



Eurofound

Tackling undeclared work in 27 European Union Member States and Norway

Approaches and measures since 2008



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When citing this report, please use the following wording:

Eurofound (2013), *Tackling undeclared work in 27 European Union Member States and Norway: Approaches and measures since 2008*, Eurofound, Dublin.

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Research project: Measures for tackling undeclared work in the EU, the candidate countries and Norway since the crisis



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Executive summary

Introduction

Since the publication of previous reports on how undeclared work is being tackled in the 27 Member States of the European Union (EU27) and Norway (Eurofound, 2008, 2009), the ongoing recession took hold. The aim of this report is to provide an updated overview of the policy approaches and measures that have been implemented to tackle undeclared work since the beginning of the recession in 2008.

Policy context

Two contrasting views exist regarding what happens to the size of the undeclared economy in times of economic crisis. One is that it grows relative to the declared economy. The theory is that firms and households will seek to save on costs to support falling profit and income by substituting declared work with undeclared work, and unemployed workers will be more willing to engage in undeclared work as a coping strategy. The alternative view is that the undeclared economy declines due to the lower demand for undeclared labour because of less money being available; traditional sectors where undeclared work is concentrated (such as construction and catering) will be harder hit in times of economic crisis, and undeclared work will be substituted by 'flexible' and cheaper declared labour.

So how has the undeclared economy changed in terms of its size since the onset of the recession? Has it grown or declined? Estimates by Schneider (2012) reveal that besides a small increase between 2008 and 2009 across most of the EU27, there has been an ongoing, incremental decline in the size of the undeclared economy from the equivalent of 22.3% of GDP in 2003 to 18.4% by 2012. This trend is apparent across all EU27 Member States and Norway.

Despite this common trajectory, the size of the undeclared economy varies significantly across Member States, ranging from 7.6% of GDP in Austria to 31.9% in Bulgaria. Indeed, there is a clear north–south and east–west divide within the EU27. Countries with below average-sized undeclared economies are largely west European and Nordic Member States, and those with above average-sized undeclared economies are either east-central European or southern European Member States.

Who is being affected by the decline in the undeclared economy during the current economic crisis? In Nordic countries, those in declared work who have traditionally topped up their earnings using the undeclared economy are suffering more than others from the decline of the undeclared economy during the current recession. In southern Europe, the unemployed are suffering the most from this decline. This is also the case in western and east-central Europe, and the EU27 as whole. Even when unemployed people get undeclared work, it is less well paid and the annual income from it is lower than that earned by employed people engaged in such work.

Key findings

Since the beginning of the recession, a wide range of policy approaches and measures to tackle undeclared work have been introduced across the EU27. Although a deterrence approach, which seeks to engender compliance by detecting and punishing non-compliance, 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. This approach provides encouragement and incentives for people and businesses to join the formal economy.

By 2010, 90% of the 30 countries in the European Economic Area (EEA) and Switzerland had implemented policy measures to help prevent businesses and people from engaging in undeclared work from the outset, 64% of countries were using one or more curative measures to enable the transfer of undeclared work into the declared realm, and 69%

had adopted commitment measures to try to facilitate a greater commitment to ‘tax morality’. However, the range of measures implemented remained relatively narrow.

Beyond the simplification of compliance, only a limited number adopted other preventative policy measures. Beyond targeted direct tax incentives (such as income tax relief, tax reduction and subsidy schemes), less than one-third of countries had adopted other curative policy measures, and beyond awareness-raising campaigns, very few had adopted other commitment measures. Nevertheless, many innovative policy measures have been implemented since the onset of the recession in certain countries, which could be transferable to other countries. These have been included in the expanded knowledge bank of good practice policy measures that accompanies this overview report (see <http://www.eurofound.europa.eu/areas/labourmarket/tackling/search.php>).

Policy pointers

The first important finding of this synthesis report is that many new policy measures are being pursued in Member States of the EU27 and Norway that are transferable to other sectors and countries. If the accompanying knowledge bank is used by Member States to identify new possibilities for policy initiatives, so as to expand their existing repertoire, an important objective will be achieved. This report provides pointers of potentially good practice policy measures that Member States might wish to further consider.

The second important finding is that there is a strong correlation between the wider austerity measures pursued and the size and growth of the undeclared economy. Evaluating the implications for undeclared economies of pursuing the neo-liberal austerity measures of reducing taxes, pursuing deregulation and minimising state intervention and the social democratic austerity measures of bolstering state expenditure on the labour market and welfare provision, this report reveals that neo-liberal measures are strongly correlated with larger undeclared economies and social democratic measures with smaller undeclared economies. Not only is there no correlation between lower tax rates and smaller undeclared economies, welfare regimes in which there is higher expenditure on labour market interventions, social protection and redistribution, and greater levels of equality (as measured by the Gini coefficient) have smaller undeclared economies. Such findings, however, need to be treated with caution. Although these correlations do not suggest a cause–effect relationship, they do hint that there is some relationship between the types of austerity measures pursued and the size and growth of undeclared economies. It might be useful to evaluate longitudinally, within each Member State, whether there is a similarly strong correlation between expenditure on labour market intervention and welfare provision, and the size of undeclared economies. If a strong correlation is identified, this will provide further evidence that the size of undeclared economies is related to the broader economic and social policies being pursued. The aim of this overview report is to provide a resource that enables policymakers to select effective policy approaches and measures.

Introduction

Since the publication of previous reports on how undeclared work is being tackled in the 27 Member States of the European Union (EU27) and Norway (Eurofound, 2008, 2009), the economic recession has taken hold and Europeans now live in a very different economic landscape. The aim of this new report is to provide an updated overview of the policy approaches and measures that have been implemented to tackle undeclared work since the beginning of the recession in 2008.

The first section of this report provides an overview of what is known about changes in the size of the undeclared economy since the onset of the economic crisis, along with who is being affected. Having shown how the undeclared economy is continuing to decline in terms of its share of GDP during the economic crisis and how different groups are being affected by this in different EU regions, the next section presents an analysis of how policy approaches towards undeclared work have changed since the beginning of the recession. The third section provides a synthesis of the multifarious policy measures that have been implemented in the EU27 and Norway since the onset of the economic crisis. The fourth section evaluates whether or not a correlation exists between the wider austerity measures pursued and the size and growth of the undeclared economy. It also discusses whether anything additional is required to what is already being pursued in the EU Member States and Norway in order to tackle undeclared work. The overall outcome is an evaluation of the policy approaches and measures implemented since the start of the recession to tackle undeclared work in the EU Member States and Norway.

Defining undeclared work

As in earlier reports (Eurofound, 2008, 2009), undeclared work is here defined as ‘any paid activities that are lawful as regards their nature but not declared to the public authorities, taking into account the differences in the regulatory system of Member States’ (European Commission, 2007, p. 2). In consequence, the only difference between undeclared and declared work is that undeclared work is not declared to the authorities for tax, social security or labour law purposes. Any activity that involves other differences is not defined as undeclared work. For instance, if an activity involves illegal goods or services – such as drug-trafficking – it is criminal activity, and if unpaid, it is deemed part of the ‘unpaid’ economy rather than the undeclared economy.

This definition covers diverse paid activities ranging from informal domestic services to clandestine activity conducted by illegal residents. For analytical purposes, three broad types of undeclared work are distinguished:

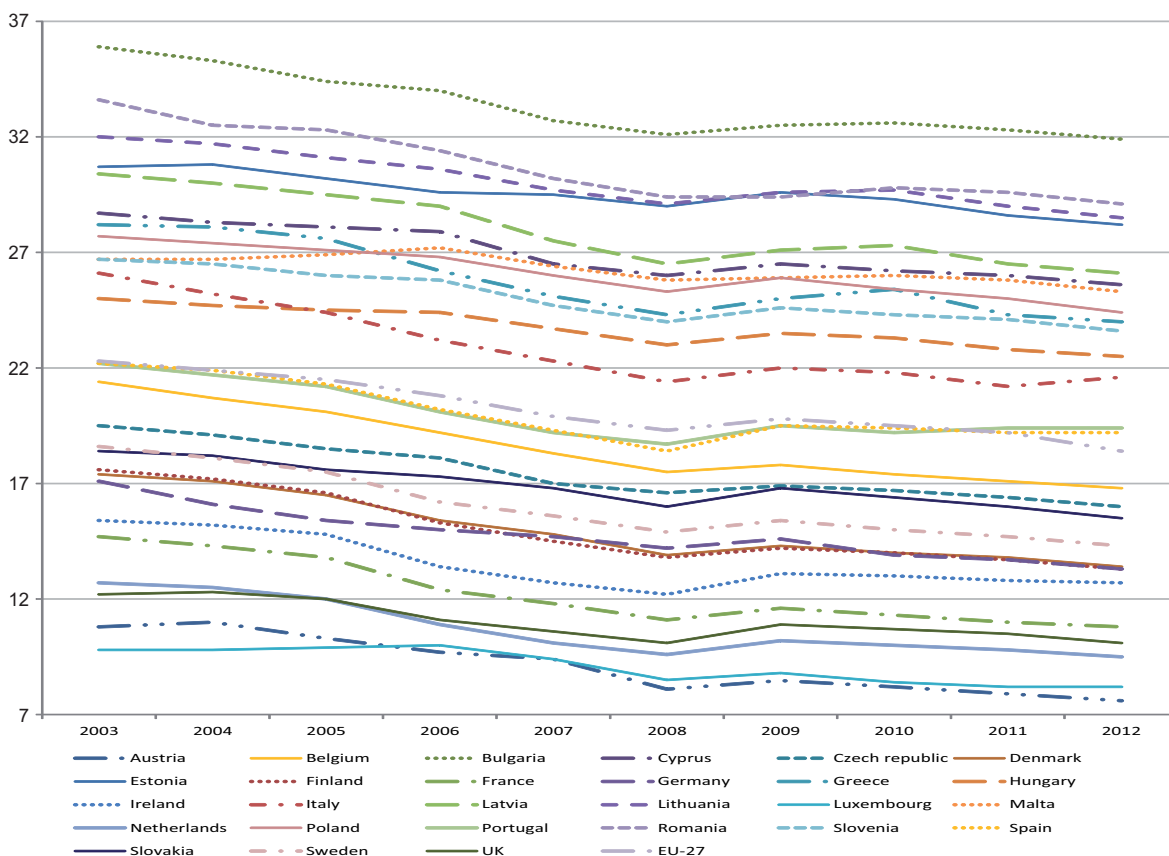
- undeclared work within a formal or informal enterprise, or what might be termed undeclared waged employment. This can be either wholly undeclared, where all one’s wages are paid ‘off the books’, or partially undeclared, where a portion of the wage from one’s formal employer is paid officially and a portion off the books (‘envelope wages’);
- own-account undeclared work for an enterprise or another client such as a household, conducted in a similar way to self-employment; and
- more socially embedded own-account undeclared work, delivering goods and services directly to consumers who are neighbours, kin, friends or acquaintances.

