved in dealing with construction businesses who offer 'under-the-table' cash deals, and emphasizes the benefits of written contracts and receipts. In Québec, the Association provinciale des constructeurs d'habitations du Québec is managing the campaign.

Human Resource Development Canada

The federal government has established the Fair Wages and Hours of Labour Regulations for the construction sector. The rules state that labourers must be paid a fair wage (not less than the minimum wage) and include miscellaneous provisions dealing with fair employment practices.⁵⁵ The Fair Wage Act does not apply to the residential construction sector. The act covers only those people involved in construction, remodelling, repair, or demolition for the federal government.

3.5 Concluding Comments

This review of the literature reveals that there is no clear consensus among researchers and policy experts on the definition and nature of the underground economy or on the most reliable ways to measure its scale and impacts. Nevertheless, there is a substantial body of current research on the underground economy in general, and in the residential construction sector in particular, in Canada and in other countries. From this research we have drawn the following general points about the underground economy in Canada and internationally:

1. Underground activity within the overall economy, and in the home building and renovation sector in particular, is substantial, and has grown significantly over the past decade or more.
2. The major factors influencing the expansion of underground economic activities would appear to be:
 - a. The introduction of value added or general sales taxes;
 - b. The trend to self-employment; and
 - c. Consumer demand for cost savings.
3. Underground activity in the home building and renovation sector is a serious constraint on housing quality, on consumer protection and on the ability of the industry to meet its human resources challenges.

⁵⁵ Human Resources Development Canada website - http://info.load-otea.hrdc.gc.ca/fair_wages/home.shtml

4. A range of measures have been taken in different jurisdictions to reduce or control underground activity, the most common being:
 - a. Innovation in tax measures and tax surveillance and enforcement;
 - b. Innovations in home inspections, building permits and building inspections practices;
 - c. Contractor licensing and mandatory certification of trades; and
 - d. Consumer education.

5. While the federal government has taken steps to reduce tax avoidance in the home building and renovations sector, and some provinces – most notably Québec – have taken strong measures to reduce underground activity, including mandatory licensing and certification, there is as yet no concerted, cross-jurisdictional effort in Canada to control underground economic activity more effectively.

4.0 Survey of Employers

4.1 Survey Methodology

The intent of the survey was to assess the impact of the underground economy on the residential construction industry in Nova Scotia and the extent to which legitimate firms are affected by competition from this invisible sector. For the purposes of the survey, the underground economy is defined as working under the table and/or hiding income. It includes not charging HST, not paying Workers' Compensation for employees, working while on EI, etc.

4.1.1 Target Population

The target population of the survey was identifiable professional home builders and renovators in Nova Scotia. The sampling frame, or list of companies, was derived from lists provided by the client, namely the Atlantic Home Building and Renovation Sector Council. The lists comprised active members of the: (1) Nova Scotia Home Builders' Association (NSHBA) and (2) Atlantic Home Warranty Program (AHWP) with the exception of service professionals and suppliers/manufacturers. These lists may not include all professional home builders, renovators and trade contractors in Nova Scotia but for practical purposes these lists were used as the sampling frame.

The lists were culled for duplicate entries. The final sampling frame comprised 334 company names.

4.1.2 Sampling Procedure and Response Rate

The sampling procedure was a census of companies on the list. Each company was contacted an average of 3.7 times.

A pre-test was completed on July 8th and 9th, 2003. The pre-test list comprised thirty companies and nine pre-test surveys were completed. Based on the results of the pre-test, only slight changes were made to the coding of the questionnaire (see Appendix A for questionnaire).

The full-scale survey was completed during the two-week period between July 11th and July 25th. A total of 111 surveys were completed with an average duration of 17 minutes. The overall response rate was 33% of the original sample frame (111 divided by 334). Of the 223 non-respondents, 20 were wrong, disconnected, or fax numbers, 17 refused, and 11 were disqualified as they did not report new home construction and/or home renovations and repair activity in 2002. The remainder were non-respondents for various other reasons including no answer, line busy, respondent not available, and interrupted.

4.1.3 Statistical Accuracy of Results

The statistical accuracy of the data will depend on the group under discussion. The minimum statistical accuracy for the survey results is plus or minus 8.2%, 19 times out of 20, for proportions. This statistical accuracy estimate for proportions assumes a conservative estimate of 50%, corrected using a finite population correction factor, and assumes 10% or less missing data. The minimum statistical accuracy is plus or minus 0.47 for means using a finite population correction and assuming 10% or less missing data. The accuracy will vary by question but will, in almost all cases, be better than the reported accuracy levels (except where noted with an *).

4.2 Survey Findings

4.2.1 Profile of Survey Respondents

In 2002, the survey respondents were active in the following industry sectors:

Table 11: Number and Percentage of Companies, by Construction Activity

Types of Construction Activity	#	Percentage of Respondents (N=111)
New Home Construction (NHC)	99	89%
Home Renovations and Repair (HRR)	80	72%
Non-Residential Building Construction (Institutional, Commercial, Industrial - ICI)	17	15%
Multiple-Unit Housing Construction (MUH)	2	2%
Engineering Construction (EC)	2	2%
Non-Construction ⁵⁶	6	5%

Source: AHB&RSC Underground Economy Survey 2003, Question 2.

The responses indicate that companies are primarily involved in new home construction and/or home renovations and repair. In fact, respondents must have been involved either in NHC and/or HRR to qualify for the survey.

New home construction accounted for some part of overall business revenues for 99 companies. For these companies, the following table depicts the distribution of the level of involvement (as measured by

⁵⁶ The six respondents are involved in one of the following: agriculture, designing, heating and ventilation, land development, real estate and leasing.

percentage of revenues) in the NHC sector:

Table 12: Number and Percentage of NHC Companies, by Level of Involvement in the NHC Sector

Level of Involvement	#
Exclusively (100% of business revenues)	25
Mostly (50% to 99%)	50
Significantly (25% to 49%)	12
Partly (less than 25%)	12
Total	99

Source: AHB&RSC Underground Economy Survey 2003, Question 2.

For over three-quarters of NHC companies, revenues generated from the NHC sector account for more than 50% of overall business revenues.

Using the same measure, the level of involvement of HRR companies in their sector is as follows:

Table 13: Number and Percentage of HRR Companies, by Level of Involvement in the Sector

Level of Involvement	#	Percent
Exclusively (100% of business revenues)	8	10%
Mostly (50% to 99%)	28	35%
Significantly (25% to 49%)	8	10%
Partly (less than 25%)	36	45%
Total	80	100%

Source: AHB&RSC Underground Economy Survey 2003, Question 2.

Compared to those involved in the NHC, companies involved in the HRR sector are more reliant on revenues from other sectors.

The degree of specialization for companies involved in each of the remainder sectors is presented in the following table.

