



EUROPEAN SEMESTER THEMATIC FICHE

UNDECLARED WORK

Thematic fiches are supporting background documents prepared by the services of the Commission in the context of the European Semester of economic policy coordination. They do not necessarily represent the official position of the Institution.

1. Introduction

Although no official definition of undeclared work exists, in the EU undeclared work is understood as "any paid activities that are lawful as regards their nature, but are not declared to the public authorities, taking into account the differences in the regulatory systems of the Member States".¹ Undeclared work takes a variety of forms ranging from undeclared work in a formal enterprise to clandestine work done by own account workers, but excludes those involving illegal goods or services.

Undeclared work constitutes a political challenge for various reasons:

- from a macroeconomic perspective, it is a form of tax evasion undermining public finances; it also has an impact on working conditions and the quality of jobs with notably no access to lifelong learning, with consequences on potential growth in the long-run;
- from a microeconomic perspective, it distorts competition among firms, paving the way for social dumping and causes productive inefficiencies by keeping companies in business that would otherwise probably be absent from the market. Informal businesses typically avoid access to formal services and have no adequate access to credit and therefore their growth is limited;
- from a social perspective, it is characterised by poor working conditions, deficits in terms of health and safety requirements, lower income and the absence of social security.

Moreover, the scope of undeclared work can be exacerbated by several socioeconomic trends:

¹ European Commission Communication "Stepping up the fight against undeclared work", p.2 COM(2007) 628.

- reorientation of the economy towards sectors most affected by undeclared work (household and care services, which are not easily met by market or publicly supplied services);
- reduction in usage of standard forms of work with a growing flexibility of contractual relationships and notably an increase of self-employed work, subcontracting and outsourcing;
- growth of cross-border business, which requires efficient international cooperation between monitoring and enforcement bodies;
- increase of the social distress in some Member States, with some people who might try to compensate income losses through undeclared work.

Generally three types of undeclared work can be defined. The first category is that of undeclared work in a formal enterprise. Such activity can be completely undeclared or partially undeclared in form of "envelope wages" or "cash-in-hand" (where only part of the salary is paid officially, while the rest is given to the employee unofficially). Secondly, there exists undeclared own account or self-employed work, providing services either to a formal enterprise or other clients, such as households. While in the Nordic countries undeclared work involves mainly undeclared self-employment, in other Member States it concerns mostly employer-employee relations in a formal enterprise. A third type of undeclared work consists in providing goods and services to neighbours, family, friends or acquaintances, which can involve construction or repair works, cleaning, provision of childcare or care for the elderly. This is sometimes akin to mutual aid.

Undeclared work is consequently a multifaceted phenomenon, it is not just the scale but also the structure of undeclared work that varies from one Member State to another; this is owing to differences in the productive structure, in the institutional strength of public bodies and regulatory systems, or in the extent of welfare state systems. The nature and incidence of undeclared work in a country can be seen as reflecting the imperfections of its formal labour market economy.

2. Identification of challenges

Several key indicators can be used to identify challenges in the area of undeclared work. As undeclared work is an unobserved variable, these indicators are those associated with the different drivers of undeclared work. The scale and nature of undeclared work are influenced by a wide range of factors, applying to different stakeholders, as discussed below.

Box: How to estimate undeclared work

There is no reliable and harmonised aggregate data on undeclared work at EU level, but different methods exist to estimate the size of undeclared work, and that of the shadow economy (see also Annex).

Indirect methods are often based on the comparison of macroeconomic aggregates (national accounts, electricity consumption, cash transactions). They tend to capture broader aspects of the "non-observed economy" (NOE), going beyond the standard definition of undeclared work by encompassing illegal activities or household production for own use, hence a bias towards overestimation of undeclared work. An approach often employed in such international comparisons is based on the Multiple Indicators Multiple Causes (MIMIC) model, which assumes a relationship between the unobserved shadow economy and a set of observable macro-variables. However, this methodology faces strong criticism. One of the weaknesses is said to be that it tends to over-estimate the level of undeclared work and that country comparisons can be difficult. In addition, the Intersecretariat Working Group on National Accounts (ISWGNA)² warned against the use of the "macro-model" methods indicator in 2006.