Changes in the undeclared economy in the EU27 1

Two theories exist regarding what happens to the size of the undeclared economy in times of economic crisis. According to one, the size of an undeclared economy grows relative to that of the declared economy. The rationale underpinning this is that firms and households seek to save on costs to support falling profit and income by substituting declared work with undeclared work, and unemployed workers are more willing to engage in undeclared work as a coping strategy. An alternative view is that the undeclared economy declines because of the lower demand for undeclared labour due to less money being available; traditional sectors where undeclared work is concentrated (such as construction and catering) are harder hit in times of economic crisis, and undeclared work is substituted by ‘flexible’ and cheaper declared labour.

Figure 1 charts how the undeclared economy has changed in terms of its size since the onset of the recession across the EU27 using estimates from Schneider’s (2012) Multiple Indicators Multiple Causes (MIMIC) measurement method. It reveals that besides a slight rise between 2008 and 2009 across most of the EU27, undeclared work continued to decline in size relative to the declared economy across all Member States between 2003 and 2012. The current economic crisis has not reversed the previous trend of an ongoing incremental decline in the size of the undeclared economy as a proportion of GDP.

Figure 1: *Changing size of the undeclared economy as % of GDP, 2003–2012*

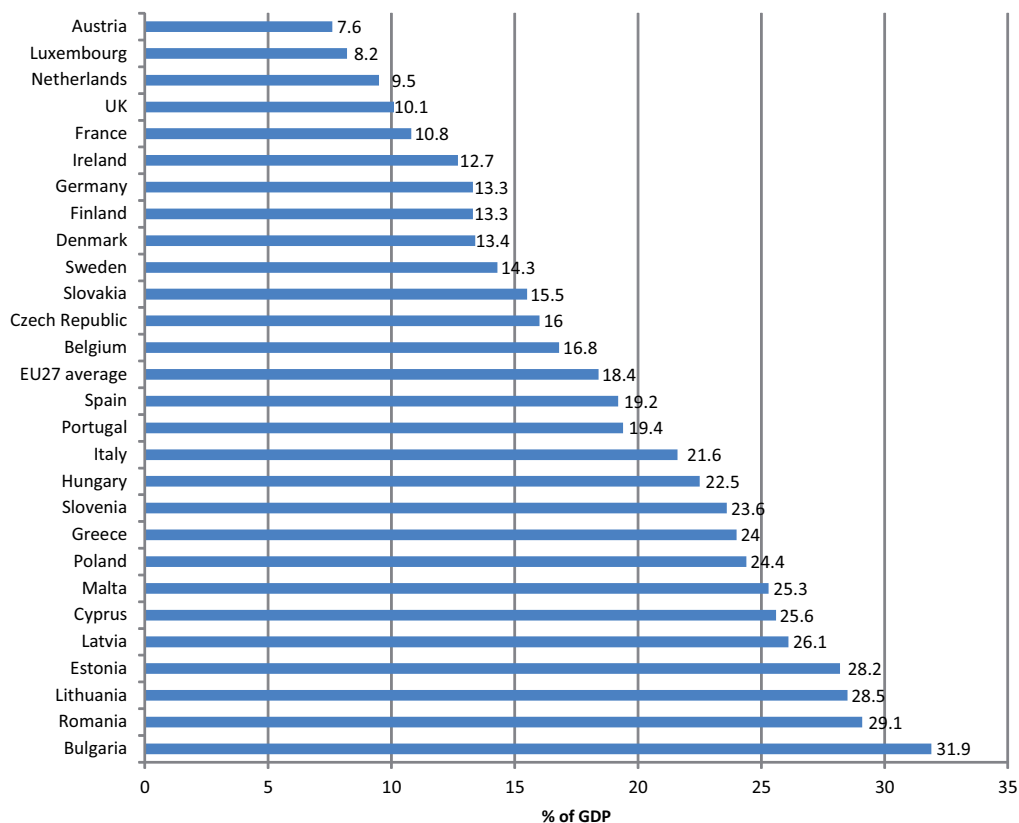


Source: *Derived from Schneider (2012, Table 1.1)*

By 2012 and as Figure 2 displays, the average size of the undeclared economy across the EU27 was equivalent to 18.4% of GDP, although this varied significantly between Member States, ranging from 7.6% in Austria to 31.9% in Bulgaria. Figure 2 also shows how most of the Member States with relatively large undeclared economies in 2012 are either east-central European or southern European Member States. Those with below-average undeclared economies, meanwhile,

are largely west European and Nordic Member States. This signals a clear north–south and east–west divide within the EU27 concerning the relative size of the undeclared economy.

Figure 2: Size of the undeclared economy as % of GDP 2012 by country



Source: Derived from Schneider (2012, Table 1.1)

Who is being affected?

This reduction in the size of the undeclared economy means that some groups who were relying on the undeclared economy as a source of income are no longer able to do so. Who is being affected depends on where one is in the EU27. Two contrasting theses exist regarding who relies on the undeclared economy. The ‘marginalisation’ hypothesis holds that marginalised populations, such as the unemployed, disproportionately participate in and gain from undeclared work. The ‘reinforcement’ hypothesis holds that marginalised populations such as the unemployed benefit less from undeclared work than those in declared employment; undeclared work reinforces, rather than reduces, the inequalities produced by the declared realm. Table 1 assesses which hypothesis is valid across different regions of the EU27 using the results of Special Eurobarometer No. 284 (‘Undeclared work in the European Union’), conducted in 2007 as part of wave 67.3 of the Eurobarometer. It shows that the marginalisation hypothesis is not applicable in Nordic countries: only 9% of the unemployed participate in undeclared work compared with 12% of the employed and 20% of those falling into the ‘other non-employed’ category. Although the unemployed comprise 4% of the surveyed population in Nordic countries, they conduct just 3% of all undeclared work and receive just 2% of all undeclared income. However, the marginalisation hypothesis is valid in western Europe, east-central Europe and southern Europe. In western Europe, 6% of the unemployed conduct undeclared work compared with 5% of the employed and 4% of the other non-employed. Similarly, in east-central Europe, 12% of the unemployed conduct undeclared work compared to just 7% of the employed and 3% of the other non-employed. In southern Europe, 12% of the unemployed conducted undeclared work over a 12-month period, compared to only 2% of the employed and 2% of the other non-employed.

Table 1: Extent and nature of participation of employed, unemployed and non-employed in undeclared work by EU region

	% engaging in undeclared work	% of all undeclared work conducted	% of surveyed population	Average total hours	Average hourly undeclared wage (€)	Mean annual undeclared income (€)	% of total undeclared income earned
EU27	4	100	100	80	11.02	881	100
Unemployed	9***	11	6	98***	8.04***	788***	9
Other non-employed	3*	32	44	9.31***	9.31***	754***	30
All employed	5*	57	50	14.08***	14.08***	1,084***	61
Nordic countries	11	100	100	40	13.75	550	100
Unemployed	9***	3	4	42**	11.83**	497**	2
Other non-employed	20***	34	39	43**	11.81**	508**	32
All employed	12***	63	57	37**	15.20**	562**	66
Western Europe	4	100	100	58	12.82	744	100
Unemployed	6**	8	6	52**	9.94***	517**	5
Other non-employed	4**	35	43	65**	10.38***	674**	32
All employed	5**	57	51	59**	14.90***	879***	63
East-central Europe	5	100	100	98	7.34	720	100
Unemployed	12***	17	7	136***	5.24**	713**	17
Other non-employed	3***	21	45	85***	6.20**	527***	16
All employed	7***	62	48	96**	8.31**	798***	67
Southern Europe	3	100	100	120	9.14	1,096	100
Unemployed	12***	16	4	141***	8.98**	1,266***	18
Other non-employed	2**	40	46	138***	7.88**	1,087*	39
All employed	2**	44	50	111***	10.30**	1,143***	43

Statistical significance: * = 0.05 (5% probability), **=0.01 (1%) and ***= 0.001 (0.1%)

Source: Williams and Nadin (2012)

Only the reinforcement hypothesis is valid in Nordic nations. There, the employed have higher participation rates than the unemployed in undeclared work. Although the employed only comprise 57% of the surveyed population, they conduct 63% of all undeclared work; earn 65% of all income from undeclared work; receive 28% more per hour from their undeclared work than the unemployed; and have annual earnings that are 13% higher than those of the unemployed.