Table 14: Distribution of Companies, by Level of Involvement, in Each of the Remainder Sectors

Level of Involvement	ICI		MUH		EC		Non-Construction	
	#	%	#	%	#	%	#	%
Mostly (50% to 99%)	5	29%			2	100%	4	66%
Significantly (25% to 49%)	2	12%					1	17%
Partly (less than 25%)	10	59%	2	100%			1	17%
Total	17	100%	2	100%	2	100%	6	100%

Source: AHB&RSC Underground Economy Survey 2003, Question 2.

To assist in the interpretation of the survey results, survey respondents provided estimates of gross value of sales in 2002:

Table 15: Gross Value of Sales, 2002

Gross Value of Sales	NHC			HRR		
	#	% of Total	% of Sub-Total	#	% of Total	% of Sub-Total
Less than \$100,000	8	7%	9%	32	29%	42%
\$100,001 to \$200,000	14	13%	15%	16	14%	21%
\$200,001 to \$500,000	19	17%	20%	15	14%	20%
\$500,001 to \$1 million	25	23%	27%	11	10%	14%
\$1,000,001 to \$3 million	21	19%	22%	2	2%	3%
Greater than \$3 million	7	6%	7%			
Sub-Total	94		100%	76		100%
Refused to Answer	5	5%		4	4%	
Not Applicable	12	11%		31	28%	
Total	111	100%		111	100%	

Source: AHB&RSC Underground Economy Survey 2003, Questions 15 and 16.

4.2.2 Capture Area of Companies

Respondents were asked to define the community or region where they conduct business and are most familiar with in terms of business activities. For analysis purposes, the communities and regions were classified into seven areas. The distribution of respondents by these areas is as follows:

Table 16: Distribution of Firms by Community/Region

Capture Area	Number of Companies	Percent
Maritimes and Beyond	1	<1%
Nova Scotia	1	<1%
Two or More Counties (including HRM and CB)	22	20%
HRM Only	46	41%
One County Only (Other than HRM)	23	21%
A Few Communities	8	7%
One Community (excluding Halifax)	10	9%
Total	111	100%

Source: AHB&RSC Underground Economy Survey 2003, Question 3.

4.2.3 Size of the Underground Economy

Respondents were asked to estimate levels of underground home building or renovations activity taking place over the last twelve months in the community or region where they conduct business. The estimated percentage of total business activity for new home construction that might be characterized as “underground” is as follows:

Table 17: NHC – Total Business Activity Categorized as Underground

Percentage of Total Business Activity	Number of Companies	Percent
Less than 25%	59	53%
Between 25% and 49%	22	20%
Between 50% and 74%	10	9%
75% or higher	0	0%
Don't Know	20	18%
Total	111	100%

Source: AHB&RSC Underground Economy Survey 2003, Question 3.1.

Within the new home construction sector, the average percentage of total business activity categorized as underground is 21%. Taking into account where respondents conduct business, it would appear that the estimated underground activity is slightly higher in Cape Breton, however, the sample sizes are too small to draw statistically accurate conclusions.

The estimated percentage of total business activity for home renovation or repair that might be characterized as “underground” is:

Table 18: HRR – Total Business Activity Categorized as Underground

Percentage of Total Business Activity	Number of Companies	Percent
Less than 25%	25	23%
Between 25% and 49%	36	32%
Between 50% and 74%	27	24%
75% or higher	5	5%
Don't Know	18	16%
Total	111	100%

Source: AHB&RSC Underground Economy Survey 2003, Question 3.2.

The average percentage of total business activity categorized as underground is 36% within the home renovation or repair sector. Again, the estimated underground activity is higher in Cape Breton, however, the sample sizes are too small to draw statistically accurate conclusions.

4.2.4 Incidence of Underground Economy Activities

The underground economy encompasses a variety of activities. Survey respondents were asked how often each of the activities occurs in the region where they work on a scale of 1 (very rarely) to 5 (very often).

The following table summarizes their responses for the New Home Construction sector (in order from the most to the least frequently occurring activities):

Table 19: NHC - Frequency of Occurrence of Underground Activities

Type of Underground Activity	Mean Rating
The stealing of building supplies from new home construction job sites	2.84
People with full-time jobs in other industries who “moonlight” as new home builders in their off-hours	2.81
Builders who knowingly disregard workplace health and safety rules in new home construction projects	2.55
Employers not paying Workers’ Compensation for employees on new home construction projects	2.38
Sub-contractors not fully charging HST to contractors for work on new home construction projects	2.13
Contractor-builders not fully charging HST to customers for new home construction work	1.99
Builders working on new home construction projects while receiving EI benefits	1.97
Builders who knowingly do new home construction that does not meet Building Code specifications	1.74
Other activities mentioned: Cash transactions Hiring sub-contractors to avoid paying Workers’ Compensation and other benefits	4 mentions 3 mentions

Source: AHB&RSC Underground Economy Survey 2003, Question 4.

For the home renovation and repair industry, survey respondents rated the frequency of occurrence of underground activities as follows (in order from the most to the least frequently occurring activities):

Table 20: HRR - Frequency of Occurrence of Underground Activities

Type of Underground Activity	Mean Rating
People with full-time jobs in other industries who “moonlight” doing home renovation or repair work in their off-hours	3.46
Builders not fully charging HST to customers for home renovation or repair work	3.04
Employers not paying Workers’ Compensation for employees on home renovation or repair projects	2.96
Sub-contractors not fully charging HST to contractors for work on home renovation or repair projects	2.87
Builders who knowingly disregard workplace health and safety rules on home renovation or repair projects	2.86
Builders working on home renovation or repair projects while receiving EI benefits	2.60
Builders who knowingly do renovations or repairs that does not meet Building Code specifications	2.47
The stealing of building supplies from home renovation or repair job sites	2.27
Other activities mentioned: Cash transactions - particularly for labour Downward pressure on prices Moonlighting by pensioners, union workers within the sector	10 mentions 3 mentions 2 mentions

Source: AHB&RSC Underground Economy Survey 2003, Question 5.

4.2.5 Impact of the Underground Economy

Survey respondents were asked on a scale of 1 to 5 where 1 means strongly disagree and 5 means strongly agree, how much they agree or disagree with the following statement:

“The underground economy creates unfair price competition that pressures legitimate operators in the . . . sector to lower the prices they charge for their work.”

The responses to this question are as follows:

Table 21: Degree to Which the Underground Economy Creates Unfair Price Competition

Sector	Strongly Disagree 1	2	3	4	Strongly Agree 5	Mean Rating
NHC	8%	3%	12%	16%	61%	4.18
HRR	5%	2%	8%	14%	71%	4.44

Source: AHB&RSC Underground Economy Survey 2003, Questions 6 and 7.

Respondents were asked whether their pricing proposals and total sales revenues are typically reduced because of competition from underground operators.

Table 22: Impact of Underground Economy

Sector	Response	Pricing Proposals		Total Sales Revenues	
		#	%	#	%
NHC	Yes, reduced	53	58%	49	56%
	No, not reduced at all	38	42%	39	44%
	Total	91*		88*	
HRR	Yes, reduced	40	46%	42	49%
	No, not reduced at all	46	54%	44	51%
	Total	86*		86*	

Source: AHB&RSC Underground Economy Survey 2003, Questions 6.1, 6.2, 7.1, and 7.2.