Direct methods are based on statistical surveys, thereby providing greater detail and comparability, although they tend to underestimate undeclared work (they usually focus on undeclared work by individuals – often prone to underreporting –, leaving many undeclared activities performed by companies out of the scope, like subcontracting; another issue is the way to take account of illegal immigrants). Such Europe-wide survey was conducted for the first time in 2007 (Special Eurobarometer 284) and repeated in 2013 (Special Eurobarometer 402), while the European Employment Observatory (EEO) collected national data in 2004 and 2007 concerning the share of undeclared work (as the corresponding figures are based on a mix of direct and indirect methods, they are significantly lower than under the MIMIC approach). At a worldwide level, the World Bank's research on informal workers includes those working without a contract, informal self-employment, or unpaid family work, but this measurement may be less adequate for advanced economies than for emerging ones.

The European Economic and Social Committee (EESC) has recommended adopting a common indirect method, the so-called Italian methodology, in order to measure the scale, impact and development of undeclared work. This method, developed by the Italian institute of statistics, is based on labour input: the comparison of actual social security declarations and imputed declarations based on the European Labour Force Survey³.

Generally, the figures published by official national sources tend to be lower than those contained in the studies of experts and international organisations – the exact definition used has important implications⁴.

² Declaration of the ISWGNA (2006), Estimates of the unrecorded economy and national accounts. The ISWGNA gathers representatives of the five international organisations (European Commission, IMF, OECD, UN, World Bank) that have co-signed the international manual System of National Accounts, 1993.

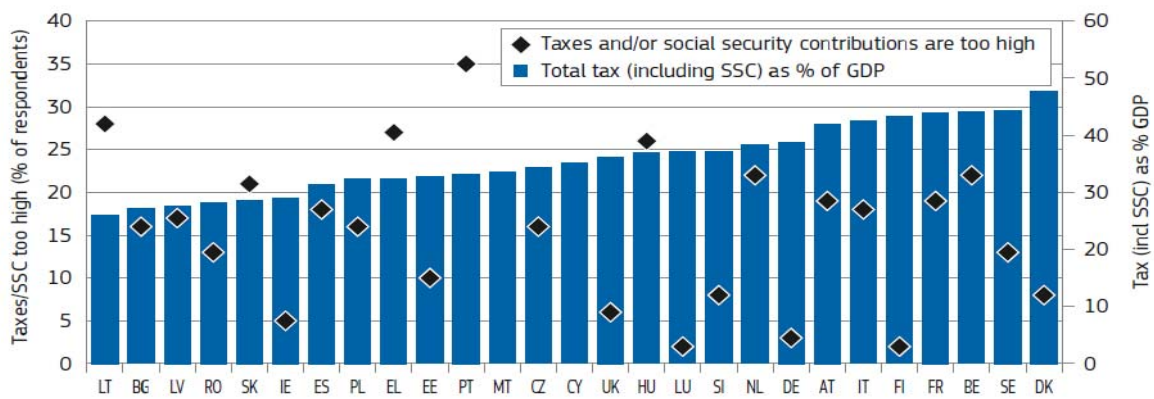
³ Ciccarone, G. et al. (2009) Study on indirect measurement methods for undeclared work in the EU, GHK & Fondazione G. Brodolini, Final report to the European Commission, DG Employment, Social Affairs and Equal Opportunities.

⁴ For an overview of official statistical estimations see Gyomai, G. and P., van de Ven (2014), 'The non-observed economy in the system of national accounts,' OECD Stat. Brief, 18 (2014) and Eurostat (2013) 'Essential SNA: Building the Basics,' Eurostat, Luxembourg

(1) **Structural economic factors** with:

