

European Employment Observatory

Review : Autumn 2004

Employment & European Social Fund



Employment & social affairs



European Commission

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Directorate-General for Employment, Social Affairs and Equal Opportunities
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OVERALL DEVELOPMENTS

Denmark: Structural reform

The recently proposed reform of structures and areas of responsibility in the public sector will have major consequences for employment policy and services in Denmark.

Current structures

Until now, efforts to find jobs for unemployed people in Denmark have operated under two systems: a municipal programme for recipients of welfare benefits, and a National Employment Service (AF Arbejdsformidlingen) programme for those receiving unemployment insurance compensation. The two systems have both similarities and differences.

The municipal programme is locally administered. The 271 local authorities organise and implement programmes for residents who are receiving welfare benefits. The local authority selects a programme for each recipient, based on his or her situation. Welfare benefit recipients include those with problems other than unemployment. The municipal system therefore covers a broad spectrum of problems, many of them social in nature (such as mental or physical health problems or addiction).

The programme for unemployed people who are receiving unemployment compensation is administered by the National Employment Service. It consists of 14 AF regions, corresponding to the country's 14 counties or administrative districts. There are approximately 60 AF service units. Trade unions and employers' associations participate in the administration of regional programmes through membership of regional labour market councils. Unemployment compensation can run for four years, with the right to receive and an obligation to accept job offers and/or training offers. At the end of this period, recipients can be transferred to welfare benefits under certain conditions.

Every year, more than 1.2 million people have contact with some aspect of these systems for varying periods of time, including those who receive sickness benefits. The AF is responsible for slightly less than two-fifths of this group, while municipalities deal with the remaining three-fifths. Overall, AF employees work approximately 2,100 person-years on employment-related matters, while local authorities' estimated personnel expenditure in this area amounts to approximately 6,200 person-years. In addition, trade unions' unemployment insurance systems account for about 5,000 person-years of work.

Reform to a comprehensive approach towards unemployment programmes

The new government that took office in 2001 established an Employment Ministry to co-ordinate the employment policy efforts of local and national governments. This was done by transferring the labour market section of the Social Affairs Ministry to what was then the Labour Ministry.

In autumn 2002, the government proposed a reform called 'More People into Employment', which gained the support of a majority of the political parties as well as trade unions and employers' organisations. Since then, the Danish parliament (the Folketing) has consistently passed the necessary legislation to maintain the programme. The reform programme consists of the following seven main points:

- a co-ordinated labour-market system;
- putting people to work more quickly, with fewer intermediate stages;
- involving more players/external providers in the overall effort to provide jobs;
- using simple and active programmes – simplification without reduction;
- making it pay to work;
- simplification, less bureaucracy, and harmonisation; and
- establishing an Employment Council to co-ordinate overall effort.

A co-ordinated labour-market system

'More People into Employment' is intended to ensure greater co-ordination of the efforts made by municipalities on behalf of welfare recipients and by the AF on behalf of those entitled to unemployment insurance compensation. There have already been several positive and concrete co-operation projects between the AF and municipalities. However, the continuing division between the two systems has meant a considerable overlap in services. 'More People into Employment' is therefore a step towards ensuring a co-ordinated system in the future. The government would like to see a greater degree of co-ordination and co-operation between the two systems, based on this vision of a future unified system. Co-ordinating the two systems' efforts should result in further improvements which will benefit both unemployed people and business.

There will be continuous harmonisation of the service provided by the two systems with regard to opportunities, rights and obligations. There are plans, for example, to use a joint model for all applicant interviews.

In order to move towards a unified system, the AF has been required to make co-operation agreements with municipalities. Financial support has also been provided for a form of trial co-operation between the AF and municipalities, using labour market centres. A total of 30 million Danish kroner (DKK) (a little over 4 million euro) was allocated for this purpose in 2003 and 2004. The National Labour Market Authority distributes funds on the basis of joint applications from municipalities and the AF. Some 10-12 co-operation projects were launched in 2003-4. Labour market centres are seen as a means of testing greater joint efforts by local and county employment services.

Structural Commission

In October 2002, the government set up the Structural Commission to review public services and their areas of responsibility, including the division of responsibility among different levels of government – national, county and municipal. The commission submitted its report in January 2004. Labour

market and employment policy programmes were naturally included in the areas reviewed by the commission, which recommended setting up a unified system under municipal administration. Trade unions and employers' organisations, on the other hand, wanted a unified system to be administered by the national AF organisation.

The government's negotiations with the Social Democratic Party and National Liberal Party subsequently broke down, and the government presented a programme for comprehensive municipal reform with the support of the Danish People's Party.

This agreement provides for major changes in employment service programmes. In concrete terms, new joint jobcentres will be established in all municipalities around the country. AF and municipal employment officers will occupy the same premises, so that unemployed people and businesses seeking staff will only need to contact one office. The AF will still be responsible for those receiving unemployment benefits, while municipalities will handle the cases of individuals receiving welfare, rehabilitation and sickness benefits, as well as other groups. The number of municipalities will be reduced from 271 to approximately 100.

Even though there will still be a division of responsibility, jobcentre personnel will no longer be restricted to handling cases from their target groups. Experienced and competent employment officers from the AF and municipal systems will be brought together under one roof. This will create a strong employment service in a high quality, professional environment. Joint jobcentres will encourage personnel to use their expertise across target-group boundaries.

All of these jobcentres will be able to assist both those on welfare and those who receive unemployment benefits. Among other things, they will help people to register or deregister as unemployed, provide assistance in writing or updating CVs, help with job searches and provide advice. In approximately 40 of the largest municipalities, jobcentres will be able to provide people on unemployment benefits with all types of job offers. Smaller jobcentres, on the other hand, will have to refer certain categories of unemployed people, such as those at risk of becoming long-term unemployed, to one of the 40 larger jobcentres. The first of these new jobcentres will open at the end of 2005. A jobcentre should be operating in all municipalities no later than 1 January 2007.

Pilot jobcentres will be set up in about 10 municipalities, where local authorities will provide employment services on behalf of the state to those receiving unemployment benefits. The state will still be responsible for services to this group of unemployed people, but the municipality will provide employment office services.

There will thus be various different types of jobcentre in the future. It has been agreed that starting in 2007, once the new system has become established, an evaluation will be conducted to document and assess experience of it.

Another important consequence of this reform is the replacement of the current 14 AF regions with four large regions. The state run regional units will monitor jobcentres' efforts and intervene if the results are not satisfactory. The regions should also ensure that bottlenecks are cleared and that measures can be taken quickly when large enterprises close down. Unlike the current system, regions will also monitor and

take action to help municipalities' target groups. This should provide a better overview of the job situation as a whole.

Unions and employers' organisations are represented at local, regional and national levels, where they advise municipal councils, regional authorities and the Employment Minister. The reform does not change the responsibilities of 'A kasse', the unions' unemployment insurance scheme.

Denmark: Spring legislation package

In March 2004, the government presented its 'spring package', allocating 9 billion DKK (1.2 billion euro) to specific measures intended to help to stimulate economic recovery. The initiative is expected to increase the number of people in work by 12,000 during 2004. The most significant aspects of this legislation are tax relief and greater public investment.

In addition, however, there are a number of initiatives to enable unemployed people to retrain or improve their qualifications, and to provide firms with the best possible conditions for recruiting and retaining qualified personnel. Additional funding of more than 500 million DKK (67.2 million euro) will be provided over the next four years for retraining and improving qualifications in the labour force. The programme is directed primarily at unemployed people, people with little vocational training, and trained workers who have difficulty in reading and writing.

The government has launched the following new initiatives:

- There will be programmes to improve the qualifications of unemployed people with little vocational training; additional training for workers with little vocational training; and vocational training for people who have recently become unemployed.
- More young people on welfare benefits will receive vocational training. This will be achieved by allowing local authorities to require that these individuals enter a training programme. If they refuse, benefits can be withdrawn.
- 3,000 trained workers who have difficulty in reading and writing will receive Danish language instruction.
- More people will be given the opportunity to train for jobs in the social services and healthcare sectors. Among other things, this will enable adults with refugee or immigrant backgrounds and those who have difficulties in reading and writing to participate in a vocational training programme.

The National Employment Service (AF) has launched a new job database (www.jobnet.dk) called 'Hotjob', which lists jobs that have been vacant for some time, and which could be done by most people. Hotjob lists positions that employers say do not require any special qualifications. Hotjob can be used by businesses and jobseekers, as well as by the AF and municipalities in their efforts to provide employment.

The Hotjob list offers work as messengers, cleaning and kitchen staff, sales assistants in stores, removal workers, restaurant staff, warehouse personnel, jobs in caring for elderly and disabled people, industrial production, and temporary replacements for employees on holiday. Jobs are available throughout the country. Around 80 new positions are advertised every day, with the daily total reaching approximately 450. Hotjob has proved popular

with jobseekers. Each listing shows an average of almost 100 hits on the website a day, and experience has shown that Hotjobs are filled more quickly than others.

Last spring, the AF launched a campaign to create more jobs with training in the workplace – the wage subsidy programme. The wage subsidy campaign was launched because on-the-job training has generally proved much more effective in getting people back to work than training programmes. The AF has obtained a total of 10,700 jobs – 2,000 more than the original objective. About 40% of these jobs were created in private firms, and 60% in the public sector. By comparison, private-sector jobs made up only 28% of all wage subsidy jobs filled in 2003.

AF regions have had good results from using private telephone sales organisations to contact businesses and tell them about wage subsidy opportunities and make appointments for visits by AF representatives.

The AF has also had good contacts with municipalities in order to establish more wage subsidy jobs. These contacts have been supported by the Employment Minister, who wrote to all mayors and chairs of county councils, informing them about the campaign to provide the AF with wage subsidy jobs. The Employment and Finance Ministers also wrote instructing all state institutions to play a positive part in the programme.

During the campaign, there has been close weekly follow-up on the results of these efforts, in all AF regions. A weekly newsletter on the status of the campaign has been sent to all AF personnel.

The National Labour Market Authority and the AF intend to assess whether ideas and experience from this campaign can be used in the future. Among other things, they will evaluate the effect of using telephone-sales centres for employment initiatives. There will also be a survey of the campaign's effectiveness in helping unemployed people to find new jobs.

Last spring, the government also presented six new initiatives, at a total cost of 65 million DKK (8.7 million euro), which are intended to ensure that as many university graduates as possible have the chance to test their abilities in a job, and that as many firms as possible have the opportunity to try out academically trained personnel. The initiatives aim to do the following:

- involve more players;
- provide an additional 30 million DKK (4 million euro) for 70 more positions for people with PhD degrees, to ensure that talent is not lost while the country waits for an economic upswing;
- set up a nationwide campaign to create more jobs in small and medium-sized enterprises;
- provide introductory courses for university graduates to help them find jobs in the private sector;
- provide more state-sponsored jobs with workplace training, which can function as a springboard to jobs in the private sector;
- set up a new information campaign to interest entrepreneurs in hiring unemployed university graduates.

This represents follow-up on a ten-point action plan launched by the government and the Danish Confederation of Professional Associations in the spring of 2003. The government would like to strengthen this initiative, because economic recovery has been delayed. The number of unemployed university graduates

increased by 5,500 in 2003 alone.

Germany: Radical reform of the labour market

Legislation to introduce modern labour market services has provided the framework for reorientation of labour market policy in Germany. The reform focuses on creating conditions and formulating measures to promote employment, restructure the social security system for jobseekers, and reform the employment service.

The Job-AQTIV Act marked the legislative launch of this reform process. The central theme was a targeted mix of active measures and social security, following the principle of actively encouraging and motivating people to seek work – *Fördern und Fordern*. This was combined with developing a systematic, preventive approach to unemployment as a core element of labour market policy.

The Modern Labour Market Services Acts One and Two, which came into force in January 2003, further developed this approach. These acts aimed to open up employment opportunities for jobseekers. On 1 January 2004, the Modern Labour Market Services Act Three formed the legal basis for reorganising the Federal Employment Agency, reorienting its organisational structures and activities at all levels (including regional offices).

As before, individuals who have been in contributory employment for a period of 12 months within the last three years (to be reduced to 12 months within the last two years, from 1 February 2006) can claim unemployment benefit. Unemployment benefit for those with children is equivalent to 67% of the (overall) net wage, and 60% for all others. As of 1 February 2006, individuals aged under 55 will generally be entitled to claim such benefit for up to 12 months, extended to a maximum of 18 months for those aged over 55.

The amalgamation of unemployment assistance and social security benefit on 1 January 2005 into a basic jobseekers' assistance scheme (referred to as unemployment benefit II) will bring about wide-reaching reform. What were formerly two co-existing welfare systems funded and administered by different sources have become a single, unified system. One aim of the new system is to try to meet the specific integration needs of groups requiring special support in the labour market (e.g. long-term unemployed people) more effectively than before. In so doing, and in providing them with the social security they need, the principle of *Fördern und Fordern* will be implemented under an integrated system. Some 5.4 million people will benefit directly or indirectly from the new system.

Uniform system of basic support

The jobseekers' assistance scheme will support all individuals aged 15-65 who are able to work but who require special assistance, and their relatives. The system offers services, payments and benefits in kind. Jobseekers will be assisted through a special facility, generally within a team set up jointly by the municipality and the local Employment Agency; jobcentres will be established as one-stop shops. This will make

access to services and support easier. The underlying philosophy is to provide tailor-made assistance to those who are able to work, but require special assistance.

The municipal support facilities are responsible for providing accommodation and heating costs, childcare services, debt and addiction counselling, psychosocial assistance and various one-off requirements not specified in the general regulations (e.g. basic items in terms of clothing and housing, or assistance for residential school trips).

The Employment Agency is responsible for providing all other services under the jobseekers' assistance scheme. These include all labour market rehabilitation services (such as counselling, placements, promoting job-creation measures and encouraging training and vocational training) and support services (unemployment benefit II, social security benefit) except for accommodation and heating costs and various one-off requirements.

Alongside the joint team model, a few municipalities have set up a six-year pilot scheme enabling them to take responsibility for running all aspects of the scheme. In addition to their own tasks, they pay out unemployment benefit II instead of the Employment Agency, and are responsible for reintegrating benefit recipients into work.

So what specifically is the *Fördern und Fordern* concept of encouraging and motivating people to find work?

Encouragement (Fördern)

Help from a personal adviser

A personal adviser conducts an in-depth profiling interview with the jobseeker to determine the barriers preventing them from taking up an employment placement. A jointly compiled integration agreement, which is binding on both jobseeker and adviser, sets out the steps to reintegrate the jobseeker into the labour market. As a general rule, a personal adviser should not be responsible for more than 75 jobseekers and any relatives living with them in their 'community in need'.

New services

The integration agreement details the jobseeker's responsibilities, in terms of proactively seeking work, and the services to be provided by the jobseekers' assistance scheme. All jobseekers are offered the specific services they need to reintegrate them into the labour market (e.g. education or training courses). A personal adviser may also offer additional services geared towards individual needs – for example, any work clothing required, or funding towards obtaining a driving licence.

Work for young people

In future, anyone aged under 25 who applies for jobseekers' assistance will immediately receive a reintegration offer. This will involve a work opportunity, training or education to help them to obtain a qualification, or practical work experience.

It pays to work

Through tax allowances, the threshold above which every extra euro earned is taken into account in respect of unemployment

benefit II will not apply until an individual's gross monthly income exceeds 1,500 euro (the previous figure was 691 euro). This will benefit families in particular.

Integration bonus

A new introduction from 1 January 2005 is the availability of an integration bonus. Individuals who are able to work but require special assistance may claim this benefit if they accept a job offering a wage which will not be enough for them to live on.

The personal adviser decides whether an integration bonus is required in order to encourage a jobseeker to accept an offer of employment, and how much the subsidy should be. Individuals are not automatically entitled by law to a wage subsidy.

Child supplement for families

A child supplement will be paid to parents whose earnings are sufficient for them to live on, but not enough to cover the costs associated with their children. The child supplement will be paid together with child benefit, which will avoid working parents applying for assistance under the jobseekers' scheme solely for maintenance of their children. Families in low income situations will therefore be dependent on unemployment benefit II and social security benefit.

Parents whose earnings exceed their personal need for unemployment benefit II or social security benefit will be charged up to a maximum of 70% of the child supplement, thereby providing an added financial incentive for them to work.

Social security

In future, all individuals who are able to work but require special assistance, and receive unemployment benefit II, will have contributions paid towards health insurance and homecare insurance, provided that they do not already have family insurance. They will also be covered by statutory pension insurance on the basis of the minimum contribution. Accordingly, for the first time, individuals who are able to work but require special assistance, and who previously claimed social security benefit, will receive their own pension cover together with statutory health and homecare insurances.

Motivation (Fordern)

Reasonable work

Any individual who receives assistance must make every effort to find a job as quickly as possible, so that they no longer depend on support from the state. Any job is therefore considered reasonable for jobseekers requiring special assistance. Accordingly, they may not reject an offer of employment because:

- it is different to their previous job or in an occupation for which they are not trained;
- it is located further away than their previous job; or
- the employment conditions are less favourable than those of their previous job.

Nor can a job be considered unreasonable because it offers a wage which is below a collectively agreed level or less than average local wages. However, the job may not be illegal or offend common decency.

Rejecting an employment offer

Unemployment benefit II is a form of social security benefit granted to those in need, and is funded by the taxpayer.

Anyone who rejects any reasonable offer of employment, training, work opportunity or reintegration measure will have their unemployment benefit II reduced by approximately 100 euro for three months. This also applies to individuals who fail to make satisfactory efforts to find work. The temporary subsidy paid for a maximum of two years during the transition from unemployment benefit to unemployment benefit II will also be withdrawn.

If a jobseeker aged under 25 in need of special assistance turns down a reasonable offer of employment, training, reintegration measure or work opportunity, they will receive no financial support for three months. During this time, accommodation and heating costs will be paid directly to the landlord. However, the individual will continue to have access to counselling and assistance as well as all integration services. As with those aged over 25, in such cases additional financial or material services may also be provided.

Estonia: Recent changes in the labour market

Since 2001, employment and unemployment trends in Estonia have changed. As a result of improvement in the economic situation, employment started to rise and unemployment started to fall. However, economic inactivity continued to grow until 2003, then decreased.

According to Labour Force Survey data in 2003, as a yearly average 594,000 of the population aged 15-74 were employed, 66,000 were unemployed and 387,000 were economically inactive. According to Labour Market Board data, the number of unemployed people registered at state employment offices was 43,000 in the same period.

Although the activity rate (69.8%) and employment rate (62.6%) increased in 2003 compared with 2002, these figures are much lower than the European Union (EU) average. The employment rate of women in Estonia (58.8%) is, however, higher than the EU average and already exceeds the Lisbon summit's target set for 2005 (57%). The employment rate for older people is also high (52.1%) and exceeds the target set for 2010 (50%). A relatively high age of exit from the labour market (61.6) in Estonia compared with the EU average is caused by a gradual rise in the pension age.

Despite increasing employment, the unemployment rate is still high at 10%. It is especially high for young people (20.6%) and long-term unemployed people (46% of all unemployed people).

Overall, more men than women are unemployed, but the situation for young unemployed people is the opposite. In 2003, the unemployment rate of young women reached 26%, and that of young men 16.9%.

New Employment Strategy

The Employment Strategy 2004-2008, approved by the Estonian Government in May 2004, sets out new policy developments. The aim is to meet the challenge of improving labour market performance and increasing employment opportunities,

especially for the most disadvantaged groups of people.

The Employment Strategy is in accordance with the broader European Employment Strategy and Employment Guidelines, as well as the Lisbon targets of achieving full employment. The strategy covers the provision of active labour market measures and suggests several changes to Estonia's employment services. The new look of the Employment Service is seen as more client-oriented, work-focused (as opposed to benefit-focused) and effective. Necessary amendments to labour market legislation (Social Protection of the Unemployed Act, Employment Service Act) on the basis of the Employment Strategy are currently being drafted.

The Employment Strategy emphasises the importance of minimising the duration of unemployment, as well as motivating and supporting people to move from receiving benefits to being active in the labour market. To achieve this, active labour market measures need to be effective and accessible by all those who need them. As well as widening the range and increasing the quality of active labour market measures, the strategy foresees improved working methods in employment offices. An individual approach to unemployed people (case-management techniques) and joint working with other institutions (e.g. rehabilitation teams, social insurance departments, vocational training centres) as well as good co-operation with employers will all play a crucial role in changing the Employment Service from passive to active.

Greece: Recent developments

Promotion of part-time work

In Greece, part-time employment is limited in scale. In the context of efforts to encourage this form of work, part-time employment in the public sector was introduced in 2003 (Law 3174/03). More recently, Law 3250/2004, which amended Law 3174/2003, now allows public sector institutions to recruit unemployed people on a part-time basis in order to promote certain social services. Under the new law, local, prefectural and regional authorities are allowed to recruit part-time personnel under fixed-term contracts in order to provide these social services. The services mentioned by the law relate to:

- home care for elderly and disabled people;
- school guards and road safety for pupils;
- social inclusion measures for immigrants; and
- cultural events and citizen awareness campaigns.

Selection of applicants for the new posts is to be based on social criteria. The new law includes changes to the groups from which the personnel to be hired can be drawn. People with several children are included, and long-term unemployed people can benefit.

More specifically, 30% of the posts foreseen by the new legislation will be filled by unemployed workers (above 30 years of age) who have exhausted their unemployment benefits, and 20% by unemployed workers who are close to retirement. Further, 20% of the posts are reserved for workers registered as unemployed for a period of at least 18 months, 10% for women with young children, and 10% for disabled people. For most

categories, there is a provision that women will occupy 60% of the posts.

Presidential decrees regulating fixed-term contracts

Two recent Presidential Decrees (PD 180/2004 and PD164) regulate the process and prerequisites for those working under fixed-term contracts to become permanent employees in the private and public sectors respectively. With these Presidential Decrees, Greek legislation falls into line with EU Directive 1999/70/EC by establishing rules to regulate fixed-term contracts in the private and public sectors, and also by regulating the employment status of those who currently work under successive fixed-term contracts.

Latvia: Recent economic and labour market developments

The reforms accomplished in Latvia and integration into the European Union (EU) have had a positive impact on economic development. The Latvian economy has become one of the fastest growing in Europe. In 2003, gross domestic product grew by 7.5%, and in the first quarter of 2004 by 8.8%.

To ensure balanced and sustainable growth of the national economy, the Ministry of Economics – in co-operation with other ministries and organisations – has developed the draft ‘Unified Strategy for the National Economy’. This strategy provides a system of more than 50 indicators to chart Latvia’s process of convergence to the average level of EU countries in all areas characterising the quality of life.

As a result of a combination of factors such as economic fluctuation, expectations of inflation and anticipated price increases arising from accession to the EU, inflation in July 2004 compared with July 2003 has increased by 6.7%. However, the Ministry of Economics forecasts that over the coming years inflation will gradually return to its previous levels.

Successful economic growth has recently made a positive impact on the main labour market indicators. The activity rate was 69.2% in 2003, an increase of 0.4 percentage points over the previous year. The employment rate was 61.8% (an increase of 1.4 percentage points), and the unemployment rate was 10.5%, which was a decrease of 2.1 percentage points compared with the previous year. These figures are improving year by year.

The main increase in the number of employed people during the last year can be seen in construction, transport and communications as well as in financial mediation. However, there are still significant regional differences in the employment situation. For example, registered unemployment rates in the rural areas of the Latgale region (in eastern Latvia) are still very high. The high level of long-term unemployment is also noteworthy, although the situation is gradually improving.

Integration into the EU: main employment policy initiatives

Latvia’s first National Action Plan (NAP) for Employment was developed in 2000, in accordance with the concept ‘On promoting employment in the country’ adopted by the Cabinet of Ministers in 1999. This provided for the development of an annual NAP for Employment, in line with EU employment policies. However, this year is the first time when Latvia, as a new EU Member State, must submit a NAP for Employment to the European Commission.

The NAP for Employment 2004 was developed by a steering group comprising representatives from the Ministries of Economics, Welfare, Education and Science, Agriculture, and Regional Development and Local Governments; the State Employment Agency; and the Union of Local and Regional Governments of Latvia, Free Trade Unions Federation and Latvian Employers’ Confederation.

The NAP’s employment promotion measures are closely linked to implementation of the employment policy priorities set out in the Joint Assessment Paper, the Single Programming Document 2004-2006 and the European Employment Guidelines 2003-2005, as well as country specific recommendations.

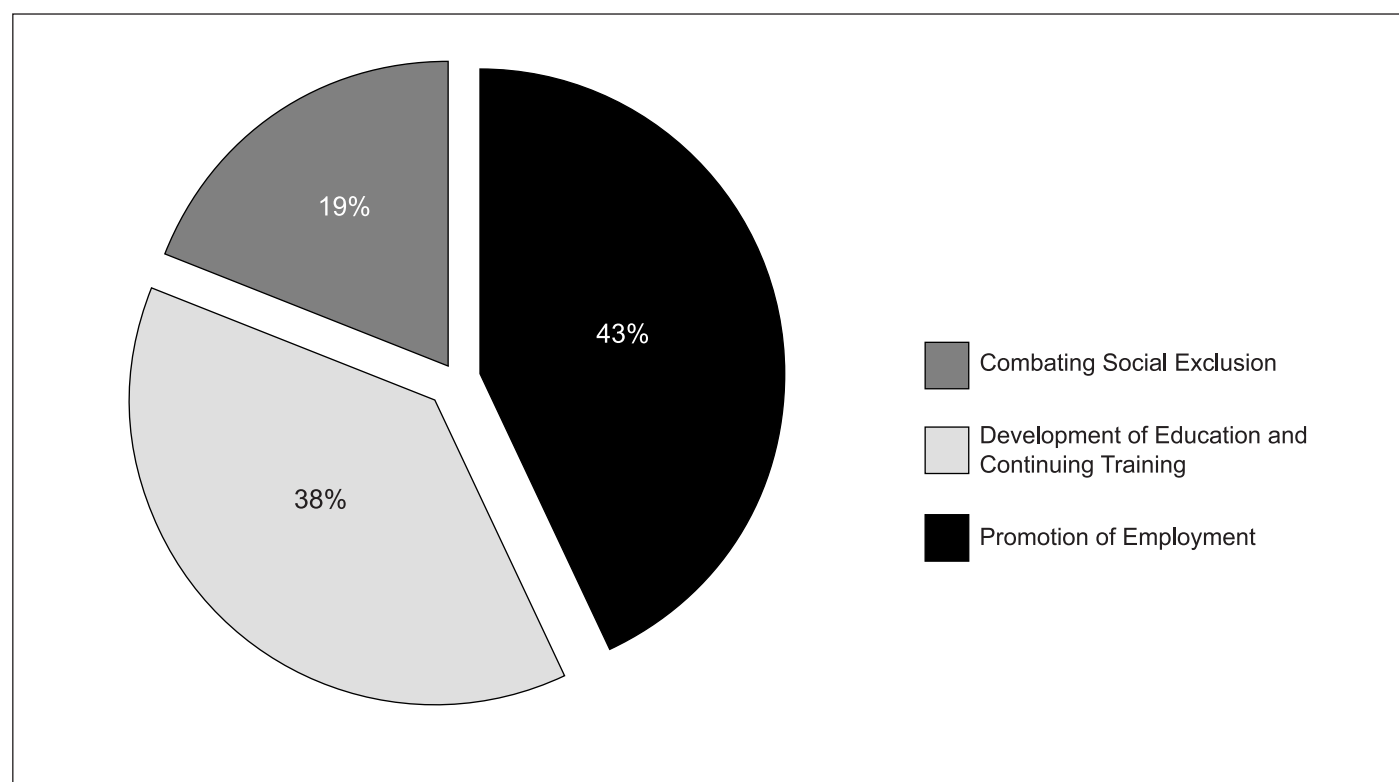
In the NAP for Employment, the objectives and measures set out under each of ten specific guidelines in order to achieve three overarching objectives were chosen in relation to the current situation in the Latvian labour market, as well as available financial resources. Within the EU framework, the assistance of high-level specialists from the Federal Ministry of Economics and Labour in Germany was available during drafting of Latvia’s NAP for Employment 2004. Nevertheless, there is still much to do to improve the organisation and co-ordination of the developing process of the NAP for Employment in Latvia.