In western Europe and east-central Europe, similar to the EU27 as a whole, both the marginalisation and reinforcement theses are applicable. Although the unemployed have higher participation rates in undeclared work, they benefit less than the employed from such work. In western Europe, despite making up only 51% of the surveyed population, the employed conduct a disproportionate share of the undeclared work (57%); earn 63% of all undeclared income; and earn 50% more per hour than the unemployed, as well as 70% more in total undeclared earnings. In east-central Europe, despite comprising only 48% of the surveyed population, the employed conduct 62% of undeclared work; earn 67% of the total undeclared income; and earn 59% more per hour than the unemployed, as well as 12% more in total undeclared earnings. In southern Europe, only the marginalisation hypothesis is applicable. Despite making up 50% of the surveyed population, the employed conduct just 44% of undeclared work and earn just 43% of the undeclared income.

As Table 2 summarises, the marginalisation hypothesis is not valid in Nordic countries but is in western Europe, east-central Europe and southern Europe, whilst the reinforcement hypothesis is valid in western Europe, east-central Europe and the Nordic countries, but not in southern Europe. In other words, in Nordic countries only the reinforcement hypothesis applies, whilst in southern Europe only the marginalisation hypothesis is applicable. In western and east-

central Europe, both the reinforcement and marginalisation theses are valid. In these EU regions, and similar to the EU27 as a whole, a new perspective regarding the participation of the unemployed in undeclared work is required to portray how undeclared work leads to a ‘reinforced marginalisation’ of their position. The unemployed disproportionately engage in undeclared work, but their participation in this realm reinforces their marginalised position in that their undeclared work is less well paid and their total annual undeclared income is lower than that of employed people engaged in such work.

Table 2: *Validity of marginalisation and reinforcement hypotheses by EU region*

	Marginalisation hypothesis	Reinforcement hypothesis
Nordic countries	X	✓
Western Europe	✓	✓
East-central Europe	✓	✓
Southern Europe	✓	X

Who is being affected by the decline in the undeclared economy during the current economic crisis? The clear suggestion is that in Nordic countries, those in declared work who have traditionally topped up their earnings using the undeclared economy are suffering the most from the decline of the undeclared economy in the current recession. In southern Europe, the unemployed are suffering more than others from the decline in the undeclared economy. This is also the case in western and east-central Europe, and the EU27 as whole. In these regions, even when the unemployed get such work, it is less well paid and results in a lower annual income than that of employed people engaged in undeclared work.

How can these variations be explained? Williams and Nadin (2012) argue that they are strongly correlated with the broader work and welfare regimes that exist in these different EU regions. In work regimes that do not pursue active labour market policies for those excluded from the declared labour market, and in welfare regimes where benefit compensation payments are less widespread and/or benefit payments are relatively low compared with the average wage, the unemployed are forced into undeclared work to secure a livelihood; this results in higher participation rates of the unemployed in undeclared work. In regimes where active labour market policies are more pursued and unemployment compensation benefits are more widespread and/or the level of benefit payments is relatively closer to the average wage, unemployed people do not disproportionately engage in undeclared work. The clear implication is that broader economic and social policies have a major impact on both the size of the undeclared economy and who is affected. This will be returned to later. Before doing so, it is necessary to review, firstly, how policy approaches towards undeclared work being pursued by Member States have changed since the onset of the economic recession and, secondly, the diverse range of policy measures that have been implemented in the EU27 and Norway since the beginning of the recession in 2008.

Policy approaches since the economic crisis 2

This chapter analyses the policy approaches being pursued in different Member States. It then evaluates policy changes adopted in the Member States and Norway since the onset of the economic crisis.

Table 3 identifies two broad policy approaches towards undeclared work: a deterrence approach, which seeks to engender compliance by detecting and punishing non-compliance, and an enabling approach, which aims to encourage compliance by either preventing businesses or people from engaging in undeclared work from the outset, enabling the transfer of undeclared work into the declared realm, or facilitating commitment to ‘tax morality’ (Eurofound, 2009).

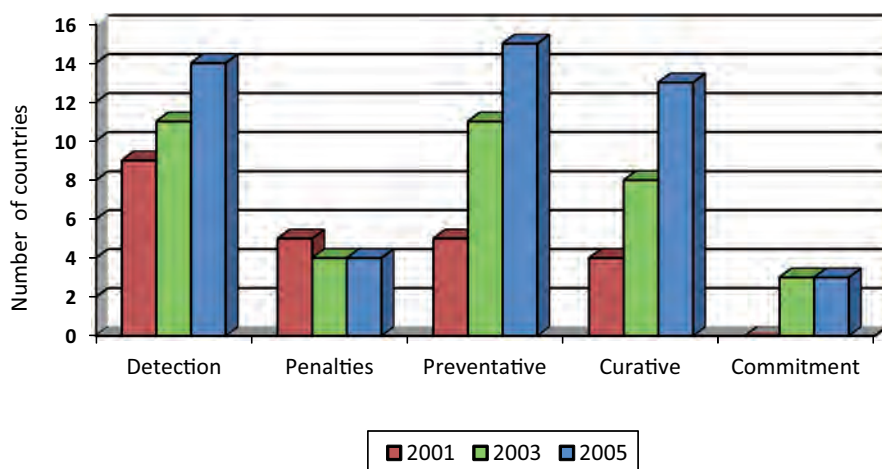
Table 3: *Policy approaches towards undeclared work*

Approach	Method	Measures
Deterrence	Improve detection	Data matching and sharing Joining up strategy Joining up operations
	Penalties	Increase penalties for evasion
Enabling compliance	Preventative	Simplification of compliance Direct and indirect tax incentives Smooth transition into self-employment Introducing new categories of work Micro-enterprise development
	Curative	Purchaser incentives: <ul style="list-style-type: none"> • service vouchers • targeted direct taxes • targeted indirect taxes Supplier incentives: <ul style="list-style-type: none"> • society-wide amnesties • voluntary disclosure • business advisory and support services
	Fostering commitment	Promoting benefits of declared work Education Peer-to-peer surveillance Tax fairness Procedural justice Redistributive justice

Evaluating the shifts in policy approach

Figure 3 reports the extent to which these different policy approaches were adopted in Member States prior to the economic crisis. It shows that in 2001, the deterrence approach dominated (mostly through improved detection rather than penalties), with some nations adopting preventative measures. Nonetheless, by 2003, punishing non-compliance and preventative measures had become more commonplace, as had curative measures to enable compliance across a wider array of Member States.

Figure 3: Approaches used to tackle undeclared work in the EU27



Source: Eurofound, 2009

On the whole, between 2001 and 2003, measures to enable compliance, with one or two exceptions, were largely confined to western European and Nordic Member States. However, by 2005, a wider range of Member States were beginning to adopt such measures, albeit mostly countries from the original 15 EU Member States. Other Member States were still displaying a preference for measures aimed at detecting and punishing non-compliance, and where an enabling approach was adopted, it was mostly confined to prevention measures. Measures to engender greater commitment to tax morality, meanwhile, remained largely absent.

Since 2008 and the onset of the recession, a wider range of approaches and measures have started to be adopted across the EU27. This is reflected in the findings of a 2010 survey of senior officials in 31 European countries located in labour inspectorates, revenue administrations, social security administrations, trade unions, employer organisations and other relevant agencies such as customs, border police and immigration (Dekker et al, 2010). As Table 4 shows, when asked to rank the importance of four measures in their country’s approach to tackling undeclared work in 2010, 57% stated that the deterrence approach was the most important and just 43% deemed enabling approaches the most important. The preventative approach was cited by 19%, the curative approach by 14% and the commitment approach by just 10%. Regarding those measures deemed least important, 84% cited enabling approaches while only 16% cited the deterrence approach. The clear indication is that since the onset of the recession, although there has been a movement towards enabling approaches, the majority of Member States remain entrenched in a deterrence approach that seeks to stamp out undeclared work.

Table 4: Importance accorded to different policy measures, 2010

Approach	Most important	Second most important	Least important
Deterrence measures	57%	17%	16%
Enabling measures:			
• preventative measures	19%	46%	23%
• curative measures	14%	19%	32%
• fostering commitment to declared work	10%	18%	29%

Source: Dekker et al, 2010

With the emergent and growing emphasis on the enabling approach, the outcome has been that a wider range of approaches and measures are being used now than was the case prior to the recession. As Table 5 illustrates, in 2010 all 30 European Economic Area (EEA) countries and Switzerland were continuing to use deterrence measures aimed at stamping out undeclared work, with all seeking to improve detection and 93% using penalties or sanctions. At the same time, in that year there was greater uptake of the preventative, curative and commitment approaches than in the period prior to the recession.