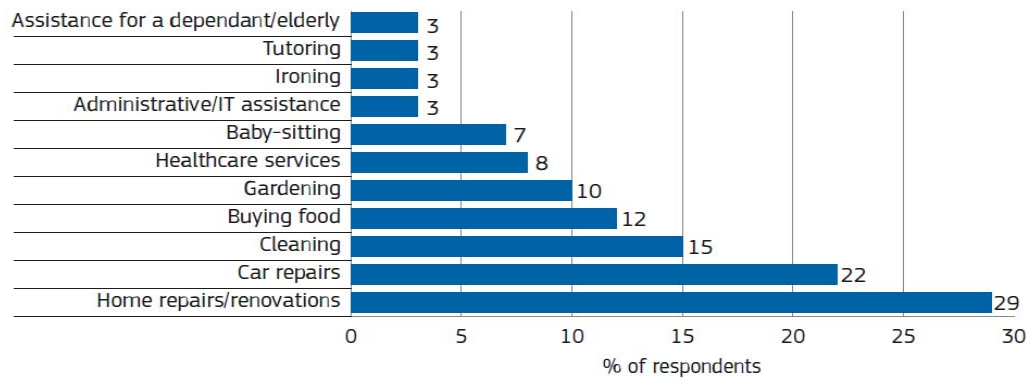
- the taxation levels and compliance costs (including with labour regulations). Nevertheless, according to Eurofound studies, work and welfare regimes that pursue tax reductions, de-regulation and minimal state intervention do not lead, on average, to smaller undeclared economies. A stronger driver is the perception of high taxation and compliance costs: it is not necessarily in the countries with the highest rates of taxation⁵ that people perceive taxes as a driver for undeclared work, which may reflect dissatisfaction with the public services they receive for the taxes that they pay (see below "societal factors"). "Red tape" can be estimated according to the ranking of countries in the World Bank's "Doing business" survey.

Chart 1: Real versus perceived tax burden



Source: DG EMPL calculations based on Eurobarometer 2013 and Eurostat.

Chart 2: Types of goods/services purchased undeclared in the EU-27



Source: Eurobarometer 2013 (1).

(1) The chart is based on question 6: 'Which of the following goods or services have you paid for during the last 12 months, where you had a good reason to believe that they included undeclared work, i.e. that the income was not completely reported to tax or social security institutions? (MULTIPLE ANSWERS POSSIBLE)'.

⁵ For more detailed information on tax wedges, including on low-income earners and second earners, see the guidance note on tax wedge and particularly tables 4 and 5.

- The sectorial composition of the economy, with some sectors⁶ showing a strong exposure to undeclared work, also deserves some attention. In addition, size of firms is also important: dependent employees in receipt of envelope wages are more likely to be working for smaller organisations, with 56% of them working in entities employing fewer than 20 people, which reflects the duality of the labour market between large companies and small firms.⁷

(2) **Cyclical economic factors.** On the employers' side, a difficult business context may encourage to seek to evade or limit tax liabilities. For employees, the corresponding social developments also matter: the increasing length of unemployment⁸ spells (cf. chart 3) and numbers of discouraged workers, a low job vacancy rate (cf. chart 4), the situation of vulnerable groups including illegal immigrants, and the downward pressure on wages are generally seen as conducive to undeclared work. The Eurobarometer 2013 shows that suppliers of undeclared work are more likely to be young, unemployed or students.

Box: Envelope wages and poverty

Envelope wages (where only part of the salary is paid officially, while the rest is given to the employee unofficially) are more prevalent when GDP decreases. A higher level of relative poverty (at-risk of poverty, in-work poverty) makes people more inclined to accept envelope wages, and the relationship is even stronger when referring to severe material deprivation⁹. This may contribute to explain why all countries of Central and Eastern Europe had a proportion of envelope wages above the EU average. A distinction should therefore be made between workers who are obliged to remain in the shadow economy and those who make a deliberate choice to do so (own-account market or social undeclared work).

(3) **Legal factors** such as transparency of legislation, or the adjustment of legislation to cover new types of work.

(4) **Institutional factors**, such as legislation enforcement with notably the existence of a single or coordination entity fighting undeclared work. If control mechanisms are lacking, unclear and/or inefficient, people may be more prone to evade taxes by performing undeclared work.