As a new Member State, Latvia has access to the EU Structural Funds for the first time. Effective and full absorption of the financial resources available from EU funds represents a challenge because of a lack of institutional capacity and appropriate experience.

Policy priority

The priority ‘Development of human resources and promotion of employment’, co-financed by the European Social Fund (133 million euro), is set out in the Single Programming Document 2004-2006. Under this priority, the following measures (see also Figure 1) will be implemented:

- combating social exclusion;
- development of education and continuing training; and
- promotion of employment;

Figure 1: Division of the priority's financing, by measures (%)

Remarkable work has been done by civil servants from the various ministries, State Employment Agency and other institutions in developing national programmes and projects, aid schemes and open calls for projects. For example, the following national programmes have been developed within the framework of the priority:

- 'Support for active labour market measures' (33.7 million euro);
- 'Capacity building of the institutions responsible for developing and implementing labour market and gender-equality policies, as well as capacity building of other relevant institutions, organisations and project promoters, including non-governmental organisations' (10.9 million euro); and
- 'Promotion of research on labour market issues, including studies on ethnic minorities and the gender-equality situation in the labour market' (4.5 million euro).

Nevertheless, co-ordination of the planning process for the absorption of EU funds needs to be improved, and more support needs to be provided to prepare projects of good quality.

Latvia: Pension reform

Latvia is the first of the Central and Eastern European countries to begin to radically reform its pension system and implement a new approach in its pension system framework.

In the former Soviet Union, full employment and favourable demographics meant that it was possible to have a low pension age (55 for women and 60 for men). The Soviet-style pay as you go (PAYG) state pension scheme led to greatly increased

expenditure on pensions. People were not interested in paying taxes because the amount of the pension was not related to the contributions paid; undeclared employment increased rapidly. In the meantime, the ageing population would necessitate an increase in the statutory minimum retirement age.

Efforts were made to improve the system in the years 1991 to 1993. Legislation to regulate the pension system at that time made the state take the main responsibility for providing security in old age. But the conditions for receiving the pension were too generous and over the long term the state would not be able to finance this system. Therefore Latvia decided to radically reform its pension system and build one that could comply with the new social and economic conditions of a market economy. The concept of pension reform was adopted in 1995.

The targets to be achieved in implementing the pension reform were to:

- create a pension system based on everyone's motivation to ensure a secure old age (the amount of pension being related to the amount of social insurance contributions paid);
- create a three-level pension scheme, sharing the responsibility of the individual and the state in providing security in old age;
- increase the statutory minimum retirement age; and
- provide the opportunity to invest the accumulation of contributions, thus developing financial and capital markets.

The three-tier pension system

The reformed pension system in Latvia consists of three tiers, as follows:

- First tier (implemented in January 1996) – contribution-defined state pension scheme (Notional Defined Contribution

PAYG). Latvia was one of the first countries in the world to implement a notional contribution-defined state pension scheme, originally designed for Sweden. The compulsory non-state funded pension scheme differs considerably from traditional PAYG schemes. The principle of intergenerational solidarity is still applied, as the actual contributions are used to finance current expenditure on pensions. The difference is that social insurance contributions are recorded in notional individual accounts, with the accumulated pension capital indexed according to the wage index.

- Second tier (launched July 2001) – mandatory state-funded pension scheme. Participation in the second tier is compulsory for those who were under the age of 30 on 1 July 2001 (i.e. born after 1 July 1971), but voluntary for those born between 2 July 1951 and 1 July 2001. Additional savings in this tier are made by people investing part of the resources registered in their individual account (see Figure 1 for the proportions) into stocks, shares, bonds and other securities as well as in bank deposits. Investing is done by a licensed fund manager. At the end of 2003, seven licensed fund managers (including the State Treasury) were offering 17 different investment schemes. These schemes are divided according to the investment policy used: there are conservative, integrated and active pension schemes, depending on the risk and profit made from investments. By 31 December 2003, there were 495,062 people involved in the second tier of pensions.
- Third tier (operating from July 1998) – private voluntary pension scheme. Everyone has the option to create additional savings for their pension by paying contributions into private pension funds.

Social insurance contributions (20% of contribution wage) are divided between the first and second tiers as shown in Figure 1.

Figure 1: Division of insurance contributions for pensions between the first and second tiers

Years	1st tier	2nd tier
2001-2006	18%	2%
2007	16%	4%
2008	12%	8%
2009	11%	9%
From 2010	10%	10%

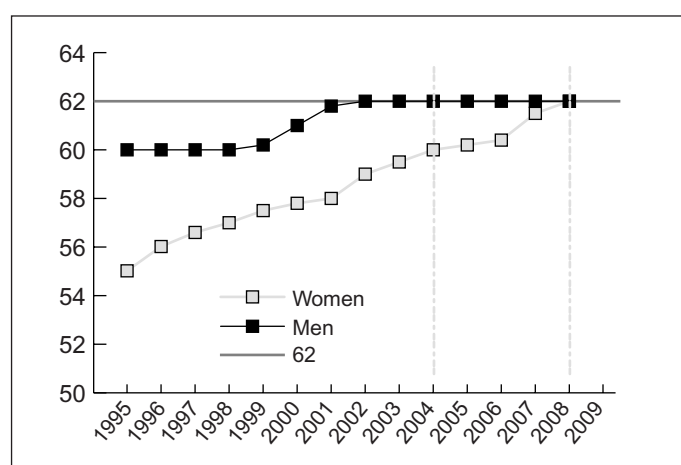
Source: National Social Insurance Agency

Raising the retirement age

As indicated above, in the Soviet era the statutory minimum retirement age was 55 for women and 60 for men; many opportunities were also given for earlier retirement. One of the aims of pension reform in Latvia was to gradually raise the retirement age, in order to secure the stability and sustainability of the pension system and ensure an acceptable balance between the working and non-working population.

In determining the new age for retirement, it was necessary to take into consideration that average life expectancy in Latvia for those born in 2002 is 71.7 (65.4 for men and 76.8 for women). For this reason, raising the statutory minimum retirement age above 62 was considered to be too far-reaching. Latvia is also

Figure 2: Changes in statutory minimum retirement age



moving towards an equal retirement age of 62 for women and men (see Figure 2). For men, a retirement age of 62 has already been reached (from January 2003); for women, it will be reached in 2008. The current retirement age for women is 60 (from 1 July 2004); raising it to 62 is being carried out on a step-by-step basis.

Up to mid-2005, the law provides for the possibility of retiring two years before the age of 62 for men and two years before the increasing schedule to 62 for women if the period of social insurance contribution is not less than 30 years. Those with insurance contributions of more than 30 years who have brought up five or more children or a handicapped child to the age of eight have the right to retire five years before the statutory minimum retirement age.

The employment rate of older workers (aged 55 to 64) has risen since 2000 from 36% to 44% in 2003, mainly because of raising the statutory minimum retirement age. The reformed contributory pension scheme is also expected to encourage people to extend their working life, because the principle of “retire later – get still more” is being applied.

The new pension scheme was created as an insurance system based on everyone’s motivation to achieve financial security in old age. Nevertheless, pension reform has been more rapid than the improvement in living standards for pensioners, partly because the beneficiaries of the reformed system will be the rising generation and generations to come. The reform of the pension system is expected to stimulate active ageing, discourage early retirement and encourage work after retirement.

Hungary: Recent labour market trends

According to the Labour Force Survey, the number of employed people in Hungary was 3,892,800 in the first part of 2004, which equates to an increase of 40,000 over the last two years. The number of employed people increased mainly between 2002 and 2003; the data show stagnation of employment over the past year. The number of employed women has increased by 30,000 during the last two years, while the change in the number of employed men has been very small (within statistical sampling error). The dynamic growth in women’s employment also occurred in the period 2002-3.

The employment rate for the 15-64 age group was 56.6% in the first half of 2004. This represents a 0.6 percentage point increase during the last two years. In spite of this improving trend, the Hungarian employment rate lags behind the EU average.

The unemployment rate presents a more favourable picture in terms of international comparison. It was 6% in the first half of 2004. This was 0.3 percentage points higher than two years earlier, but still much lower than the EU average.

Taking a longer-term view of recent trends in the labour market, it can be seen that the dynamic growth in employment – which started in the second half of the 1990s – came to a halt as a consequence of the recession in the world economy. The government temporarily stimulated the labour market. The most important new measure was the revision of wages in the public sector, which caused significant structural changes in employment by sector and gender. The number of people employed in the service sector has grown strongly, and the number of women employed in this sector has also increased. As a result of a more than 20% wage increase in real terms in the state sector, vacancies in education, public healthcare and to an extent in public administration have been filled.

Compared with the first half of 2002, the number of people employed in education and public administration has increased by 25,000 in both cases, by 32,000 in health and social work, and by more than 40,000 in the field of real estate, renting and business activities. Other parts of the service sector, however, have shown some (less significant) decreases in employment, so that the net growth in employment in the service sector has amounted to 110,000 over two years (see Figure 1). The value of this development is limited by the fact that it has been concentrated mostly in state services.

Another important trend is that the construction industry has shown continuous increase. The number of people employed in this industry has increased by 40,000 during the last two years (see Figure 1). This suggests that the recession in the Hungarian economy is gradually receding. However, economic growth over the past year has still not entailed significant growth in employment.

Figure 1: Changes in employment by major sectors in Hungary between the first half of 2002 and 2004 (1,000s of workers)

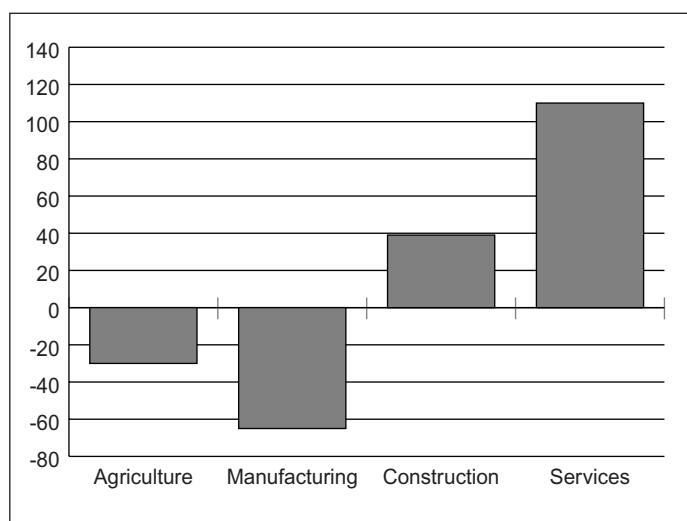


Figure 1 also shows that the improving employment trend of the service sector is overshadowed by stagnation in manufacturing, where the number of workers has decreased by 66,000 over the last two years. The decline has appeared in almost every branch of manufacturing; the drop in employment has particularly hit the textile, leather and food industries.

Since 2002, remarkable growth in activity has been experienced, and both employment and unemployment have increased. This is a new phenomenon in the Hungarian labour market. One reason for the increase in unemployment is that the significant wage increases in real terms have activated people who were economically inactive, and they have started to seek jobs again.

The age profile of workers has changed considerably in recent years, partly because of the ageing population. The number of workers aged 15-24 has declined by 85,000 during the last two years, while the number of those aged over 50 has increased by 120,000 over the same period. The reasons are manifold: the expansion of education has reduced young people's willingness to seek a permanent job; student employment has decreased too, partly as a consequence of the student's credit; the higher retirement age has increased the number of older people in work; and since older workers stay longer in the labour market, demand for career starters has shrunk.

Despite this shift in employment towards the older age brackets, the employment rate of the older population is below the EU average. Hungary lags behind most of all in this sphere of employment. In the first half of the 1990s, many workers moved out of unemployment into inactivity. Getting this group back into employment requires considerable efforts on the part of the government.

A new phenomenon of the Hungarian labour market is unemployment among young people with a degree. This is partly a consequence of the expansion in education. At this recent stage of economic development, graduates cannot be entirely absorbed by the economy. In many cases, the profession attained does not meet the labour market's demand. According to the unemployment register, the number of unemployed young graduates has increased, and their proportion among registered unemployed school leavers has also grown in recent years. The government has introduced a new central programme targeted at this special category of career starters, to enhance their labour market integration. In this new programme, young graduates are offered work places in public administration for up to a year.

Seasonal or non-permanent employment has shown an increase this year. The number of those employed through the use of a 'casual work card' is about 50% higher than a year ago. Despite the growing trend, this form of temporary working remains a subsidiary factor in employment.

In spite of the weak employment performance, enterprises have shown an increase in demand for labour. Growing demand has appeared in central Hungary and the more developed western part of the country, mainly in seasonally sensitive sectors. Vacancies grew in the first half of 2004 by more than 50% in agriculture, 30% in sale, retail trade, hotels and restaurants, and by 20% in construction. Registered vacancies increased in the

whole national economy by about 10% compared with the previous year.

The low employment rate – coupled with a growing labour shortage – reflects structural tensions in the Hungarian labour market. This is confirmed by the fact that the number of foreign workers with official permits increased by 13,000 in the first half of 2004 compared with the previous year. The number of permitted foreign workers amounts to 62,000, comprising mostly non-EU citizens.

Malta: Consultation on the National Action Plan for Employment

In light of Malta's accession to the European Union (EU), the Maltese government has drafted the country's first National Action Plan (NAP) for Employment. The draft consultation plan sets out Malta's employment priorities and the strategic elements to be pursued between 2005 and 2010. The principal strategies covered by the plan include:

- improving the levels of education and certification among the workforce;
- raising the national employment rate;
- enhancing the business environment;
- increasing productivity in the public sector;
- modernising the public employment service; and
- improving the governance of labour market policies.

Table 1 sets out some of these targets as referred to in the plan.

Table 1: Targets referred to in the National Action Plan

Targets for 2010	Situation December 2003	Target 2010	EU target 2010
Raising the overall employment rate by 3 percentage points	53.7%	56.7%	70%
Raising the female employment rate by 7 percentage points	33.7%	40.7%	60%
Raising the employment rate of older workers by 2.4 percentage points	32.6%	35%	50%
Increase of 1.2 percentage points in the business start-up rate	6.8%	8%	None
An increase of 17.5 percentage points in 22 year olds with upper secondary qualifications	47.5%	65%	85%
A reduction of 13.5 percentage points in early school leavers' rate	48.5%	35%	<10%

To reach these targets, the plan provides for 55 measures as well as 30 European Social Fund (ESF) projects, which have been approved for funding and will run from 2004-6. The measures still have to be discussed by the consultees prior to presenting

the NAP to the European Commission. The following are some of the measures included in the draft consultation plan:

- improved incentives for enterprise training of low-skilled workers, and of workers in micro-enterprises;
- introduction of childcare regulations and a fee subsidy scheme;
- an action plan to 'Make Work Pay';
- a social pact for economic development;
- a scheme to redeploy public-sector workers;
- reformation and extension of preventive and active measures; and
- strengthening of capacity for employment policy definition, co-ordination and evaluation.

The projects proposed for ESF funding cover a wide range of issues. Most cover training initiatives for jobseekers, trainers, workers in various industries (such as engineering, electronics and construction), and targeted training for people with disabilities. Other projects involve studies related to measures to improve gender equality, incentives for the provision of childcare services, and various training and employment schemes. These projects are intended to supplement the measures proposed by the government as well as helping in attaining the general targets set for 2010.

Malta: Public-sector reforms

A series of reforms are being introduced in the public sector in Malta, with the aim of providing a more efficient and effective service. High service costs and the rise in the fiscal deficit were the prime motives behind these changes. The reforms involve the introduction of new management practices within the public sector in general (including public agencies and public majority companies), and the redeployment of public-sector workers.

The White Paper on the Public Sector, drawn up in 2003, sets out all the new provisions which will eventually be taken up in the coming years. Among other reforms, the White Paper proposes greater decentralisation of authority from the Public Service Commission to department heads, and more results-based accountability across government departments and public agencies.

Meanwhile, the redeployment of public-sector workers is intended to continue in the coming months. In 2003, a government-owned company, Industrial Projects and Services Limited, was set up to absorb workers who did not opt for early retirement in the restructuring of the Maltese shipyards. This year, an agreement was reached between the government and the Malta Federation of Industry to retrain and employ these workers within the private sector over a three-year transition period. During this period, workers' salaries will be shared between government and the private sector. On termination of the three-year period, the companies concerned will eventually employ these workers.

This agreement will be extended to other public-sector workers who are to be made redundant, namely those employed by the Public Broadcasting Services, Malta Export Trade Corporation, Malta Development Corporation, and the Institute for the Promotion of Small Enterprises.

Austria: The Labour Market Reform Act in brief

Austria's new Labour Market Reform Act of 14 July 2004 will further enhance flexibility in the country's labour market. The regulations contained in the Act take into consideration the increased dynamism in the labour market brought about by structural changes.

In addition to measures to boost placement efficiency and make the provisions on reasonable entitlement more flexible, the Act contains a number of interesting new rules. The main changes are set out below in relation to the relevant laws. Appropriate accompanying measures are also planned, in a bid to give people further incentive to enter employment and to limit the unwanted disadvantages involved for unemployed people.

The main points of the Labour Market Reform Act are:

- an individual assistance plan to be drafted by the Employment Service for all jobseekers;
- examination of regional placement capabilities and timely arrangement of vocational protection benefit (i.e. individuals' right to be employed in the occupation for which they have trained, in the context of wage protection); and
- further grading of penalties if individuals reject reasonable employment.

Unemployment Insurance Act

New rules on reasonable travelling time

Current legislation stipulates only that if people are employed outside the town in which they live, account must be taken of any duty of care they may have. Accordingly, there has been virtually no limit on the amount of time that an individual may have to spend travelling to a new job.

From now on, reasonable travelling time from home to work and back again will, as far as possible, be limited to a quarter of the duration of the working day. Significantly longer working hours will only be deemed reasonable "under special circumstances". For those threatened with long-term unemployment, longer travelling time may be considered reasonable.

But in any case, full-time workers should not spend more than two hours each day travelling. Those working part-time should not spend more than one and a half hours travelling, provided that they work at least 20 hours a week.

Vocational protection benefit

This benefit is currently limited to 100 days. A new individual wage-protection benefit now comes into effect. Under the new rules, during the first 120 days of entitlement to unemployment benefit, the wage offered in an occupation other than that for which an individual has trained, or for part-time employment, may not be less than 80% of that person's previous average earnings. After the first 120 days, the wage may not be less than 75% of such earnings.

In the case of part-time work (during at least half of the working hours less than 75% of normal working time), a 100% wage-protection benefit will apply. Anyone supplying false

information regarding the number of part-time hours they work in an attempt to claim wage-protection benefit will be penalised.

Simplification of rules on temporary employment

The limit of 16 days' temporary employment in any one calendar month will be abolished and the upper limit of net income will be raised, thereby encouraging people to remain employed for longer. If a job ends on a Saturday or a Sunday and the worker is entitled to claim unemployment benefit, he or she may no longer claim benefit in respect of said Saturday or Sunday.

Extension of rules on the allocation period – to include periods of entitlement to a pension advance.

Improved protection for relatives providing care

Protection is being improved by extending the period of entitlement to unemployment benefit. For independent contracts, there will also be compulsory issue of a statement setting out the mutual rights and obligations arising from the contract with respect to unemployment benefit, in the case of care of relatives from care level 3 upwards.

Modernising the application process and assertion rules on supporting early unemployment registration.

Bringing about equality between foreign and domestic pensions – no entitlement to unemployment benefit or severance pay if an individual is claiming a foreign pension, as is the case with unemployment assistance.

Elimination of hardship cases for pension advances

Individuals with impaired health who have applied for pension payments and are required to go into hospital will no longer lose their payment at the end of the limited period during which they may claim sickness benefit. Nor will they be required to apply in person in future. In addition, stays abroad of up to three months will be allowed without the need for costly and time-consuming leniency proceedings, since such individuals are not available to the labour market.

Stipulation of training leave

In future, a minimum number of hours will be stipulated for continuing training. Only those following training for at least 16 hours a week will be entitled to claim a continuing training allowance, and will thereby be able to improve their prospects in the labour market.

Clarification that entitlement to severance pay ends no later than the point at which an individual reaches statutory retirement age.

Closing of the one-week gap in health-insurance protection – this applies to unemployed individuals who, because of the four week waiting period, do not claim unemployment benefit straight away and are therefore not covered after the end of the three week period of health insurance protection.

Equalising treatment of all unemployment insurance periods – by abolishing the limited eligibility of the contribution periods of prisoners who fulfil their duties in respect of work.

Employment Service Act

In addition to protection regulating the employment of different groups and wage-protection benefit, a binding assistance plan will be introduced. This plan must be drawn up jointly by the Employment Service and the unemployed individual. It should ensure that an individual's new job enables them to at least maintain their level of qualification and, wherever possible, improve it. If no agreement can be reached, the Employment Service is authorised to formulate the assistance plan on its own. The new provisions do not constitute a legal entitlement to training.

Labour Market Policy Funding Act

As a general rule, employers are not required to pay contributions towards unemployment benefit (bonus) for employees aged 50 or over. To date, a further precondition for the bonus has been that the individual concerned must not have been employed by the same employer within the previous three years.

From now on, the following rules will apply. In contrast to the previous rules, if a company hires an older employee who previously worked for the company before reaching the age of 50, the bonus may still be paid – even if said worker was employed by the company within the three years prior to turning 50. In all other cases, the three-year rule will continue to apply.

Federal Act on Bad-weather Compensation for Workers in the Construction Industry

There will be a non-discretionary increase in the number of bad-weather hours (as per calculations based on data from the Central Institute for Meteorology and Geodynamics) in accordance with this Act, through the Construction Workers' Vacation and Severance Pay Fund.

Amendments will be made to the wording of this Act to reflect the Federal Ministries Act and the First Euro Legal Collateral Law Act. Obsolete rules on overall payments will be removed.

General Civil Code

It will be compulsory to issue a statement for independent employees, setting out the mutual rights and obligations arising from the contract.

Youth Training Consolidation Act

The measures set out in this Act are extended and prolonged:

- courses will remain open to 2004 and 2005 school leavers;
- the course duration may be extended to a maximum of 12 months; and
- courses may be arranged which prepare young people for the final exam.

Poland: New labour market legislation

The launch of two important new pieces of legislation – the Employment Promotion and Labour Market Institutions Act, and the Pre-retirement Benefits Act – is of key importance for the development of labour market policy in Poland. Both Acts came into force on 1 June 2004, with some articles of the Pre-retirement Benefits Act coming into force on 1 August 2004.

Employment Promotion and Labour Market Institutions Act

This Act is a component of the pro-growth plan for 2002-4 (Business – Development – Labour II), adopted by the Council of Ministers on 1 July 2003. It aims to create a comprehensive system to stimulate employment and check unemployment growth.

The Act implements the provisions of the European Employment Strategy, in particular its Employment Guidelines, as well as the European Social Charter (ESC) and the Charter of Basic Employee Rights. It also pursues the objectives of the Lisbon summit agenda. This set the strategic goal for the European Union (EU) to become the most competitive and dynamic knowledge-based economy in the world, which will generate sustainable growth, create more and better jobs and have better social cohesion.

Effective implementation of the Lisbon agenda calls for EU Member States to develop three main and mutually complementary objectives within their employment policies: full employment, increasing the quality and productivity of work, and social cohesion and inclusion. According to the Lisbon agenda, the average employment rate should increase to 70% by the year 2010. In Poland, the employment rate was 43.4% in the first quarter of 2004, with 73.2% only being achieved by university graduates. The increasing level of education within Poland is evidenced here, and in particular the growing number of people entering higher-level education.

The goals set out in the Lisbon agenda will be implemented through active and preventive measures, in compliance with the agenda's guidelines, to ensure that unemployed and economically inactive people are included within the labour market and can actively compete there. Ensuring that unemployed people receive the support of labour market institutions is an important factor.

The Act also implements the requirements of the Conventions of the International Labour Organisation, which were ratified by Poland, in addition to the provisions of the European Social Charter, which protects the basic social and economic rights of nationals of the signatory states. Poland ratified the ESC in 1997 by implementing, among other things, such provisions as:

- striving to achieve full and stable employment;
- maintaining free employment services for all workers;
- supporting adequate vocational training, guidance and retraining; and
- recognising the right of male and female employees to equal pay for work of the same value.

Basic provisions of the Act

The Act:

- sets out active and preventive measures for unemployed and economically inactive people;
- identifies mechanisms to prevent discrimination in the labour market and promote the employment of women, including sanctions against those who limit the access of women to the labour market (including within the employment services);
- assumes a growth in demand for work and the promotion of vocational activity for older people;
- provides for the implementation of guidelines on promoting flexibility, adaptability and mobility in the labour market (including, for example, the Labour Fund refunding the costs of travel to and accommodation at the place of work);
- provides for more severe sanctions for those employers who employ people illegally;
- takes account of the existing institutions and arrangements in the European labour market, including the EURES (network of European public employment services) system;
- incorporates EU regulations on the free movement of people and the co-ordination of social insurance systems for unemployment benefits into Polish legislation; and
- provides for comprehensive changes in the operation of labour market institutions and instruments.

In addition, to encourage unemployed people to actively seek work, the Act provides for the option of combining work and receipt of unemployment benefits. If someone who is eligible for unemployment benefit takes up a part-time job and earns a salary below the minimum pay, they are entitled to receive an 'activation' allowance.

An important change incorporated in the Act is the transfer of responsibility for payment of pre-retirement benefits and decisions on eligibility for such benefits from the labour offices to the Social Insurance Institution.

The Act supports co-operation and partnership working in relation to the labour market. Consultation procedures are already in place to support the active participation of social partners in state interventions, along with measures relating to the labour market.

The Act also supports progress towards the achievement of uniform, consistent definitions regarding the operation of employment services and other labour market institutions, as well as uniformity of qualification requirements for staff of public employment services.

Pre-retirement Benefits Act

The solutions adopted in this Act are closely linked with the regulations set out in the Employment Promotion and Labour Market Institutions Act, and the programme for employing people aged over 50.

Pre-retirement benefits aim to benefit those who find themselves in the most difficult situations. The existing policy of relaxing the eligibility criteria in relation to age and length of employment service led to the vocational de-activation of over 500,000 people.

The main aim of this new Act is to propose a series of activation measures in the initial period after loss of a job. The activation programmes are set out in the Employment Promotion and Labour Market Institutions Act, and consist of organisational and financial services for employers and directly interested parties, geared towards securing employment in the first six months after registration at a labour office. People becoming eligible for pre-retirement benefits during this first six months will have unemployed status and the entitlement to receive unemployment benefit. If they do not access employment during this six-month period, they will then be able to apply to the Social Insurance Institution for the right to receive pre-retirement benefit, provided that other specified conditions are satisfied.

The regulations set out in the new Act will stimulate unemployed people with long service records to actively seek work. At the same time, the transfer of benefit payments from labour offices to the Social Insurance Institution will reduce bureaucracy within the labour offices. It will also substantially increase the involvement of labour offices in both employment placement and vocational guidance activities.

Finland: Launch of the new Working-life Development Programme 'Tykes'

Development of the information society by means of equipment and education alone is not enough to face the challenges of globalisation. We need workplace communities that continuously develop their operations. We also need workplace communities in which education and knowledge are refined through true co-operation and teamwork. In these workplaces, new technology serves the accumulation of the entire workplace community's knowledge and know-how. The new Working-life Development Programme 'Tykes' is intended to build Finnish working life towards this goal, as Finland invests in knowledge, but does not yet know how to make best use of it.

Tykes, which was launched at the start of 2004, supports the development of work organisation through the co-operation of management and personnel. The programme aims at growth in productivity, into which is interwoven the simultaneous improvement of employees' development potentialities, their scope to influence matters, well-being at work, and workplace functionality. Tykes is based on positive results from earlier working-life programmes (The Workplace Development Programme 'Tyke', National Productivity Programme, and Well Being at Work Programme).

Tykes' goal for 2004-9 is to have as many as 1,000 workplace development projects with 250,000 participants. Special attention is given to small and medium-sized enterprises and social and health services. Success in the global economy calls for greater and greater productivity and efficiency. Maintenance of welfare structures also requires higher productivity, because the population is ageing and the labour force diminishing. Sustainable growth in productivity and the economy can be attained only through knowledge and innovations.