For those responding yes, the estimated impact of the underground economy on pricing proposals and total sales revenues is presented in the following two tables:

Table 23: NHC – Estimated Impact

Percentage Reduction	Pricing Proposals		Total Sales Revenues	
	#	%	#	%
1%- 10%	23	43%	15	31%
11%- 20%	16	30%	16	33%
21% - 40%	9	17%	9	18%
41% - 60%	3	6%	6	12%
61% - 80%	2	4%	2	4%
81% - 100%	0	0%	1	2%
Total	53	100%	49	100%

Source: AHB&RSC Underground Economy Survey 2003, Questions 6.1 and 6.2.

The average percentage reduction is 19% for pricing proposals and 24% for total sales revenues.

Table 24: HRR – Estimated Impact

Percentage Reduction	Pricing Proposals		Total Sales Revenues	
	#	%	#	%
1%- 10%	10	25%	9	21%
11%- 20%	15	38%	15	36%
21% - 40%	7	18%	9	21%
41% - 60%	5	12%	6	14%
61% - 80%	1	2%	3	7%
81% - 100%	2	5%	0	0%
Total	40	100%	42	100%

Source: AHB&RSC Underground Economy Survey 2003, Questions 7.1 and 7.2.

The average percentage reduction is 26% for pricing proposals and 28% for total sales revenues.

Survey respondents were asked whether the amount of underground activity in the region where they work has changed over the last two years.

Table 25: Changes in Underground Activity by Sector

Sector	Decreased a Large Amount 1	Decreased Somewhat 2	Stayed the Same 3	Increased Somewhat 4	Increased a Large Amount 5	Mean Rating
NHC	5%	15%	52%	23%	5%	3.08
HRR	2%	8%	46%	33%	11%	3.43

Source: AHB&RSC Underground Economy Survey 2003, Question 8.

For those respondents indicating that underground activity has either decreased (1 or 2) and/or increased (4 or 5), they were asked what are the three main reasons, in order of significance for this change. The responses are summarized in the following table, grouped under topic headings and listed in order of frequency of mention.⁵⁷

Table 26: Reasons for Change in Underground Activity

Major Reasons for <i>Decreased</i> Underground Activity	NHC	% of Total	HRR	% of Total
Changes in Consumer Awareness and Expectations:	47	46%	14	26%
Growing Demand for Legitimate/Certified Builders – consumers are seeking less hassles, higher quality work, and documentation from builders (invoices, proof of business number, warranty, Workers’ Compensation, and insurance)	26		9	
Increasing Public Education/Awareness – re: liability/safety risks	21		5	
Increasing External Pressures:	27	27%	16	30%
Increasing Pressures from Government – CCRA contract reporting, building permit requirements	11		9	
Increasing Pressures from Lending Institutions - requiring homeowners use certified builders (home builder must show evidence of warranty/builder’s number before bank will lend money to homeowner)	8		2	
Overall Increase in Surveillance	5		2	
More Safety Regulations (underground operators can not afford equipment and/or training)	2			
Increasing Pressures from Workers’ Compensation Board	1		3	
Improved Economic Conditions:	15	15%	19	36%
Improved Economy/Low Interest Rates - less impetus for moonlighting as consumers are not as concerned about price	15		19	
Pressures from within the Sector:	12	12%	4	8%
Builders Realizing Underground Economy is not a Viable Option	4		4	
Builders are Developing Relationships with Employees - less reliant on sub-contractors	3			
Improved Co-ordination/Communication – between trades people and the Nova Scotia Home Builders’ Association	3			
Increasing Self-Regulation - licensed contractors are threatening to report underground activity	2			
Total	101	100%	53	100%

Major Reasons for <i>Increased</i> Underground Activity	NHC	% of Total	HRR	% of Total
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⁵⁷ Interviewees were asked to name three factors in order of importance. In summarizing the results, the first named factors were given three points each, the second two and the third one. The table shows the total scores assigned to each factor on this basis. Note that not all respondents provided three reasons.

Consumer Demand:	53	31%	65	28%
Consumers Want to Avoid Paying HST				
Business Conditions:	52	31%	86	37%
Harmonized Sales Tax – Tax is too high thereby places pressure on other costs such as labour; threshold limit of \$30,000 also promotes underground	18		24	
More Moonlighting – way of dealing with labour shortage problem, people on fixed incomes work for cash and not report it, people within the fishery only report income from fishing and not from other sources, people are not receiving raises at their jobs so need to supplement income	16		23	
Increased Volume of Building Activity	11		14	
Rising Costs – Taxes are a function of costs therefore as costs increase taxes rise; only way to remain competitive is to not charge HST	5		20	
Construction Costs (labour, materials)	2		3	
Workers' Compensation Premiums			2	
Costs Associated with Dealing with Occupational Health and Safety Issues				
Lack of Awareness/Understanding:	11	6%	12	5%
Lack of General Public Awareness – re: Legal Risks, Value of Quality Workmanship	9		10	
Builders Lack Understanding of Impact of U/G economy	2		2	
Enforcement and Surveillance:	20	12%	38	16%
Deficiencies in Enforcement - insufficient penalties, lack of consistent enforcement, lack of risk of being caught especially for small trades/jobs, municipalities allow homeowners to get a building permit	11		23	
No Mandatory Requirements to use Certified Builders (anything over \$20k should require a licensed contractor)	9		14	
Insufficient Focus on Inspection and Safety			1	
Economic/Social Conditions:	33	19%	31	13%
Disintegrating Social Conditions – the booming economy/falling interest rates has taught people to hide or ignore their morals/values and be greedy	16		6	
Rising Unemployment Rate – people need work/money to survive	14		25	
Worsening Economy – companies are slashing prices/cutting corners to compete	3			
Total	169	100%	232	100%

Source: AHBGRSC Underground Economy Survey 2003, Questions 8.3 and 8.4.

The following table summarizes the responses when asked to rate the impact of the following underground economy activity on the labour force on a scale of 1 (strongly disagree) to 5 (strongly agree).

Table 27: Ratings of Impact of Underground Activity

Statement	Sector	Strongly Disagree 1	2	3	4	Strongly Agree 5	Mean Rating
Underground activity has little or no impact on retaining a skilled labour force in the ... sector	NHC	42%	12%	18%	7%	21%	2.53
	HRR	44%	12%	18%	9%	17%	2.45
Competition from underground builders holds down wages for the ... sector	NHC	17%	11%	25%	8%	38%	3.40
	HRR	12%	11%	19%	13%	44%	3.67
Underground activity helps to recruit and train new workers for the ... sector	NHC	78%	11%	9%	0%	3%	1.40
	HRR	71%	13%	12%	0%	4%	1.54
Underground activity gives the whole industry a bad image for young people making career choices	NHC	13%	5%	6%	12%	65%	4.10
	HRR	12%	6%	9%	9%	64%	4.08
Employers cannot afford to train their workers to higher standards because of business competition from underground builders	NHC	25%	11%	16%	12%	36%	3.24
	HRR	20%	7%	21%	14%	37%	3.41

Source: AHB&RSC Underground Economy Survey 2003, Questions 9.1 and 9.2.