Table 5: Policy measures to tackle undeclared work in 31 European countries, 2010

Policy approach	Countries using measure (%)	% stakeholders stating measure is:		
		Effective	Neutral	Ineffective
1. Deterrence				
<i>Penalties</i>	93	50	45	5
Administrative sanctions for purchasers/companies	87	46	49	6
Administrative sanctions for suppliers/employees	83	41	59	0
Penal sanctions for purchasers/companies	74	59	33	8
Penal sanctions for suppliers/employees	52	53	42	5
<i>Measures to improve detection</i>	100	64	34	2
Data matching and sharing	83	72	25	2
Workplace inspections	100	75	17	8
Registration of workers prior to starting work or on first day of work	74	74	23	3
Coordinating strategy across government	57	56	44	0
Certification of business, certifying payments of social contribution and taxes	65	62	33	5
Use of peer-to-peer surveillance (e.g. telephone hotlines)	39	20	80	0
Coordination of operations across government	61	64	36	0
Coordination of data sharing across government	65	82	19	0
Mandatory ID in the workplace	65	70	30	0
2. Enabling compliance				
<i>Preventative measures</i>	90	45	43	12
Reduce regulations	48	56	38	6
Simplify compliance procedures	87	62	38	0
Technological innovations (e.g. certified cash registers)	43	73	27	0
New categories of work (e.g. for small or mini-jobs)	35	59	33	8
Direct tax incentives (e.g. exemptions, deductions)	61	57	33	10
Social security incentives	35	62	15	23
Ease transition from unemployment into self-employment	65	29	63	8
Ease transition from employment into self-employment	44	15	77	8
Changing minimum wage upwards	48	24	59	18
Changing minimum wage downwards	9	0	50	50
Training and support to business start-ups	61	50	46	4
Micro-finance to business start-ups	52	48	52	0
Advice on how to formalise	61	33	67	0
Connecting pension schemes to formal labour	61	47	41	12
Introducing supply chain responsibility	17	78	0	22
Restricting free movement of (foreign) workers	43	29	53	18

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Policy approach	Countries using measure (%)	% stakeholders stating measure is:		
		Effective	Neutral	Ineffective
2. Enabling compliance				
<i>Curative measures</i>	64	61	35	40
<i>Stimulate purchasers to buy declared goods and services</i>				
Service vouchers	26	58	42	0
Targeted direct tax incentives	61	65	29	6
Targeted indirect taxes	17	63	25	13
<i>Stimulate suppliers to formalise their operations</i>				
Society-wide amnesties	9	10	0	0
Individual-level amnesties for voluntary disclosure	17	75	25	0
Formalisation advice to business	30	44	56	0
Formalisation support services to businesses	30	57	29	14
Targeted VAT reductions	17	43	43	14
Free record-keeping software to businesses	13	50	50	0
Factsheets on record-keeping	22	57	43	0
Free advice/training on record-keeping	22	57	43	0
Gradual formalisation schemes	13	67	33	0
<i>Fostering commitment to declared work</i>	69	44	52	4
Campaigns to inform undeclared workers of risks and costs of working undeclared	61	64	36	0
Campaigns to inform undeclared workers of benefits of formalising their work	57	43	47	10
Campaigns to inform users of undeclared work of the risks and costs	61	50	40	10
Campaigns to inform users of undeclared work of the benefits of declared work	52	35	59	6
Use of normative appeals to people to declare their activities	52	33	67	0
Measures to change perceived fairness of the system	26	25	75	0
Measures to improve procedural justice of the system (i.e., degree to which people believe government has treated them in a respectful, impartial and responsible manner)	17	60	40	0
Measures to improve tax/social security/labour law knowledge	65	50	50	0
Adoption of commitment rather than compliance approach (e.g. 'responsive regulation')	30	50	40	10
Campaigns to encourage a culture of commitment to declaration	39	29	64	7

Source: Dekker et al, 2010

By 2010, 90% of countries adopted one or more preventative policy measures, but fewer stakeholders (45%) in the countries in which they had been implemented viewed them as effective compared with deterrence measures. Moreover, the range of measures adopted was relatively narrow. Beyond the simplification of compliance, only a limited number adopted other preventative policy measures. Neither are they seen to be as effective as repression measures.

Similarly, 64% of countries were by 2010 using one or more curative measures to tackle undeclared work although where implemented, just 61% of stakeholders saw them as effective. Again, the range of curative measures used was relatively narrow. Beyond targeted direct tax incentives (such as income tax relief, tax reduction and subsidy schemes),

less than one-third of countries had adopted another curative policy measure, and none was seen to be as effective as repression measures in tackling undeclared work.

Finally, 69% of the countries had by 2010 adopted commitment measures, although again just 44% of stakeholders viewed them as effective in tackling undeclared work. These mostly involved campaigns targeting various groups. Few countries had pursued policy measures to improve either procedural justice or the perceived fairness of the system, and in those that had, relatively few stakeholders viewed them as an effective means of tackling undeclared work. Nevertheless, of the 30% of countries that had adopted a commitment rather than compliance approach, only 10% of stakeholders viewed it as being ineffective.

Since the onset of the recession, the deterrence approach remains widely used and is viewed as more effective than the preventative, curative and commitment policy approaches when tackling undeclared work. However, the enabling approach and its accompanying measures have been more widely implemented than was the case prior to the recession. In the next section, we review some of the diverse array of policy measures that have been adopted since the onset of the recession in the 27 Member States and Norway.

Policy measures implemented since 2008 3

This chapter presents some of the diverse measures that have been implemented in the 27 Member States and Norway since the onset of the crisis to tackle undeclared work. Further details can be found in the expanded knowledge bank of good practice policy measures that accompanies this overview report (see <http://www.eurofound.europa.eu/areas/labourmarket/tackling/search.php>). This section considers deterrence measures, prevention measures, curative measures aimed at legitimising undeclared work, and ‘softer’ measures that aim to change attitudes and engender commitment to the payment of tax.

Deterrence measures

Deterrence measures seek to force people to shift from undeclared to declared work by changing the cost–benefit ratio, confronting those engaged in undeclared work or contemplating participation. To achieve this, attempts are made to increase the perceived or actual likelihood of detection, and penalties are used to ensure that the expected cost of being caught and punished is greater than the economic benefit of engagement (Allingham and Sandmo, 1972; Falkinger, 1988; Hasseldine and Zhuhong, 1999; Milliron and Toy, 1988; Sandford, 1999). In other words, the focus is upon increasing the actual or perceived costs of engaging in undeclared work. For this reason, this section reviews measures implemented since 2008 for improving detection and penalising those who are caught engaging in undeclared work.

Detection

Measures to improve the perceived or actual likelihood of detection have focused on increasing the effectiveness of inspections and joining up strategies and operations, including data matching and sharing either at the national or cross-national level.

Improving the effectiveness of inspections

Nearly all tax authorities and labour inspectorates have pursued initiatives since the onset of the recession to improve the effectiveness of inspections. For example, in recent years Belgium, the Czech Republic, Denmark, Portugal, Slovakia and Spain have all adopted new approaches. These initiatives range from simply seeking to increase the number of inspections conducted through to initiatives that seek to improve the effectiveness of inspections in terms of, for example, the number of undeclared situations identified and the value of the undeclared tax collected or sanctions imposed. To achieve this, some administrations have concentrated inspections on ‘suspect’ sectors where undeclared work is rife. For example, inspections have focused on the construction, garment and textile industries in Romania, the hotel and catering sector in Latvia and Portugal, the taxi industry, hairdressing and construction sectors in Sweden, driving schools in Slovenia and the cleaning industry in Norway. ‘Announced inspection visits’ have also been used to reduce the incidence of undeclared work, whereby a place or sector is informed that a visit from the authorities is to occur in the near future; examples may include hotels and restaurants, construction sites, bakers, doormen, and so forth, as has occurred in Denmark. Below, two examples are cited, one from Italy (Text box 1) and one from Estonia (Text box 2).

Text box 1: Coordinated inspections in agriculture and construction in southern Italy

In 2010, the Italian Ministry of Labour launched a special inspection plan to fight undeclared work in agriculture and construction in four southern Italian regions (Calabria, Campania, Puglia and Sicilia). This consisted of a series of planned and coordinated inspection activities carried out jointly by teams of labour inspectors, inspectors from the social security agency (INPS) and the workplace accident insurance agency (INAIL), and military personnel of the Carabinieri (the Italian military force responsible for public order). The plan identified seasonal agricultural activities as a specific target for inspections and listed the areas, crops and the months in which the inspections should be concentrated. For both agriculture and construction, quantitative targets were identified. Overall, the plan provided that a total of 10,000 agriculture firms and 10,000 building sites had to be inspected in the four regions during the period

March to December 2010. Some 550 inspectors were employed, including 50 from other regions. The programme budget was €1.9 million to cover the expenses of the personnel coming from other regions. The outcome was the identification of more than 20,300 irregular workers, of which around 9,150 were totally undeclared workers. Some 44% of the inspected agriculture firms and 60% of the construction sector firms showed some form of irregularity (Ministry of Labour (Italy), 2011).

Text box 2: The inspection of construction companies, Estonia

Recognising that undeclared work is rife in the construction sector, with the Estonian Tax and Customs Board estimating that around €40 million of due taxes are not paid in the construction sector each year, in March and April 2012 tax officials initiated an inspection campaign targeted at 278 construction companies, including 132 unannounced visits. The tax officials interviewed a total of 1,600 employees of whom around a quarter claimed to be working for the first day. In the construction companies inspected, 125 improved their tax behaviour. Before the inspection visits, the average declared salary in these companies was €388, which increased to €532 after the inspections. Furthermore, the number of declared employees increased in 52 companies by a total of 166 employees. Some 79 construction companies did not change their tax behaviour or did not present their tax declarations on time and in 74 companies, tax declarations reduced. As a result of this targeted campaign, tax officials have identified undeclared and unpaid taxes of €780,000 (Estonian Employers' Confederation, 2012).

Two other common initiatives since 2008 have aimed to improve the effectiveness of inspections: ensuring that workers are registered prior to commencing work and the use of identity cards. The obligation to report new employees to the relevant authorities is now the case in many EU nations, including Austria, Bulgaria, Italy, Slovakia and Sweden. Identity cards, meanwhile, have been introduced in Italy, Luxembourg, Norway, Sweden and the Czech Republic for instance. Text box 3 reviews how this has been achieved in Luxembourg.