(5) **Societal factors** with the shared understanding of the overall institutional, taxation and social framework, and its perceived fairness and transparency, fostering ownership of tax

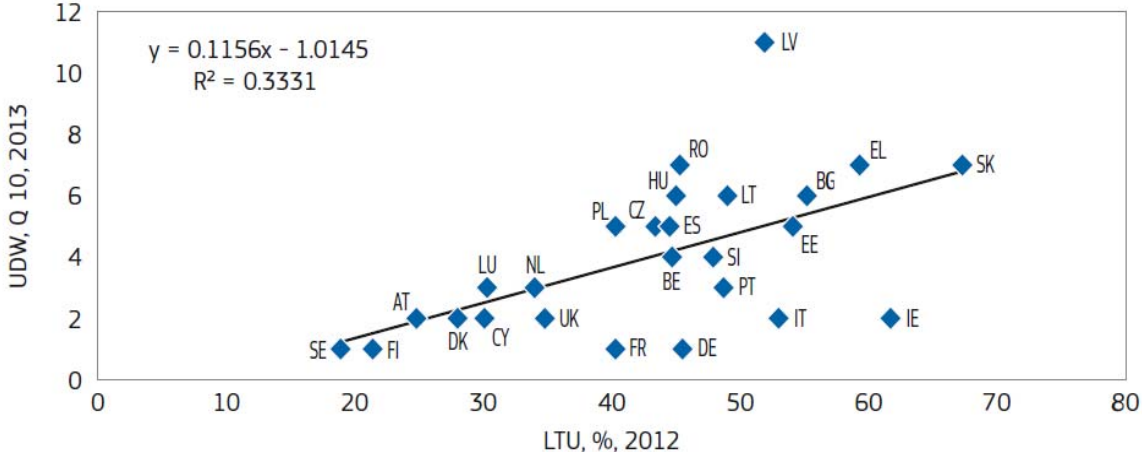
⁶ Construction sector, household services, including domestic cleaning services and child and elderly care, personal services, private security, industrial cleaning, agriculture and hotel, restaurant and catering industry.

⁷ Large firms and exporting and foreign-owned businesses are usually less affected by unregistered businesses, and less likely to view them as a major constraint, than smaller and medium-sized businesses and non-exporting and domestically owned businesses.

⁸ According to the analysis carried-out in European Commission (2013), Employment and Social Developments in Europe, long-term unemployment as a share of the unemployed is slightly more correlated to undeclared work than long-term unemployment as a share of the active population (cf. table 12 of this report).

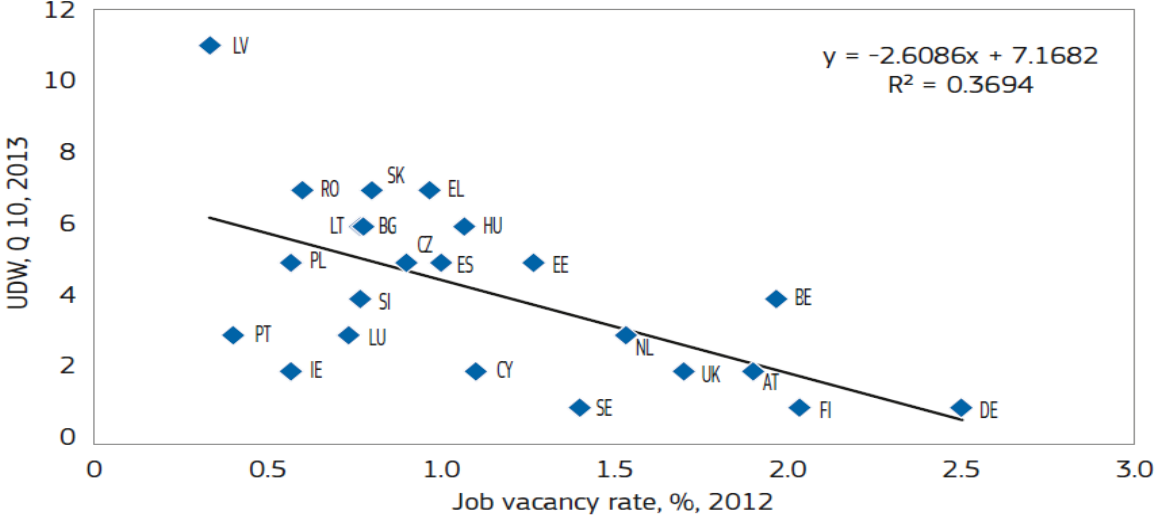
compliance. There is for instance a strong negative correlation between undeclared work and social protection expenditure (excluding pensions). Analyses have shown that the higher the CPI (Transparency International's Corruption Perception Index, that is the less perception of corruption), the lower the probability of having part of the salary paid as envelope wage. This is strong evidence that the existence of a public sector in which citizens trust discourages them from undeclared work.