4.2.6 Licensing and Certification

At present, there is compulsory certification for plumbers and electricians, but other trades are not covered and there is no mandatory licensing system for home building and renovation. The survey respondents were asked whether they would support introduction of mandatory licensing and compulsory certification.

Table 28: Level of Support for Licensing/Certification

Support introduction of	Yes	No
Mandatory licensing for home builders	86%	14%
Mandatory licensing for renovators	87%	13%
Compulsory certification for carpenters	87%	13%

Source: AHB&RSC Underground Economy Survey 2003, Question 10.

4.2.7 Ways to Limit or Control Underground Activity

A number of changes might be made to control underground activity. On a scale of 1 to 5 where 1 means *not effective at all* and 5 means *very effective*, respondents were asked to rate how effective each of the following changes might be in controlling underground activity in . . . the sector.

Table 29: Effectiveness of Controlling Underground Activity

Statement	Sector	Not at All Effective 1	2	3	4	Very Effective 5	Mean Rating
Expand surveillance and enforcement efforts of:							
Building Inspectors	NHC	28%	5%	20%	15%	32%	3.18
	HRR	25%	7%	16%	14%	38%	3.33
Government Tax Auditors	NHC	22%	11%	19%	16%	32%	3.25
	HRR	21%	14%	13%	14%	37%	3.32
The Nova Scotia Department of Labour	NHC	19%	15%	20%	15%	31%	3.25
	HRR*(n=98)	17%	12%	18%	16%	36%	3.41
The Nova Scotia Workers' Compensation Board	NHC	24%	13%	18%	11%	34%	3.18
	HRR*(n=98)	24%	10%	18%	11%	37%	3.28
The EI System	NHC	20%	13%	19%	14%	33%	3.28
	HRR*(n=98)	19%	9%	20%	13%	38%	3.41
Educate:							
People who work in the underground sector about the legal risks they are taking	NHC	34%	11%	15%	8%	32%	2.92
	HRR	32%	16%	13%	8%	31%	2.90
People who work in the underground sector about the health and safety risks they are taking	NHC	33%	15%	13%	7%	32%	2.90
	HRR	31%	17%	13%	5%	33%	2.92
Consumers about the risks of having work done through underground activities	NHC	3%	5%	10%	11%	71%	4.42
	HRR	2%	6%	12%	8%	72%	4.42
Encourage:							
Encourage banks and other mortgage lenders to refuse to finance underground building and renovation	NHC	10%	4%	7%	13%	66%	4.21
	HRR	8%	6%	5%	10%	71%	4.29
Encourage insurance providers to refuse to insure underground building or renovation projects	NHC	12%	6%	8%	9%	65%	4.12
	HRR*(n=97)	9%	7%	7%	9%	67%	4.18

Source: AHB&RSC Underground Economy Survey 2003, Questions 11 and 13.

Respondents were then asked to identify other ways that they thought would be effective to limit or control underground activity. The responses are summarized in the following table, grouped under topic headings and listed in order of frequency of mention.

Table 30: Suggested Approaches to Limit or Control Underground Activity

Suggested Approach	NHC	HRR
<p>Building Permit and Inspection System: Changes to Building Permit Application Process</p> <ul style="list-style-type: none"> ■ Only issue to licensed builders, builders with HST #s, builders with proof of liability insurance and general contractors (do not allow homeowners to be their own contractor or audit them closely) ■ Require all jobs to have a permit ■ To avoid builders working in phases for large jobs, the permit application process should take less than 2 to 3 weeks ■ Introduce new permit pricing structure for (1) licensed contractors versus (2) non-licensed contractors <p>Changes to Inspection Process:</p> <ul style="list-style-type: none"> ■ Hire more inspectors ■ Inspectors should have more authority and control to hold builders accountable ■ Inspectors should be able to go to building suppliers, get a list of materials and addresses and check out the contractor ■ Inspectors should target small renovation jobs that require building permits before the large companies ■ Building inspectors should be trained on how to identify and catch underground operators 	46	46
<p>Educate/Public Awareness: Educate consumers of the risks/consequences of hiring underground Educate contractors about risks of operating in the underground economy, merits of professionalism, values and beliefs</p>	42	40
<p>Enforcement/Surveillance: Increase surveillance and policing; enforce rules and regulations with stiff penalties Provide opportunity and reward for anonymous whistle blowing/hotline Encourage self-policing – everyone has to buy into it or it will not work</p>	30	32
<p>Government Taxation System: Should:</p> <ul style="list-style-type: none"> ■ change HST taxation system (for instance, lower cap on HST from \$30k to \$0 or eliminate HST) ■ introduce new legislation/tax incentives to discourage underground ■ change HST rebate system (for instance, offer to homeowners if report HST #s of those who worked on project) ■ increase surveillance of tax auditors (focus on small companies, review accounts of building supply stores) 	27	23
<p>Mandatory Licensing: Mandatory licensing for builders/renovators and certification of all individuals (one suggestion was that contractors should be licensed for jobs over \$20,000)</p>	22	21
<p>Lending Institutions: Refuse to finance underground operators</p>	16	12

Suggested Approach	NHC	HRR
Change Workers' Compensation: Expand enforcement and surveillance efforts (e.g., focus on small businesses) Expand scope – should be mandatory for all companies regardless of number of employees Lower premiums for licensed contractors and increase for non-licensed contractors	8	8
Change Insurance Policies: Refuse to insure projects completed by unlicensed contractor/builders Do not raise insurance premiums for legitimate contractors Require that all building people have insurance – they are not insuring the small renovator	7	7
Building Supply Companies/Wholesalers: Should: <ul style="list-style-type: none"> ■ monitor large cash transactions for materials ■ require purchaser of building materials to provide name and contact number of the job site ■ control amount of materials purchased by unlicensed contractors ■ only allow licensed builders to purchase supplies ■ only provide discount to licensed contractors 	8	3
Change EI System: Expand enforcement and surveillance efforts of EI system During EI waiting period, HRDC should pay employers and employers keep paying employee; EI penalizes laid-off workers – makes them wait for \$ and therefore provides an incentive to moonlight	5	4
Other: Raise wages of construction workers/ carpenters Reduce unemployment rates Focus efforts on moonlighters – civil servants, union workers Improve training/education system (certify trades people, focus on shortages) Bring together key stakeholders from the industry (three from each province) to develop formulas/forms to eliminate the underground Construction association should be present on job site and monitor who is doing what Nova Scotia Homebuilders Association should help strengthen the industry; many legitimate companies are not following industry standards and are doing poor work	10	7
Total	234	216

Source: AHB&RSC Underground Economy Survey 2003, Questions 12 and 14.