The total budget of the Tykes' programme to be financed through the state has been estimated at 87 million euro for 2004-9. The aim is for workplaces to invest double this amount in the projects. The programme's budget for 2004 is 12.5 million euro.

The programme supports researchers' and consultants' efforts in the development projects. Development work is based on management, staff and experts in the workplaces working together as a team. In particular, Tykes aims to strengthen developmental co-operation between enterprises and educational research and design establishments. The research-political goal of the Tykes programme is that the projects become topics for doctoral dissertations and licentiate studies. The aim is for Finland to become a leading player in the field of working-life development.

The application process for projects began in February 2004. Regional networks of contact people in the TE Centres and Occupational Health and Safety Inspectorates are also being set up for the programme.

At the launch of the Tykes programme, the results of researcher Pekka Ylöstalo's study on the prevalence of team-based methods of operation in workplaces in Finland were published. This study showed that team-based methods of operation are more common in workplaces in Finland and Sweden than in other European Union (EU) Member States on average. Industry is ahead of the service sector in Finland, unlike in other EU Member States. The Finnish data for the study was based on management assessments of 316 private enterprises employing at least ten people. The study also used a sample of 810 businesses from ten other EU countries as comparison material.

The study indicated that typical reasons why team-based methods have not been of interest to all enterprises in Finland include enterprises' conscious choices of strategies, cultural factors and the difficulty of measuring the benefits. However, Finnish business leaders mentioned resistance from employees, trade unions or middle management as an impediment to change less frequently than did businesses in other EU countries. Similarly, legislation and collective agreements were more seldom considered as problems inhibiting the use of new methods of operation in Finland.

The Ministry of Labour, other ministries and labour market and entrepreneurs' organisations are taking part in the Tykes programme. More information on the programme can be found at: www.tykes.fi

Sweden: Better integration of immigrants into the labour market

Against the backdrop of a low employment rate among the immigrant labour force, the government has emphasised that continuous efforts are needed to accommodate general labour market activities for all individuals, irrespective of ethnic or cultural background. Co-operation between public employment services, municipalities and the Swedish Migration Board must be developed and improved, particularly during the first weeks and months after an immigrant's arrival. The integration of immigrants must focus on work and self-support.

In spring 2003, the government appointed a working group for co-operation on labour market integration. The group's tasks were to investigate the private sector's commitment to the integration of immigrant workers, and to assess how public and private partnership could be developed in this area. The

working group consisted of representatives from the Swedish Enterprise Confederation and the government.

In April 2004, the working group delivered the results of its investigations in: Open doors – lowered thresholds. The group suggested a number of measures, including a new system of 'trial traineeships' for those with limited or no work experience. The purpose is to provide individuals with closer contact with Swedish working life, and to give unemployed people the chance to demonstrate their skills and knowledge.

In response, the Swedish Enterprise Confederation pointed out that hiring a worker with a degree and work experience from another country involves a certain degree of risk. The working group took the view that trial traineeships would reduce this risk, since it gives employers a chance to identify the skills and knowledge of immigrant workers without any long-term commitment. The working group also suggested that the Swedish Employers Confederation should actively promote trial traineeships among its members in the private sector.

If the trial traineeship does not result in a job in the regular labour market, the employer must provide the unemployed person with a certificate on the extent and content of the trial traineeship. Further investigation is needed as to the possibilities for making an assessment of the skills and work experience gained by immigrant workers at their place of work.

The government's view is that the main direction of integration policy should be to encourage self-supportive work. On the other hand, it is vital that immigrants get a foothold in the Swedish labour market. The trial traineeship could provide a gateway into the Swedish labour market in support of this process. In preparing the Budget Bill for 2005, the government will return to parliament with a response to the working group's proposals.

Norway: Overall developments

Since the second quarter of 2003, there have been solid signs of recovery in the Norwegian economy, though the recovery has not yet resulted in significantly increased employment or lower unemployment rates. It is expected that the recovery will continue through 2004 and 2005, leading to increased employment and reduced unemployment.

Recovery in the Norwegian economy

The growth rates identified in 2003 have continued, with new figures showing that growth in the mainland economy has continued to be high in the first part of 2004. Low interest rates, high demand from the household sector and increased investments and exports have pushed up the rates of growth. The upswing is expected to continue through 2004 and 2005. With an increased level of unemployment (up one percentage point since the summer of 2001), and some decrease in the labour-force participation rate, there are labour resources available to support the economy. Money and wage inflation pressure is thus expected to stay low despite increased growth rates.

Continuing high labour market participation rates

Norway has a high labour market participation rate, although the rate has decreased since 2002. According to the Organisation for Economic Co-operation and Development (OECD) figures, 79.4% of the total population aged 15-64 were participating in the labour force in 2003. The comparable figure for the European Union (EU) was 69.4%, and the OECD average was 69.8%. The relatively high participation rate in Norway is partly explained by a high proportion of employment among women and older workers.

A fall of one percentage point in the participation rate and a reduction of approximately 1% in the numbers of employed people has been noted from the second quarter of 2002 to the second quarter of 2003. In the second half of 2003 and so far in 2004, the demand for labour and the unemployment rate have been stable.

Rising unemployment has come to an end

From a level of 3.2% in 1998, the unemployment rate increased to approximately 4.6% in the third quarter of 2003. Weak demand for labour contributed to lowering the rates of flow from unemployment to employment, resulting in a growing proportion of long-term unemployed people. Joblessness among immigrants has increased at the same rate as other unemployment in the last few years. Today, one in six unemployed people is an immigrant. The rate of unemployment stopped rising in the third quarter of 2003 and has since been stable. The economic forecasts indicate a decrease in unemployment in the second half of 2004 and in 2005.

Declining activity in the manufacturing sector

The manufacturing sector has experienced the highest loss of activity and the sharpest decline in employment during the recession. From the second quarter of 2002 to the second quarter of 2004, employment in this sector decreased by about 10%, compared with an overall fall in employment of 1%.

Increased numbers of people on state benefits

Particularly challenging long-term trends in the Norwegian labour market since the mid-1990s have included:

- an increased number of people receiving disability pension;
- an increased number of people on early retirement schemes; and
- increased sickness absence and increased numbers of people receiving medical and vocational rehabilitation.

These trends have contributed to a lowering of the effective labour supply and a constraint on public budgets. About 20% of people of working age are on these state benefits.

EU enlargement and new regulations

Norway decided to make use of the possibility of a transitional period in order to prevent possible negative consequences for

Table 1: Main macro-economic figures for Norway
(Percentage change from previous year unless otherwise stated)

	2003	2004	2005
Gross domestic product (excluding oil sector)	0.6	3.2	3.1
Private consumption	3.8	4.5	3.7
Investments	-3.7	4.9	5.0
Exports	1.2	1.6	3.0
Employment	-0.6	0.2	0.8
Unemployment (level, rate)	4.5	4.3	4.1
Inflation (trend)	1.1	0.75	2.25

Source: Statistics Norway (2003) and White Book (forecast 2004 and 2005)

employment and welfare schemes after EU enlargement in May 2004. The focus has been to avoid 'social dumping'. Migrant workers from the new EU Member States (with the exception of Cyprus and Malta) are required to obtain work permits before starting work in Norway. Work permits will only be issued for full-time employment at normal rates of pay and under normal working conditions.

The government submitted a new proposal to parliament on May 28 2004, as follow-up to a request from parliament for new regulations. In accordance with this proposal, the Labour Inspectorate and the Petroleum Safety Authority are to carry out necessary inspections within companies to ensure compliance with the terms of work permits. Any suspicions concerning violations of the terms of work permits are to be reported to the immigration authorities. The proposal also stipulates that the Labour Inspectorate and Petroleum Safety Authority are to oversee the enforcement of collective agreements declared universally applicable by the Norwegian Tariff Board. Any non-conformity is to be investigated by the police.

Employers in certain sectors may, by a regulation to be imposed by the Ministry of Labour, issue ID cards to their employees if this is considered necessary for health, safety and environmental reasons. Building and construction companies will be the first to be affected by this new regulation. Finally, the proposal contains certain amendments concerning tax registration by Norwegian firms buying services from abroad.

Parliament adopted the proposal in June 15, 2004, and the new regulations came into force on 1 October, 2004.

Norway has ratified the International Labour Organisation's Convention Number 94 (the Labour Clauses (Public Contracts) Convention). The Norwegian government is in the process of implementing the convention through new guidelines for state agency purchases.

An increased number of work permits has been issued so far in 2004 compared with 2003. By the end of July, the Norwegian Immigration Authorities had given about 5,000 work permissions. The increase was mainly in employees from the new EU Member States.

Norway: New Ministry of Labour and Social Affairs

The Norwegian government has established a new Ministry of Labour and Social Affairs, effective as of June 18, 2004. The new ministry has been created as a first step in reforms to co-ordinate the Public Employment Service, the National Insurance Service and the Social Assistance Offices. The new Ministry has overall responsibility for labour market policies, working environment and safety, income insurance and social welfare. It was established by merging relevant departments and units from three different ministries: the former Ministry of Social Affairs, the former Ministry of Labour and Government Administration and the Ministry of Municipal and Regional Affairs.

Norway is facing challenges to secure the basis for continued welfare. Strategies to reduce the strong growth in withdrawal from work due to sickness absence, disability pension and early retirement are some of the most urgent political priorities in the social field. In addition, the government is dealing with important pension policy issues and strategies to promote social inclusion and reduce poverty. Norway, like most Organisation for Economic Co-operation and Development countries, is also experiencing a significant ageing of its population.

One important measure to meet these challenges is better co-ordination of employment and social policies and services. Currently, administration of income security and employment services in Norway is divided between three main public welfare agencies: the National Insurance Service and the Public Employment Service, which operate nationally, and the municipal Social Assistance Offices. The present system has been criticised for being fragmented and inaccessible to clients who need to combine services from two or three agencies. It has also been claimed that co-ordination of the different services has been inefficient or lacking.

In August 2003, the government appointed an independent committee with a mandate to consider different organisational models for co-ordinating the three agencies, and to submit a report by June 30, 2004. The government invited organisations and interest groups to submit comments on the report by 1 November 2004 before deciding on a model and submitting a proposal to parliament well before the general election in September 2005.

There are three main goals for the reforms:

- increasing the number of people working and engaged in other activities, and reducing the number of people dependent on welfare benefits;
- developing a more user/client-oriented welfare system; and
- developing a more effective welfare system.

The committee has argued for the merging of work-related measures into one agency. It has also argued for the need to shape a slender organisation with unambiguous objectives, a limited number of responsibilities, and a clear focus on the single purpose of getting people back to work and reducing the number of people on inactive benefits. For these reasons, the committee has proposed replacing the existing National Insurance Service and Public Employment Service with two new agencies:

- A centre for work and income that will cover all working-age

people who lack work or have other work-related problems, whether these stem from health or social reasons. The main objective of this agency will be getting people back to or into work more efficiently.

- A separate agency for pensions and child/family-related benefits and matters that are currently the responsibility of the National Insurance Service. The committee's argument is that a separate agency will be better equipped to handle the demanding tasks and challenges related to future pension reform.

The committee has advocated maintaining municipalities' responsibility for the social safety net for their inhabitants, and has therefore not proposed any changes in the municipal Social Assistance Offices. However, the need to develop a client/user focus is one of the central reasons for the reform. Emphasis will therefore be placed on a user-friendly system and easy access to services, either by personal attendance or through electronic gateways.

To ensure better co-ordination of national and municipal services and a user-friendly system, the committee has advocated the following measures:

1. To enhance motivation to seek work rather than receiving social welfare, the government should consider a new jobseeker's allowance for active jobseekers who are not eligible for unemployment benefit. The objective of such an allowance would be to cover people without work or income who would otherwise have to seek economic support from the Social Assistance Offices.
2. A joint front-line service (one stop shop) based on co-operation between the local offices of the proposed national centre for work and income and the municipal Social Assistance Offices. This front-line service would assist all clients in need of active measures to obtain work or get back to work, and related income support.

A reform of the three welfare agencies will be one of the greatest organisational changes in the public sector in Norway in recent years. At any one time, these agencies cater to half of the population and are responsible for measures covering the whole lifespan.

The reform will involve more than 16,000 person-years and total budgets of more than 200 billion Norwegian kroner (24.3 billion euro) – 13% of gross domestic product. Implementation of the proposed reforms offers a great number of challenges, but on the other hand the potential for improved services for clients/users and reduced costs is considerable.

These goals cannot be reached by organisational changes alone. Benefits, regulations, statutory rules and services must also be designed to motivate those who are able to work to return to or get into working life. These matters will be addressed at a later stage.

Bulgaria: Continued preparation for participation in the European Employment Strategy

In 2004, Bulgaria continued its preparation for full participation in the European Employment Strategy (EES). In this regard, legislative changes have continued, along with improvements in policy implementation and administrative capacity. Important stages in preparation for Bulgaria's accession to the European Union (EU) have been the adoption of the national Employment Strategy, and the first report on progress in implementing the Joint Assessment of Employment Priorities (JAP) on employment priorities in Bulgaria.

Employment Strategy 2003-2010

The Employment Strategy incorporates and supplements the best practices of the employment policies applied during the market-economy transition period. It establishes objectives, priorities and activities that, when implemented, will comply with the macro-economic framework adopted in the National Development Plan.

The Employment Strategy is a more general strategic document than a labour market strategy, since it is not restricted to the functioning of the labour market. At the same time, it does not cover all the issues regarding labour relations, freedoms and protection for workers, ensuring health and safety at work, social insurance and living standards.

The Employment Strategy defines the path for achieving the EES goals in Bulgaria, namely: ensuring full employment, increasing quality and productivity at work, strengthening social cohesion and ensuring an inclusive labour market. In terms of Bulgarian conditions, these goals imply a significant increase in employment and a reduction in unemployment, as well as better quality of work. To achieve this for a wider range of working-age people means ensuring that there are appropriate and satisfying jobs for workers (job content, income, working conditions) and sufficient productivity for enterprises.

The Employment Strategy outlines the main challenges and problems, including low levels of labour market participation, high rates of unemployment, large numbers of discouraged people, and significant regional variations. In addition, more general challenges are expected to influence long term development of the labour market. These include unfavourable demographic trends, an ageing workforce, Bulgaria's integration into the EU, and the need for orientation towards a knowledge-based society.

To overcome these challenges and problems, the main medium-term objectives, from 2004-7, are increasing employment and decreasing unemployment. The long-term objectives, to 2010, are to increase the population's labour-force participation and potential. The Employment Strategy gives special attention to the particular tasks needed to realise its goals and sub-goals.

Realisation of the Employment Strategy's objectives requires considerable financial resources. In their annual policy planning, the relevant ministries, agencies and administration services will include as a goal for implementation the priority tasks set in the strategy, according to the fixed terms given.

Thus, resources from the state budget regarding maximum defined expenditure will be used in the most effective way to achieve the strategy's objectives. In addition, resources from various EU programmes and international sources will be used, along with resources from employers, municipalities, local donors and non-governmental organisations (NGOs).

To monitor implementation of the strategy's goals, a database will be created and annually updated. This database will contain performance indicators that enable progress in implementing the strategy's objectives, sub-objectives and tasks to be tracked. The indicators are divided into the following sub-groups: population and social development, labour market, active labour market policy, and educational system.

In 2007, an assessment of the implementation of the medium term objectives will be conducted and the Employment Strategy will be updated if necessary.

Progress in implementing the Joint Assessment of Employment Priorities (JAP)

In relation to the EU accession partnership, a priority for Bulgaria was the preparation and endorsement of the Joint Assessment of Employment Priorities. The report was signed by the Commissioner for Employment and Social Affairs and the Deputy Prime Minister and Minister of Labour and Social Policy in October 2002.

In a short term action plan, a number of state institutions, social partners and NGOs undertook activities to resolve the challenges outlined in the JAP. As preparation for this process, a seminar was held in February 2003 with representatives from the EU and Bulgarian institutions. The seminar's main goal was to discuss achievement of stated priorities and challenges in the employment field, and to initiate the monitoring process.

In May 2004, a follow-up seminar was held. At this event, the first report on Bulgaria's progress in implementing the JAP was formally presented. The progress report was developed by the interdepartmental working group, which included experts from all ministries, agencies and other institutions participating in the JAP process and concerned with meeting the challenges set out in it. The progress report was also disseminated among the ministries and social partners in Bulgaria, and sent to the EU, where it was well received.

The Bulgarian government sees implementation of the priorities set out in the JAP as particularly important in the process of preparing for full EU membership. The main objective of the progress report is to present advances made in implementing the labour market challenges outlined in the JAP, and preparation for implementation of the EES.

The progress report goes through each priority identified in the JAP in detail. The major spheres where progress has been observed are as follows.

As a result of enhanced economic growth and the focus on active labour market policy, **the employment situation is improving**. The number of people employed is increasing along with the employment rate. Unemployment is going down significantly.

During recent years, there has been considerable growth in the financial resources spent by the government **on active labour market policy**. This in turn allows for more unemployed people to be included in the active programmes and measures. The Employment Agency is being reformed to improve the quality of services provided to the public and to optimise activities in the Labour Office Directorate.

The **social insurance system** and the employment system continue to make concerted efforts towards encouraging unemployed people and those who benefit from social insurance to obtain employment.

Amendments and supplements to the Social Assistance Act and its Implementing Regulations have introduced **a differentiated approach** to providing assistance to various at risk groups, depending on their specific characteristics and needs. This has made it possible to raise the incomes of those with the lowest incomes (e.g. lone parents and people with disabilities).

In developing the **gender equality policy**, efforts are being made to set up a structure to track indicators of equal treatment and report on the level achieved. The legal framework was set up under the Protection from Discrimination Act, which is instrumental in guaranteeing the constitutional right of equality.

As a result of legislative amendments in **education** as well as methodological and organisational measures, the number of children dropping out of schooling is decreasing. Measures have been put in place to improve conditions for the integration of minority ethnic groups and students with specific educational needs.

Reform in **vocational education and training** is in progress. The network of institutions is being rationalised. The admission of students takes into account the occupational needs of the labour market; the list is approved by the Minister for Education and Science after co-ordination with the Minister for Labour and Social Policy and the Minister for Regional Development and Public Works. Educational standards for the acquisition of a profession are being elaborated.

The regulation concerning wage formation in commercial companies with more than 50% State shares which was adopted in 2003, makes it possible for them to set their wage fund by observing a strict fiscal discipline, depending on labour productivity, by preventing any losses or overdue debt.

To reduce non-regulated employment, national employers' organisations and trades unions have supported the government in the introduction of a register of employment contracts, and a minimum social insurance threshold by sector and by nine categories of post. Following a proposal by employers' organisations, the government agreed that the minimum insurance wage per sector should be agreed between sectoral organisations of employers and those of workers and employees.

An important element of the **fiscal policy** is the measures aimed to gradually raise the tax threshold on incomes, and in parallel with this reduce the tax rate on the lowest incomes.

Not all of the EU's recommendations have been followed through and/or implemented fully in the period between the signing of the JAP in 2002 and the end of 2003 – for instance, those referring to the level of employment, structural changes in the economy, adequate development of the service sector and

agriculture, the wage negotiation system, and the replacement of tripartite negotiations by bipartite ones. However, it should be emphasised that the JAP challenges continue to be an important instrument for development and reform in the process of preparation for implementation of the EES.

Romania: Facilitating participation in employment

Romania has adopted the European Employment Strategy (EES), the main instrument for co-ordinating employment-policy priorities at European Union level, as the framework for elaborating its National Action Plans for Employment (NAPs). The first NAP (2002-3) was developed according to the 2001 Employment Guidelines, whereas the second NAP (2004-5) was developed in line with the revised EES and Employment Guidelines adopted for 2003. The second NAP is built on three inter-related strategic objectives: full employment, increasing quality and productivity at work, and strengthening social cohesion and inclusion. It takes into account the ten Employment Guidelines.

The National Development Plan (NDP) 2004-6 is a strategic document for human resource development in Romania. Priority III of the plan envisages the objective of “increasing employment levels and combating social exclusion”. This objective contains three general measures: increasing the long-term adaptability of the workforce, combating structural unemployment, and actively combating social exclusion.

The approach used within the NDP synthesises the conclusions of the Joint Assessment of Employment Priorities (JAP). The same approach can be found in the 2004-5 NAP.

The main legislative instrument for implementing labour market policy in Romania is Law 107/2004, which amends and complements Law 76/2002 on the unemployment insurance system and stimulation of employment. The new law creates the basis for a high level of employment through ensuring the adaptability of the workforce to labour market requirements, active measures to stimulate employment, and measures to encourage employers to hire jobseekers.

Active measures to stimulate employment include: information and vocational counselling, job matching, vocational training, counselling and assistance in starting up an independent enterprise or business, and encouraging employers to hire unemployed people, with the assistance of subsidies from the Unemployment Insurance Budget. Subsidies are available for disabled people, graduates, unemployed people aged over 45 and unemployed lone parents. Grants and credits are also available to employers under favourable terms.

The following groups can also benefit from job matching and vocational training services financed from the Unemployment Insurance Budget:

- those working in rural areas who do not earn a monthly income or earn an income lower than the level of unemployment benefit;
- people seeking work after returning from parental leave or after completing a period of military service;
- people seeking employment after recovering work capacity

- following the expiry of invalidity benefit;
- those in detention and prison who have up to nine months left of their detention; and
- foreign citizens or stateless people who have been employed during the period of their domicile or residence in Romania.

In the context of the national strategic documents, the future priorities of Romanian employment policies are as follows:

- **Long term improvement of adaptability to the labour market, promotion of lifelong learning and continuous vocational training**

This objective will be achieved through a range of measures, including training and retraining of employees of state or privately owned enterprises. The following measures will be promoted: continuous vocational training programmes to maximise the use of new production technologies in economic sectors with the potential for high added value; new information and communication technologies; improvement of human resources management in the context of industrial restructuring; counselling programmes; activities to develop management skills in the field of human resources; and the promotion of entrepreneurship.

- **Fighting ‘structural unemployment’, which has arisen as a result of the economic restructuring process**

This will be achieved through preventive and active measures targeted at young people, long term unemployed people and those working in rural areas who do not earn a monthly income or who earn an income which is lower than unemployment benefit. Measures will include the promotion of vocational training programmes according to labour market demands, specialised information services and career counselling, and entrepreneurship development programmes.

- **Promoting social cohesion and inclusion, particularly for vulnerable groups**

Vulnerable groups include the Roma population, young people leaving placement centres and other childcare institutions, and disabled people. Priorities will include preventing and combating social marginalisation, and increasing access to active measures to integrate these groups into the labour market. Promoting social inclusion and equal opportunities will also support the process of tackling discrimination in the labour market for vulnerable groups.

In this respect, the employment policies promoted within Romania’s national policy documents are in accord with employment policy trends at EU level:

- increasing the adaptability of employees and enterprises;
- stimulating better quality job creation;
- combating undeclared labour;
- integrating unemployed people within the labour market; and
- increasing social cohesion through combating all forms of discrimination against those at risk of marginalisation in the labour market.

Turkey: Developments in employment policy

The Institution of Employment and Employees (IIBK) was established in 1946 to carry out public employment services. The IIBK’s function was to provide labour market mediation services in finding jobs and employees. It functioned successfully in this field, particularly in addressing the labour-force needs of developing industries and monitoring the sectoral and geographical activity of the workforce.

In the 1960s, the IIBK focused on sending employees abroad. However, the demand for these employees ceased with the stagnation and unemployment experienced during the oil crisis of 1973. This situation led to a major decline for the IIBK. It was not able to reorganise itself to provide services based on the various needs of the labour market. As a result, the role of public services in the labour market was gradually reduced.

Reform in employment services needed to be in tune with the requirements of the labour market. The quality of services for employers and employees needed to be improved, making use of modern data-processing technologies and forging strong partnerships involving all the relevant players in the labour market (e.g. social partners, local authorities, social security institutions, educational institutions).

The IIBK was restructured as the Turkish Employment Organisation (İŞKUR) in 2003. The aim was to establish a modern employment organisation providing high-quality services to an increased labour force, implement both active and passive labour market policies effectively, and analyse the problem of unemployment in Turkey.

İŞKUR (Turkish Employment Organisation)

The innovations provided by the law establishing the restructured Turkish Employment Organisation are as follows.

1. Four extra functions in addition to that of mediation services for finding jobs and employees:

- assisting in the formulation of national employment policies, preserving and improving employment, and preventing unemployment;
- establishing and monitoring a database system for the labour market, establishing an Advisory Board for the Labour Market and co-ordinating its activities;
- implementing active labour market policies such as improving the qualifications of the labour force, vocational training, training at work, job and career counselling; and
- implementing passive labour market policies such as unemployment insurance and compensation for dismissal.

2. Fundamental changes in organisational structure

The law establishing İŞKUR ensured a working and organisational model which is open to social dialogue and participation. Three new boards include social partners at the different administrative levels, especially organisations of both employees and employers.

A General Board was set up to assist in formulating national employment policies and determining appropriate targets for İŞKUR regarding these policies. The General Board comprises 79 members, including representatives from the public sector and universities; 46 members are representatives of social partners. The General Board meets every two years in November, generally at the invitation of the Ministry of Labour and Social Security.

The Unemployment Insurance Foundation and the Board of Directors were combined. The Board of Directors was restructured as the main administrative, decision-making, competence and responsible body for İŞKUR. The Board of Directors has six members: the General Director of İŞKUR (who acts as the chair), and representatives from the Ministry of Labour and Social Security, the Undersecretariat of the Treasury, the Confederation of Workers, the Confederation of Employers, and the Confederation of Tradesman and Craftsman.

In addition, Provincial Employment Boards were established, with the governor as the chair and participation by representatives from the public sector, social partners, vocational/occupational organisations, universities and non-governmental organisations. The Provincial Employment Boards will improve local initiatives at regional level, and will determine local employment and labour market policies. Thus İŞKUR has the chance to improve and implement appropriate policies for the differing labour markets in each province. Provincial Employment Boards meet in September each year.

Reorganising the structure of İŞKUR gave an impetus to decentralisation. An important change was made in İŞKUR's local organisational structure, by abolishing Regional Directorates and reorganising them as Provincial Directorates in each province. It was also foreseen that, where necessary, branch directorates will be established in towns that have a population of more than 100,000, or more than 10,000 workers registered with the Social Insurance Organisation.

3. Abrogation of the monopoly authority in the field of employment

As a result of the new structure of İŞKUR, private employment offices (PEOs) could be established. Private employment offices can find jobs and employees (except for the public sector), on condition that they receive permission or a licence from İŞKUR. Founders of PEOs need to fulfil certain conditions, such as possessing a university degree, not having a criminal record, keeping financial documents, and employing experts. Permission is given for three years and can be extended for three years. If a PEO does not respect the provisions of the law, its permission is not renewed or can be cancelled. The Board of Directors of İŞKUR takes the decisions on giving permissions, renewals and cancelling permissions.

Private employment offices cannot demand any benefits or fees from workers; fees for employment activities can only be charged to employers. PEOs cannot make contracts that include clauses on employment without insurance, not being a member of a trade union, or paying less than the minimum wage. İŞKUR will inspect PEOs.

It is important for İŞKUR to operate effectively within this new structure by strengthening its institutional capacity-building in

order to carry out its legally required duties. The support and co-operation of all parties (national and local public and private-sector representatives, social partners, international organisations) are necessary to create an effective employment organisation for the labour market.

Joint Assessment of Employment Priorities (JAP)

The Ministry of Labour and Social Security and İŞKUR are undertaking activities towards participating in the European Employment Strategy (EES), in line with the procedures followed by other candidate accession countries. The first step in participating in the EES was to prepare an Employment Background Report, which was sent to the European Commission and was approved.

The second step, on the basis of the Employment Background Report, is to prepare a Joint Assessment of Employment Priorities (JAP), which will be accepted as a policy document. Studies for the JAP began in February 2004.

The JAP has three parts. The first and second parts summarising the current situation and labour market problems have been prepared by Turkish academicians and experts from the European Commission. When the responses of relevant parties are received, these will be reflected in the report and will be discussed in a seminar (planned for October). The third and final part of the report will include policy proposals. These will be developed based on the situational analysis contained in the first and second parts of the JAP.