Chart 3: Long-term unemployment and undeclared work



Source: Eurostat and Eurobarometer 2013.

Chart 4: Job vacancy rate and undeclared work



Source: Eurostat and Eurobarometer 2013.

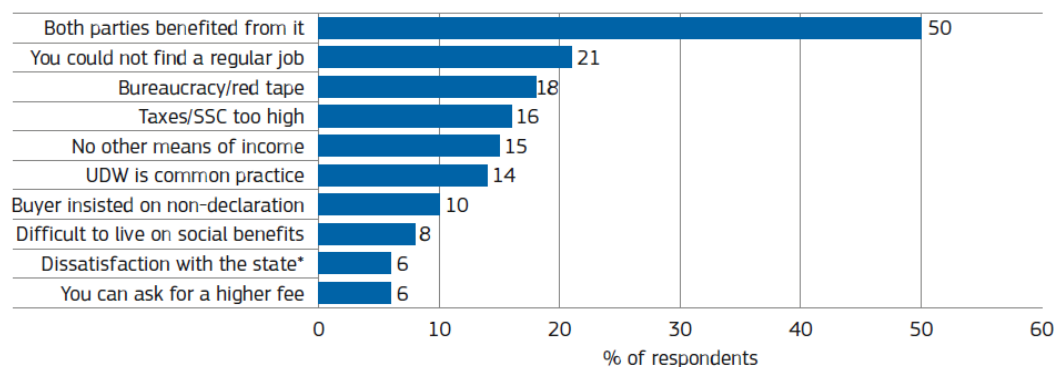
⁹ European Commission (2013), Employment and Social Developments in Europe 2013, Chapter 4: Undeclared work: recent developments

3. Identification of policy levers to address the challenges

Preventing and deterring undeclared work are primarily tasks of the Member States. We have seen in previous sections that undeclared work is a multi-faceted problem calling for a tailor-made comprehensive response.

In order to tackle undeclared work while making formal work attractive, a right mix of policy measures is therefore needed. Its design should be differentiated depending on institutional features of the Member States (administrative organisation, sectorial composition of the economy, employment types), so as to address the specific factors that drive undeclared work.

Chart 5: Reasons for working undeclared in the EU-27



Source: Eurobarometer 2013 ⁽¹⁾.

⁽¹⁾ Based on question 17, 'Among the following, what were the reasons for doing these activities undeclared? (MULTIPLE ANSWERS POSSIBLE)'. * The exact wording is 'The state does not do anything for you, so why should you pay taxes'.

The corresponding policy mix should usually include, in variable proportions, deterrence, compliance-enabling, and commitment approaches:

- On the "cost side" of the equation, the necessary deterrence approach aims at increasing the perception of risk through more efficient detection and enforcement and/or increased penalties. Sanctions can be made tougher, but also extended to additional parties involved, if appropriate; and attention should also be paid to their effective implementation.
- It has been increasingly recognised that it is also possible to alter the cost benefit ratio by changing the "benefits side" of the equation. The compliance-enabling approach, which has recently gained ground¹⁰, aims at facilitating compliance with the existing rules either by preventing businesses and people from engaging in

¹⁰ While the deterrence approach remains the dominant approach across the majority of Member States, there has been wider take-up of an enabling approach since the onset of the recession. (Eurofound (2013), Tackling undeclared work in 27 EU Member States and Norway: Approaches and measures since 2008)

undeclared work or by encouraging and enabling them to transfer undeclared work into the formal economy. This approach includes preventive and curative measures.

- The commitment approach corresponds to measures fostering higher tax morale and a culture of commitment, for example through awareness-raising campaigns concerning the consequences of undeclared work both at the individual and collective level, and by enhancing the perceived tax fairness, procedural and redistributive justice.