4.2.8 Additional Comments

At the conclusion of the interview, respondents were asked if they wished to add any further comments. The following table presents the specific comments clustered by subject matter, and the frequency of mention for each.

Table 31: Comments

Comment	Frequency
<p>Taxation and Workers' Compensation System</p> <ul style="list-style-type: none"> ■ Government should stop taxing without giving a rebate to the legitimate companies. Punishments should be given to companies legally hiring two workers, hiring others under the table, and not having to pay Workers' Compensation. ■ Contractors are taking advantage of Workers' Compensation and thereby legitimate operators are paying the price. The costs are much too high for legitimate contractors. Workers' Compensation is definitely not what he thought it would be. It is beginning to seem like a scam. The more the public is made aware of the risks the faster the Underground Economy will be stopped, people will start realizing the dangers and not look for those kind of discounts. ■ The biggest problem is the HST. (2 mentions) One way to make more go underground is not being able to offer your employees what they are worth because of such high taxes. ■ Workers' Compensation charges so much for each employee it is no wonder the contractors go underground to avoid it. ■ UE keeps skilled workers out of the hands of legitimate companies but eventually they may return. Depends on where they make more money. UE gives the whole industry a bad image, not only for young people but it makes certified builders look bad too because customers have had bad experiences with hiring people from UE. ■ Government (who don't seem to have even a \$ not accounted for) focuses more on bigger/well-known companies than on smaller/not so well-known companies. Not right those hiring 2 or less employees don't need to pay Workers' Compensation promotes them to stay small and hire under the table. ■ There is so much paperwork that it is impossible to stop working. We are getting our jobs done and going home to get all the paperwork done and going back to work, etc. Why is this necessary? 	<p>8</p>
<p>Not Clear of Viable Means to Eliminate/Reduce Underground Economy Activity</p> <ul style="list-style-type: none"> ■ Underground economy is not controllable - nothing will be effective. It is great to say policing will work but the government does not do it. They need more people to effectively do the job. ■ Unclear as to how inspectors can determine whether the contractor is paid cash – the builder/renovator may have a license and permit but may be doing it for cash. ■ It will never change. The government talks about it a lot but nothing is done. I realize that is costs money to reinforce the rules and regulations but without public support and knowledge "what's the point". I have given up hope. ■ The Underground Economy is a small problem in the industry but there are so many other issues. Like government officials only auditing company names that are easy to find. Also taxes being raised and the economy in general. ■ Not sure how contractors could be caught if doing the job properly but for cash. ■ Unsure of how you can stop it but I believe it must be stopped. Stop the government from working against the industry and you may see a change. 	<p>6</p>

Comment	Frequency
<p>Surveillance and Enforcement</p> <ul style="list-style-type: none"> ■ The major problem is not enough policing. Police, police, police and this will stop. The problem has been here for many years but if the government would police the situation it would get under control. ■ The issues are pretty much the same with both sectors. The things that would be effective would work with both. Mostly just enforce, enforce, enforce. ■ The government does not react to health and safety issues. "It is no wonder contractors don't bother reporting, nothing is done". If there was a place to call if loose jobs to no HST, etc. or if see a law being broken. Legitimate companies help police. We must see government working with us through severe punishments when UE being reported. ■ The insurance companies would not help this situation, as they run their own show. There are not enough government inspectors to deal with the underground economy. 	4
<p>Training</p> <ul style="list-style-type: none"> ■ If government helped pay for training for small company barely scraping by every year spending 100s of \$ on training (the company) they could afford to train more. The more government throws (in terms of financial reporting) at small companies, the more Underground Economy problems are created. Some small companies cannot afford it "Let's go and do the job for 15% less" Cannot afford not to do it u/g. ■ People doing shoddy work knowingly was a big problem but that people who were simply unaware of the proper ways to do things but just went in and did them anyway was an even bigger problem. 	2
<p>Underground Economy is Not an Issue</p> <ul style="list-style-type: none"> ■ Do not work in the Underground Economy and do not know anyone who does so do not know too much about it. It does not really affect us because we are a small business. ■ UE does not affect us at all. We are quite busy, do not have staffing problems, and do not lower prices. We have had a consistent crew for years and we have trained them over the years. 	2
<p>Mandatory Licensing</p> <ul style="list-style-type: none"> ■ If mandatory licensing was put in effect then it would eliminate the UE. The government has been promising to do this for about ten years. If it happens it is about time. The government needs to take some responsibility. ■ The Underground Economy is forcing the legitimate contractor to pay more across the board. If the government enforces the licensing of all builders, maybe prices can be lowered. 	2
<p>Other Comments</p> <ul style="list-style-type: none"> ■ Only plumbers and electricians can buy plumbing or electrical supplies whereas anyone can buy building supplies. This must stop in order to maintain and follow rules. Will become an even more serious problem if not dealt with now. ■ Education of both homeowner and underground economy operators is important. They know the pros so stress the CONS. The government should stop hassling those who are legitimate and focus on non-legitimate companies. ■ The consumers themselves are the biggest problem. ■ Most of the underground is police officers and firefighters. They work 4 days on and 3 off. During off days they are moonlighting. ■ The survey has too many general questions. The survey questions are very misleading. The questions should be reworded to recognize professionals from the scam artists. 	5

4.3 Industry Consultations

4.3.1 Employer Workshop

A workshop session with employers was held on October 16th, 2003 in Dartmouth Nova Scotia. The meeting was not well-attended due in large part to very good weather and the high level of business activity in the industry at the time. The 114 employers who participated in the survey were all invited through direct contacts (telephone, e-mail and fax). After two rounds of contacts nine employers were committed to attend but only four actually participated together with the Executive Director of the Home Building & Renovation Sector Council. Fortunately, the four participants were excellent representatives of the sector including leaders in industry associations who had participated in government consultations on underground economy issues. Three were from renovations and new home construction companies and one was from a sub-trades firm.

The workshop began with a review of findings from the literature review and the employer survey. The following were main points of discussion:

- ▲ The group was in agreement that the estimate of underground activity in new home construction – i.e., 21% of all business activity takes place “underground” -- was too low.
- ▲ They felt that the underground sector generates less downward pressure on price proposals and overall sales in the renovations sector than in new home construction because the renovations sector is so much busier.
- ▲ There was general agreement that the industry does not do enough to promote consumer awareness of the disadvantages and risks of using underground builders, and of the benefits of using professional builders. Home Builder’s Association and the Renovations Council are currently doing public education all over the province through the ‘Get It In Writing’ campaign and other initiatives. It was felt that industry groups should also be putting more pressure on municipal officials and politicians to improve the regulation and inspections systems.
- ▲ After review of the survey results the participants were in agreement that these findings constitute a fair representation of current realities in the industry.
- ▲ There was strong support in the group for introduction of mandatory licensing for home builders and renovators.
- ▲ There was agreement on the need to target banks, insurers and consumers to generate wider support for licensing.
- ▲ There were concerns that in the home heating and ventilation fields the home inspectors do not

have sufficient expertise and they accept credentials from sub-trade operators that are bogus.