PLACEMENT AND VOCATIONAL GUIDANCE

Spain: Reform of the Public Employment Service

The creation of the National Employment Institute in 1978 represented the first national employment service within Spain that undertook the comprehensive tasks of acting as intermediary in the labour market, stimulating job creation and providing occupational training and unemployment insurance. These public services were provided free of charge under a statutory monopoly and with centralised management.

The National Employment Institute is currently being reformed in accordance with a constitutional mandate. The aim of this reform is the development and implementation of active employment policies for the regions. The Spanish constitution establishes a model for a decentralised state that confers a large degree of political autonomy on the regions (autonomous communities). The constitution also determines which powers are to remain with central government and which may be devolved to regional governments.

For employment policy, the state reserves the power to adopt general legislation and approve general plans, while the regions are granted the necessary powers for the practical provision of services. There is only one proviso: the implementation of passive employment measures (such as unemployment insurance) also rests with the state, insofar as these measures affect the state's resources and the financial regime of the system.

This model, in which the regions have a fundamental role, has to be harmonised with the administration of unemployment insurance by the central administration, as well as with the activities of a range of parties that play a role in the labour market. These include private work-placement agencies, temporary employment agencies and other organisations that provide information and guidance services as well as job search services.

General outline of the reform

The reform entails the creation of a new national employment system, comprising the state employment service and the regional public employment services. The process of transferring powers from the central administration to the regions means that each region can create its own public employment service. To this end, a transfer of personnel and equipment is taking place, including employment offices. The administration of active employment policies is entrusted to the regions.

The administration of unemployment insurance rests with the central administration. Central government retains control of collecting contributions to the unemployment fund and disbursing benefit payments for unemployment. It also retains the power to adopt legislation in this regard; such legislation is uniform throughout all the regions.

The structuring of the new system must guarantee equal treatment throughout Spain, and must conserve the principles of a free public service, equality of opportunities, and workers' professional and geographical mobility. To this end, the following basic elements are required:

- a public service that is free of charge;
- an integrated labour market;
- a national budget, with regional distribution on the basis of objective criteria;
- linking of active and passive policies;
- collaboration among the regional public employment services;
- integrated administration of employment policy;
- activity programmes financed by central government which are unified and general in nature;
- empowerment of the regions, insofar as they make use of their own financial resources, to implement their own programmes;
- retention of the one-stop shop principle;
- homogeneous criteria for setting in motion the Employment Action Plan, which involves activities, priority groups and monitoring;
- a single, centralised register of jobseekers, job offers and employment contracts, which also indicates specific regional information;
- national statistics and a national occupational observatory;
- integration of information systems;
- compatibility of the state's computer system and those of the regions, and the establishment of common data and administrative processes for all the public employment services; and
- the participation of workers and employers in the public employment services, in both bipartite and tripartite fashion.

The new Employment Law

A new Employment Law (published in December 2003) outlines the constitutional powers of the state and the autonomous regions, co-operation among the various government bodies, participation by the major business organisations and trades unions, and co-ordination between active and passive policies.

As indicated above, the new national employment system comprises the National Public Employment Service and the regional public employment services. The National Public Employment Service is an autonomous institution of central government, attached to the Ministry of Labour and Social Affairs. Its assigned functions include analysis of the labour market and, in collaboration with the regions and major social partners, the design of the National Action Programme for Employment.

The National Public Employment Service is also responsible for managing programmes whose geographic boundaries exceed the jurisdiction of a given region, as well as relocation programmes for employees, programmes to integrate immigrant workers (carried out in their countries of origin), and programmes aimed at improving the employment rate. In addition, it is in charge of the centralised management of unemployment benefits.

The regional Public Employment Services are responsible for labour market mediation and active employment policies. Their functions include:

- participating in the design of the National Public Employment Service's annual work programme plan;
- managing information programmes and measures, occupational counselling and job-search services;
- promoting stable employment and work placements;
- developing continuing training programmes;
- promoting policies aimed at integrating people at risk of social exclusion into the labour market;
- job creation and support for self-employment; and
- facilitating employee relocation across the country.

In addition, and to guarantee seamless co-ordination, public and private institutions and organisations are now required to provide the National Public Employment Service and the regional public employment services with any information that may be requested. For its part, the National Public Employment Service is to collaborate with the regions during the process of transferring powers to the regions. This is to guarantee the co-ordination of labour market mediation and insertion measures, and in particular measures related to establishing eligibility for, and the receipt of, unemployment benefits.

Lithuania: Electronic services for public employment service customers

The Lithuanian Labour Exchange (LLE) uses modern information technologies to support the successful delivery of services and the provision of information to its customers. In particular, it is constantly expanding its electronic services, which are provided to customers for free.

Lithuanian Labour Exchange information system

Since 1995, the LLE's information system has been developed to conform to international standards and the requirements of the Lithuanian information infrastructure. It is geared towards effective, high-quality service provision to both employers and jobseekers. The information system is based on a client/server structure and uses the Windows NT operating network and SQL databases within its management systems.

This modern information system has helped to computerise staff functions in relation to serving employers and jobseekers. The system consists of a global computer network which covers all the local offices of the LLE. The software employed allows users to exchange information with other information systems, such as social insurance companies, banks and state registers, in addition to being integrated into the information space of the European Union.

With the help of this system, users can gain access to databases of jobseekers and vacancies, which have been set up in the local employment offices. The system also provides a variety of other services oriented towards people who are looking for a job, including vacancy search, the provision of benefits and training benefits, and the application of active employment measures.

The system also caters for employers, who can address enquiries about jobseekers to local employment services at any time.

In 2003, the system began to be modified as part of the LLE's entry into the EURES network of European public employment services. From 2005 onwards, all vacancies registered at the LLE will be announced on the internet, on the single EURES platform database of vacancies. The vacancies will therefore be accessible to the population of all European countries.

Self-service system for vocational information

Between 1997 and 2000, the LLE created and implemented a self-service system for vocational information and guidance. Self-service terminals were installed in the information and consultation centres of every local employment office. To improve the services available to jobseekers, self-service terminals have also been established in busy public places and premises. By 2004, more than 130 terminals were operational across Lithuania, supporting access to vocational information and guidance.

The terminals provide access to information about vacancies, data on the labour market situation and other services, including suggested programmes and employment schemes and advice on how to look for a job. The terminals are connected via the internet with the vacancy databases held by the LLE.

The vocational information and guidance system was created as a result of co-operation between the German Ministry of Labour and Social Affairs and the Lithuanian Ministry of Social Security and Labour. Users of the system can access a computer-based testing system which helps them to evaluate their professional interests and decide on potential career paths. The vocational information terminals contain descriptions of 300 professions and 100 video films about the day-to-day nature of different professions.

The LLE's website and the 'Public Employment Service on the Internet'

The LLE's website (www.ldb.lt), created in 1997, is continuously being renewed, with additional functions added to it. The website contains general information about the public employment services, advice for unemployed people and information on the labour market situation, including labour market trends and forecasts, and advice on the prospects for acquiring a job in Lithuania and abroad. In 2004, a new EURES web page called Lietuva (EURES Lithuania) was created on the website to inform people about the free movement of workers in Europe and about EURES activities. A question and answers function allows customers to consult interactively with LLE professionals. Each year about a thousand people use this service.

In 2001, the *Public Employment Service on the Internet* was created and put on the LLE's website as an additional service for employers and jobseekers. It is part of the LLE's information system, providing services to unemployed people, information connections to the vacancy database, and information on jobseekers. The information about vacancies and jobseekers is introduced into the system automatically, replicated from the LLE's databases.

The Public Employment Service on the Internet allows both those who are already registered with the local employment services (such as jobseekers and students) and those who are not registered to fill in a registration form and make themselves known to others. Vacancies registered at local employment offices and other workplaces are registered directly on the internet.

In 2003, the government awarded the Lithuanian Labour Exchange with a special prize for the realisation of its internet programme.

Electronic information channel

In 2004, the LLE implemented a package of new electronic services for its customers. The new system allows employers and jobseekers to order information over the internet. When customers make a request via the internet, the information about a suitable employee or a vacancy is sent back to them by e-mail.

An additional information service is provided by SMS or text messaging to unemployed people who own a mobile telephone and are registered at the local employment office. When a vacancy is registered by the public employment services, an automatic matching of suitable candidates takes place. Matching is carried out according to desired profession, education and work experience. The candidates are then sent an SMS message informing them of the vacancy. These services save customers' time and shorten the job search process, while also facilitating the recruitment of employees.

Malta: Manual for gender-sensitive vocational guidance

In its efforts to promote gender-sensitive vocational guidance and counselling, the Employment and Training Corporation in Malta has published a manual on this topic. The manual has been distributed among guidance and counselling schoolteachers in order to help them to provide guidance that is free from gender bias.

The manual covers a wide range of topics, including issues such as:

- the different training and employment choices that students make once they finish their studies;
- gender segregation at work and how men and women tend to choose different occupations; and
- problems related to the work-life balance and how these have an impact on men and women's career choices and their levels of participation in family life.

Other topics covered by the manual include the social integration of people with disabilities – including the differences that exist between disabled men and women – as well as current labour market legislation and how this impacts on male and female levels of participation in the labour market.

The Netherlands: A comprehensive approach to unemployment

In 2003, 83% of newly unemployed individuals received an offer of work, training or work experience within a year. The municipalities and the Institute for Employee Benefit Schemes (UWV) are pursuing a so-called 'comprehensive approach' to unemployment. The aim of this approach is that all newly unemployed individuals will receive such an offer within 12 months. This strategy was set out in a study on the Evaluation of the Comprehensive Approach 1999-2003, submitted by the Secretary of State for Social Affairs and Employment to the lower house of the Dutch parliament in June 2004. The evaluation was conducted by the Foundation for Economic Research and the Amsterdam Institute for Advanced Labour Studies.

The percentage of newly unemployed individuals who found a job or were offered work, training or work experience within a year dropped from 84% in 2002 to 83% in 2003. This was still an estimate, however, and definitive figures were due to be published in September 2004. In addition, fewer people in 2003 found a job independently without the support of a reintegration programme. The Secretary of State explained this as being a result of the poor economic situation.

The evaluation would indicate that the Netherlands is being more ambitious with its comprehensive approach to unemployment than other countries. In the Netherlands, individuals who are threatened with long term unemployment are offered a reintegration programme immediately, while people in the same situation in other countries have to wait between three and six months. Also, in the Netherlands the term 'support' refers solely to a reintegration programme rather than, for example, mediation discussions.

The evaluation also suggests that the introduction of the comprehensive approach to unemployment has, among other things, led the Ministry to conclude concrete agreements with the municipalities and the UWV on the number of reintegration programmes to be implemented. The information provided by institutions involved in reintegration policy has also improved.

Independent job coaches to help people back into work

In February 2004, the Minister for Social Affairs and Employment submitted a proposal to the lower house of the Dutch parliament on the use of *independent job coaches*. The proposal recommends that benefit recipients interested in rejoining the workforce should be able to request assistance from a job coach.

A job coach is an independent person who supports jobseekers by providing them with the tools they need to take charge of their own reintegration. Job coaches should help jobseekers to create their own tailor-made programme. It is hoped that job coaches will soon be available in 20 to 30 locations across the Netherlands, and in 60 locations by January 2005.

A final decision on the actual reintegration programme to be followed is taken by the municipality or the UWV. However, the Minister has confirmed that people will be able to conclude an individual reintegration agreement with the UWV.

Job coaches will work from specially provided customer service desks. Representatives of the UWV, the public employment agencies (CWIs) and the municipalities should also be available to provide assistance via these desks. The customer service desks are located in CWI offices and shared buildings housing the UWV, CWIs, companies and the municipalities. Requesting assistance at the customer-service desk is voluntary. The UWV, CWIs, Divosa (association of social services managers) and the National Client Council are drawing up further details on this proposal.

The Netherlands: Return to work for people on benefit schemes

From mid July 2004, all clients of the Institute for Employee Benefit Schemes (UWV) who are disabled or unemployed now have the opportunity to develop their own reintegration programme (IRO) with the UWV. This will increase the choice on offer for jobseekers.

Until early this year, clients undertaking reintegration programmes had to choose from companies with which the UWV had concluded agreements. Sometimes, however, the options available did not fully meet individuals' needs and the companies in question were not able to offer the expertise required in order to help them. To address this problem, clients may now follow their own personalised programme. Prior to the introduction of the individual IRO, from 1 January 2004 onwards it was possible to apply to the UWV for such an agreement. The UWV has so far received some 500 applications.

Jobseekers who opt to follow a self-created reintegration programme enjoy the same rights and are subject to the same obligations as those following a programme offered by the UWV. Jobseekers opting for an IRO must draw up their own individual programme for finding work (for example, securing a placement or applying for a training course) and select a company themselves. This process must be completed within the same time frame as under a UWV-arranged agreement. The organisation responsible for implementation of reintegration policies takes the final decision on an individual's IRO once it has reviewed the application. A programme may last no longer than two years.

In the same way as a UWV-arranged programme, the aim of an individual IRO is for the jobseeker to find work for a period of at least six months. To ensure that the jobseeker is successful and that the money has been spent efficiently, the UWV concludes individual IROs with the companies chosen by jobseekers. Companies are reimbursed on the basis of services rendered.

Gearing social security organisations more closely towards work

Organisations responsible for implementing social security policies are increasingly gearing themselves towards mutual co-operation and making greater efforts to build programmes around individual jobseekers' requirements. Their working methods are gradually shifting towards an approach aimed primarily at helping people to get back into employment.

This shift follows the introduction in 2002 of the Implementation Structure for Work and Income Act, and a period during which the organisations responsible for its implementation spent a great deal of time and energy getting their own structures in order and ensuring that benefits continued to be paid. The Minister for Social Affairs and Employment and the Secretary of State detailed this shift in a letter of 19 May 2004 to the lower house of the Dutch parliament at the time of the interim evaluation of the Act.

Under the terms of the Act, by 1 January 2006 a social security system must have been introduced which promotes work over benefits and is customer-oriented and efficient. The authorities will verify that the organisations responsible for implementing the Act remain on schedule.

The interim evaluation revealed that the organisations responsible for implementing reintegration policies (UWV, CWIs and the Social Insurance Bank – Sociale Verzekeringsbank or SVB) made considerable progress in 2003 in providing services that were more customer-oriented. Greater efforts were being made to involve the client in the process and to devise tailor-made programmes and arrangements for clients. For example, the UWV was operating 20 client advice points while the launch of the website www.werk.nl helped CWIs to significantly improve their digital services. However, jobseekers, benefit recipients and employers were still not satisfied, hence the interim evaluation. Over the next two years, considerable efforts need to be made in order to boost customer satisfaction.

One particular area of concern is that there is still too little grass-roots co-operation and networking among the organisations responsible for implementing reintegration policies. According to the Inspectorate for Work and Income, this is resulting in increased costs and delays. Officials at the Ministry of Social Affairs and Employment have recently announced improvements in this area.

Sweden: Service routes to the Employment Service and the range of services

The Swedish National Labour Market Board has undertaken extensive development work in recent years, some of which is now being put into effect. The objective of this work has been to create a nationwide Employment Service, whose operations will be characterised by uniformity, efficiency and legality. Efforts have also been made to clarify the Board's mandate and define the services provided by the Employment Service, as well as ensuring that these services are provided as economically as possible and at a high level of quality.

One important aspect of this project has been the development of a new model for interaction among the Employment Service's three service routes: the internet, Customer Service Division, and local employment offices. This article provides an overview of the service routes and the range of services that have now been defined.

Service routes

The objective of the three service routes (internet, Customer Service Division and local employment offices) is to develop a co-ordinated Employment Service in which these routes do not compete with each other but co-operate and reinforce each other. The overall objective is the effective use of the Employment Service's total resources.

The **internet** route (www.ams.se) is accessible to everyone around the clock. The **Customer Service Division** is being expanded to cover the needs of the entire country and will be accessible seven days a week. **Local employment offices** will adapt their services to the individual needs of unemployed people who need more assistance than can be provided via the internet or Customer Service Division.

The Employment Service will continue to expand the services it offers via the **internet**. Technical developments have created new possibilities for assisting people in finding work and accessing other government services. These developments also mean that the public and the government now have higher expectations for accessibility and service. One expression of this is the term 'the 24-hour office'. From autumn 2004, the Employment Service registration form is available on the website (www.ams.se). Prior to this, registration had to be done in person at an employment office.

The Employment Service is also developing and testing a new way of constructing action plans that requires more active involvement by those seeking work. If people are to take greater responsibility for finding their own employment, they first need a clear view of their situation. Devising an individual action plan is the first step.

This development will allow greater scope for providing unemployed people with professional help in finding work, if they are seen to need such assistance. The process will begin with a client completing a questionnaire found on the website (www.ams.se), which will form the basis for the individual action plan. This is the initial step in an interface where dialogue can take place between the applicant and the Employment Service via the internet. At a later stage, the process can be supplemented with options such as clients making return visits via the internet, to follow up on the provisions of the action plan.

Currently, the Employment Service's **Customer Service Division** provides counselling, information and follow-up. Customer service advisers do not take any formal decisions or conclude any agreements that involve financial decisions for local employment offices. In the future, the expanded Customer Service Division will take over a large number of the telephone calls which are currently received by local employment offices. This should result in more scope for providing initial assistance which is better adapted to the individual needs of both employers and jobseekers. It should also give greater scope for providing ongoing assistance. Examples of the benefits are:

- opportunities for improving the quality of initial contact with applicants and determining their service needs;
- more time for introducing and explaining the services available, so that clients can make maximum use of the internet service at www.ams.se (such as the job-search function), and the assistance provided by the Customer Service Division; and

- better services to employers and jobseekers who need more assistance than can be provided through the internet.

The Customer Service Division already has experienced employment officers who will continue to work for it. In addition, 200 new officers have been recruited to this service route. When fully expanded, the Customer Service Division will operate by telephone from three locations.

Services provided by the Employment Service

The objective of development work in this area has been to secure a consistent range of services across the Employment Service. Implementation of the new system of uniform, well-defined services began in the summer of 2004. Nine services are provided in all – seven for jobseekers and two for employers. There are two descriptions of each service: an internal one for employment officers and an external one for clients.

The purpose of the **external** service descriptions for **clients** is to:

- describe the objective of the service and what it entails;
- define the division of roles and responsibilities between the employer or jobseeker and the Employment Service; and
- explain the principle of assistance for self-help.

The purpose of the **internal** descriptions for **employment officers** is to ensure uniform, efficient performance that respects the legal rights of individuals, and is supported by the monitoring of outputs and results. By their nature, internal descriptions are considerably more detailed and precise.

The following are the seven services offered to jobseekers:

- looking for work;
- improving your job application;
- guidance in looking for work;
- job training;
- setting up your own business;
- clarifying jobseekers' capacity to carry out work; and
- adjusting to a work situation.

The external descriptions of these services also tell jobseekers that the employment office adjusts its services to the needs of the local labour market and applicants' personal qualifications. They also explain what is meant by an individual action plan and financial resources.

There are two services for employers looking for personnel:

- recruiting new personnel; and
- training before recruitment.

The external descriptions of these two services also include information on preconditions, such as the following:

"You will preferably work independently in looking for new employees. You can do this by making use of the service found on the Employment Service website (www.ams.se). More extensive services are reserved for employers who do not have sufficient resources for recruiting or who are unable to recruit using the support found on the Employment Service website. In such cases, the Employment Service will make an agreement with the employer on ways to meet their recruiting needs."

Interaction between service routes and the services provided

To decide which parts of the system should be used to support a client, a step-by-step thought process is required. The assessment should be based on charting the client's needs and formulating a plan of action:

- step 1: Can the service be provided via the internet?
- step 2: Can the service be provided by the Customer Service Division?
- step 3: If the internet service or that provided by the Customer Service Division is not sufficient, assistance can be provided through the local employment office.

The service route used will depend on the particular case, and several routes can be used in parallel for a client. One option does not exclude another, but it is important to consider and direct efforts so that the most efficient channel is used, and the one requiring the least resources. Sometimes, for example, it may be necessary to supplement the service available at www.ams.se with efforts by the Customer Service Division or the local employment office.

The Swedish Employment Service has only recently launched these service routes and defined the services outlined above. So it is too early to say how they will work out in practice. In addition, considerable development work must still be carried out before the full benefits of these innovations can be realised.

Bulgaria: Employment Agency reforms

The Bulgarian Employment Agency (EA) is an administrative arm of the Ministry of Labour and Social Policy (MLSP) and is responsible for implementing the government's employment policy. The agency's functions are to:

- analyse labour market demand and supply and labour market trends;
- register job vacancies and unemployed people;
- participate in implementing employment and training programmes and measures directed towards jobless people who find it hard to adapt to the labour market for various reasons;
- support the MLSP's activities concerning PHARE programming; and
- mediate in the field of employment for Bulgarian citizens abroad and for foreigners in Bulgaria.

Structure of the Employment Agency

The EA has a three-tier structure: Central Management, Regional Employment Services and local employment offices. The Central Management headquarters are located in the capital, Sofia. The second tier comprises nine directorates of Regional Employment Services, each covering two to four regions. The Regional Employment Services co-ordinate and assist the activity of the 117 local employment offices, which make up the third tier of the EA's structure; and implement employment policy at local level. The total number of EA staff is currently 3,141. The EA also has an Executive Director's

Council based on a tripartite principle of management by national representative organisations of employers and trade unions.

In the first half of 2004, the EA continued to effect the changes started in 2003. These changes aim to transform the agency into a modern organisation and to guarantee the successful implementation of Bulgaria's active employment policy. The agency's vision and activities are about creating an efficiently operating organisation for labour market regulation at national and regional levels, through its function as a public mediator.

The reform of the EA's administrative structure, which began in 2003, aims to bring the agency's services into line with European standards. Shifting some of the administrative functions from local employment offices to the Regional Employment Services is part of this change. Administrative capacity is being freed and redirected by this switch, increasing the number of employees (approximately 500 people) who are directly servicing customers.

A new operating model is being developed to improve the quality of customer services. A process model of client-oriented service is being introduced in local employment offices, which will optimise activities within the offices. This 'one-stop shop' approach enables unemployed people's needs to be addressed as quickly as possible through support and active measures, adapted to their individual circumstances.

The one-stop shop toolkit model is being piloted in three employment offices, in the towns of Montana, Pazardjik and Velinograd. Information and service centres have been built there and the new system has begun operating. Another three offices, in the towns of Pirdop, Kazanluk and Rhodopes, are starting to work under this new model of customer service.

The introduction of the one-stop shop principle optimises the management of the system, as well as its organisational structure, since a large part of the staffing capacity is directed to servicing clients through two main teams. The first team, 'working with clients', is equivalent to the front-line office. The second, 'programmes, measures, qualifications and contracts', corresponds to the 'back office'. Through the introduction of this front-line and back office system, the aim is to reach the standards of the services provided by employment agencies in the EU Member States.

The system will gradually be launched in other employment offices. It is envisaged that staff training on the new customer-service model will be started in another 50 offices by the end of 2004. Staff training, particularly at regional level, is important for creating a culture that assists in the development of a dynamic labour market.

An Information and Services Centre has been in operation in the Employment Agency's headquarters since October 2003. Based on the one-stop shop principle, it is designed to provide services to members of the public and to enterprises (legal persons). In this centre, whose purpose is to give speedy and accurate answers to questions, clients can receive information on all the activities provided by the Employment Agency. In addition, the centre offers specialised services on intergovernmental agreements for working abroad.

The data show that during the first six months of 2004, the Information and Services Centre – the front-line office of the EA's headquarters – was visited by 2,515 clients and registered 2,655 phone enquiries. A great many of the enquiries concerned intergovernmental agreements and job vacancies across the country, as well as the options for taking part in employment programmes and measures. Over the same period, 962 written complaints, requests and enquiries were submitted to the agency. The data reveal considerable public interest in this new possibility for providing services in a speedy, easy and accessible way.

Within the process of developing an information society in Bulgaria, the Employment Agency is successfully developing an open, client-oriented information system for the labour market. This system is constantly being developed and updated.

There has also been great interest in the Online Labour Exchange, which enables employers to search for suitable staff easily and free of charge without leaving their workplace. The Online Labour Exchange contains databases of all jobseekers registered with the local employment offices. Similarly, jobseekers can find out about all job vacancies announced by the local employment offices, as well as those published on the Employment Agency's website. They can also submit a 'job wanted' announcement free of charge, as the Online Labour Exchange guarantees protection of personal data.

To strengthen the EA's administrative capacity, a development plan was drawn up in March 2004 for the period 2004-7, and was approved by the Minister of Labour and Social Policy in April. The plan sets out practical capacity-building activities to be undertaken, focusing on staffing, training and networks. Within these three areas, it is envisaged that a total of 500 employees will be trained, costing 423,370 leva (216,140 euro).

JOB CREATION

Malta: New enterprise schemes

The newly established Malta Enterprise – the government body responsible for the overall development of Malta's enterprise strategy – has launched three new schemes to help small and medium-sized enterprises (SMEs) to improve and expand their products. These schemes are eventually intended to assist SMEs in identifying the opportunities available to them through Malta's membership of the European Union, and in upgrading their products and services to local and EU quality standards.

One scheme targets companies operating in the food-processing sector. It aims to help them to adopt and implement quality systems and undertake product development. The scheme targets micro-enterprises and SMEs, mainly in the areas of traditional bakeries, processed fruit and vegetables, beef and meat processing, pasta products, traditional Maltese products, dairy products and wines. The assistance consists of a grant that covers up to 60% of the pre-agreed expenditure on advisory services, certification costs and implementation measures.

Another scheme will help SMEs to comply with EU directives through development and certification of quality standards, environmental management systems and health and safety management systems. As with the scheme for the food-processing sector, the compliance scheme covers up to 60% of the pre-agreed expenditure on advisory services, certification costs and implementation of measures. Special consideration will be given to those enterprises that intend to take into account the upgrading of their personnel.

The third scheme is specifically designed for tenants of workshops situated in the Malta Crafts Village, to help them to obtain bank loans to cover the purchase of new workshops.

These schemes will form part of Malta Enterprise's other programmes and facilities, which cover training measures, a business incubation centre to help projects during their start-up phase, export promotion activities and dissemination of EU information.

Finland: Expansion of the business start-up allowance system

A Finnish working group recently proposed expanding the business start-up allowance system to apply to unemployed people and those at risk of unemployment, those who are switching from paid home-based work to starting up a business, and students who have completed their studies. During the initial stage of the system, any individual starting up in business would receive 650 euros a month for the first six months and 500 euros a month during the next six months. The proposals of the working group, which was appointed by the Minister of Labour, were presented in Helsinki in March.

Finland needs business start-ups and entrepreneurs. Entrepreneurs are especially vital in the service sector. The government wants to see many more business start-ups than in the past. In future, most companies will be set up without state

subsidies. The reform aims to enable as many people as possible who want to become entrepreneurs to claim a start-up allowance, provided there is a genuine need for support and the business venture appears likely to be profitable. Expansion of the start-up allowance system is part of the government's political programme for encouraging enterprise.

The effect of the start-up allowance system on the numbers of unemployed people has been encouraging. According to recent studies, 80% of companies receiving a start-up allowance are still in business five years after their launch. This is equivalent to 53% of all businesses.

The high success rate can be explained by the business training and consulting services offered by experts as part of the start-up allowance. Those who give up usually do so as a result of insufficient know-how. Decisions are taken on the basis of consultation between the customer and the expert. If the entrepreneur has to make a financial investment, they can apply for a small-business loan, a loan for female entrepreneurs or a micro-loan from Finnvera. The start-up allowance is primarily designed to cover living costs.

The working group is proposing that the start-up grant should be made available to all projects which it may realistically benefit. The overall timescale of the grant would be 12 months, with an interim assessment after six months. This assessment would look at the progress of the business at that stage and its future prospects.

Additional support

Entrepreneurship training and consulting services are available for anyone considering setting up in business. Part of the consulting service involves a start-up review. The expert assesses the chances of success of the proposed business and gives an opinion to the Labour Office. These training and expert services are provided by different organisations depending on the geographical region.