Text box 3: Identity cards in the construction sector, Luxembourg

In 2012, a tripartite social dialogue involving social partners involved in the fight against undeclared work in the construction sector in Luxembourg led to the introduction of an ID card for workers on construction sites. The intention is to improve the effectiveness of inspections. The ID card system was set to commence in early 2013 (see <http://www.paperjam.lu/article/fr/construction-eviter-le-dumping-social>). This ID card will contain personnel data of each worker, such as the name of their employer, the type of contract signed and the date their job began, and will make it easier to conduct effective inspection visits. Given that this initiative has not yet been introduced at the time of writing, no evaluation is available. However, concerns exist. One is that the Luxembourg labour inspectorate, ITM (see <http://www.itm.lu/>), lacks sufficient labour power to conduct the inspections. For example, in the canton of Esch-sur-Alzette, where there are multiple construction sites, there is only one labour inspector. The trade unions, meanwhile, believe that the sanctions should be serious, involving both financial sanctions and even closure of the construction sites.

Coordinating strategy and operations, including data sharing

Another popular initiative used since the onset of the economic crisis to improve detection has been the enhanced coordination of strategy and operations, with many countries putting a particular emphasis on improving the sharing of data. Text box 4 highlights how this has been achieved in Finland.

Text box 4: The Grey Economy Information Unit, Finland

Established on 1 January 2011, the Grey Economy Information Unit (Harmaan talouden selvitysyksikkö) in the tax administration section (of the Ministry of Finance) in Finland is a specialist unit, which, at the request of other organisations, investigates specific organisations and persons suspected of engaging in undeclared work. The unit has the power to obtain information from the authority that requests the compliance report. A compliance investigation can also be based on a general phenomenon report. Its budget in 2011, the unit's first year, was €1.6 million and its budget for 2012 was €1.9 million. Its 20 employees are roughly divided equally between its two main tasks: (1) information gathering and dissemination and (2) compliance reporting. Following a year and a half of operation, the unit had completed over 40 information-gathering and dissemination tasks. It had also produced some 11,000 compliance reports for other authorities (this mandate started in July 2011). Indeed, in 2011, a total of 732 tax audits were conducted, resulting in €42 million of undeclared wages and €65 million in undeclared sales being recovered.

Penalties

Since the onset of the recession, many countries have also imposed higher penalties for participating in undeclared work. In Slovakia, for example, in 2010, the penalty for failing to register an employee was raised from the previous maximum of SKK 500,000 (€16,600) to €200,000. Sanctions have been also strengthened in many other countries, including the Czech Republic, France, Denmark, the Netherlands and the UK. This has been done despite the earlier warning that a cautious approach was best due to the lack of evidence that increasing penalties leads to a reduction in undeclared work (Williams and Renooy, 2009).

Prevention measures

At least six broad policy measures can be adopted to enable people to work legitimately from the outset, namely: simplifying compliance; technological interventions; introducing new categories of legitimate economic activity; providing direct or indirect tax and social security incentives to encourage people to engage in regular declared employment; offering micro-enterprise development programmes (MDPs) to help businesses set up and develop in a formal manner; and introducing initiatives to ensure a smoother transition into self-employment.

Simplifying compliance

Most Member States have continued to pursue simplifications of their compliance procedures since the onset of recession, such as reducing the number of tax forms and returns, or pursuing an integrated approach to audit, with a single visit to inspect records rather than separate inspections for different taxes. These are often incremental changes not considered noteworthy by Member States when detailing new measures, but when taken as a cumulative whole have major impacts on compliance behaviour.

Technological interventions

Since the onset of recession, greater use has been made of technological interventions, largely in the form of cash registers. Text boxes 5 and 6 review their introduction in Sweden and Poland. Similar schemes have been introduced in Belgium, Denmark, Greece, Italy and Hungary.

Text box 5: Cash register legislation, Sweden

As of 1 January 2010, businesses selling goods and services in return for cash payments must have a certified cash register. A certified cash register consists of two parts: a cash register and a black box connected to the cash register that reads transactions. Only staff at the Swedish Tax Agency can access the information in the black box. The businesses must buy the cash register, which costs SEK 15,000 (€1,785). Companies not complying can be fined SEK 10,000 (€1,190) by the Swedish Tax Agency. If it once again fails to comply with the law within a year, a fee of SEK 200,000 (€23,800) is imposed. Cash payments registered include those made by debit (bank) card. It is too early to evaluate the impact. Statistics from the Swedish Tax Agency do, however, show that the reported VAT for restaurants rose by 7% and 11% in the hairdressing industry in 2010.

Text box 6: Fiscal cash registers, Poland

In 2010 the Polish Ministry of Finance made electronic fiscal cash registers mandatory in a range of professions (for example doctors, lawyers, tax advisers, physicians running private practices, funeral homes and translators). The immediate effect was weaker than expected, as less than 30% of the estimated number notified the tax administration of having acquired fiscal cash registers within a month of the law coming into force. The exact figure of those who complied in subsequent months is not known. Another problem is that it remains possible to avoid recording sales. For example, physicians reportedly only have to record sales during official opening hours, thus excluding patients seen after hours, those seen on home visits and those patients agreeing to a lower fee if no 'paperwork' is involved.

Introducing new categories of legitimate work

Another possible method for encouraging people and businesses to engage in declared work is to introduce new categories of legitimate work so as to allow work that is currently, often by necessity, conducted as undeclared work to become declared activity. Perhaps the best known example is the 'mini-jobs' category of employment introduced in 2002 in Germany (Eurofound, 2009). Since the onset of recession, this has been more widely used by the German population, with mini-jobs in household services rising from 102,907 in December 2004 to 234,453 in March 2012. A similar scheme for simplifying obligations for minor employment has been introduced in Hungary (see Text box 7).

Text box 7: Simplified Employment Act 2010, Hungary

In 2010 the Hungarian government introduced the Simplified Employment Act (Egyszerűsített foglalkoztatási törvény) to simplify seasonal employment and casual or temporary work. This Act enables an employer to notify this work either by a simple text message (SMS) or electronically via the Client Gate System (<https://ugyfelkapu.magyarorszag.hu/>), once registered on the system. For seasonal work, the employer has to pay taxes of HUF 500 (€1.75) and for casual work HUF 1,000 (€3.50) on a daily basis. According to the National Tax and Customs Administration, between April and May 2010, 505,621 simplified employment cases were registered, of which 417,937 were for ad hoc or casual employment, 15,877 for seasonal agricultural employment, 6,393 for seasonal tourism employment, 761 at non-profit organisations, and 10,326 in plant cultivation. Some 499,987 lasted less than five days. Between 1 August 2010 and 31 December 2011, around 12.5 million working days were registered and HUF 8 billion (€28 million) flowed into the state treasury (http://hvg.hu/gazdasag/20120312_alkalmi_munkasok_bevetel).

Smoothing the transition to self-employment

Although unemployed people are nearly twice as likely as the general population to engage in undeclared work, only 11% of all undeclared workers are unemployed (Williams and Nadin, 2012). Despite this, a vast amount of energy has been devoted to tackling the unemployed engaged in undeclared work. Text box 8 reviews the start-up premium in Germany, which has replaced the earlier Ich AG scheme.

Text box 8: Start-up premium, Germany

The ‘start-up premium’ (*Gründungszuschuss, GZ*) is granted to recipients of unemployment benefit wanting to start up their own business. In addition to their unemployment benefit, recipients receive a €300 monthly grant for the first six months, and can receive an additional €300 for another nine months. Bernhard and Wolff (2011) show that between 119,000 and 147,000 recipients of unemployment benefit enrolled annually in the GZ scheme between 2007 and 2010, and Caliendo et al (2011) show that 19 months after start-up, 75%–84% of former GZ recipients are still in business.

Curative measures

In addition to measures to prevent people from engaging in undeclared work in the first place, many different initiatives have been introduced to help those already participating in undeclared work to legitimise their activities. Such measures fall into two categories: measures designed to help undeclared workers make the transition to the declared realm and measures to encourage purchasers to use declared rather than undeclared labour. In relation to undeclared workers, at least three types of measure can be pursued: society-wide amnesties, voluntary disclosure, and tailored business support and advisory services to help unregistered enterprises make the transition to the formal economy. Measures that aim to encourage purchasers – that is, either customers or employers – to acquire goods and services on a declared rather than undeclared basis include targeted indirect tax measures, targeted direct tax measures, and wage costs subsidies, including voucher schemes. Some schemes implemented since the onset of the recession in 2008 are reviewed below.

Amnesties

At a European level, a call has been made for a ‘pact to declare the undeclared’, which would allow undeclared activities to gradually move towards legitimisation over a transition period of, say, two years, without involving any sanctions, at the end of which stronger sanctions would be imposed on those who continue to work on an undeclared basis (European Parliament Employment and Social Affairs Committee, 2008, p. 7). Spain introduced such a scheme in 2011 (see Text box 9); its evaluation will have useful lessons for the implementation of this approach at European level.

Text box 9: Amnesty for undeclared workers, Spain

On 26 May 2011, the Spanish Parliament enacted a Royal Decree (5/2011) to tackle undeclared work. In the first phase, an amnesty was granted allowing employers to register any undeclared employees with the social security authorities and to sign a contract of employment with them lasting at least six months, regardless of whether it was fixed-term or open-ended. Businesses following these procedures before 31 July 2011 were not penalised and were not charged for any backdated social security contributions. They were only required to pay social security contributions from the point of registration onwards. In the second phase, from 31 July 2011 onwards, new measures and sanctions were applied to businesses continuing to employ undeclared workers. Sanctions became stricter with offences, punished with a fine of between €3,126 and €6,250 for minor infractions, €6,251 and €8,000 for medium offences and between €8,001 and €10,000 for major infringements. Previously, the penalty ranged between €626 and €1,250 for minor breaches, €1,251

and €3,125 for medium infractions, and €3,126 and €6,250 for major breaches. The fines for ‘very serious offences’ have not changed. They remain at €10,001 to €25,000 for minor infractions, €25,001 to €100,005 for medium offences, and €100,006 to €187,515 for major breaches. Any enterprise sanctioned as a result of a serious or very serious offence will not be eligible to apply for public contracts for a period of five years. No evaluation is currently available of the outcomes of this amnesty.