- ▲ There was agreement on the need for a better means to select people for training who are suited to particular trades and will be more likely to stick with them after training. This might include aptitude testing.
- ▲ There was agreement on the need to communicate to politicians and regulators the need for higher basic standards for all home building including self-built houses that become part of the housing stock.
- ▲ One way to “sell” licensing to the industry is to grandfather in people with well established careers in the sector. The participants were willing to consider this option provided that there ways to determine that the people being grandfathered in had made their principal livelihoods in the industry. There should be an effective prior learning and assessment process to assess whether candidates for grandfathering have proven competencies and experience.
- ▲ It was pointed out that the EI system includes programs to help people start their own businesses. It might be possible to use these programs to support people achieving professional status.

The key messages from the workshop were that the participants were comfortable with the findings and conclusions drawn from the literature review and the survey research, and that they strongly supported the Sector Council in its efforts to promote professionalization through licensing, improved education and training, and the recognition of the knowledge and skills of people already established in the industry.

In terms of follow-up action, the principal directions recommended were expanded public education about the dangers of the underground economy and the benefits of patronizing legitimate professional builders and renovators, and the need to work with government, the banks and insurance agencies to move forward with mandatory licensing.

4.3.2 Sector Council Board and Employers

The findings from the underground economy study were presented and discussed at a consultation session with members of the Sector Council Board and five other employers on November 19th, 2003. Participants in the session were in agreement with the principal findings, and strongly supported renewed efforts by the Sector Council to establish professional licensing for home builders and renovators. The negative impacts of the underground sector were clearly identified as the strongest reason why licensing and professionalization are necessary. There was some disagreement whether licensing of contractors should be accompanied by mandatory certification for carpenters. Consensus on

this direction was achieved in the meeting based on a commitment to full consultation with industry groups across the province.

5.0 Estimated Size of the Underground Economy in the Residential Construction Sector in Nova Scotia

The following attempts to quantify the size of the underground economy in the residential construction sector in Nova Scotia. Size estimates are based on approximations presented in the literature review and provided by the survey responses of legitimate businesses. It is noted that the following estimates simply illustrate the potential magnitude of the underground economy and are not necessarily derived using robust data and statistical techniques.

In 2002, the gross domestic product, expenditure based, for residential structures⁵⁸ totalled \$1.39 billion in Nova Scotia.⁵⁹ The estimated investment, excluding any underground activity, in each segment is as follows:⁶⁰

- ▲ \$645 million (or 46.4%) for new housing;
- ▲ \$588 million (or 42.3%) for renovations; and
- ▲ \$157 million (or 11.3%) for transfer costs.

The report prepared for the Ontario Construction Secretariat indicates that the underground economy accounts for 13% of new housing income and 48% of renovation income in Ontario. Using these figures, the size of the underground economy in Nova Scotia is approximately \$83.8 million for new housing and \$282.2 million for renovations. The total underground activity is therefore \$366 million or 26% of gross domestic product for the sector.

Statistics Canada calculates that the underground economy accounts for an estimated 9% of new residential construction and 13.9% of alterations and improvements. These approximations equate to \$58.1 for new housing and \$81.7 million for renovations. Note, however, that due to differences in classification of data, the renovation data is not necessarily the same as the alteration and improvement data and therefore are not directly comparable. Nevertheless, these figures translate to total underground activity of \$139.8 million or 10% of the sector's gross domestic product.

The survey responses from the legitimate businesses estimate the average percentage of total business activity characterized as underground to be:

⁵⁸ Investment in residential structures includes new housing investment, expenditure on renovations and transfer costs. Transfer costs consist primarily of real estate commissions.

⁵⁹ Statistics Canada. CANSIM Table 384-0002 – Gross Domestic Product (GDP), expenditure-based, Provincial Economic Accounts.

⁶⁰ Statistics Canada. *Trends in Provincial and Territorial Economic Statistics: 1981 – 2002*. Cat No 13-604-MIE – No. 043. November 2003.

- ▲ 21% - new home construction sector; and
- ▲ 36% - home renovation or repair sector.

Using these rates, the size of the underground economy is estimated to total \$135.45 million for new home construction and \$211.68 million for renovations. The total value of underground activity is estimated to be \$347.13 million or 25% of gross domestic product for the sector.

In summary, the report findings point to the fact that the underground economy accounts for a significant share of Nova Scotia's residential construction sector.

Table 32: Estimated Size of the Underground Economy in Nova Scotia

Based on Approximations From:	New Housing Segment (\$ Million)	Renovations Segment (\$ Million)	Overall Sector (\$ Million)	% of Sector's GDP
Ontario Construction Secretariat Report	\$ 83.8	\$ 282.2	\$ 366.0	26%
Statistics Canada	\$ 58.1	\$ 81.7	\$ 139.8	10%
Survey Responses	\$ 135.4	\$ 211.7	\$ 347.1	25%

It is interesting to note that the estimates for the Ontario residential construction sector are close to those provided by the survey respondents. Despite this fact, measuring the underground economy is a complex and often elusive task, therefore further analysis would likely yield estimates that are more rigorous.

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Appendix: AHB&RSC Underground Economy Survey 2003

Atlantic Home Building & Renovation Sector Council Underground Economy Interview Guide

Survey# _____

Postal Code _____

I am calling on behalf of the Atlantic Home Building and Renovation Sector Council. Could I please speak to _____ (Interviewer: Ask for contact person provided on the list – if that person no longer works for the company then ask for the person most responsible for managing the business. If you interview a different contact person then record their name.)

I am calling on behalf of the Atlantic Home Building and Renovation Sector Council. The Council develops and delivers education and training for the homebuilding and renovation sector in Nova Scotia. It also does research and makes representations to government on human resources issues in the home building and renovation industry.

We are conducting a telephone survey dealing with the sensitive issue of underground activity in the homebuilding and renovations industry. The Canadian Home Builder's Association has estimated that up to 55% of home renovation and repair activity, and a smaller but still significant proportion of new home construction, is currently done "under the table". We are interested in assessing the impact of this underground activity on your industry and the extent to which legitimate firms are affected by competition from this invisible sector. For the purposes of this survey, the underground economy is defined as working under the table and/or hiding income. It includes not charging HST, not paying Worker's Compensation for employees, working while on EI, etc.

We are only interested in knowing generally about what goes on in the industry to help improve the business and regulatory environments. The information you give us will be kept strictly confidential and will only be used for the purpose of this study. The results will be aggregated in the report so that individual responses cannot be identified. Your comments will never be attributed to you in any report or public statement arising from the project.

The survey should take about 15 minutes of your time. We hope that you will assist your sector council in completing this important research. To thank you for your assistance, your name will be entered into a draw to win one of four prizes (up to \$150 value each). If you are one of the four names drawn, you will win a \$150 gift cheque. Your chances of winning will be approximately one in 25. The draw will be held on August 15th, 2003 and the winner will be notified by telephone.

Would you help us by participating in a brief survey about your industry?

Interviewer: If the respondent says "No", ask if it might be possible to schedule a more convenient time to call back for the interview.