Regional business services generally provide assistance for business start-ups. Under the government's programme for encouraging enterprise, there will be 50 regional providers of business services in different parts of the country. The final decision on the start-up allowance is still made by the Labour Office.

Minimising distortion of competition

It is important that the businesses which are granted a start-up allowance do not distort local competition. The effect of each new enterprise on the local competitive situation is carefully assessed. Enterprises which would distort the competition are not granted a start-up allowance. One of the main starting points of the proposed amendment to the start-up programme is that the allowance would not support so-called 'forced enterprising'. This means that projects where the previous work was paid on a salary basis and which would artificially be transformed into enterprises will not receive start-up funding.

Increasing the number and range of start-ups

In the future, it is expected that business start-ups will increasingly be seen in the nursing sector, other healthcare services, the travel industry and business services.

At present, some 4,000 business start-ups are launched every year, accounting for approximately 20% of all companies established. The working group estimates that the proposed amendment to the start-up system would boost this figure to 10,000, giving a combined annual employment potential of over 20,000.

The underlying principle of the amendment is that the start-up system will be expanded within the government's budget framework. Funding will be through national and European Union Structural Funds. For the start-up allowance for unemployed people and those threatened with unemployment, the amendment will be implemented through subdivisions of the Ministry of Labour.

Under the present procedure, business training, advice and consulting support are also funded through subdivisions of the Ministry of Trade and Industry and the Ministry of Education. During 2004, the start-up system for those transferring from paid work, home-based work and study to become entrepreneurs will be funded via the entrepreneurship section of the European Social Fund's product-development project.

The start-up working group was led by the Ministry of Trade and Industry, with members from the Ministry of Labour, Finnvera and the advisory services for new business start-ups. The group conducted extensive interviews with labour market representatives and representative organisations as well as with the local and regional government sectors. The proposed expansion has received support during the consultation period, and the timeframe for implementation has been shortened. The proposal has required a change in the law. In practice, the new system may be brought into operation between late autumn 2004 and early 2005.

Bulgaria: Work experience in public administration for graduates

The processes of economic and social restructuring and the transition from a centralised economy to a market-oriented one have led to considerable decline in labour demand. Young people (aged up to 29) are in a disadvantaged position in the labour market. Unemployed young people aged up to 29 form 26.6% of all the unemployed people registered with the Public Employment Service (PES). Of these, graduates comprise 6.9%.

The most frequent reasons for long term unemployment among young people include lack of experience and length of service, and lack of appropriate vocational competences. There is also a considerable discrepancy and mismatch between the numbers and suitability of vocational training of young people, and the actual demand and requirements on the employers' side.

The development of young people's potential, skills and abilities is of paramount importance for the future progress of Bulgaria. Young people are the country's future labour force, which after 2007 must compete in the joint European labour market. The Ministry of Labour and Social Policy is implementing a number

of active measures and programmes to ensure young people's access to the labour market and improve their employability.

The pilot phase of the programme *employment in public administration for young graduates* started in 2002. The aim of this programme is to increase young people's employment prospects by helping them to gain vocational competences and work experience. The programme is intended to ease the transition from education to the labour market.

The programme is aimed at unemployed graduates aged up to 29 years of age. It gives them the opportunity to start work in public administration immediately after graduation. Thus they have the chance to acquire the necessary work experience to enter the labour market. The work placements are financed with resources from the state budget for active employment policy, and are made available according to the needs of all ministries, agencies, municipalities and regional administrations in the country.

The employer receives resources to pay the young person's wages, social security and bonuses, as well as their paid annual leave. In accordance with the latest amendments to the programme, employment is provided for nine months. The PES organises and implements the application procedure, and provides appropriate information to employers and young people on the programme's requirements and how to participate. Employers select the young beneficiaries according to selection criteria such as diploma grades, computer skills, language skills and so on.

Regular monitoring and assessment of the programme's implementation is carried out, and reports are prepared on the basis of the information collected. This provides the possibility of correcting the scope and mechanisms of the programme and adapting it to suit the conditions and needs of the labour market.

In 2003, 880 young people were included in the programme, and 210 by mid 2004. Overall, at the end of July 2004, 909 people were employed through the programme. The *employment in public administration for young graduates* programme has received wide publicity and support. As a result of implementing this programme, long-term unemployment among young people is expected to fall, their qualifications to improve, and their prospects for future integration into the labour market to be enhanced.

TRAINING

Cyprus: Human Resource Development Authority's Strategic Plan

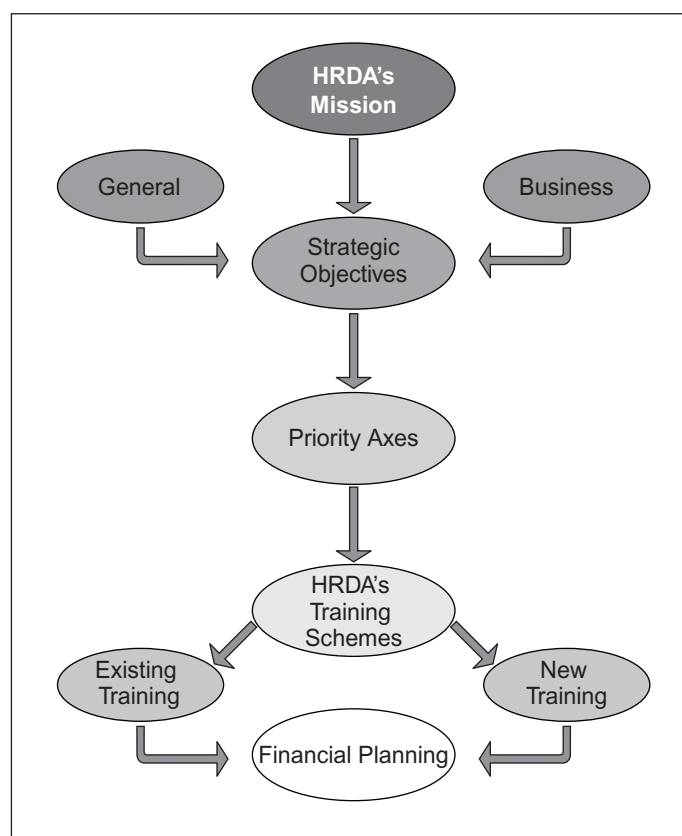
This article summarises the Strategic Planning of the Cyprus Human Resource Development Authority for the three-year period 2004-2006, defining the strategic objectives and directions of the HRDA, the targets of the existing and new training schemes as well as the financial planning of the organisation. Cyprus's accession to the European Union on 1st May 2004 along with the concomitant potential for utilising community funds from the European Social Fund have provided the compass for the formulation of HRDA's strategy.

In formulating and specifying the strategic objectives for the period 2004-2006, it was taken into account that it was necessary to focus the efforts of HRDA's services on issues of immediate priority as well as of long-term significance. In particular, through the strategic objectives for the period 2004-2006, the HRDA will seek to promote the following activities:

- Development and effective operation of four New Training Schemes, co-financed by the European Social Fund, each of which aims to promote the training and employability of Young School-leavers, the Unemployed, Economically Inactive Women and the provision of Consultancy, Guidance and Training Services to micro-enterprises employing one to four persons, respectively.
- Promotion of the gradual establishment and operation of a System of Vocational Qualifications in Cyprus, in cooperation with the other competent agencies, on the basis of relevant decisions of HRDA's Board of Directors.
- Development and implementation of special actions with the main aim of substantially increasing HRDA's effectiveness. These actions include the conducting of a scrutiny exercise of the organisation's operation methods, including its computerisation, the development of a Code of Good Operation Conduct, the assessment of the existing Training Schemes and the gradual introduction of a system of assessment and certification of training providers.

With the implementation of HRDA's strategic objectives for the period 2004-2006, it is expected that there will be a marked improvement in the problems encountered in the labour market, especially that of the long-standing quality imbalances vis-à-vis the observed unemployment rates. It is also expected that they will contribute to the efforts for improving the productivity and competitiveness of enterprises as well as to the further adjustment of the Cyprus economy to the requirements of the Acquis Communautaire.

Figure 1: HRDA's Mission



The Human Resource Development Authority of Cyprus is a semi-public organisation, governed by a 13-member Board of Directors of a tripartite character, and which comprises representatives of the Government, Employers and Trade Unions.

HRDA's mission is the creation of the necessary prerequisites for the planned and systematic training and development of Cyprus' human resources, at all levels and in all sectors, for meeting the economy's needs, within the overall national socio-economic policies.

The Strategic Goals of the Human Resource Development Authority have been formulated on the basis of Cyprus's strategic goals as these are defined in the National Strategic Development Plan for the period 2004-2006 and the Single Planning Documents for Objective 3 (Human Resources) and the Community Initiative EQUAL, the European Employment, Education and Training Strategy, as well as the general and more specific characteristics of the labour market.

HRDA's strategic goals for the three-year period 2004- 2006 are:

- upgrading the **country's human resources** through appropriate training and development in order to increase their labour mobility all throughout the European Union, and
- **strengthening the competitiveness of Cypriot enterprises** through better utilization of their human resources and improvement of their adjustment to change.

In the framework of HRDA's strategic goals, the following **strategic objectives** have been set for the three-year period 2004-2006:

Strategic Objective 1: Participation in the implementation of the Acquis Communautaire and utilisation of the possibilities afforded by the Structural Fund/European Social Fund as well as by other programmes and initiatives of the European Union.

Strategic Objective 2: Facilitation of the entrance and integration/re-integration in the labour market of the human resources, with emphasis on actions and measures for enriching and adjusting the skills and knowledge of new entrants, the unemployed and economically inactive women to the needs of the labour market and of enterprises.

Strategic Objective 3: Participation in the formulation of a national strategy for the promotion of lifelong learning and the set up of coordination and follow-up mechanisms in cooperation with other competent agencies and the social partners. In this framework, to enable all people in employment to adjust their skills and knowledge to the needs of their enterprises and of the labour market by attending training programmes. At the same time, the HRDA will continue to consider the perspective of including the self-employed in its sphere of competence.

Strategic Objective 4: Provision of consultancy services to Small and Medium sized Enterprises with the aim of improving their mode of operation and efficiency and their competitiveness in general through better development and utilisation of their human resources as well as the solution of important restraining problems they are faced with.

Strategic Objective 5: Adjustment of the training system to today's needs of the labour and the training markets with the improvement of the quality and effectiveness of the training provided. In particular, the HRDA will promote the review and gradual introduction of the assessment and certification of training providers as well as the utilisation of the possibilities afforded by the information and communication technologies.

Strategic Objective 6: Assessment of the findings of a special feasibility study, formulation of an integrated policy and promotion of the gradual establishment and operation of a System of Vocational Qualifications in Cyprus, in cooperation with all other competent agencies, on the basis of relevant policy decisions of HRDA's Board of Directors.

Strategic Objective 7: Conducting research studies and surveys in strategically important areas and issues regarding Cyprus's human resources, the assessment of its work and its effectiveness in the formulation of the training and development strategy for the country's human resources.

Strategic Objective 8: Development and strengthening of HRDA's public relations and co-operation, mainly through the promotion and information campaigns for the services offered by the Authority, as well as the extension and strengthening of international relations and co-operation, with emphasis on closer contacts with the competent services and agencies of the European Union and those of member-states.

Strategic Objective 9: Intensification of the effort for a substantial increase of the effectiveness of HRDA's services, mainly through the conducting of a scrutiny exercise of the organisation's operation methods, the implementation of an Information Strategy for the significant upgrading of the Authority's computerisation as well as the continuing and focused training and development of its staff.

Objectives of the new schemes of the HRDA to be co-financed by the European Social Fund

In the three year period 2004-2006, the HRDA will develop and put in operation four new schemes, to be co-financed by the European Social Fund. Each of these schemes aims to promote

Figure 2: HRDA Expenditure 2004-2006

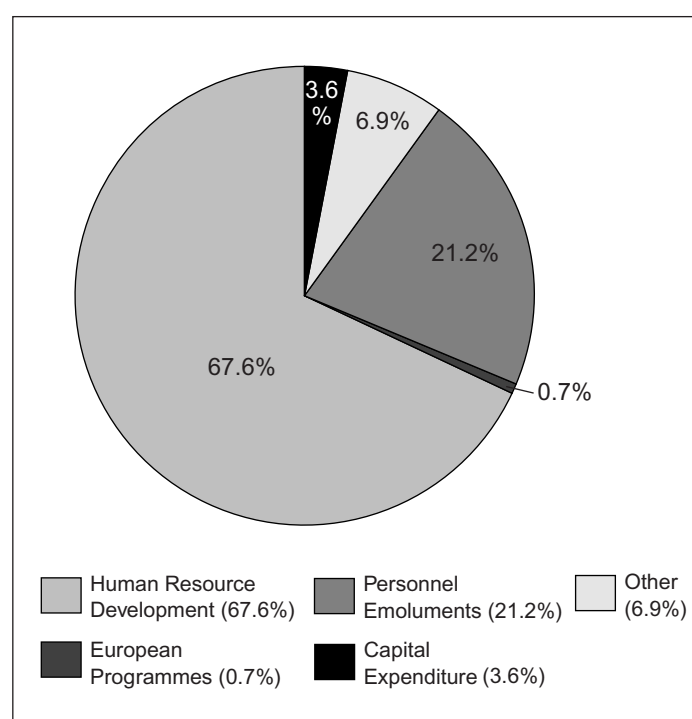
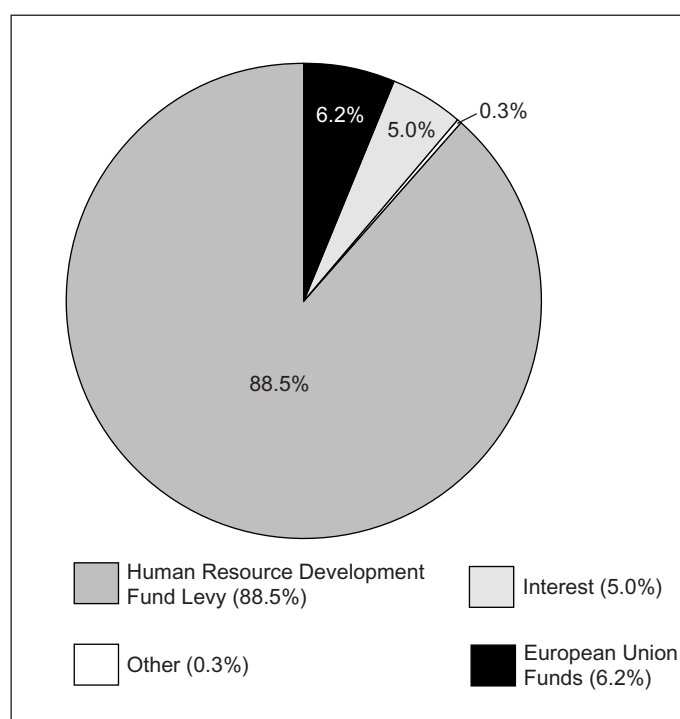


Figure 3: HRDA Income 2004-2006



the training and employability of young school-leavers, the unemployed, economically inactive women and the provision of consultancy, guidance and training services to micro-enterprises employing one to four persons, respectively.

- **Scheme for the promotion of the training and employability of young school-leavers:** The aim is to effectively meet the training needs of young school-leavers in order to facilitate their smooth and effective entrance to the labour market through the acquisition of specialised complementary skills and knowledge.
- **Scheme for the promotion of the training and employability of unemployed:** The aim is to effectively meet the training needs of selected target groups of the unemployed in order to improve their employability through the acquisition of specialised complementary skills and knowledge.
- **Scheme for the promotion of the training and employability of economically inactive women:** The aim is to effectively meet the training needs of selected target groups of economically inactive women in order to improve their employability and to encourage them to enter the labour market through the acquisition of specialised complementary skills and knowledge.
- **Scheme of consultative, guidance and training services for micro-enterprises employing one to four persons:** The aim is to improve the operation, effectiveness and overall competitiveness of Micro-enterprises employing one to four persons, through the systematic diagnosis of the weaknesses/problems they encounter and then the training/development and fuller utilisation of their owner/manager and their human resources.

HRDA's Financial Planning 2004 – 2006

In the three year period 2004-2006, it is estimated that the HRDA will expend a total amount in the region of 41,658,000 euro (24,010,000 CYP) for Human Resource Development purposes, representing an increase of 82% compared to the three-year period 2001-2003. This amount is distributed as follows:

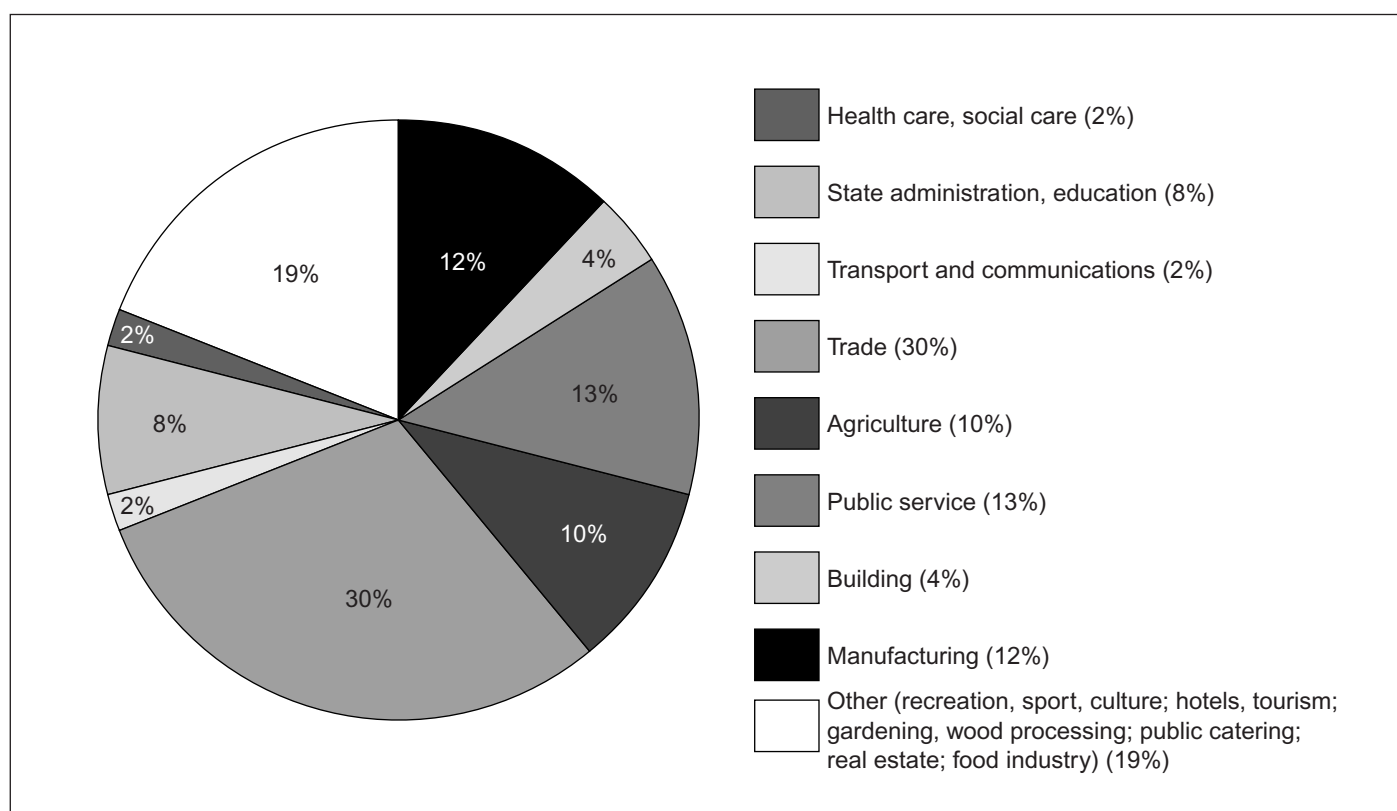
- Existing Training Activities (72.1%)
- Special Development Activities (12.1%)
- New Schemes to be Co-financed by the ESF (15.8%)

The total budgeted expenditure of the HRDA in the three-year period 2004-2006 is anticipated to increase by 66%, compared to the three-year period 2001-2003. The total budgeted income of the HRDA for the same period is anticipated to increase by 29%.

Latvia: Acquisition of working skills for vocational training students

The unemployment rate among 15-24 years-olds still remains high and it was 18.5% in 2003, therefore it is important to take action and to implement active labour market measures to combat this problem. About 46% of the young unemployed have no previous work experience. Starting in June 2004 and in order to promote the professional orientation and further integration of young people into the labour market, the State Employment Agency (SEA) has implemented the pilot project 'Acquisition of working skills during the summer holidays for students from secondary and secondary vocational schools'.

Figure 1: Branches the students were employed in (%)



The stakeholders involved in the project were students, employers and the SEA. The SEA was acting as a negotiator between the involved parties and was responsible for control, as well as for building a database where all participants concerned were to be registered.

Within the framework of the project, students from secondary and secondary vocational schools aged 15-18 had the opportunity to be employed for a month both in the private or public sector during their summer holidays (June to August) earning in excess of the minimum monthly wage 80 LVL (approx. 120 euro). The project was partly subsidized by the state budget (50% from minimum monthly wage), so state funding made up part of the wages. Employers had to pay at least half of the minimum monthly wage (approx. 60 euro) for each student being employed in the enterprise or organization within the framework of the pilot project. During the project, every participating student was supervised by a Practice manager. The wage of the Practice manager was also subsidized by the state budget, making approx. 30 euro to 120 euro per month depending on the number of students they were responsible for. The total funding provided by the state for the pilot project was 150,000 LVL (approx. 225,000 euro) from the active labour market measure Measures for the promotion of competitiveness, therefore a limited number of persons had the opportunity to take part. The pilot project was implemented in close cooperation with employers, who showed significant interest to employ young persons; it was also the first time the government financially supported employers who are willing to employ students.

The number of applicants who wanted to be employed in the summer and were registered (by August 1, 2004) at the SEA offices as job seekers was 8410 (approx. 11.2% of the target group – all students from secondary and secondary vocational schools aged 15-18) but considering the limited funding only 3191 of them got a job (priority was given to students coming from large families) for one month. The applicants had to take part in job interviews that were taking place mainly in the SEA. The students had to sign employment contracts and submit other necessary documentation (tax books, health certificates etc.). For some of the students, it was the first time they had to respond to such formalities.

At the beginning of the project, contracts were signed with 448 employers (enterprises and organizations) throughout Latvia and there were 3191 jobs offered. 1295 jobs were offered in Riga (capital city of Latvia) and the Riga region, 573 in Kurzeme (in the west of Latvia), 473 in Latgale (in the east of Latvia), 497 in Vidzeme (northeast) and 353 in Zemgale (central Latvia). The project end date was the 31 August, 2004. The employers who offered the majority of the jobs were retailers, food factories and farm enterprises, while some positions were also offered by a children's hospital. (See figure 1.)

The main objective of the project was to undertake a practical preparation for students entering the labour market, to enable them to acquire basic working skills and knowledge about working conditions and the legal basis that the labour market is operating on. The experience and skills gained within the framework of the pilot project will be useful when it comes to choosing an occupation and to entering the labour market.

The pilot project proved to be of interest for students as well as

for employers although in some rural areas there were not enough jobs offered and students had to work half-time to ensure that as many students as possible took part in the project. Some of the employers were highly satisfied with the employed students and asked them to continue the cooperation after the pilot project was finished. There were also some cases where employers were dissatisfied with students, but in most of these cases students were brought to the job interviews by parents and therefore their motivation to work in the summer holidays was rather low.

The pilot project Acquirement of Working Skills During the Summer Holidays for Students from Secondary and Vocational Schools can be evaluated as successful, but there is also room for organisational improvements and the discussion concerning needs and ways for setting special target groups, such as students from large families, for example.

Malta: Training in specific sectors

The need for having human resources trained according to labour market requirements has led to the provision of new training programmes that are tied directly to recent labour market developments. An example of this policy initiative is a new training programme for young job seekers wishing to embark on a career in the pharmaceutical industry.

The expansion and setting up of a number of pharmaceutical companies in Malta during the past year, has led towards the development of a training programme that targets young job seekers who are ready to work in the pharmaceutical sector. The Employment and Training Corporation (Malta's Public Employment Service) together with Malta Enterprise (Malta's public entity responsible for the country's enterprise strategy), and the chemistry department at the University of Malta have launched a course for chemical technology operators. The course is being organised in close collaboration with a number of pharmaceutical companies who eventually intend to employ those course participants who successfully complete the course. At the end of the course participants will receive a certificate of performance that will also enable them to continue their studies in clinical chemistry at the Malta College of Arts Science and Technology to HND (tertiary) level.

This initiative has also led to other similar training initiatives organised at the University of Malta and the Malta College of Arts Science and Technology. Initiatives include the launching of a BTEC National Programme in applied laboratory and industrial science, short courses for employees working as chemical operators in the healthcare industry as well as training in industrial pharmacy for undergraduate students. The BTEC programme involves training to students in scientific principles, laboratory organisation and scientific applications as required by industry especially the pharmaceutical sector.

The Netherlands: More training opportunities for the unemployed

There are many opportunities for individuals on unemployment benefit to follow training courses. On 27 August 2004, Minister of Social Affairs and Unemployment, Aart Jan De Geus, made it possible for individuals to follow training courses with a substantial element of practical training, without suspension of their unemployment benefit. Unemployed individuals may also follow an internal training course within a company. In specific cases individuals may be allowed to follow training courses lasting up to a maximum of two years (as opposed to one currently). The only precondition is that the training be necessary for the individual to return to work.

Minister De Geus has made a ministerial settlement to broaden the rules on training for the unemployed. Under the new rules, the UWV can provide more targeted support to individuals on unemployment benefit to enable them to return to work more quickly. Four such pilot schemes were conducted recently. They demonstrated that more targeted support and greater flexibility were required (the latter in the case of both the UWV and the jobseeker).

Individuals may continue to receive unemployment benefit whilst following a training course. Training does not affect benefits in any way, so the fact that an individual is following a training course does not provide a reason either to withdraw benefit or to extend it. If the individual's entitlement to unemployment benefit expires during their training course, they may complete their training. This rule is now in force and has been backdated to 1 August 2004.

SPECIAL CATEGORIES OF WORKERS

Belgium: Stimulating proactive job-hunting

In Belgium, any individual without employment once they have completed their studies or after losing their job is, in principle, entitled to claim unemployment benefit. Throughout the period of unemployment, unemployed individuals receiving unemployment benefit must meet certain conditions; in particular, they must not be unemployed through choice. This means that an unemployed individual may not refuse any suitable job offered to them and must agree to follow any training course proposed. Unemployed individuals must also remain available for work; they must actively engage in any support activities, training, work experience or placements offered by the public employment service (regional employment offices, Employment and Training Information Centres (FOREM), the Flemish Office for Employment and Vocational Training (VDAB), the Brussels Regional Employment Office (ORBEM/BGDA) and local employment offices) and must actively try to find work themselves.

Insofar as individuals are not entitled to claim unemployment benefit indefinitely in Belgium, it is normal practice for the National Employment Office (ONEM/RVA) – the federal body responsible for managing the unemployment benefit scheme – to check at regular intervals that an unemployed individual is indeed looking for work and therefore still meets the requirements for entitlement to unemployment benefit. On 1 July 2004, a new system for monitoring unemployed individuals entered into force, the primary aim being to actively monitor such individuals and to support them in their efforts to reintegrate into the labour market. At the same time, the Regions and the Communities pledged to increase measures offering tailor-made support to all unemployed individuals requesting it.

Monitoring Procedure

The efforts made by an unemployed individual to reintegrate into the labour market are assessed during one-to-one interviews with a specially trained ONEM representative (facilitator) hired specifically for this purpose.

A completely unemployed individual (*chômeur complet*), i.e. an individual whose employment contract has been terminated or who works only a set number of part-time hours, is invited to an initial interview with a facilitator after either 15 months of unemployment (if aged under 25) or after 21 months (if aged 25 or above).

This initial interview is designed to assess the efforts made by the unemployed individual to find work during the 12 months prior to the interview. Their efforts are assessed in light of their personal circumstances (age, level of training, social and family situation, etc.) and the situation on the labour market in the sub-region in which they live. If the individual is deemed to be making sufficient efforts to find work, another interview is scheduled for 16 months later.