Voluntary disclosure

Another policy option is to offer amnesties on an individual basis to those voluntarily disclosing that they have been working on an undeclared basis. So far as it is known, no such schemes have been implemented in the EU27 since the onset of recession. Neither have any notable new advisory and support services been developed in Member States since the onset of recession that seek to facilitate the formalisation of businesses.

Targeting customers with indirect tax measures

One very popular initiative since the onset of recession has been the use of reverse charges for VAT whereby the buyer, not seller, must file and pay VAT. Reverse charging has been introduced in the construction industry in several European countries, including Sweden, Cyprus and Finland. Text box 10 reviews how it has been used in Finland.

Text box 10: Reverse VAT scheme in the construction industry, Finland

In April 2011, Finland introduced reverse VAT whereby the VAT is paid by the buyer (main contractor) as opposed to the seller (subcontractors) as is usually the case. This was deemed more effective because the tax liability does not as easily disappear into the subcontracting chain, and the main contractors tend to be large, established and reputable companies. Subcontractors do not charge VAT to the main responsible party. If there is a chain of subcontracting, as is typical, all invoicing excludes VAT, which is only disbursed at the top of the chain. The reverse system only applies to construction services, not materials, and private individuals as buyers are excluded. The tax administration estimated that during the first three years the reverse system would annually require 60 work years, followed by 30 work years in each subsequent year. In the legislative proposal, the increase in VAT revenue was estimated to be between €80 and €120 million. However, as the reverse VAT system has operated only for a short period of time, only preliminary evaluations have been carried out. The Grey Economy Information Unit of the tax administration reports that the impact on VAT collection cannot be estimated at this point. The disbursement of VAT has been shifting towards the main contractors as intended. Information from a few tax audits have been analysed and reported. They have uncovered both honest mistakes and suspicious activity. There are no reports, however, of suspected appearances of ‘front’ organisations as fraudulent main contractors.

Targeting consumers with direct tax measures

Numerous direct tax measures targeted at consumers have been introduced in order to move activity into the declared economy in realms where the undeclared economy is rife. Text box 11 details how tax incentives for consumers have been offered in Sweden. Similar schemes have been introduced in Denmark and Finland.

Text box 11: Tax deductions for household work, Sweden

Since December 2008, Swedish citizens can receive a 50% tax deduction on labour costs for the renovation, conversion and extension of homes (ROT) and for household services (RUT), up to a maximum of SEK 50,000 (€6,000) per annum. Companies charge the customer the costs of materials and half the labour costs, including VAT. The company requests the outstanding sum from the Swedish Tax Agency. In 2010, 1.1 million people used this scheme and the Swedish Tax Agency paid out SEK 1.4 billion (€16.6 million) in RUT deductions and SEK 13.5 billion (€1.6 billion) in ROT deductions. Some 7.6 million hours of RUT services and 53 million hours of ROT services were performed. The Swedish Tax Agency (2011) estimate that undeclared work decreased by 10% between 2005 and 2011 in these sectors.

Service voucher schemes

Service vouchers have been a popular initiative used to tackle undeclared work (Eurofound, 2009). Since the onset of the recession, the range of activities to which they have been applied has expanded, such as to seasonal work. An example is a 2008 pilot service voucher scheme introduced in Italy in the agricultural sector during the grape harvest (*Il sistema dei voucher nel settore agricolo*). The objective was to regularise the students and pensioners who supply their labour on an occasional basis during the grape harvest. Each worker can only work for 30 days and the maximum remuneration is €5,000 in a calendar year. Each employer can use the voucher scheme up to a maximum of €10,000 per annum. They are paid in these vouchers. The vouchers are credited to the workers on a magnetic card and then used to make cash withdrawals at ATMs. The magnetic card also carries information about the worker that is relevant to the social security agency (INPS) and the workplace accident insurance agency (INAIL). Early results suggest that since August 2008, 540,000 vouchers (worth €10 each) were sold to employers, resulting in the regularisation of 36,000 workers for 108,000 working days. Decree law 112.2008 (Article 22) enacted by Law no. 133 has now extended the voucher scheme to all agricultural activities, and a maximum of €7,000 of vouchers can be used by each employer. This could be further extended to other sectors and activities, including private coaching (such as music lessons), gardening, holiday work by young people and door-to-door deliveries.

Commitment measures

In the commitment approach, rather than alter either the costs of undeclared work or benefits of declared work so as to encourage compliance, the intention is to engender commitment to tax morality so that such ‘sticks’ and ‘carrots’ are not needed. Put another way, there is a shift from direct to indirect controls, or from compliance to commitment. Since the onset of recession, commitment measures have blossomed throughout the EU27 and Norway.

Campaigns

One tactic for engendering commitment to tax morality so as to reduce undeclared work is to run awareness-raising and information campaigns. Such campaigns can inform undeclared workers of the costs and risks; inform potential users of undeclared labour of the risks and costs; inform undeclared workers of the benefits of being official, such as increasing their credibility as business people and opening up business opportunities; and inform potential users of undeclared work of the benefits of formal labour. Since the onset of the economic crisis, such campaigns have been widely implemented. Text boxes 12, 13 and 14 provide case studies of such awareness-raising campaigns in Lithuania, Latvia and Norway respectively.

Text box 12: Public information and awareness-raising campaign, Lithuania

In 2009 the State Labour Inspectorate (VDI) in Lithuania embarked on a fundamental change of approach for tackling undeclared work, placing greater emphasis on business consulting, public information and awareness raising (Visuomenės informavimo ir švietimo iniciatyva). These activities were implemented through various media channels, such as radio, television, press, the internet, information screens in shopping centres and public transport. According to the VDI, this decreased tolerance towards undeclared work in Lithuania. As a result, a growing number of alerts are made by members of the public about illegal workers. In 2011, 2,400 people reported incidents of undeclared work anonymously. More than 50% of total registered anonymous calls prove to be true.

Text box 13: LDDK campaign: ‘Against the shadow economy – for fair competition’, Latvia

In October 2011, the Latvian Employers’ Confederation (Latvijas Darba Devēju konfederācija, LDDK) conducted this campaign. It included an advertisement campaign entitled ‘I spit on it’ (*Man uzspļaut*) and an online test for measuring the impact of an individual’s ‘shadow’ activity. Around 12,000 individuals tested their impact in the online test. Answering 11 questions in the test, individuals could discover their ‘shadow’ behaviour in shops, markets and with service providers (taking or leaving a receipt on purchase), in hospitals (extra payments to doctors), transport (extra payments to policemen), employment (working with or without employment contract, undeclared income from work, or ‘envelope wages’) and their total impact on the shadow economy in Latvia. Participants were advised how to reduce their own shadow economy impact, for example by paying official prices for services, acquiring a receipt in shops and other shopping places, ensuring that a taxi counter was working, and only purchasing certified car fuel.

Text box 14: Collaboration against the black economy, Norway

In 2008, Norway’s social partners, the Ministry of Finance and the tax administration agreed to develop awareness-raising activities and provide companies, entrepreneurs, workers and consumers with information on the societal consequences of undeclared work and guidelines on how to follow tax rules through their websites, as well as popular educational programmes directed at young people. A survey of students who had participated in the alliance’s educational programme showed that 8 out of 10 found it useful. More than half were more inclined to pay taxes as a result of taking part (see http://www.samarbeidmotsvartokonomi.no/Spllg_200k_elever.htm).

Many more examples exist of awareness-raising campaigns implemented since the recession began. In Bulgaria, a national centre called Business to the Rules has been established to change the attitudes of employers and employees towards undeclared work and increase public awareness of its damaging impact and consequences. This national centre started its work in April 2010, implemented by the Bulgarian Industrial Capital Association in partnership with the Confederation of the Independent Trade Unions in Bulgaria for the period 2009–2013. The total project budget is about BGN 8.9 million (€4.5 million). The target groups are employers and employees, as well as state employees engaged in the detection and prevention of undeclared work. The pilot sectors include mechanical engineering, electrical engineering, information technology, infrastructure construction, light industry, perfumery and cosmetics, dairying, tourism, non-bank financial services and services of general interest. No evaluations have yet been published.

In Slovenia, a public campaign entitled 'Let's stop undeclared work' (*Skupaj ustavimo delo in zaposlovanje na črno*) was launched on 16 August 2010 by the Ministry of Labour, Family and Social Affairs, in cooperation with social partners. It consisted of various promotional media (hoarding posters, brochures, radio ads, ads in business magazines and web banners). The purpose was to inform and raise public awareness on the risks and negative consequences of undeclared work from the viewpoint of the welfare state, business and individuals. No evaluations have been conducted.

Advertising and awareness-raising campaigns have not always been led by the government. Since the recession began, there have been campaigns involving or led by social partners. Examples include the campaigns in Sweden to tackle undeclared work in the construction industry and the taxi-driving sector. In Germany, public alliances have been established between the government and social partners in the construction and transport sectors; these alliances have pursued public information campaigns on undeclared work. In France a 'good practice charter' agreed by sector representatives has been implemented in the construction sector.