4. Cross-examination of policy state of play

Different types of policy measures have been implemented by various Member States to tackle undeclared work¹¹.

The detection process can be improved by relying on peer-to-peer surveillance, for instance in the Netherlands, the inspectorate of the Ministry of Social Affairs opened, in 2012, a hotline to report illegal or rogue temporary employment agencies.

It can also benefit from a deeper cooperation between public bodies (with joint inspections and exchange of data). For instance, in Finland, a Grey Economy Information Unit was established on 1 January 2011, for gathering information and conducting investigations.

Making full use of automated tools and risk management techniques allows concentrating limited human and budgetary resources on high value-added investigation and innovation tasks.

The detection process can also be strengthened by the calibration of benchmark indicators of labour costs broken down as appropriate by sector, category of company and region, and agreed on by the social partners. For instance, in Italy, the social partners defined a set of appropriate parameters in October 2010 to be used to assess the regularity of construction firms on the basis of the incidence of labour on their total costs. Setting up fora for stakeholders witnessing undeclared work, such as social partners, may therefore prove advisable.

Preventive measures are multifaceted:

- using technological innovations for better monitoring, such as certified cash registers in Sweden since 2010;
- adaptations of the legal framework in order to take into account new categories of work, so that they are not misused but provide a way for companies and workers to reconcile their needs. However, legislation to cover new types of work, so that they

¹¹ Eurofound describes close to 200 case studies at:
<http://www.eurofound.europa.eu/areas/labourmarket/tackling/search.php>

respond to new work patterns, should not translate into additional segmentation of labour markets;

- simplification and e-government measures focusing on self-employment or on the creation of new companies. In the latter case one example is the Simplex programme in Portugal, making it possible to establish a company in a single office in a single day;
- minimum wage levels and income support are other levers to reduce the share of undeclared wages, respectively by preventing employers from paying official wages lower than the reservation¹² wage, or by making undeclared work less attractive for workers. According to the 2013 Eurobarometer, this is particularly true for Southern, and Eastern and Central Europe, where respectively 41% and 28% of respondents working undeclared say they cannot find a regular job, with 26% and 19% mentioning no other means of income. It should be noted that the hourly cost for undeclared work is higher than the minimum hourly wage in all Member States, except Poland. This may be due to the semi-skilled nature of undeclared work, which seems to go against the assumption that high minimum wages make undeclared work more attractive. For instance, in Estonia, one of the arguments to increase minimum wage levels has been to reduce the share of undeclared wages¹³.

Curative measures in turn include measures to stimulate purchasers to buy declared goods or services through targeted tax reliefs or reductions, subsidies or service vouchers. Examples can respectively be found in Denmark, which introduced in 2011 the possibility to deduct up to €2000 of the costs of employing domestic helpers under the "home job plan" project, in Austria, with subsidies for private geriatric nurses, and in France and Belgium, with the so called "chèques emploi-service universels" and "titres-services".

Amnesties can also be envisaged on either a societal or individual level to those who put their affairs in order. However, such measures should not be overused at the risk of creating incentives for future tax avoidance.

Awareness campaigns have been carried out for example in Portugal, Slovenia, Latvia, Lithuania and Estonia, including very concrete examples of public services in daily life (healthcare, police, education...).

As regards the exchange of best practice, Decision (EU) 2016/344 of 9 March 2016 established a European Platform to enhance cooperation in tackling undeclared work¹⁴. This Platform brings together different enforcement authorities¹⁵, which are involved in the prevention and/or deterrence of undeclared work. The Platform has been launched in May 2016. The initiative aims to improve cooperation through sharing information and best practices, developing expertise and promoting and facilitating cross-border cooperation. It may *inter alia* work on evidence-based measurement tools, promote comparative analysis and relevant methodological instruments as well as develop the analysis of effectiveness of

¹² Wage level on which persons are ready to work

¹³ For further examples see Eurofound (2013)

¹⁴ Official Journal L65 of 11 March 2016

¹⁵ Such as labour inspectorates, social security, tax and migration authorities.

different policy measures, and establish tools such as a knowledge bank of different practices and measures used by Member States to deter and prevent undeclared work.