However, if the individual is not considered to have made sufficient efforts to find a job, he or she is offered an action plan detailing practical steps such as contacting the relevant Regional Employment Office, consulting job listings, applying for jobs and so forth) over the next four months and is asked to commit to taking the action required. A second interview is then scheduled four months later to assess whether the individual has followed their action plan. If they have, then a further interview will be arranged 12 months later.

If the individual has failed to comply with the terms of their action plan, he or she will incur a penalty. This penalty is temporary and is limited to four months and entails either a reduction in the amount of unemployment benefit the individual may claim or complete suspension of the benefit. The individual must also once again pledge to follow a new (more intensive) action plan over the next four months and a third interview will be arranged at the end of that four-month period. If the individual has complied with the terms of the second action plan, his or her full benefit entitlement will be restored and a further interview will be arranged 12 months later. If the individual has failed to stick to their second action plan, all benefits will be suspended. However, if the individual is receiving unemployment benefit as a head of household, a single person, or as a co-habiting partner in a household with a low income, this suspension will be preceded by a period of six months during which the individual will continue to receive benefit but at a reduced level.

At each stage of the process, the unemployed individual may be accompanied by someone of his or her choice (at the first interview) or by a lawyer or trade-union representative (during the second and third interviews).

Unemployed individuals who have incurred a penalty may lodge an appeal with the National Administrative Commission (Commission Administrative Nationale/Nationale Administrative Commissie) and with the labour courts.

Entry in force

This new monitoring system entered into force on 1 July 2004. To enable the Regions and the Communities to develop an adequate range of support services whereby they can offer all unemployed individuals support, training or work experience, the system is being introduced gradually. The first phase (up to June 2005) pertains only to unemployed individuals under the age of 30. Subsequently, it will be extended to unemployed individuals aged under 40 and to those aged under 50, from July 2005 and July 2006 respectively.

Belgium: First Job Agreement Scheme

The First Job Agreement (CPE) scheme is designed to promote access to the labour market for young people. To this end, some employers are obliged to hire young people on a CPE. Since the scheme was introduced in April 2000, countless changes have been made to the rules governing CPEs. Following the National Conference on Employment (concluded in October 2003), the framework law of 22 December 2003 and the Royal Decree of 21 January 2004 once again amended the regulations, in a bid to simplify their application.

Employers involved

For all employers in the private sector with a workforce of 50 or more as of 30 June of the previous calendar year, 3% of their staff must be young people hired on a CPE (calculated as full-time equivalents) based on the total number of staff during the second half of the previous year. For employers in the public sector, including private employers in a non-market sector, employing fewer than 50 workers as of 30 June of the previous calendar year, 1.5% of their staff must be young people hired on a CPE (calculated as full-time equivalents) based on the total number of staff during the second half of the previous year.

Exemption from the requirement to hire young people under the First Job Agreement scheme may be granted for specific reasons (e.g. companies in difficulty, companies which have made reasonable efforts to promote employment) and subject to compliance with a special procedure.

Categories of recipients

Any individual aged under 26, who is a registered jobseeker at the time they are hired by an employer may be considered for the First Job Agreement scheme. Foreign young people or those who are disabled count as two individuals for the purposes of compliance with CPE regulations.

Types of CPE

A CPE may take three different forms:

- ordinary employment contract (at least half-time work);
- part-time employment contract (at least half-time work) combined with a training scheme; in all cases, an average of 240 hours per year must be spent on training;
- apprenticeship contract (apprenticeship contract for professions pursued by salaried workers, "middle-class" apprenticeship contract (contrat d'apprentissage des classes moyennes), agreement on a course as part of training to become a business manager, an integration agreement or any other type of agreement or contract on training or insertion determined by Royal Decree).

The CPE must be a written document. This document may take the form of a contract of employment, apprenticeship, course or insertion etc. in which it is stipulated in a special clause that the contract (or agreement) is also a First Job Agreement. There is therefore no need to draw up a separate written CPE. In principle, the CPE will terminate at the same time as the employment

contract (if the latter is fixed-term), apprenticeship contract, course contract or integration agreement and, in any case, no later than the last day of the quarter during which the young person reaches the age of 26. However, termination of the CPE does not automatically terminate an employment contract (e.g. an open ended contract); thus an individual will continue to perform his or her job as determined by the parties but from the time the CPE ends, the employer may no longer include the young person concerned in their figures pertaining to their hiring obligations.

Reduction in contributions

Both public- and private-sector employers are entitled to reduced contributions in respect of the target group of young people regardless of their total number of employees. Clearly, though, they must meet their CPE obligations.

Workers are divided into two categories:

- Category 1: young people up to 31 December of the year during which they turned 18 (minors);
- Category 2: young people from 1 January of the year during which they turned 19 until the end of the quarter in which they turn 26.

For young people in Category 1 (minors), no further conditions need be met in order to claim entitlement to reduced contributions.

For young people in Category 2, a worker must have been a registered jobseeker prior to being hired, must be bound by a CPE and must be low-skilled (must hold no qualifications above a certificate of lower-level secondary education).

Employers are granted a reduction of 1,000 euro per individual per quarter for young people in Category 1 hired up to the fourth quarter of the calendar year during which the worker turned 18.

For Category 2 workers hired, employers receive a reduction of 1,000 euro per quarter for the first eight quarters after hiring the worker and a reduction of 400 euro per quarter up to and including the quarter during which the worker turns 26.

Monitoring and penalties

Employers who fail to comply with their CPE obligations will be fined 75 euro per calendar day of non-compliance and per worker concerned (i.e. young people not hired or workers dismissed to compensate for hiring young people).

Belgium: The Experience Fund

In the near future, Belgium's increasing ageing population, which is leading to an excessively low level of participation among older workers and early departure from the labour market will have a significant impact on the state budget in the form of extremely high pension costs. However, the experience gained by this ageing population could continue to play a key role in business and enterprise.

In an effort to alter the perception of these workers and their link with employment and retirement, the Experience Fund

(Fonds de l'expérience professionnelle/Het ervaringsfonds) is offering companies a subsidy for measures they take to improve conditions for workers aged 55 and over.

Employers involved

Subsidies from the fund will only be allocated to employers who fall within the field of application of the law of 5 December 1968. In practice, this means that subsidies will only be allocated in respect of measures designed to improve conditions for contracted workers aged at least 55 and similar individuals. Employers must also meet the following criteria:

- The company must not be bankrupt or in liquidation, must not have been issued a legal winding-up arrangement and must not be in the process of declaring itself bankrupt;
- The company must have met its social and tax-related obligations for a period of two years prior to its application for a subsidy;
- The company must pledge to actively implement measures to adapt working conditions or its work-organisation schedule vis-à-vis the workers in respect of whom the measures have been taken;
- The company must pledge to continue to employ the workers in respect of whom the measures have been taken for one year under the working conditions or according to the work-organisation schedule stipulated by the measure.

Conditions governing subsidies

Two types of measure will be considered for subsidy:

- Work-organisation schedule and pertaining primarily to safety at work, workers' health, ergonomics or the psycho-social burden associated with the work. These measures may include, among others, specific modifications to working time, adapting workstations, altering working processes or even a decrease in salary as a result of a worker being transferred to a post more suited to his or her capabilities;
- Studies conducted at the employer's request, in particular by the company's prevention department, prior to the introduction of measures altering working conditions or modifying the work-organisation schedule. Such studies may only be subsidised if the resulting findings are actually applied in the company.

The above measures must also meet the following criteria:

- Measures must not be limited to implementing labour regulations and legislation in force on well-being in the workplace;
- The workers at whom the measures are aimed must be involved either individually or as a group in drawing up and implementing the measures;
- The company's internal prevention department (service interne pour la prévention et la protection au travail) and the prevention committee (comité pour la prévention et la protection au travail) must have approved the drawing up and implementation of the measure taken;
- If the employer enlists or is forced to enlist the services of an external prevention body, the latter must also approve the drawing up and implementation of the measure taken.

A subsidy is granted mainly for measures meeting one or more of the following criteria:

- A measure designed to avoid risks;
- An innovative measure;
- A measure which could also be applied in other companies.

Employers may only claim a subsidy if a Collective Agreement has been concluded on the matter by a joint body or within the company.

Subsidy amounts

If an employer takes measures designed to improve working conditions or alter the work-organisation schedule, the subsidy available is fixed at a certain percentage of that employer's spending and is capped depending on the size of the company in question.

Table 1: Subsidy amounts

Size of company (workers)	Subsidy %	Ceiling (€)
fewer than 20	80%	12,500
20-49	70%	10,000
50-199	60%	7,500
200 or more	50%	5,000

If an employer conducts studies to ascertain improvement in working conditions and the work-organisation schedule, the subsidy available is fixed at 30% of the cost of the study, up to a maximum of:

- 10,000 euro (for companies employing 20 workers or less);
- 8,000 euro (for companies employing between 20 and 49 workers);
- 6,000 euro (for companies employing between 50 and 199 workers);
- 4,000 euro (for companies employing at least 200 workers).

This amount is increased to 50% of costs if:

- the study pertains to actions which are clearly applicable and which can be applied by other employers without any substantial alterations;
- the author of the study agrees to the latter being distributed and applied by other employers without payment of any additional fee.

The ceiling is fixed as follows:

- 12,500 euro (for companies employing 20 workers or less);
- 10,000 euro (for companies employing between 20 and 49 workers);
- 7,500 euro (for companies employing between 50 and 199 workers);
- 5,000 euro (for companies employing at least 200 workers).

However, employers who claim subsidies both for the actual measures they are introducing and for studies into those

measures may not receive a total subsidy of more than:

- 20,000 euro (for companies employing 20 workers or less);
- 16,000 euro (for companies employing between 20 and 49 workers);
- 12,000 euro (for companies employing between 50 and 199 workers);
- 8,000 euro (for companies employing at least 200 workers).

The subsidy may not be combined with any other benefit which the employer may receive in respect of the same worker and for the same purpose, except for a reduction in social-security contributions.

Denmark: Knowledge centres for refugees and immigrants

Refugees and immigrants possess many job-relevant skills. Future integration policy will focus to a greater degree on the qualifications and resources possessed by individuals that are relevant to current manpower needs. For this purpose, five new regional knowledge centres were established on 1 August 2004. They are intended to ensure more professional assessment of refugees' and immigrants' skills by the authorities. A total of 80 million DKK (10.8 million euro) has been allocated to set up the five regional knowledge centres.

The knowledge centres are not intended to assume responsibility for the integration efforts of municipalities and the AF (National Employment Service), but rather to supplement and improve the programs in use today.

The knowledge centres are intended to improve the way in which skills have been assessed up till now, because it has proved deficient and limited in many respects, and has not been sufficiently adjusted to labour-market requirements.

The knowledge centres' primary functions will be those of help-desk for municipalities and the AF, and point of contact for the undertakings and educational institutions involved in the assessment process.

Methods of assessing the skills of refugees and immigrants vary greatly depending on the target groups involved. The knowledge centres will therefore function primarily as knowledge banks for municipalities and the AF. The centres should ensure that there is an overview of the various institutions and methods involved in assessing skills. In addition, the centres will help municipalities and the AF make agreements with enterprises and educational institutions concerning the relevant assessment procedures.

The knowledge centres are intended to improve the organisation of the skills assessment process through cooperation with various actors in this area. Among other things, they will help realise the following objectives:

- Better and more professional assessment of skills, which will enable refugees and immigrants to move from passive maintenance via welfare benefits to ordinary work.
- Assistance with and improvements in the quality of efforts by municipalities and the AF to find the right opportunities for

refugees and immigrants, so that applicants can be presented with suitable options early in the interview process.

- Improvements in the efforts of educational institutions to supply the appropriate assessment procedures, as well as ensuring that undertakings can utilise the assessment information provided to them.

Among the knowledge centres' other important responsibilities are assistance in developing three instruments for nationwide use:

- An electronic database of skills assessment methods that will give the authorities easy access to the expertise and qualified knowledge of the skills assessment options that are available locally, along with information on programs that are effective for different target groups.
- Each immigrant receiving welfare benefits should have a certificate of competence that precisely describes his/her job-relevant qualifications.
- Undertakings should have an operations chart/template, in order to ensure that the skills assessment done in the workplace is relevant and effective.

The National Labour Market Authority issued tenders for establishing the five knowledge centres, and private and public-sector suppliers have now been selected for each of these five facilities.

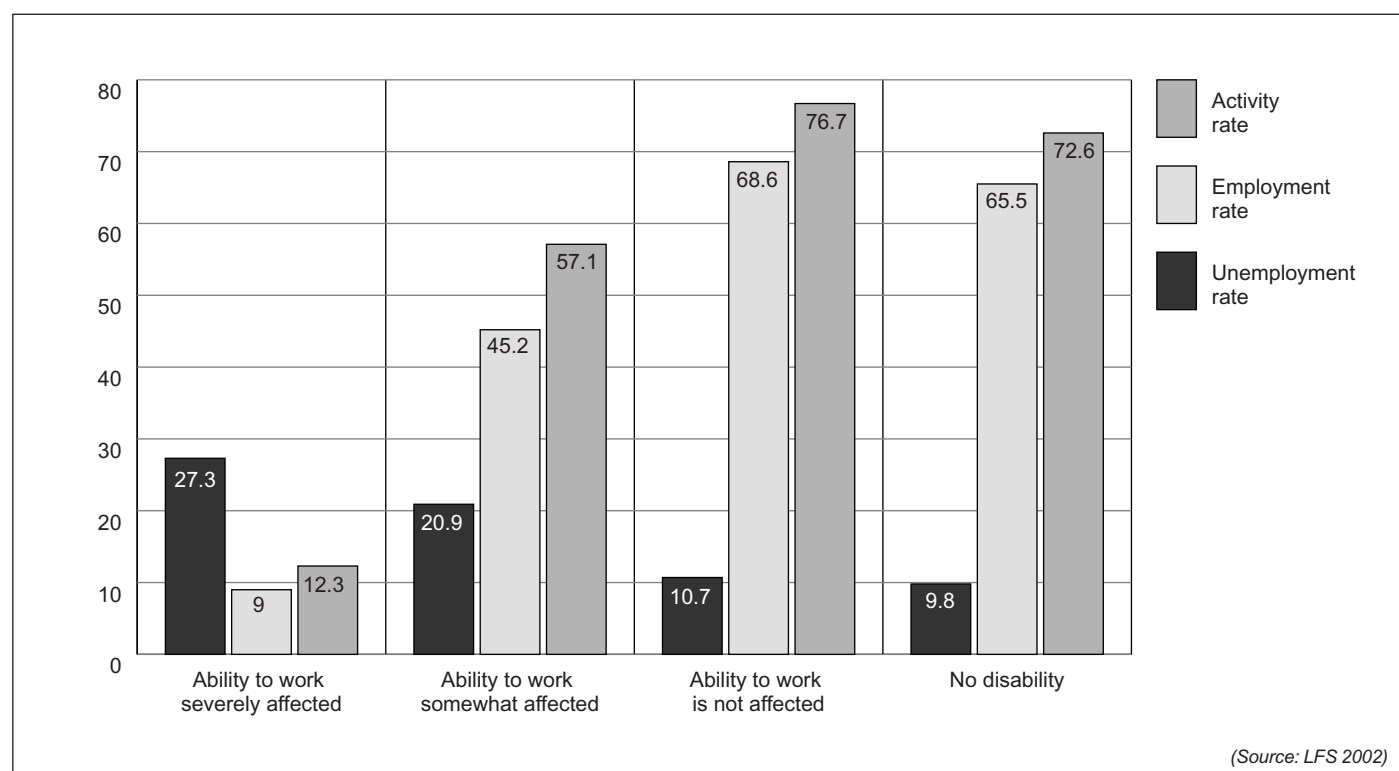
Estonia: Enhancing employment opportunities for people with disabilities

From April 2003 to April 2004, a PHARE Twinning project on disability employment was carried out in co-operation between the governments of Estonia and the United Kingdom. As part of the project, UK experts analysed the situation of disabled people in the Estonian labour market¹, made recommendations to develop labour market and rehabilitation services and trained a number of officials and employers to support disabled people in their search of work. The training included case-management skills and joint working between institutions, as well as specific knowledge of workplace adaptation. As a result, 12 local networks of all relevant institutions (labour market offices, rehabilitation teams, social insurance departments, local authorities, vocational training centres) were created to help disabled people into work.

The potential employers were targeted with an extensive awareness raising campaign, while a Good Practice Guide on how to employ and work with disabled people was produced and distributed. Over 400 people participated in the programme (leaders, managers, employers) improving their understanding of disability employment issues. More disabled people are expected to be hired as a result. To raise the awareness of the wider public (including disabled people themselves) about disability employment and to provide a forum for sharing views and to disseminate good practice, the website www.pite.ee was established.

Disabled people are socially disadvantaged in a number of areas of life, including employment. Even in the context of a general

¹ Report on Review of Labour Market Measures (<http://www.pite.ee/pite/index.php?lk=15&grupp=7>)

Figure 1: Impact of disability on employment prospects

decline in labour market participation and rising unemployment during the 1990s, the employment of disabled people has been much more seriously affected. The number of people who were inactive because of sickness or disability more than doubled between 1991 and 2002. A survey of disabled people in Estonia demonstrated, however, that the majority of disabled people would be interested in taking up paid employment.

According to the 2002 Estonian Labour Force Survey (LFS) 201,300 people of working age (i.e. aged 15-64) have longstanding health problems or disabilities. However, only about half of them (96,500) are classified as disabled in terms of the labour market as their disability or longstanding health problems affect the type/amount of work they could do and/or their ability to travel between home and work.

The 2002 LFS employment rate in Estonia for disabled people of working age was 25%, as compared with an overall employment rate of 62%. As in other EU countries, the relatively low employment rate for disabled people is associated much more strongly with low labour market participation (and the 'discouraged worker' effect) than with high unemployment. About 90% of the 71,300 disabled people without jobs (potential target group of active labour market measures) are economically inactive.

At the same time, the 2002 LFS provides strong evidence that the individuals' employment prospects do not simply depend on their medical condition but can differ depending on their occupations, qualifications, experience and preferences. About half the respondents with long standing disabilities or health problems said these did not affect them at work. The employment rate for this group of people was even slightly higher than that for people without long standing disabilities or health problems – 68.6% as compared with 65.5%.

It would also be wrong to imply that effective employment help for people with disabilities is necessarily expensive. A wealth of evidence from other countries clearly shows that the most cost effective way of reintegrating disadvantaged people into the labour market is by encouraging and helping them with their job search efforts.

The joint networks that were established and trained in Estonia, as part of the above mentioned PHARE project has shown some good results: during the course of training, 48 disabled people became employed, and a further 34 were considered to be likely to achieve work in the near future with the help of the new joint networks. In addition, a Workplace Adaptation Programme for disabled people was designed and staff training about its implementation was delivered in the local employment offices. On the basis of the same joint networks and trained specialists (case-managers), the government is ready to pilot and implement a Workplace Adaptation Programme through the local employment offices.

The Employment Strategy approved by the Estonian Government in May 2004, sets out some new policy actions to enhance the integration of disabled people in the labour market in the near future. New active labour market schemes for disabled people will be piloted in 2004-2005 with the help of ESF funds. From 2006, all disabled people looking for a job will be able to apply for help under the Workplace Adaptation Programme, which will aim to meet the applicant's minimum requirements to overcome disability related barriers to employment in the shortest possible time. The individual approach (case-management) and joint working techniques will be applied when helping disabled people into work.

Estonia: Activation of the long-term unemployed

According to the Labour Force Survey data there were 30,400 long-term unemployed in Estonia in 2003. The projects for long-term unemployed people can be applied only for those who have been registered at the employment offices for twelve months. Hence, the state can only help a part of the long-term unemployed, because not all of them register and some of them give up the services of employment offices. For example, in March 2004 there were just 8,104 long-term unemployed people registered at employment offices which makes up just 26% of all long-term unemployed.

Similar to other countries, Estonia also applies an individualised approach and case management development for long-term unemployed people. Since 2001, employment offices have implemented special projects for the long-term unemployed. In the frame of the state programme *Increasing employment, preventing long-term unemployment and exclusion of risk groups from working life* consultants were hired in all employment offices for providing labour market services to the long-term unemployed.

In parallel with employment of consultants, another project "Reintegrating the long-term unemployed into the labour market" coordinated by employment offices was also started in 2001. For every unemployed participating in the project an individual action plan was compiled, individual or group vocational guidance was applied and the unemployed were sent to adaptation or labour market training. The aim of the group guidance was to find out the need for additional consultation, prepare the unemployed persons for job seeking and raise their self-confidence. Adaptation training enabled the unemployed to get information about the labour market situation and how to start their job search. All in all the projects were successful. In 2001-2003, approx 1,100 long-term unemployed were participating in these projects. Since 2004 it is also possible to use ESF funds, making it possible to increase the number of participants in the projects. In the following years, more attention will be paid to preventive activities in order to shorten the duration of unemployment through activation of the unemployed and through prevention of long-term unemployment.

Latvia: Measures for unemployed at risk of social exclusion

In 2003, the State Employment Agency (SEA) developed active employment measures according to the requirement of the labour market, implemented new services and improved the possibilities for the unemployed with disabilities to be integrated into the labour market.

New measure for the unemployed and job seekers offered by the SEA – Acquisition of Basic Skills Demanded by the Labour Market

A new measure entitled Measures for the Promotion of Competitiveness Implemented by Legal Persons for unemployed and jobseekers was developed and initiated as a

pilot-project by the SEA within the framework of measures for the promotion of competitiveness in December 2003. Within the framework of the project, the unemployed have the opportunity to acquire basic skills necessary for the labour market (national and English language skills, computer skills, project management skills etc). Training is based on a module type scheme. 1,808 unemployed and job seekers have been involved in this measure to acquire basic working skills up to August 1, 2004. 14,150 unemployed persons and jobseekers will be able to acquire basic skills necessary for the labour market within the framework of the national project Training to Improve the Competitiveness of the Unemployed and Job seekers that is included in the national program Support for Active Labour Market Measures co-financed by the European Social Fund.

Improvement of opportunities for persons with disabilities in the Latvian labour market

New measures initiated in 2003 in order to improve the competitiveness of the unemployed with disabilities include:

1. Measures for Improving the Mobility of Unemployed Persons with Disabilities: this new activity was initiated in order to develop professional or social skills of the unemployed with disabilities in 2003. Within the programs that promote the acquisition of working skills for unemployed with disabilities according to their profession, work experience and the prospective profession, opportunities are given to acquire the professional or social skills they miss and to get a document certifying the skills acquired. 119 unemployed with disabilities were involved in this measure in 2003. In classes that lasted 40 hours they acquired skills in accountancy, electrical safety, labour protection, working with cash register, communication with clients and other working skills.

2. Professional training: In 2003 the first time a competition took place organising professional training, retraining and improvement of the qualifications of unemployed people with disabilities. 415 unemployed with disabilities started the training courses within this measure. Within the framework of the national program Support for Active Labour Market Measures (co-financed by the European Social Fund) and its national project Training for the Groups at Risk of Social Exclusion there will be opportunities for improving professional qualifications or for acquiring a profession for 6,520 unemployed persons at risk of social exclusion, including 1,100 unemployed persons with disabilities.

3. Subsidized active labour market measures for unemployed persons with disabilities: In 2003 the State Employment Agency in co-operation with 340 employers created 566 subsidised work places for unemployed persons with disabilities. 138 unemployed with disabilities participated in the job practice for young persons with disabilities or in subsidised work places for unemployed with disabilities. These were individuals who have acquired professional education or graduated from professional training or retraining courses for unemployed persons or who have acquired professional skills at the workplace (having worked in the profession for at least 2 years). 471 unemployed with disabilities who have not acquired professional education or wished to change the acquired profession participated in the measure Support for Unemployed with Disabilities to Acquire Professional Skills at Work Place. The work places are

established or adjusted according to the types of functional disorders of the unemployed disabled persons. Within the framework of the measure, there were 261 work places established or adjusted to the functional disorders of persons with disabilities.

4. Social Enterprises for Employment of the Less Competitive Unemployed: In 2003 unemployed with disabilities were involved in the measure Social Enterprises for Employment of the Less Competitive Unemployed and a tender was announced in order to establish social enterprises in which the unemployed with disabilities will be employed. Companies, which have worked out business plans for establishing new enterprises or new divisions at the existing enterprise, can apply for the organization of social enterprises. The goal of the measure is to employ the unemployed from disadvantaged groups (long-term unemployed – persons who are registered within the SEA for more than a year, pre-retirement age unemployed persons with not more than five years remaining until retirement and unemployed with disabilities) at appropriately created work places. Thus the preconditions for acquiring working skills and promoting competitiveness will be created. Within the established social enterprises the unemployed with disabilities are employed in professions such as carpenters, electronic equipment mechanics and others. The work places are established or adjusted accordingly to the type of the functional disorders of disabled unemployed.

The Netherlands: General measures for individuals at a disadvantage

It is important that general government measures to remove obstacles in the labour market should be aimed primarily at individuals who are at a disadvantage. Such measures may include programmes combining work and care, or programmes which provide individuals with additional training. A more general approach focuses on the structure of the labour market and aims to resolve difficulties for all parties concerned. The government also emphasises that the various bodies responsible for implementing general labour market policy must take full account of people's individual circumstances. The Centres for Work and Income (CWIs) can use such an 'individualised' approach to help young people with little work experience to secure a placement to boost their chances of finding a job.

The memorandum on future Dutch labour market policy endorsed by the Council of Ministers on 23 April 2004 states that if general and 'individually focused' approaches do not prove successful, the government will opt for separate measures targeted at specific groups within society. Under this system, separate measures may be implemented to tackle specific difficulties faced by a particular group of individuals on the labour market measures for specific groups of disadvantaged individuals such as young people, older people and ethnic minorities are, for example, a possibility.

Temporary measures may also be required as a stimulus for both employers, relevant supporting bodies and the target group itself and to help them overcome barriers towards either offering or seeking work. Organisations such as Taskforce Jeugdwerkloosheid (the Youth Unemployment Taskforce) and

the Committee for Participation by Women from Ethnic Minorities (PaVEM) can help in this regard.

The government believes that separate policies for groups of disadvantaged individuals should not become the norm since such an approach can lead to stigmatisation and a fragmented approach – after all, not all older people are disadvantaged, and the barriers encountered to the labour market are not always unique to a single group.

Cabinet abolishes tax-cuts for pre-pension schemes and introduces new leave provisions

In July 2004 the Dutch government decided to abolish fiscal support for early retirement schemes. As a replacement the government is introducing a Life Course Plan. Workers can apply for tax cuts to save for unpaid leave, which they can use during different phases of their career.

It is vital to increase participation in the labour market due to the Netherlands' increasingly ageing population. This is necessary to ensure a sustainable social security system. The government has therefore decided to no longer stimulate early-retirement with tax-cuts. Instead, they want to increase the possibilities for taking leave during a worker's entire career. The main aim is to share the financial burdens and perks more fairly between generations and to offer workers more freedom of choice.

The government and its social partners (trade unions and employers organisations) held lengthy negotiations last year about a new fiscal system for early retirement and the proposed Life Course Plan. The parties agreed in autumn 2003 that they would reach an accord in the spring of this year. At the same time the social partners agreed to freeze salaries in 2004 and 2005. The parties eventually failed to reach agreement but the government decided in July to implement reforms in any case. The new measures are meant to go into effect on 1 January 2006. The current fiscal provisions will still apply to the early-retirement rights accrued before that date. A limited transitional period will also be observed.

On 27 August, the government relaxed the transitional arrangements for the abolition of tax incentives for early retirement and an early retirement pension as of 1 January 2006. Employees who are aged 57 or over on 1 January 2005 will remain entitled to current tax benefits. The premiums for early retirement and an early retirement pension, designed to pay benefits for this group, will remain tax deductible. As from 1 January 2006, tax incentives will no longer be available on contributions into an early retirement pension for employees aged under 57 on 1 January 2005 and these individuals will be required to pay tax on their premiums. Benefits will remain tax-free. All entitlement to an early retirement pension already accrued will remain unaltered. In addition, older employees aged over 50 will be able to save more via the new Life Course Plan due to come into force on 1 January 2006.