Appeals

Since the recession began, the use of normative appeals in the form of notification letters has increased. In November 2011, for example, the Estonian Tax and Customs Board sent out notification letters to 1,300 companies, which were asked to revise their accounting and tax related information and give feedback to the tax authority on the results of their business activities. One thousand letters were sent out to those legal persons whose average wages in the company were considerably lower than the average of the relevant region and economic sector. An additional 300 letters were sent to companies where a risk assessment undertaken by the Tax and Customs Board showed the possibility of turnover being hidden or the use of fictitious invoices. According to the Tax and Customs Board, an estimated €30.2 million in tax income remains unpaid in these 1,300 companies (Estonian Tax and Customs Board, 2011c). The notification letters gave companies a period of time to improve their tax behaviour. Companies that did not improve their tax behaviour or could not provide satisfactory reasons for issues raised in the assessment were subjected to a control of tax payments and accounting. For instance, as a result of this specific wave of notification letters, additional control was initiated in 500 companies in February 2012. As a result of the control visits and the notification letters, a number of companies improved their tax behaviour; for example, the total number of declared employees increased and the wage levels of employees were increased, indicating that the share of undeclared wages in these companies reduced. However, a number of companies did not change their tax behaviour and will be further controlled.

So far, rather less attention has been paid to providing tax education, improving the perceived procedural justice and distributive fairness of the tax system, and changing the organisational culture of tax offices.

Impact of austerity measures on the undeclared economy 4

This section considers whether a correlation exists between the wider austerity measures being pursued and the size and growth of the undeclared economy. It goes on to discuss the need for any additional measures in the EU Member States and Norway in order to tackle undeclared work.

Two contrasting viewpoints exist regarding the austerity measures required to solve the current economic recession. According to the neo-liberal model, the way forward is to reduce taxes, pursue de-regulation and minimise state intervention. According to the social democratic model, there is a need to bolster state expenditure.

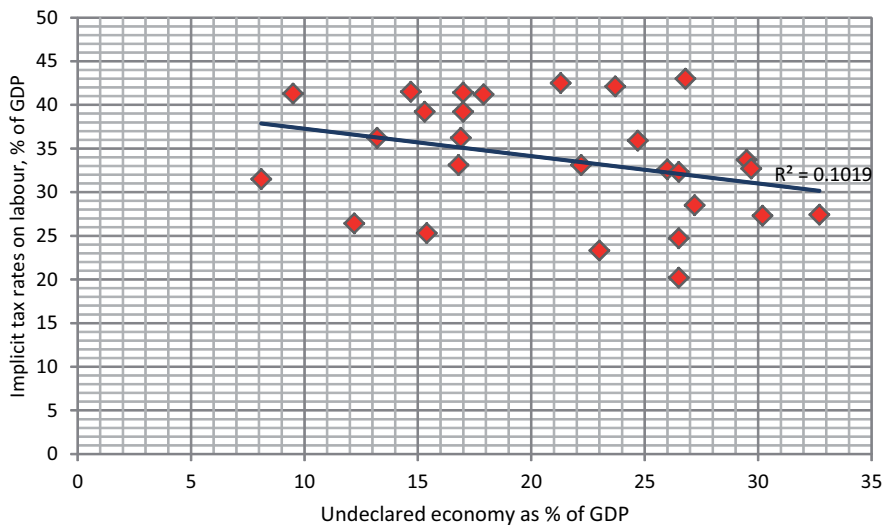
Parallel to this, two macroeconomic approaches are proposed for tackling the undeclared economy. A neo-liberal approach argues that the undeclared economy is a direct result of high taxes, over-regulation of the economy and too much government interference in the realm of welfare provision and that therefore economies should pursue tax reductions, deregulation and minimal state intervention to prevent the undeclared economy from growing. A social democratic approach argues that the undeclared economy is a by-product of the deregulation of economies and reductions in state welfare provision, and that one should therefore bolster state expenditure on the labour market and welfare provision to tackle the undeclared economy.

The validity of each of these macroeconomic approaches can be evaluated by analysing the size of the undeclared economy in each Member State against each Member State's work and welfare regimes. To do this, five indicators are considered: the level of implicit tax rates on labour income (Eurostat, 2007, 2011); state expenditure on interventions in the labour market as a proportion of GDP (Eurostat, 2011); the level of state social protection expenditure (excluding old age benefits) as a proportion of GDP (European Commission, 2011); the effectiveness of state redistribution via social transfers (European Commission, 2011); and the level of intra-national equality in the society, as measured by the Gini coefficient (European Commission, 2011). For fuller details of the datasets and methodology used, see Williams (2012a, b) and Vorley and Williams (2012).

The first step is to test the hypothesis that that undeclared work rises when tax rates are higher and that the solution is to decrease taxes in order to reduce the size of the undeclared economy. This involves analysing the relationship between the variations in the magnitude of the undeclared economy and the variations in implicit tax rates on employed labour across the EU27 (Eurostat, 2010). The implicit tax rates on employed labour represent a summary measure of the average effective tax burden on the income of employed labour. This is because it calculates the sum of all direct and indirect taxes and employees' and employers' social contributions levied on employed labour income divided by the total compensation of employees working. Direct taxes are the revenue from personal income tax that can be allocated to labour income, while indirect taxes on labour income are taxes such as payroll taxes paid by the employer. Employers' contributions to social security (including imputed social contributions), as well as to private pensions and related schemes, are also included. The compensation of employees is the total remuneration, in cash or in kind, payable by an employer to an employee in return for work done.

As Figure 4 displays, and contrary to the hypothesis that high tax rates result in the growth of undeclared work, no statistically significant correlation exists between the implicit tax rates on labour (the average effective tax burden on labour income) and the size of undeclared economies in the EU27. Using Spearman's rank correlation coefficient (r_s) due to the non-parametric nature of the data, no statistically significant correlation is found between the size of the undeclared economy across the EU27 and the implicit tax rates on labour ($r_s=-0.266$). Indeed, merely 10.2% of the variance in the size of the undeclared economy is correlated with the variance in implicit tax rates ($R^2=0.1019$). Hence, EU Member States with higher average tax burdens on labour income do not have larger undeclared economies, refuting the hypothesis that undeclared work is a direct result of high taxes and that the solution is to therefore pursue tax reductions. Member States with low average effective tax burdens are not significantly correlated with smaller undeclared economies.

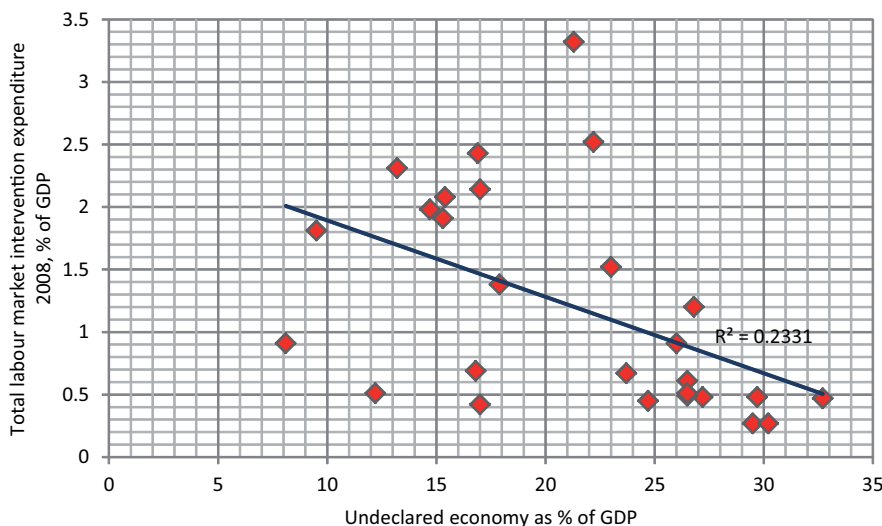
Figure 4: Relationship between implicit tax rates on labour as % of GDP and size of undeclared economy in EU27 Member States



Is it the case, therefore, that the pursuit of active labour market policies is in any way correlated with the size of the undeclared economy? To assess this, public interventions in the labour market aimed at correcting disequilibria are analysed across the EU27. Here, the term ‘public interventions’ refers to measures taken by governments that involve expenditure, either in the form of actual disbursements or of foregone revenue (reductions in taxes, social contributions or other charges normally payable), explicitly targeted at groups of people with difficulties in the labour market. This includes the unemployed, people in employment but at risk of involuntary job loss and inactive persons who are currently not part of the labour force but who would like to enter the labour market and are disadvantaged in some way (Eurostat, 2010).

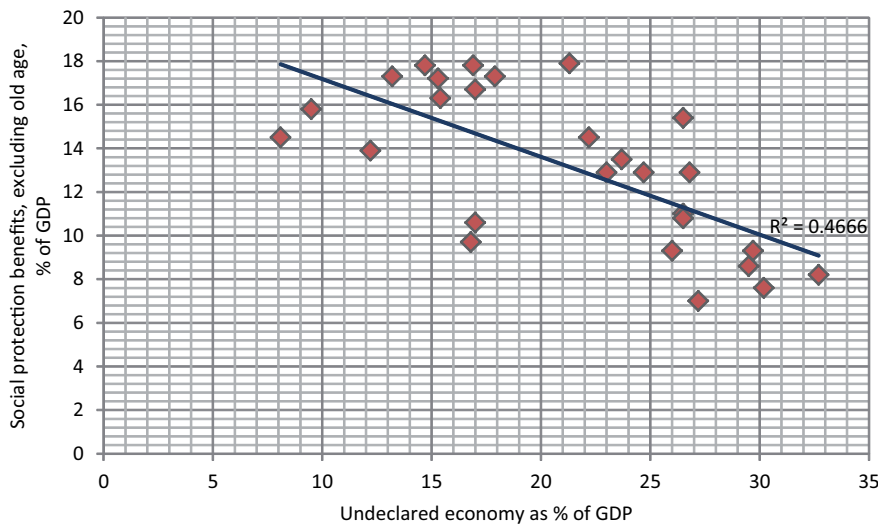
A statistically significant correlation was found between the size of the undeclared economy and the level of state expenditure on labour market interventions ($r_s = -0.599^{**}$). As Figure 5 displays, the greater level of expenditure on public interventions in the labour market, the smaller is the undeclared economy. Indeed, 23.3% of the variance in the size of the undeclared economy is correlated with the variance in the level of expenditure on public interventions in the labour market ($R^2 = 0.233$). Therefore, no evidence exists that public ‘interference’ in the labour market results in the growth of the undeclared economy. There is a statistically significant correlation, but the trend is one in which greater interventions in the labour market lead to a reduction in the size of the undeclared economy.