Yes ___1___,

No ___2___ (end of call)

Would you like your name entered into the draw? If so, what telephone number should we call?

Yes ___1___,

No ___2___

If Yes, phone number _____

1. Did your company do business in the home building and renovation industry in 2002?

Yes ____ 1 ____,

No ____ 2 ____ (end of call)

If No, Thank you very much for your time. We are surveying only those companies currently conducting business in the residential construction industry.

If Yes, please respond to the following questions.

2. In which of the following industry sectors was your business active in 2002?

Interviewer: Please ask for a YES or NO answer for each category of work. For each category where the answer is YES, please ask: approximately what percentage of your overall business revenues were generated in each of the following types of work? (1st Field: Yes=1, No=2; 2nd Field: Actual Percentage)

Category of Construction Activity	Y/N	Percentage
New home construction – single detached including cottages	2.1	2.1.1
Apartments, condominiums or other multiple-unit housing construction	2.2	2.2.1
Home renovations and repair	2.3	2.3.1
Non-Residential Building Construction (Commercial, Institutional and Industrial buildings, including renovations)	2.4	2.4.1
Engineering Construction	2.5	2.5.1
Other – Non-Construction (please specify)	2.6	2.6.1
Total (<i>should equal 100%</i>)		2.7.1

If did not reply to question 2.1 and/or question 2.3 with a YES,

Thank you very much for your time. We are surveying only those companies currently conducting business in the residential construction industry.

If did reply to question 2.1 and/or question 2.3 with a YES, please respond to the following questions.

3. Please define the community or region where you conduct your business and that you are most familiar with in terms of business activities.

The following two questions ask you to estimate the levels of underground home building or renovations activity taking place over the last twelve months in the community or region where you conduct your business.

- 3.1 In your estimation what percentage of total business activity for *new home construction* might be characterized as “underground”?

Percentage _____

Don't know ____99____

- 3.2 In your estimation what percentage of total business activity for *home renovation or repair* might be characterized as “underground”?

Percentage _____

Don't know ____99____

4. Underground activity in the *new home construction* industry may include different types of activities. On a scale of 1 to 5 where 1 means *very rarely* and 5 means *very often*, how often do you think each of the following activities occurs in the region where you work?

Frequency of Occurrence

	Low		High			Don't Know
	1	2	3	4	5	99
4.1 Contractor-builders not fully charging HST to customers for new home construction work						
4.2 Sub-contractors not fully charging HST to contractors for work on new home construction projects						
4.3 Employers not paying Workers' Compensation for employees on new home construction projects						
4.4 Builders working on new home construction projects while receiving EI benefits						

Frequency of Occurrence

	Low			High		Don't Know
	1	2	3	4	5	99
4.5 People with full-time jobs in other industries who "moonlight" as new home builders in their off-hours						
4.6 Builders who knowingly do new home construction that does not meet Building Code specifications						
4.7 Builders who knowingly disregard workplace health and safety rules on new home construction projects						
4.8 The stealing of building supplies from new home construction job sites.						
4.9 Other _____ _____ _____						
4.10 Other _____ _____ _____						

Interviewer: Please record all "other" activities mentioned by respondent. In other words, do not limit to two other activities if they mention more than two.

5. Underground activity in the *home renovation and repair* industry may include different types of activities. On a scale of 1 to 5 where 1 means *very rarely* and 5 means *very often*, how often do you think each of the following activities occurs in the region where you work?

		Frequency of Occurrence					
		Low			High		Don't Know
		1	2	3	4	5	99
5.1	Builders not fully charging HST to customers for home renovation or repair work						
5.2	Sub-contractors not fully charging HST to contractors for work on home renovation or repair projects						
5.3	Employers not paying Workers' Compensation for employees on home renovation or repair projects						
5.4	Builders working on home renovation or repair projects while receiving EI benefits						
5.5	People with full-time jobs in other industries who "moonlight" doing home renovation or repair work in their off-hours						
5.6	Builders who knowingly do renovations or repairs that do not meet Building Code specifications						
5.7	Builders who knowingly disregard workplace health and safety rules on home renovation or repair projects						
5.8	The stealing of building supplies from home renovation or repair job sites.						
5.9	Other _____ _____ _____						
5.10	Other _____ _____ _____						

Interviewer: Please record all "other" activities mentioned by respondent. In other words, do not limit to two other activities if they mention more than two.

6. On a scale of 1 to 5 where 1 means *strongly disagree* and 5 means *strongly agree*, how much do you agree or disagree with the following statement:

“The underground economy creates unfair price competition that pressures legitimate operators in the *new home construction* sector to lower the prices they charge for their work.”

1	2	3	4	5	D/K
					99

Interviewer: do not ask questions 6.1 and 6.2 if the response is strongly disagree (rating of 1) or disagree (rating of 2).

- 6.1 By what percentage, if any, would you estimate that your pricing proposals for *new home construction* were typically reduced because of competition from underground operators? (coding instructions: require two fields (A) and (B): (A) code as 1 – if reduced, 2 – not reduced at all, 99 – don't know (B) actual percentage)

- Reduced by (code as 1 and actual percentage) _____%
- Not reduced at all _____2_____
- Don't know _____99_____

- 6.2 By what percentage, if any, would you estimate that your total sales revenues from *new home construction* for 2002 were reduced because of competition from underground activity? (coding instructions: require two fields (A) and (B): (A) code as 1 – if reduced, 2 – not reduced at all, 99 – don't know (B) actual percentage)

- Reduced by (code as 1 and actual percentage) _____%
- Not reduced at all _____2_____
- Don't know _____99_____

7. On a scale of 1 to 5 where 1 means *strongly disagree* and 5 means *strongly agree*, how much do you agree or disagree with the following statement:

“The underground economy creates unfair price competition and pressures legitimate operators in the *home renovation and repair* sector to lower the prices they charge for their work.”

1	2	3	4	5	D/K
					99

Interviewer: do not ask questions 7.1 and 7.2 if the response is strongly disagree (rating of 1) or disagree (rating of 2).

- 7.1 By what percentage, if any, would you estimate that your pricing proposals for *home renovation and repair* projects were typically reduced because of competition from underground operators? (*coding instructions: require two fields (A) and (B): (A) code as 1 – if reduced, 2 – not reduced at all, 99 – don't know (B) actual percentage*)

- Reduced by (code as 1 and actual percentage) _____%
- Not reduced at all ____2____
- Don't know ____99____

- 7.2 By what percentage, if any, would you estimate that your total sales revenues from *home renovation and repair* projects for 2002 were reduced because of competition from underground activity? (*coding instructions: require two fields (A) and (B): (A) code as 1 – if reduced, 2 – not reduced at all, 99 – don't know (B) actual percentage*)

- Reduced by (code as 1 and actual percentage) _____%
- Not reduced at all ____2____
- Don't know ____99____

8. Over the past 2 years do you think the amount of home building and renovation activity that takes place “underground” in the region where you work has decreased a large amount, decreased somewhat, stayed the same, increased somewhat or increased a large amount?