The Life Course Plan makes it possible for workers to save a maximum of 12% of their annual income tax free. They can use that balance to finance unpaid leave during their work career. The provision can also be used to retire early. The maximum amount a worker can save corresponds with 2.1 years of leave with 70% of the last gross salary. If a worker goes on a leave-of-absence of less than two years, they can subsequently build up a

full balance upon returning to work. To enable older employees to build up a substantial balance, individuals aged between 50 and 57 may build up their pension more quickly by contributing up to maximum amount of 150% of their gross annual salary.

Dutch government assists municipalities in improving the position of ethnic minority women

On 9 June 2004 the Dutch government concluded an administrative agreement (covenant) with five municipalities to improve the position of ethnic minority women. The move concerns the improved integration and social participation of such women. To this end, the municipalities will be able to make use of a Participation Toolkit (Toolkit Participatie). They will also be able to apply for subsidies.

The municipalities concerned are Amsterdam-Noord, Breda, Groningen, Nijmegen and Zaanstad. The Ministry of Social Affairs and Employment and the Ministry of Justice will jointly bear the costs of this project. The project fits within the emancipation and integration action plan, for which both ministries share responsibility.

The Participation Toolkit offers municipalities a helping hand in improving the position of ethnic minority women. The five municipalities will test the toolkit for half a year. Thereafter, other municipalities will also be able to make use of it.

To begin with, the toolkit will enable municipalities to determine which group of ethnic minority women they wish to focus on the most. By means of a questionnaire, they can synthesise information which they already have available at the municipal level according to relevant issues such as work and income, safety and domestic violence.

The municipalities can subsequently determine which policy instruments are already available locally, and which have to be developed. They could, for instance, draw up a local integration agenda which sets out policy over a four-year period. Within this framework, they could, among other things, determine which municipal institutions will receive subsidies and what their respective duties are.

The toolkit can also help in acquiring insight into the means by which the municipality can fund the activities. More ethnic minority women could be helped into work, for instance, using money from the Fund for Work and Income (FWI) available to every municipality. With the aid of a 'policy performance indicator' (beleidsprestatie-meter), the municipality can keep track of results and adjust their policy if and when necessary.

Portugal: Integration of immigrants

Following the Decree-Law No. 251/2002 of 2 November, whereby the Office of the High Commissioner for Immigration and Ethnic Minorities (Alto-Comissariado para a Imigração e Minorias Étnicas) was created as a body directly attached to the Office of the Prime Minister, two National Support Centres for Immigrants (Centros Nacionais de Apoio ao Imigrante – CNAI) were set up in Lisbon and Oporto. These aimed to provide an integrated response to the problems faced by immigrants, promoting the latter's participation and integration in Portuguese society, particularly as regards employment and vocational training.

The Joint Order No. 228/2004 of 13 April provides for the establishment of a Unit for Inclusion in Active Life (Unidade de Inserção na Vida Activa – UNIVA) in each of the two above-mentioned CNAIs, given that active employment policies aim to provide support services for vocational guidance, the organisation of courses and vocational training programmes and other activities intended to promote contact with the labour market. The UNIVAs are responsible for implementing the following tasks in cooperation with the Employment and Vocational Training Institute (Instituto do Emprego e Formação Profissional – IEFP):

- To provide support, information and vocational/career guidance for immigrants, with the aim of integrating them in working life and assisting them in identifying training needs and suitable vocational/professional pathways;
- To help immigrant citizens to find employment, and to offer ongoing support for their integration in working life;
- To encourage immigrant citizens to follow training programmes and vocational training courses, and to promote other forms of contact with the labour market;
- To collect and disseminate information on employment and vocational training opportunities and to promote contacts with business companies and other organisations in the world of work;
- To provide information and support with regard to the recognition of the vocational/professional qualifications of immigrants, referring the latter, as appropriate, to the Recognition of Qualifications Support Bureau ("Gabinete de Apoio ao Reconhecimento de Habilitações") or to the IEFP when the relevant qualifications fall within the competence of this body.

The above measures have significantly facilitated the inclusion of immigrant workers in working life.

The Joint Order No. 453/2004 of 27 July, issued by the Ministry of Education and the Ministry of Social Security and Labour, provides for the development of training and education courses. This measure aims to promote academic achievement and prevent school failure, especially the phenomenon of young people dropping out of school without qualifications. The importance of this legislation becomes apparent if we bear in mind the large number of young people who currently drop out of school and are in transition to employment, particularly those who join the labour market prematurely with an inadequate level of education and/or insufficient vocational qualifications.

Another recent development has been the extension of compulsory education to a total of 12 years. As a result, there is a need to provide additional training opportunities with the aim of ensuring an ongoing training process, structured in sequential levels or modules that enable students to resume education/training for limited periods of time and gradually acquire higher levels of qualification.

The courses that have now been developed are intended primarily for young people aged 15 or over who are at risk of school failure or who have already left education before completing 12 years of schooling, as well as young people who having completed 12 years of schooling, do not have a vocational qualification and wish to gain one in order to enter the world of work.

These courses, which include social and cultural education components as well as scientific and technical training, lead to qualifications at levels 1,2 and 3, providing equivalents to 6, 9 and 12 years of schooling.

The courses will be offered by the network of state schools and by private and cooperative schools, vocational training schools and teaching establishments managed directly or jointly by the IEF, as well as by other accredited institutions in cooperation with community entities such as local authorities, companies or employers' organisations, other social partners and local or regional associations.

A follow-up committee, including representatives of the Ministry of Education and the Ministry of Social Security and Labour, has been set up to support these measures.

SOCIAL PROTECTION AND UNEMPLOYMENT BENEFIT SYSTEMS

Lithuania: Unemployment insurance as a means for reducing unemployment

At the end of 2003 the Seimas of the Republic of Lithuania adopted a new Law on Social Insurance of Unemployment, which will come into effect on 1 January 2005. The purpose of this Law is the establishment of a financially stable and reliable system of unemployment insurance to guarantee sufficient subsistence income for individuals covered by this type of insurance when they are deprived of their previous work, or seek a new job according to the profession they have acquired, or are acquiring. The reorganised system of unemployment insurance should strengthen the validity of control over unemployment benefits and improve motivation of the unemployed for active job seeking. The new unemployment insurance system was harmonised with the social insurance system applicable in the country, as well as with active labour market policy measures and system of social support. Unemployment is one of the most serious social problems, therefore unemployment insurance is one of the means to address this problem, first of all through partial compensation of lost working income of the unemployed, as well as providing them with a source of subsistence until they find a job.

The Law on Social Insurance of Unemployment defines the categories of individuals insured with compulsory social insurance of unemployment, eliminating individuals who do not earn income from labour relations. Compulsory insurance cover will be provided to individuals who receive remuneration for work – work under employment contracts in enterprises, institutions, organisations, or other organisational structures, serve in elective office on the basis of membership in elective bodies, are public servants, state politicians, soldiers, etc. Entitlement to the unemployment benefit shall be acquired by the insured enrolled with labour exchange as the unemployed specified in the previous sentence, as well as those who have not been offered a job by the labour exchange according to their occupational skills and health condition, or active labour market measures. Entitlement to the unemployment benefit shall be conditional upon fulfilment of certain mandatory requirements. That is, prior to enrolment with the territorial labour exchange, the unemployed must have at least 18 months unemployment insurance period during the period of the last 36 months, dismissed from work on the initiative of the employer in the manner established by laws without any fault of the unemployed due to circumstances that are out of control of the unemployed, and in case of bankruptcy of the employer. This provision of the Law shall apply to servicemen who have completed the initial period of the continuous mandatory military service or alternative national defence service or who were dismissed from such services after serving at least half of the established time. In addition, the right to unemployment benefit shall be enjoyed by the unemployed who have been granted a leave to take care of a child aged from 1 to 3 years.

The new Law defines the right to receive the unemployment social insurance benefit relating it with the implementation of active labour market policy measures. The Law provides for increasing the amount of unemployment insurance benefits and relating them with the previously paid remuneration and for reducing from 24 to 18 months the requirements for a three-year mandatory service record in order to become entitled to receive the unemployment insurance benefit. The new law extends the duration of payment of the unemployment benefit. For example, the unemployment benefit shall be paid for a period of six months, when the service record is up to 25 years, for seven months in case of a service record of 25-30 years, eight months for a service record of 30-35 years, and nine months in case of a service record of 35 years and over. In addition, and in accordance with the new procedure, the payment of unemployment benefit is envisaged only to those unemployed who are going to participate in retraining, public works and other projects offered by the labour exchange.

The methods for calculating the unemployment benefit have been essentially modified. The unemployment benefit shall comprise the fixed and the variable components. The fixed component shall cover the state-supported income, whereas the variable component shall be related with the previously insured income of the unemployed. The variable component of the benefit shall amount to 40% of the previous remuneration, calculated during the past three years, however, the total amount of the unemployment benefit may not exceed 70% of the insured income.

With a view to encouraging the unemployed to be more active in job seeking, the unemployment benefit payment conditions have been amended, establishing that full amount of the unemployment benefit shall be paid for the first three months, and for the remaining fixed period of payment of the unemployment benefit the fixed component of the unemployment benefit and half of its variable component shall be paid.

The changeover to the implementation of active labour market policy measures and to maintaining the Lithuanian Labour Exchange and the Lithuanian Labour Market Training Service with the state budget funds is envisaged gradually during the period of five years (starting from 2005). Unemployment insurance funds will be used solely for the purpose of payment of unemployment benefits. The Lithuanian Labour Exchange shall manage allocation of unemployment benefits and their payment. According to the estimates upon enactment of this Law in 2005 the amount necessary for unemployment benefits will stand at LTL 106,5 million (30.8 million euro).

The Law provides that financing of active labour market policy measures will be gradually (from 1 January 2005 till 1 January 2010) transferred from the State Social Insurance Fund Budget to the state budget.

FIGHTING THE IMMEASURABLE? ADDRESSING THE PHENOMENON OF UNDECLARED WORK IN THE EUROPEAN UNION

Introduction

This overview provides a summary of the national contributions provided by the SYSDem experts in the 25 Member States, accession countries and Norway on the phenomenon of undeclared work. In addition, it draws on information from the 1998 *Commission Communication on Undeclared Work* (COM (98) 219 final) and the study by Inregia AB and Regioplan BV completed in 2004 on behalf of the European Commission (*Undeclared work in an enlarged European Union*, Piet Renooy, Steffan Ivarsson, Olga van der Wusten-Gritsai and Emco Meijer, 2004, see http://europa.eu.int/comm/employment_social/employment_analysis/work/undecl_work_final_en.pdf).

The article will look at the various definitions and interpretations applied to the phenomenon of undeclared work. It will assess the difficulties in measuring this phenomenon, which is by its very nature unobserved, and describe the different methods used in an attempt to quantify it, as well as their respective shortcomings. Having gained an understanding of these methods, which make it difficult to provide truly comparative data, existing estimates of the size of the underground economy will be provided. Based on these estimates, it is possible to provide an insight into the sectors and types of activity where undeclared work is most prevalent and the types of individuals most likely to be engaged in such activities.

The level of political priority given to measures seeking to address undeclared work in different countries will be assessed and different preventative and punitive approaches will be described with an attempt to identify any good practice.

Finally, the article will seek to provide some conclusions on the importance and impact of the phenomenon in the European Union and beyond and the measures necessary to address it.

Definitions

A wide array of names have been used in different countries to describe the phenomenon of the underground economy and undeclared work, including the informal, hidden, parallel or shadow economy, moonlighting etc. Despite different terminology, the 29 national articles show widespread agreement with the definition provided in the 1998 Commission Communication, which defines undeclared work as any “productive activities that are lawful as regards their nature, but are not declared to the public authorities, taking into account the differences in their regulatory systems between Member States”. Under this definition, criminal activities and activities which do not have to be declared are excluded. Although this definition is widely accepted, there are some national differences in emphasis and other issues, which are argued should be taken into consideration, but are not necessarily captured by this

definition (often depending on national political or policy priorities). In Bulgaria, for example, the underground economy is often taken to include illegal activity, which is also the prime focus of public debate in this area. Large national studies in Cyprus on the underground economy include three categories under this umbrella: the informal sector (goods and services for own use and tips), the “underground sector” (unregistered production units and under-declaration of profits and activities) and the “illegal sector” (private tutoring, private account medicine, gambling, prostitution and smuggling etc.). In Greece the definition used in estimates of the size of the underground sector includes all productive activity (even unpaid), because of the level of work by family members, particularly in the agricultural sector. The contribution from the UK argues that the EU definition fails to capture instances where activity is declared but employment status is misrepresented (for example in the case of construction workers reporting themselves as self-employed, but are always contracted to work for the same employer – so called “bogus self employment”). The importance of understanding national contexts and peculiarities is also emphasised in the case of Germany which currently has 41 defined professions where an advanced certificate of proficiency (*Meisterbrief*) is required in order to practice and train staff. Any activity carried out without this certificate is therefore considered to be illegal, which makes up for a significant proportion of undeclared work in Germany.

Having highlighted some of the national differences, it is nevertheless possible to list the following activities as the mainstay of the underground economy and undeclared work in the European Union:

- employers or self employed entrepreneurs who fail to declare all or part of their activities and or fail to meet the national requirements for making social insurance contributions. In many of the new Member States and accession countries one has to add to this the widespread phenomenon of paying ‘envelope wages’ (official payment of minimum wages with additional wages or benefits being paid as cash in hand in order to avoid tax and social security obligations)
- the under-declaration of income by employees (often second or multiple job holders)
- people who are officially ‘inactive’ or ‘unemployed’ but are working while claiming benefits
- immigrants working illegally.

Participation in the underground economy is generally due to a desire to increase earnings, to avoid taxation and social contributions or to reduce costs.

The phenomenon of undeclared work has risen to increasing prominence in recent years as it is seen to undermine the financing and delivery of social protection and public services. The curtailment of receipts from taxation and social insurance leads the State either to cut public services and welfare provisions or to raise taxes which causes a vicious cycle engendering further ‘incentives’ to seek to avoid taxation through undeclared work.

These concerns led to the inclusion of Guideline 9 in the 2003 multi-annual Employment Guidelines. This Guideline, aimed at transforming “*undeclared work into regular employment*” calls on Member States to “*develop and implement broad actions and measures to eliminate undeclared work, which combine simplification of the business environment, removing disincentives and providing appropriate incentives in the tax and benefit systems, improved law enforcement and the application of sanctions*”. The Guideline also calls on Member States to reinforce efforts to measure the size of the underground economy and undeclared work.

The prevalence of undeclared work

Undeclared work is a phenomenon common to all Member States of the European Union as well as the accession countries and Norway. However, the size of the underground economy and undeclared work differs significantly from country to country.

As a result of its very nature (not being observed or registered), the prevalence and size of the undeclared economy is difficult to estimate with any level of accuracy. The study by Inregia and Regionplan (2004) distinguishes between indirect and direct forms of measurement. Indirect measurements, applied in many countries to provide an estimate of the prevalence of the phenomenon, include the following:

- *Monetary methods*, such as the measurement of the ratio between cash and demand deposits. These methods assume that most transactions in the underground economy are carried out in cash, which makes it difficult to distinguish between legal and illegal activity. OECD experts, in compiling their handbook on measuring the non-observed economy (OECD (2002) Handbook for measurement of the non-observed economy), therefore concluded that this kind of method is of limited use.
- *Labour accounts method*. This involves the comparison of labour market data (i.e. gathered through the Labour Force Survey) with data on labour market participation gathered from other sources (i.e. from household surveys).
- *Econometric modelling*. Such models use certain indicators of an undeclared part of the economy and a set of supposed determinants and gather indications of its size through modelling.
- *Electricity consumption*. These estimations compare the amount of energy required in declared activities and compare them with measurements of actual consumption. This method assumes and most undeclared labour is energy intensive and these findings are generally not perceived to provide a very accurate picture of the size of the underground economy.

Direct measurements, which the Commission study argues are preferred, are based on survey evidence. However, there are a number of difficulties with such methods:

- Few such surveys have been carried out and time series are generally not available
- Limited comparability
- Veracity of findings depend on quality of questionnaire and skill of interviewers
- Potential of under-reporting due to disinclination to report underground activity.

Bearing in mind these difficulties and the different methods applied in different countries, it is clearly unwise to make any direct comparisons. The table below gives an indication of the wide range of results regarding the level of undeclared work per country reached by using different methods by providing figures quoted in the study by Renooy et al (2004) and the articles by the SYSDERM correspondents¹. When comparing the two it becomes clear that the estimates provided by Renooy et al tend to be at the lower end of the spectrum. In particular, studies utilising primarily monetary methods generally yield significantly higher estimations of the size of the underground economy.

When looking at the above table it is clear why most researchers analysing the causes behind the prevalence of the underground economy continue to distinguish between the EU15 and the new Member States and candidate countries. While the incidence of

undeclared work as a percentage of GDP is generally below 6% (with the exception of Greece, Spain and Italy) in the EU15, in the new EU10 it is generally estimated to be between 10-20%. The candidate countries show even higher percentages, generally estimated between 20-30%.

Evidence suggests that the level of undeclared work is linked to the a country's economic and socio-political context. For example, many of the new Member States are still in the process of economic restructuring following their transition to market economies. The evidence clearly shows that in countries where this process has been linear and is advanced, the level of undeclared activity is beginning to decline. In countries where this development is at an earlier stage and the economy has faltered such as Romania or Bulgaria, it is proving difficult to bring emerging businesses and individuals out of the underground economy as they lack the confidence in market trends to declare their activities.

Of similar importance is the level of socio-political development, for example in relation to the development of social insurance and social benefit systems. In countries where these systems are underdeveloped or there is little or no link between the individual contributions and the level of benefits paid out, there is seen to be little incentive to make the move to declared activity.

The attitude of governments and the importance attached to combating underground activity is clearly also of significance, as this is linked to the measures instituted to achieve this goal and the level of resources allocated. A number of the SYSDERM articles argue that in countries at a less advanced – or more precarious – state in their economic development, governments may even be turning a blind eye to such activities in the knowledge that many individuals would not be able to survive economically without engaging in such undeclared activity (i.e. Turkey or Romania).

The study by Renooy et al (2004) argues that there are no general, universal causes for the existence and development of the underground economy. Instead, they argue that this is “brought about by a complex interplay between various variables that varies between countries”. Among the key reasons identified in this study as well as in the contributions of the SYSDERM experts are:

- Perceived high tax burdens on businesses and labour
- Bureaucratic provisions surrounding the establishment of small businesses
- Perceived labour market rigidities and the general organisation of the labour market
- Lack of trust in and the quality of government and public services ('value for money')
- Lack of a perceived threat of detection
- Cultural factors

Existing studies also provide an insight into the sectors and types of activity where undeclared work is most prevalent. They can also give some understanding of the individuals most likely to be engaged in the underground economy.

On the whole, one of the sectors most affected is construction, partly as a result of the use of illegal labour, the misdeclaration of employment status and the complex nature of employment relationships on sub-contracted arrangements prevalent in the building industry. A high prevalence of undeclared work can also be found in agriculture, the hotel and catering sector and in personal and domestic services.

Table 1: Undeclared work: estimated sizes according to different measurement methods and sources (% GDP)

Country	Estimated size (% of GDP)	Year	Sources/measurement methods
EU15			
Austria	1.5% 11%	1995 2004	Statistics Austria, national accounts, ESA95, Combining data Monetary method, Schneider (2004) ³
Belgium	3.4% 21.5%	1995-99 2003	National Bank of Belgium, national accounts, ESA; Combining and comparison of data sources ¹ Monetary method, Schneider ³
Denmark	5.5%	2001	Rockwool Foundation, study No 10, questionnaire survey ¹
Finland	4.2%	1992	Finnish Ministry of Finance; Combining and comparison of data sources ¹
France	4-6.5% 14.7%	1998 1999	Rockwool Foundation, study No 5, questionnaire survey; statistical corrections, 4% of GDP, INSEE 1999 ¹ Monetary method, ACOSS ³
Germany	6% 16.8%	2001 2000-03	Rockwool Foundation, study no 10, questionnaire survey ¹ Monetary method, Schneider (2004) ³
Greece	28.6%	2000	Monetary method, Schneider (2002) ³
Ireland	8%	2002	Monetary method, Dillon (2004) ²
Italy	16-17%	1998/2001	ISTAT, Combining and comparing various statistical sources using indirect estimation ¹
Luxembourg	No data		
The Netherlands	2%	1995	CBS, national accounts, Combining and comparison of data sources ¹
Portugal	5% 22.5%	1996 2001-02	Statistics Portugal, national accounts, Combining and comparison of data sources ¹ Monetary method, Schneider (2002) ³
Spain	15-20%	1985	Spanish government estimate ²
Sweden	3%	1997	Rockwool Foundation, study no 10, questionnaire survey ¹
United Kingdom	2% 12.3%	2000 2002-03	Rockwool Foundation, study no 10, questionnaire survey ¹ Monetary method, Schneider and Klinglmaier, 2004 ³
New Member States			
Czech Republic	9-10%	1998	Renooy et al (2004)
Cyprus	4.2% 21%	2003 1989-90	Renooy et al (2004) Monetary method, Schneider (2000) ³
Estonia	8-9%	2001	Renooy et al (2004)
Hungary	18% 15-20%	1998 2000	Renooy et al (2004) Lackó ³
Latvia	18%	2000	Renooy et al (2004)
Lithuania	15-19%	2003	Renooy et al (2004)
Malta	25%	1989	Briguglio (1989) ³
Poland	14% 26.3%	2003 2003	Renooy et al (2004) Schneider (2004) ³
Slovakia	13-15% 16.3%	2000 1998-99	Renooy et al (2004) Schneider (2002) ³
Slovenia	17%	2003	Renooy et al (2004)
Candidate Countries			
Bulgaria	22-30% 30.4%	2002/3 1998-99	Renooy et al (2004) Monetary method, Schneider (2003) ³
Romania	21% 30%	2000 2004	Renooy et al (2004) Direct observation and econometric modelling, Labour Research Institute (2004) ³
Turkey	18-30%	2003	Econometric modelling, Cetintas and Vergil ³
Norway	13%	2002	Goldstein et al, survey method ³

¹ Where no second source is provided, Renooy et al and the SYSDem experts have quoted the same source, in most cases, the SYSDem articles quote a variety of sources of data.

² Data and sources as quoted in the report to the Commission by Renooy et al (2004)

³ See respective SYSDem article

The types of individuals engaging in such work vary from country to country, depending on the parameters for undeclared work and the sectors most prevalent, but most significant in this category are illegal immigrants, skilled workers (with second, undeclared jobs), students and women providing personal and domestic services.

Measures aimed at combating undeclared work

Following the introduction of Guideline 9 in 2003, all Member States have set out their policies to address the problem on undeclared work in their National Action Plans for Employment (NAPs). The majority of countries place strong emphasis on measures aimed at simplifying rules and regulations to reduce the administrative burden on employers (and new businesses and SMEs in particular). A similar number also focus on increasing incentives to work by seeking to improve the fit between tax and benefit systems. Slightly fewer countries have instituted measures to address labour market rigidities. Indeed in some new Member States measures have been introduced to increase labour market regulation, for example by making it compulsory to register the conclusion of employment contracts and their severance. Most countries have also sought to tighten controls by setting up new and sometimes transnational enforcement bodies, strengthening old ones or increasing penalties.

Relatively few countries have sought to use new measures to increase formalisation in certain sectors particularly prone to undeclared work, such as domestic services.

The focus of measures introduced to combat undeclared work depends partly on the level of socio-economic development achieved in the respective countries, but is also linked to the political interpretation of the key causes underlying the phenomenon and the societal manifestations of the problem. As a result, countries such as Turkey, Romania or Bulgaria continue to focus their efforts on seeking to boost economic development and attracting foreign direct investment as a way of fighting the underground economy, while others such as the Netherlands, Ireland, the UK and Austria place most emphasis on stronger enforcement and sanctions.

The table below provides an overview of some of the key measures taken in different Member States aimed at combating the problem of undeclared work.

Good practice

One of the objectives of the European Commission study on undeclared work was to highlight any good practice in the fight against undeclared work, which could provide lessons for other countries. Renooy et al (2004) highlights the following measures as good practice in the fight against undeclared work (most of which are also mentioned in the table above):

- Service Vouchers in Belgium
- Visible and predictable control mechanisms and information campaigns in Sweden
- Cheque Emploi Service in France
- Mini jobs in Germany
- Committee for the Emergence of the Underground Economy in Italy

While these are interesting examples, it is fair to say that on the evidence presented in the national contributions by the SYSDM

experts that such isolated measures can only be seen as good practice within a wider co-ordinated policy framework aimed at combating undeclared work which spans the whole gambit of policy initiatives outlined above. With respect to the evaluation of the measures highlighted by Renooy et al at the French Cheque Emploi Service has generally been considered as a success with 900,000 users since the creation of the scheme in 1996. An evaluation of the Belgian Service Voucher Scheme by DeSutter (2000)³ indicated that almost half of the jobs created through Local Employment Agencies and Service Vouchers were previously clandestine. An interim evaluation of the German system of Mini-jobs (carried out by Schupp and Birkner in 2004) indicates that part of the increase in mini-jobs can be attributed to the replacement of previously existing employment. In addition, there has only been a minimal increase in mini-jobs in household employment (Weinkopf, 2004)³.

On the whole it must be emphasised that, with the exception of increased surveillance activities, many of the measures outlined in Table 2 above have been insufficiently evaluated with regard to their impact on the level of undeclared work.

Conclusions

In order to address the phenomenon of undeclared work adequately, its size and causation must first be better understood. Recent reports have gone some way towards achieving this, but the significant divergence between estimates of its size generated by different methods of calculation indicate that difficulties remain in the proper understanding of the prevalence of the phenomenon in the enlarged EU.

On a positive note, the data presented in the SYSDM reports available data appears to indicate that in the majority of countries, there has, over recent years, been a downward trend in the size of the underground economy. However, the phenomenon remains sufficiently sizeable to be of concern, particularly in Southern Europe and the new Member States and candidate countries.

While the scale of undeclared work is a concern, the causal factors leading to such practices need to be better understood. The articles from the SYSDM experts give the impression that in some countries, the measures prioritised by governments to address the problem do not adequately address these aspects or sometimes provide mixed messages.

What is clear from the evidence provided from the new Member States and candidate countries is that among the key factors behind the fight against undeclared work are the development of stable economic growth, the introduction of a welfare systems providing clear links between contributions and benefits, trust and confidence in government and government institutions and a proper balance between flexibility and security in labour market regulation. It is upon such foundations that measures for the fine tuning of incentives to work and the implementation of sanctions must be built.

More research must be carried out to generate a better understanding of the impact of different types of measures on the level undeclared employment in order to address this phenomenon effectively.

³ See respective national SYSDM contributions for references.