Date: 29.04.2016

Annex: Estimated size of the shadow economy and undeclared work (UDW) in the EU

Country	Shadow economy (in % of GDP), 2015 ¹	UDW (% of GDP), 1992-2006 ²	UDW, country data or estimations ³ (% of GDP)	Informal work ⁴ (% of extended labour force)	Demand of UDW ⁵ (% of respondents to Eurobarometer Survey 2013)	Supply of UDW ⁶ (% of respondents to Eurobarometer Survey 2013)	Envelope wages ⁷ (% of respondents to Eurobarometer Survey 2013)
Austria	8.2	1.5 (1995)	No data	19.7	14	5	2
Belgium	16.2	6-20	No data	10.5	15	4	4
Bulgaria	30.6	22-30 (2002)	20 (2011)	13.2	16	5	6
Cyprus	24.8	10 (2007)	19.1 (2012)	53.0	16	2	2
Croatia	27.7	No data	No data	No data	17	7	8
Czech Republic	15.1	9-10 (1998)	No data	12.5	19	4	5
Denmark	12.0	3 (2005)	No data	11.5	23	9	2
Estonia	26.2	7-8 (2007)	8 (2011)	9.8	12	11	5
Finland	12.4	4.2 (1992)	No data	11.2	11	3	1
France	12.3	4-6.5 (1998)	No data	10.3	9	5	1
Germany	12.2	7 (2007)	No data	11.9	7	2	1
Greece	22.4	24-30 (2007)	36.3 (2012)	46.7	30	3	7
Hungary	21.9	18 (1998)	16-17 (2006)	9.4	11	4	6
Ireland	11.3	8 (2002)	No data	33.0	10	2	2
Italy	20.6	6.4 (2006)	12.1 (2011)	22.4	12	2	2
Latvia	23.6	16-18 (2007)	No data	8.0	28	11	11
Lithuania	25.8	15-19 (2003)	No data	6.4	14	8	6
Luxembourg	8.3	No data	No data	No data	14	5	3
Malta	24.3	25 (1998)	No data	No data	23	1	0
Netherlands	9.0	2 (1995)	No data	12.6	29	11	3
Poland	23.3	12-15 (2007)	4.6 (2010)	21.6	5	3	5
Portugal	17.6	15-37 (2004)		22.4	10	2	3
Romania	28.0	16-21 (2007)	31.4	11.8	10	3	7
Slovakia	14.1	13-15	No data	12.2	17	5	7
Slovenia	23.3	17 (2003)	No data	14.1	22	7	4
Spain	18.2	12,3 (2006)	17 (2011)	18.8	8	5	5
Sweden	13.2	5 (2006)	No data	8.2	16	7	1
UK	9.4	2 (2000)	No data	21.7	8	3	2

Sources for the table: 1: Schneider, F. (2015), "Size and development of the Shadow Economy of 31 European and 5 other OECD Countries from 2003 to 2015: Different Developments"¹⁶; 2: European Commission (2004, 2007), *European Employment Observatory Review, Spring 2004 and Spring 2007*; 3: Eurofound (2012), *EU Member States and Norway fact sheets on estimates and approaches to measure undeclared work*; 4: Hazans, M. (2011), 'Informal workers across Europe: Evidence from 30 European countries,' *World Bank Policy Research Working Paper*, (5912); 5: Eurobarometer 2013, Replies to the question "Have you in the last 12 months paid for any goods or services of which you had a good reason to assume that they included undeclared work (e.g. because there was no invoice or VAT receipt)?""; 6: Eurobarometer 2013, Replies to the question "Apart from a regular employment, have you yourself carried out any undeclared paid activities in the last 12 months?""; 7: Eurobarometer 2013, Replies to the question "Sometimes employers prefer to pay all or part of the salary or the remuneration (for extra work, overtime hours or the part above a legal minimum) in cash and without declaring it to tax or social security authorities. Has your employer paid you any of your income in the last 12 months this way?"

¹⁶ This methodology is strongly criticised. One of the weaknesses is said to be that it tends to over-estimate the level of undeclared work and that country comparisons can be difficult. In addition, the Intersecretariat Working Group on National Accounts (ISWGNA) warned against similar methods in 2006.