	Decreased a large amount	Decreased somewhat	Stayed the Same	Increased somewhat	Increased a large amount	Don't Know
8.1 New home building activity	1	2	3	4	5	99
8.2 Renovation & repair activity	1	2	3	4	5	99

Interviewer: ask questions 8.3 and 8.4 only if the interviewee indicated above that underground activity has either increased (4 or 5) and/or decreased (1 or 2) in the home building or in the renovation sector. For the following open-ended questions, please ensure that you ask for sufficient detail to ensure accurate interpretation of responses.

- 8.3 If underground activity has increased or decreased in the **new home construction** sector, what do you see as the three main reasons, in order of significance, for this change?

1. _____

2. _____

3. _____

- 8.4 If underground activity has increased or decreased in the **home renovation and repair** sector, what do you see as the three main reasons, in order of significance, for this change?

1. _____

2. _____

3. _____

9. There are growing concerns about shortages of skilled workers in the home building and renovation industry. Many industry leaders have stated that it is increasingly difficult to attract and hold young people for careers in the industry.

9.1 On a scale of 1 to 5 where 1 means *strongly disagree* and 5 means *strongly agree*, how much do you agree or disagree with each of the following statements about the impacts of underground economy activity on the labour force in the *new home construction* sector?

New Home Construction						
	Strongly Disagree			Strongly Agree	Don't Know	
	1	2	3	4	5	99
9.1.1	Underground activity has little or no impact on attracting and retaining a skilled labour force in the new home construction sector					
9.1.2	Competition from underground builders holds down wages for the whole new home construction sector					
9.1.3	Underground activity helps to recruit and train new workers for the whole new home construction sector					
9.1.4	Underground activity gives the whole industry a bad image for young people making career choices					
9.1.5	Employers cannot afford to train their workers to higher standards because of business competition from underground builders					

9.2 On a scale of 1 to 5 where 1 means *strongly disagree* and 5 means *strongly agree*, how much do you agree or disagree with each of the following statements about the impacts of underground economy activity on the labour force in the *home renovation and repair* sector?

Home Renovation and Repair

	Strongly Disagree					Strongly Agree	Don't Know
	1	2	3	4	5	99	
9.2.1 Underground activity has little or no impact on attracting and retaining a skilled labour force in the home renovation and repair sector							
9.2.2 Competition from underground builders holds down wages for the home renovation and repair sector							
9.2.3 Underground activity helps to recruit and train new workers for the home renovation and repair sector							
9.2.4 Underground activity gives the whole industry a bad image for young people making career choices							
9.2.5 Employers cannot afford to train their workers to higher standards because of business competition from underground builders							

10. At present, there is compulsory certification for plumbers and electricians, but other trades are not covered and there is no mandatory licensing system for home building and renovation. Would you support introduction of the following changes?

		Yes	No	Don't Know
10.1	Mandatory licensing for home builders	1	2	99
10.2	Mandatory licensing for renovators	1	2	99
10.3	Compulsory certification for carpenters	1	2	99

11. A number of other changes might be made to control underground activity in the *new home construction* sector. On a scale of 1 to 5 where 1 means *not effective at all* and 5 means *very effective*, how effective do you think each of the following changes might be in controlling underground activity in the *new home construction* industry?

Effectiveness							
		Low			High	Don't Know	
		1	2	3	4	5	99
11.1	Expand surveillance and enforcement efforts of building inspectors						
11.2	Expand surveillance and enforcement efforts of government tax auditors						
11.3	Expand surveillance and enforcement efforts of the Nova Scotia Department of Labour						
11.4	Expand surveillance and enforcement efforts of the Nova Scotia Workers' Compensation Board						
11.5	Expand surveillance and enforcement efforts of the EI system						
11.6	Educate people who work in the underground sector about the legal risks they are taking						
11.7	Educate people who work in the underground sector about the health and safety risks they are taking						

Effectiveness						
Low			High		Don't Know	
	1	2	3	4	5	99
11.8	Educate consumers about the risks of having work done through underground activities					
11.9	Encourage banks and other mortgage lenders to refuse to finance underground building and renovation					
11.10	Encourage insurance providers to refuse to insure underground building or renovation projects					

12. Can you identify other ways that you think would be effective to limit or control underground activity in the *new home construction* industry? *For the following open-ended questions, please ensure that you ask for sufficient detail to ensure accurate interpretation of responses.*

1. _____

2. _____

3. _____

13. A number of other changes might be made to control underground activity in the *home renovation and repair* sector. On a scale of 1 to 5 where 1 means *not effective at all* and 5 means *very effective*, how effective do you think each of the following changes might be in controlling underground activity in the *home renovation and repair* industry?

Effectiveness						
	Low			High		Don't Know
	1	2	3	4	5	99
13.1 Expand surveillance and enforcement efforts of building inspectors						
13.2 Expand surveillance and enforcement efforts of government tax auditors						
13.3 Expand surveillance and enforcement efforts of the Nova Scotia Department of Labour						
13.4 Expand surveillance and enforcement efforts of the Nova Scotia Workers Compensation Board						
13.5 Expand surveillance and enforcement efforts of the EI system						
13.6 Educate people who work in the underground sector about the legal risks they are taking						
13.7 Educate people who work in the underground sector about the health and safety risks they are taking						
13.8 Educate consumers about the risks of having work done through underground activities						
13.9 Encourage banks and other mortgage lenders to refuse to finance underground building and renovation						
13.10 Encourage insurance providers to refuse to insure underground building or renovation projects						

14. Can you identify other ways that you think would be effective to limit or control underground activity in the *home renovation and repair* industry? *For the following open-ended questions, please ensure that you ask for sufficient detail to ensure accurate interpretation of responses.*

1. _____

2. _____

3. _____

15. To help us in the interpretation of the survey findings could you please estimate for us the gross value of your sales for *new home construction* in 2002?

15.1 Less than \$100,000 _____ 1 _____

15.2 \$100,001 - \$200,000 _____ 2 _____

15.3 \$200,001 - \$500,000 _____ 3 _____

15.4 \$500,001 - \$1,000,000 _____ 4 _____

15.5 \$1,000,001 - \$3,000,000 _____ 5 _____

15.6 Greater than \$3 million _____ 6 _____

16. To help us in the interpretation of the survey findings could you please estimate for us the gross value of your sales for *home renovation and repair* in 2002?

16.1 Less than \$100,000 _____ 1 _____

16.2 \$100,001 - \$200,000 _____ 2 _____

16.3 \$200,001 - \$500,000 _____ 3 _____

16.4 \$500,001 - \$1,000,000 _____ 4 _____

16.5 \$1,000,001 - \$3,000,000 _____ 5 _____

16.6 Greater than \$3 million _____ 6 _____

Thank you very much for your time. If you wish to make inquiries at the Sector Council about this study, you can call (902) 852-2151 and ask for Mary Kenny, or e-mail Mary at mkenny@ahbrsc.com.