Figure 5: Relationship between state labour market expenditure and size of undeclared economy in EU27 Member States



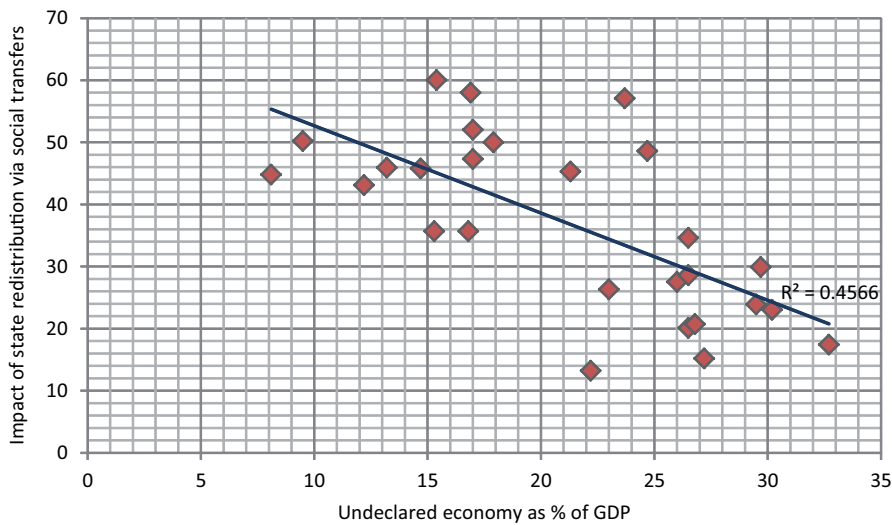
What, therefore, is the relationship between the undeclared economy and the level of welfare provision? When analysis is conducted into the relationship between variations in the magnitude of the undeclared economy and those in the proportion of GDP spent on social protection benefits, excluding old age benefits (European Commission, 2011, Table 3), a strong statistically significant correlation is identified ($r_s=-0.700^{**}$). Indeed, and as Figure 6 displays, 46.7% of the variance in the size of the undeclared economy is correlated with the variance in the proportion of GDP spent on social protection, excluding old age benefits ($R^2=0.467$). Member States where a higher proportion of GDP is spent on social protection have smaller undeclared economies, not larger ones.

Figure 6: Relationship between social protection benefits and size of undeclared economy in EU27 Member States



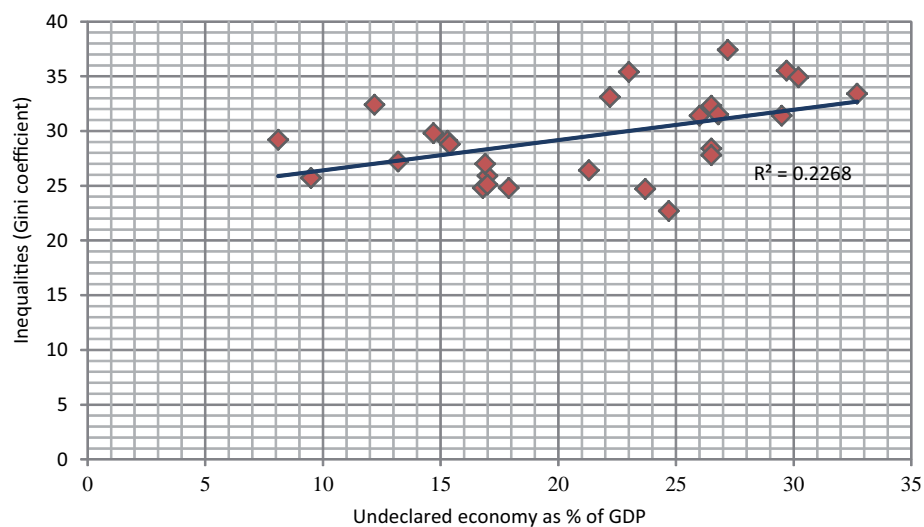
This strong correlation between the size of undeclared economies and welfare regimes is further reinforced when the impacts of redistribution via social transfers are evaluated. Defining poverty as the proportion of people with an income below 60% of the national median income, and analysing the reduction in the incidence poverty before and after social transfers (European Commission, 2011, Table 3), Figure 7 shows a smaller undeclared economy in Member States whose social transfers have a greater impact on reducing poverty. This is statistically significant ($r_s=-0.642^{**}$), with 45.7% of the variance in the size of the undeclared economy correlated with the variance in the impacts of redistribution via social transfers ($R^2=0.457$).

Figure 7: Relationship between impacts of state redistribution and size of undeclared economy in EU27 Member States



The interesting outcome, as shown in Figure 8, is that more equal societies (as measured by the Gini coefficient) have smaller undeclared economies than less equal societies and this is statistically significant ($r_s=0.448^{**}$), with 22.7% of the variance in the size of the undeclared economy correlated with the level of inequality in societies, as measured by the Gini coefficient ($R^2=0.227$). In welfare regimes where higher levels of social protection and redistribution via social transfers lead to the creation of more equal societies, the amount of undeclared work is lower than in less equal societies. In short, the size of undeclared economies seems to be a result of under-regulation, not over-regulation. Not only are higher tax rates not correlated with a higher level of undeclared work across the EU27, but welfare regimes in which there is greater labour market intervention, and social protection and redistribution, are significantly correlated with a decrease (not increase) in the level of undeclared work.

Figure 8: Relationship between inequalities and size of undeclared economy in EU27 Member States



In sum, a strong statistically significant correlation exists between the types of austerity measures pursued and the size of undeclared economies. Evaluating the implications for undeclared economies of pursuing the neo-liberal austerity measures of reducing taxes, pursuing deregulation and minimising state intervention and the social democratic austerity measures of bolstering state expenditure on the labour market and welfare provision, this report reveals no correlation between higher tax rates and larger undeclared economies. Instead, it shows that welfare regimes in which there is higher expenditure on labour market interventions, social protection and redistribution, and greater levels of equality (as measured by the Gini coefficient) have lower (rather than higher) levels of undeclared work. There is a strong correlation between larger undeclared economies and under-regulation (rather than over-regulation). The types of austerity measures pursued, therefore, are strongly correlated with the size and growth of undeclared economies.

These correlations, however, need to be treated with caution. Although such correlations do not suggest a cause–effect relationship, they do hint that some relationship exists between the types of austerity measures pursued and the size and growth of undeclared economies.

Conclusions 5

This overview report has provided an updated overview of the policy approaches and measures that have been implemented to tackle undeclared work since the beginning of the recession in 2008 in the EU27 and Norway. It has shown that since the beginning of the recession, a wide range of approaches and measures have been adopted across the whole of the EU27. Although a deterrence approach, which seeks to engender compliance by detecting and punishing non-compliance, remains the dominant approach in most Member States, there has been a much wider take-up of enabling measures that provide encouragement and incentives for people and businesses. By 2010, 90% of the 30 countries in the EEA and Switzerland had implemented policy measures to deter businesses and people from engaging in undeclared work from the outset, 64% of countries were using one or more curative measures to enable the transfer of undeclared work into the declared realm, and 69% of countries had adopted commitment measures to try to facilitate a greater commitment to tax morality.

Many of the new policy measures being pursued in Member States of the EU27 and Norway are highly innovative and potentially transferable to other sectors and countries. They are included in the expanded knowledge bank of good practice policy measures accompanying this overview report (see <http://www.eurofound.europa.eu/areas/labourmarket/tackling/search.php>). If this knowledge bank is used by Member States to identify new possibilities for policy initiatives, so as to expand their current repertoire, an important objective will have been achieved.

Another important finding of this report is that it identifies a strong correlation between the wider austerity measures pursued and the size and growth of the undeclared economy. It reveals that the neo-liberal austerity measures of reducing taxes, pursuing deregulation and minimising state intervention are strongly correlated with larger undeclared economies, whilst the social democratic austerity measures of bolstering state expenditure on the labour market and welfare provision are strongly correlated with smaller undeclared economies. Not only is there no correlation between lower tax rates and smaller undeclared economies, welfare regimes with higher expenditure on labour market interventions, social protection and redistribution, and greater levels of equality (as measured by the Gini coefficient) have smaller undeclared economies. Such correlations need to be treated with caution. Although they do not suggest a cause-effect relationship, they do hint that some relationship exists between the types of austerity measures being pursued and the size and growth of undeclared economies. It might be useful to conduct a longitudinal study of each Member State to see if this strong correlation between expenditure on labour market intervention and welfare provision and the size of undeclared economies continues to emerge. If it does, this will provide further tentative evidence that the size of undeclared economies is related to the broader economic and social policies pursued.

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