Table 2: Measures taken aimed at combating undeclared work

Country	Specific measure
Reduction of administrative burdens on businesses/private individuals	
Belgium	Crossroads Bank for Enterprises (KBO) and business one-stop-shops To simplify the administrative obligations imposed upon self-employed workers, the KBO and business one-stop-shops have been established. KBO attributes a unique identification number to every enterprise and every entrepreneur, and records the necessary identification data. This unique number provides a link to all institutions thus simplifying administrative procedures. The shops enlist new companies with KBO, fulfil all the necessary formalities and check other paperwork.
Bulgaria	The package of services offered by Labour Offices to people who are willing to start their own businesses has been extended. Free advice, market research data, facilitation of the access to grants and training are offered. The mediating role of business incubators is also intensified.
Estonia	Enterprise Estonia To simplify the creation of businesses a governmental agency named Enterprise Estonia was founded in 2000 by the Ministry of Economic Affairs. It is one of the largest institutions within the national support system of entrepreneurship in Estonia. Together with 17 business advisory centres and a one-stop internet site they form a business support network that provides information on the start-up of enterprises, including consultation, strategic analyses and assistance in contacting foreign investors. It also provides start-up grants to small-an-medium size enterprises to encourage formal economic activities. E-Tax Board To reduce the administrative costs of taxes, in 2000 the Estonian Tax Board introduced the e-Tax Board that enables tax-payers (both enterprises and individuals) to fill-in and file tax returns and to receive information on their tax liabilities and account balances on-line. Take up of this has been high.
France	Establishment of Centres for Business Formalities A one-stop-shop for start-up companies.
Germany	Law promoting ownership of small businesses and improving business financing This law entered into force in 2003 and is aimed at reducing the red tape for new business start-ups.
Greece	Guarantee Fund Facility Scheme for Small Enterprises (TEMPME) This institution, set up in 2002, covers one half of the guarantees small enterprises need in order to get bank loans.
Italy	Prestito d'onore (cheap credit) This measure allowed for the creation of numerous small firms through a simplification of the procedures for setting up a new company and for obtaining financing.
Lithuania	Lithuania developed multiple policies to support the creation of small to medium businesses. For example, small enterprises (not more than 10 employees) have the opportunity to apply at a lower rate of profit tax when their taxable income does not exceed €144 800, taxable profit is levied at a 13% instead of 15%.
Slovak Republic	Act on Business Register (2003) & Act on Trade Register (1991) These Acts, which came into force in 2004 significantly simplify and speed up the process of new business registration, entering changes and deleting records in the registrations. Insufficiently defined rules in the past led to intentional obstructions and gave rise to widespread corruption.
United Kingdom	"Starting up a business" campaign Includes a streamlined procedure for registering with the Inland Revenue, and improved guidance for new businesses on tax, National Insurance Contributions (NICs) and VAT, a guidance video, direct support from IR Business Support teams and a helpline.
International co-operation	
Bulgaria	Bulgaria signed agreements for official employment with the governments of Germany, Czech republic, Portugal and Spain. All these agreements aim to reduce undeclared work of Bulgarians abroad.
France	Because of the development of trans-national fraud, the French authorities has increasingly been focused on developing European co-operation and on bilateral agreements signed with Germany (May 2001), Italy, Spain (2002) and Belgium (2003). More recently, contacts have been made with Poland, Czech republic and Slovak Republic.
Netherlands	The UWV (Social Insurance Agency) has an export team that investigates disability benefit claimants living abroad. The Dutch municipalities have an agreement with Morocco that allows them to investigate Social Insurance and Welfare recipients living in Morocco .
Increased incentives to work in the formal economy	
Cyprus	The tax brackets for individuals have been altered in recent years. The 2004 changes in the tax rate have reduced the marginal tax rate, reducing the incentive to under-report declared work.
Norway	Tax reform 2004

Country	Specific measure
	Presented by the government in March 2004 aims to reduce marginal tax rates on labour incomes. The reform has passed Parliament in Jun. Reduced marginal tax rates will decrease the profitability of not declaring extra work.
Slovak Republic	Act on Social Insurance (2003) Established greater link between contributions and pensions, thus encouraging work in the formal economy.
Slovak Republic	New Income Tax Act Abolished progressive taxation of individuals, removed tax bands ranging from 10 to 38% and decreased the corporate tax rate of 25%.
Spain	Reduction of income tax (1999 and 2000) Reduction of the tax burden increased incentives to work in the formal economy.
Sweden	1998 Pension system reform This reform reinforced the relationship between declared work and pension payments. In the new system all declared income throughout a person's working life impacts on the pension paid upon retirement. In the previous system this was only the case for the best 15 years of income. This system makes it more costly for an individual to operate outside the system.
United Kingdom	Working Tax Credits & Child Tax Credit Special tax credit for low-income people who meet certain requirements and file a tax return Introduction (and extension) of linking rules Which enables claimants starting work to return to their same benefit rates and terms automatically if the jobs fails within a certain period. Run-ons For example the Job Grant (an automatic payment to jobseekers aged 25+, covering the transition period between leaving benefit and starting work) or an extension of housing benefit for those moving into work.
Subsidies and tax reductions (particularly for sectors with high level of undeclared work)	
Bulgaria	From social benefits to employment programme Started in 2003 for a period of 3 years. It provided employment to 117 000 working age people who previously received benefits. The programme provides funds that cover the minimal remuneration and insurance, thus removing the incentives for undeclared work without labour contracts. Companies investing in high unemployment areas are entitled to a tax exemption. This measure will stimulate higher investors' interest in these areas.
Belgium	Local Employment Agencies and Service Vouchers Were first established in 1987 and functioned as agencies that drew together the supply of labour of long-term unemployed and the demand for household services, policing tasks and seasonal work in the agricultural sector. A worker was allowed to keep earnings as extra cash alongside the allowance. Service vouchers were introduced as a follow-up to the local employment agencies. The net price of a voucher equals the market price for an hour undeclared work. The remainder is subsidised. Hitherto, the Belgian Government has certified 652 firms that function as middlemen between workers and households. These companies first hire someone with small and flexible contracts, but are obliged to offer a hiring contract of unlimited duration for a least a half-time job after a number of months.
Denmark	Home-service scheme Was already introduced in 1994 and implies a wage subsidy that is being paid to households that buy household services (cleaning, gardening, etc.) from private firms. The subsidy was about 50% of total costs. The purpose was to stimulate both the demand for (unskilled) labour and to reduce the amount of undeclared paid household work. The scheme has been gradually tightened in recent years. The subsidy has been lowered and the range of eligible services has been reduced to cover mainly cleaning services. From 2004, the type of household entitled to use the scheme has also been restricted to old-age pensioners and persons receiving disability pensions. The reasons behind these changes are the significant lowering of overall unemployment since the mid-1990s and the fact that the scheme has mostly been used by high-income families. In addition, there was the impression that the scheme had only minor effects on the size of the black economy as a whole.
Finland	In 2003, the tax deduction for household service work was increased to 1,100 euro per year (from 900 euro in 2002). This deduction can be made for household work, care work, and repairs and renovations on a home or leisure dwelling. A household can deduct either the social security contributions on the household worker's pay or 40% of the wages paid if services are bought from a company.
France	Service employment cheque scheme The establishment of this cheque made it easier for private individuals to hire staff for domestic chores (housework, childcare, and gardening) by reducing the administrative burden. Reduction of VAT rate (2000-2005) This experiment has been set up on the basis of a proposition of the European Commission. It is applied in the building sector

Country	Specific measure
	(renovation and repair work relating to private residences completed more than 2 years ago) and personal services (including cleaning and personal care). A debate is going on whether reduced VAT rates should also be applied to the hotel and catering sector.
Germany	<p>Mini-jobs On 1 April 2003, the rules on marginal part-time employment were amended to increase the incentives for both employers and employees by reducing fiscal charges and by making activities in the home tax-deductible.</p> <p>Ich AG (my business) A monthly subsidy is granted to an unemployed person to set up a business. If the attempt to set up a business fails, the person concerned is entitled to unemployment benefit. This can be claimed again before the end of the 3-year subsidised period.</p>
Netherlands	<p>Arrangement of Cleaning Services for Private Persons Cleaning companies can hire unemployed people who are interested in cleaning work for private households. This company pays their salary, and receives a subsidy from the government. Originally this arrangement only focused on long-term unemployed, but has become less rigid now by focusing also on unemployed for a minimum of 6 months (instead of 1 year).</p>
Sweden	<p>ROT tax deduction proposal The tax deduction applies to those who build or repair their dwelling between 15 April 2004 and 30 June 2005. 30% of the labour costs are tax deductible.</p>
Increased regulation of the labour market	
Bulgaria	The introduction of the requirement for the registration of all labour contracts upon their termination or modification at the National Insurance Institute.
Bulgaria	The introduction of limitations for the access to health services for people who have not been paying their social insurance contributions, are expected to further enhance the registration of the activity of the self-insured.
Czech Republic	The Czech Ministry of Finance initiated several measures in 1995. An example is the obligation for even petty traders to use cash-registers to reduce their unrecorded incomes.
Germany	<p>Law (2002) In the construction sector, the main contractor was made liable for the social security contributions of sub-contractors directly contracted by him. In addition, restrictions have been placed on advertising of clandestine employment. Not only telecommunications service providers (as before), but also newspaper, must pass on customer's names to the authorities.</p>
Romania	A new labour code was introduced in 2003. Fixed-term and part-time contracts have been properly recognised and regulated, and the concept of temporary work has also been recognized.
United Kingdom	<p>Regulation on registration with the Inland revenue From January 2001 anyone becoming self-employed/ eligible to pay Class 2 National Insurance Contributions is required to register with the IR within 3 months (reduced from 6).</p>
Addressing labour market rigidities	
Belgium	Social security contributions and taxes are being lowered. Seasonal and occasional employment has been administratively simplified and made flexible in the catering, horticultural and agricultural sectors.
Germany	<p>Reform of the Crafts Trades Code Making it easier for new craft businesses to be set up and reducing undeclared work in "simple" occupations through the employment of persons with no master craftsman's qualification in admissible trades.</p>
Romania	The Romanian government reduced employer's social security contributions by three percentage points in 2004 against 2003 levels after a first reduction of contributions in 2003. The tax burden on labour is consequently now eight percentage points lower than its 2002 level.
Slovak Republic	<p>Amended Labour Code (2001) Has improved the flexibility of employment relations, mainly through giving both parties the right to more flexibly conclude and terminate an employment relationship and by deregulating working time. The law also abolished a special type of temporary work contract (work activity agreement) which was suspected of being abused for undeclared activities.</p>
Spain	<p>The legislation on governing temporary employment agencies (1994) Put an end to the monopoly of the Spanish Employment Institute as a mediator in the labour market between employers and workers.</p>
Tightening up sanctions	
Germany	<p>Law (2002) Maximum penalty for illegal employment of aliens, regarded as particularly harmful for society, was increased from 250000 euro to 500000 euro.</p>
United Kingdom	A statutory offence of knowingly failing to meet basic tax obligations

Country	Specific measure
	<p>This has been set up under Section 144 of the Finance Act 2000 to ease the prosecution of tax offenders by allowing cases to be tried in a magistrate's court.</p> <p>Two strikes scheme The Social Security Act (2001) introduced this new scheme with effect from April 2002. Benefits can be removed for 13 weeks from those caught fraudulently claiming benefits twice within 3-year period.</p>
Increased surveillance	
Austria	<p>Anti-black economy action day This was held on 22 June 2004 as part of which an army of inspection teams was deployed across the whole of Austria involving a total of 875 officials from the tax authority, the KIAB and the tax investigation office.</p>
France	The number of workplace inspections has increased by a factor of 3.3 in 10 years.
United Kingdom	<p>Social Security Fraud Act (2001) Provides government officials with new powers to investigate and punish benefit fraud. Officials can use information from private organisation, including banks, insurance companies and utility companies, when they have reasonable grounds to do so.</p>
Improvement of fraud detection system	
Belgium	<p>Crossroads Bank for Social Security (KSZ) Was established in 1991 in combination with a social identity card (SIS) which was handed out to every Belgian citizen in 1999. It enables inspection agencies to check immediately and easy whether a person combines a social security benefit with a normal salary.</p>
Estonia	<p>Information letters In 2004, the Estonian Tax board chose the strategy of sending information letters to enterprises that had formal labour costs remarkably lower than the average of similar enterprises in the same field and asking them to check their data on taxes and make appropriate corrections. Otherwise there would be an audit by the Board. The three sectors receiving most of the letters were construction, hotels and catering, and car sales and repair.</p>
Netherlands	<p>Training of personnel to detect fraud The UWV (Agency responsible for social insurance) trained its personnel to make them more aware of suspicious practises. To make check ups for fraud more efficient, the UWV developed a risk model for unemployment benefit recipients and disability recipients. These models feature a number of criteria that generate an expected higher propensity to commit fraud. Based on these criteria, a search is done in UWV's client database.</p>
Slovak Republic	<p>Work identification card This ID will be issued by the Social Insurance Agency to every employed and registered unemployed by end of 2006. The card will contain precise data on employment, payment of social security contributions, whether the person is registered as unemployed and/or receiving social assistance. People will be obliged upon request to present the card to inspectors.</p>
United Kingdom	<p>More Frequent Attendance Regime (MFA) Because the JSA required claimants to interact frequently with officials through a regular timetable of appointments, it was easy for fraudsters to arrange undeclared work lives around them. Consequently, in 2001, the More Frequent Attendance Regime (MFA) was introduced, requiring those suspected of fraud to attend extra advisory meetings arranged at unpredictable times, to disrupt any routine undeclared working activity.</p>
New or stronger enforcement bodies	
Austria	<p>Auditing bodies The Audit Office for the Illegal Employment of Foreign Nationals (KIAB) has been operating within the Federal Ministry of Finances since 1 July 2002 and is part of the customs administration. On the basis of the Austrian Employment of Foreign Nationals Law (AusIBG) and the 2003 Budget Implementation Law (BBG) just under 200 agencies have been set up to carry out inspections in businesses and on building sites. Particular focus is put on firms operating in the building trade, restaurant and hotel trade and the haulage business.</p>
Belgium	<p>Federal board for the fight against illegal work and social fraud A federal board for the fight against illegal work and social fraud has been set up. It focuses on promoting the exchange of information between government services, provide policy recommendations, etc.</p>
Bulgaria	Bulgaria is still in its pilot stage to set up an institution responsible for the collection of taxes and social insurance: the NTICA (the project is partially financed through a loan from the World Bank). It is planned that the NTICA will start operating in January 2005.
Estonia	<p>In 2001, the Tax Board, the Labour Inspectorate, the Labour Market Board, and the Police Board reached an agreement to start exchanging information on tax frauds, violations of labour laws, and to organise joint operations to pursue the offenders.</p> <p>Tax Board Investigation Centre In December 2000 the Parliament amended the Code of Criminal Procedure and Surveillance Act to grant the Tax board the rights of</p>

Country	Specific measure
	pre-trial investigation and surveillance. As a result, in 2001 the Tax Board Investigation Centre was established. Previously, the investigation of tax frauds was divided between two different authorities (Tax Board and Police Board), but the co-operation did not yield satisfactory results.
Lithuania	Co-ordination group In 2002 this central co-ordination group was set up for the analysis of origination and control of illegal work within the State Labour Inspectorate.
Netherlands	In the Netherlands, municipalities are responsible for the execution of the welfare benefit schemes. Large municipalities have their own fraud detection teams and smaller municipalities generally arrange joint detection teams with other municipalities.
Slovak Republic	Act on illicit work and illicit employment This Act will nominate the labour inspectorates as the competent authority to carry out surveillance over illicit work and illicit employment. The most important changes in these laws concern improvements in the mutual co-operation of competent bodies in combating illicit work, the setting of penalties for illicit work and the introduction of work identification cards.
United Kingdom	Joint Shadow Economy Teams (JoSETs) In 2001, 20 JoSETs were established with staff from several branches of government, including HM Customs and Excise, Inland Revenue, Jobcentre Plus and Department of Work and Pensions officers, to tackle colluding employers involved in complex fraud and tax evasion cases. Operation Gangmaster Tackles fraud in the agricultural sector.
Tax amnesties	
Cyprus	There is the intention, within the current budget deficit reduction measures, to declare a tax amnesty so that individuals involved would be able to buy their way into legality. This is expected to generate additional revenue of 95.5 million euro between 2004-07.
Ireland	In 1988 the Irish government introduced a tax amnesty. It brought in 635 million euro in back taxes where only 40 million euro had been expected. Some years later, in 1993, the Irish Government announced another tax amnesty to try and bring those who were still not paying enough into the tax net.
United Kingdom	In April 2003, the UK government announced a 6-month amnesty for VAT registrations. Businesses were able to register without the normal late penalties (of 15%) until September, after which the government planned a strong crackdown.
Awareness raising campaigns	
Belgium	Undeclared work, a steep bill This slogan was spread in 2001 in an information campaign via handouts, advertisements in newspapers and on radio stations.
Denmark	The Danish tax authorities have launched information campaigns which, among other things, inform pupils in school about the tax system and the problems and risks related to undeclared work.
Estonia	In Spring 2004, the Estonian Tax board launched an information campaign informing workers in the underground economy of the lack of protection they receive.
Germany	Legal, illegal, nicht egal Posters and newspaper advertisements in 2002 and extensive information on the internet.
Lithuania	Large scale media announcements Large regional publications (about 70 announcements) were focused on informing people about a relevant help-line, and identifying the damage caused by illegal work and consequent liability. Some units of the SLI (State Labour Inspectorate) published information on court actions issued against employers and penalties imposed by courts.
Slovak Republic	The National Labour Inspectorate recently issued an informative brochure which aims to draw the attention of employers and employees to the negative consequences of undeclared work.
Sweden	2000 Campaign Joint campaign by the tax authorities and the recently founded Economic Crime Authority (Ekobrottsmyndigheten) with the involvement of trade unions and branch organisations are involved. The focus was mainly put on the construction sector. In 2004, the tax authorities declared particular focus would be placed on restaurants, taxis, cleaning firms, hairdressers and haulage companies. As young people are generally more tolerant to undeclared work, the Swedish authorities have targeted them through both information campaigns and tax control. Examples are an Internet Café at Sweden's largest rock festival (Hultsved), cinema advertisements on the useful social purposes for which tax income is utilised.
United Kingdom	Stop or shop Included advertisements encouraging people to stop or shop. These prominent advertisements were accompanied by a benefit fraud hotline, and a dedicated website.

Belgium

Introduction

In Belgium the definition of undeclared work used by the European Commission is generally accepted. “Undeclared work means any paid activities that are lawful as regards their nature but not declared to the public authorities, bearing in mind that differences in the regulatory system of Member States must be taken into account” (Commission, 1998). Criminal activities (e.g. trading drugs, stolen goods and gambling) are not considered part of undeclared work in Belgium.

However, a further distinction is hardly ever made. The fact that some authors distinguish productive but unpaid activities (e.g. performed by women) in their definition reflects the fine-tuning that is achievable (Renooy, 2004; OECD, 2002). This sophisticated level has never been reached in Belgium. There are as many definitions as there are authors. A number of recent seminal studies by Pacolet (1995, 2001, 2003) deal with the conceptual issue at length. Also, the National Accounts have authentically elaborated on definitions and estimations of undeclared work in an attempt to compose exhaustive accounts of the Belgian economy. Both cases integrate undeclared work in the framework of “social fraud” or the “shadow economy”. Notwithstanding its importance, this technical discussion has received very little attention in the public debate. This also appeared to be the case with the broadly-based discussion that preceded the endorsement of the Government’s strategy for preventing/fighting undeclared work. The Verhofstadt Cabinet approved a new strategy paper at its Gembloux meeting of January 2004 (hereafter called the “Gembloux Paper”), which outlines the new approach but does not provide a proper definition of undeclared work.

The public debate in Belgium has concentrated on the forms and malignant consequences of undeclared work.

Regarding the *forms* of undeclared work, the debate concentrates on illegal residents who are not allowed to work, but forced to work by human traders. Individuals who receive some type of allowance (unemployment benefit, for example) and who participate in the unofficial labour market are also targeted. The phantom self-employed face a lot of criticisms too – mainly from politicians. But the shadow labour market can assume many more shapes. Individuals taking a second but unreported job (“after normal hours”) do not feature in the public debate, and yet, according to some scholars, this type of informal work is responsible for the majority of undeclared work.

As to the *consequences* of undeclared work for the economy, especially over the last couple of years, public opinion has strongly criticised undeclared work because it further affects the already weakening financial base of the welfare state. Undeclared workers are not contributing to the social security system and might, on top of that, frequently be receiving benefits. Undeclared work also weakens the bargaining conditions on the labour market as undeclared workers forego their (social security) rights. Additionally, it is often mentioned that illicit workers cause security problems because they ignore safety regulations. Undeclared work weakens the unions, puts heavy pressure on productivity and will eventually entail wage cuts. Public opinion also agrees that

undeclared work allows businesses with low productivity to continue competing by not declaring profits. In debates it is often mentioned that undeclared work endangers enterprises that do play by the rules, and, more importantly, that it forces the Government to impose higher taxes.

In the public debate, undeclared work is in most cases considered to be part of a larger problem of fraud and corruption, and not seen as an isolated issue. There seems to be a consensus though that a preventive as well as a repressive policy should be implemented. In a report on the future of Belgium’s economic welfare, McKinsey (2004) voices the opinion of many Belgians and demands a zero tolerance policy. A stronger control of undeclared work and a zero tolerance policy can, in their opinion, be achieved by less red tape and taxes, more control on the shop floor, but also by a better integration of existing administrative databases.

Prevalence of undeclared work in Belgium

Measuring the immeasurable?

Given its very nature, undeclared work is difficult to quantify. For obvious reasons, individuals engaged in clandestine employment do not wish to be identified. The incidence of undeclared work can therefore only be estimated. Information on the size and structure of informal work collected through reliable methods is sparse – in Belgium, as elsewhere.

Some government inspection agencies sporadically publish figures regarding the number of controls and irregularities. Apparently, most agencies do not consider it their task to study and assemble statistics on undeclared work (Pacolet, 2003). For example, the “Inspection Social Laws” ascertained violations of the Undeclared Work Bill in about 40% of the companies it inspected. This figure groups all the irregularities and should not be regarded as an estimate of undeclared work in Belgium (Pirenne, 2003). Pacolet (2001) gathered data from all labour inspection agencies and concluded that social contribution fraud amounted to 6% of contributions in the 1990s.

The shadow economy can be measured directly or indirectly (Schneider, 2004; Kazemier, 2003). Direct methods are generally preferred by experts (OECD, 2002) and consist of sample surveys or fiscal auditing. Neither has yet been used in Belgium (with the notable but dated exception of Ginsburgh, 1987). The problem with surveys is the fear of getting incorrect answers – although Renooy (2004) claims that this can be remedied by special statistical and interviewing techniques. In the case of fiscal auditing, critics argue that tax payers selected for tax audits are not randomly chosen but are picked according to the likelihood of fraud.

The shadow economy has also been estimated indirectly by means of monetary transactions, electricity consumption and labour accounts¹. The resulting approximations fluctuate depending on the definition used by the author. Recently, the National Accounts and monetary macro- economic models have been applied most frequently.

In the Belgian National Accounts, added value is calculated for each branch of industry as the difference between output and

¹ For an exhaustive survey of Belgian estimates, cf.: Pacolet, 1995; Kazemier, 2003.

intermediary consumption. The data originate from annual accounts, VAT statistics or fiscal data. Some aggregates are, however, adjusted in view of conceptual differences between the sources. One of these adjustments deals with undeclared work. Each branch turnover is supplemented with an estimated percentage. Output and intermediary consumption are then estimated for each branch of industry for every product registered in the Supply and Use Tables (INR, 1998; Pacolet, 2003). First estimated in 1997, this resulted in an estimate for undeclared work of 3% to 4% of GDP. In 2002, the correction for undeclared work amounted to 9,283 million euro or 3.6%.

This method obviously has advantages as well as disadvantages (Blades, 2002), but has been well received by institutions such as the OECD (2002). Although its strength lies in the fact that it results from the combination of a large number of sources, it should not be forgotten that the System of National Accounts has not been conceived for the purpose of estimating the shadow economy. For instance, the estimate excludes undeclared work in agriculture and for domestic personnel because the data for the agricultural sector delivered to the national accountants already include adjustments for undeclared work. In the case of households with employees, an average hourly wage is applied to an estimate of the number of hours worked – which implies an adjustment for undeclared work (INR, 1998). Although the national accountants strongly stress the rudimentary character of this estimate, it is quoted widely as the official Belgian estimate. The recent report on undeclared work to the Commission (Renooy, 2004), even puts the estimate forward without mentioning any constraints.

An additional estimate by the National Bank deals with the number of people working exclusively in the shadow economy. In the fourth quarter of 2002 the informal workforce numbered 9,259 people. This tentative figure was calculated by means of the adjustments made for undeclared work in the National Accounts and is therefore subject to the same limitations. A further important restriction is that it excludes people who combine a formal and an informal job – the majority in other words.

Schneider estimates the shadow economy by means of monetary macro-economic models. He combines a currency demand method with a dynamic multiple-indicators, multiple-causes model. He considers multiple causes and effects of the shadow economy and uses factor analysis to approximate the hidden economy as an unobserved variable over time. Schneider basically estimates the model in order to get an index of the hidden output of a country, and then estimates a separate cash demand model in order to obtain a benchmark for converting this index into percentage units. According to this method, Belgium's shadow economy accounts for 21.5% of the "official" GDP in 2002/2003. In the international context, Belgium's shadow economy has the fifth largest share of GDP of all OECD countries (Schneider, 2004). In spite of the fact that "shadow economy" and "undeclared work" do not overlap completely, the large discrepancy between the estimates raises concern. Many authors have closely scrutinised Schneider's approach and have often concluded it is of very limited use, primarily because it is based on modelling assumptions that cannot be justified (OECD, 2002; Blades, 2002). In spite of strong criticism, the Gembloux Paper and the McKinsey Report also refer to Schneider's estimates and are silent on the National Accounts.

In other words, it is difficult to commit to one estimate. Combining a host of studies, Bruyninckx (1998) asserted that the number of undeclared workers in Belgium ranged between 420,000 and

560,000 full-time equivalents or 12-16% of GDP. This approximation is perhaps the most realistic.

Sectors and population groups likely to be engaged in undeclared work

Undeclared work usually occurs in *sectors* with deregulated and local economic structures, mercurial demand, labour-intensive production and low profits. Sectors where labour costs are the most important factor of competition are particularly affected. Undeclared work is present in the following sectors in Belgium²: construction (17%), meat processing (13%), old clothes business (14%), households (11%), Chinese restaurants (7%) and other catering, agriculture and horticulture (5%), transport, retail trade, clothing manufacture, gas stations and carwashes. The Belgian construction sector has probably undertaken the most in order to prevent/fight undeclared work by signing co-operation treaties with the Labour Ministry. Here the inspection agencies agree to undertake inspections outside usual business hours and the sector agrees to organise information campaigns. Like in the construction sector, Social Partners are also privileged allies in the Government's fight against undeclared work in other sectors (passenger transport, cleaning, etc.) where similar agreements have been concluded. The leading role of the construction sector is further illustrated by the reorganisation of overtime arrangements (De Tijd, 30-04-2004).

Regarding *population groups*, in Belgium a typical undeclared worker is young and male (as in other north-western European countries – Perelman 1988). In contrast to southern Europe, women participate less in undeclared work and are usually active in catering, education or cleaning. They have an undeclared job for reasons of economic necessity rather than for having some cash on the side. However, there are very few figures to support this theory. Only the case of illegal immigrants (meaning subjects of non-EU countries residing illegally in the EU) is well-documented. Although the number of controls decreased in 2003, more illegally employed foreigners were discovered.

Determinants of undeclared work

Undeclared work can be explained by the complex interplay between different factors. Most authors consider taxes and social security contributions to be the main cause of the shadow economy. Although heavily contested, the case of Belgium confirms this causal link between (perceived) high labour costs and undeclared work (Schneider, 2004).

Red tape provides a second incentive for undeclared work. Laws, regulations and requirements produce a rigid labour market where undeclared work is explained as a reaction to labour market imperfections (shortage, inflexibility or high cost of labour).

Thirdly, some contemporary socio-economic factors (sub-contracting, outsourcing, relocation to low-wage countries) and structures (number of Small and Medium Enterprises) explain undeclared work in Belgium. Additionally, economic refugees are attracted to "wealthy" countries like Belgium, often ending up undertaking underground activities.

Fourthly, experts point to the poor quantity and quality of public goods and services that might lead to a vicious cycle of escalating taxes and increasing undeclared work. Although this has not been the case in Belgium, gaps in some public provisions (day care, etc.) did encourage undeclared work just as much as unclear control mechanisms did. In Belgium, strong social networks combined with

² The percentages refer to the irregularities ascertained in 2003 by "Social Inspection" and "Inspection Social Laws" (Bureau, 2003).

a high extent of informality further induced undeclared work. Finally, “tax morality” or the degree to which citizens trust their Government has to be mentioned. While a certain level of undeclared work is deeply rooted in European culture (Mateman, 2001), evading taxes has been a “national sport” in Belgium since Independence.

Measures to combat undeclared work

Since the 1970s the Belgian Government has developed policies of avoiding/fighting undeclared work (Deneve, 1993). A coherent package of measures has been assembled in recent years. In 1993 undeclared work was first put high on the political agenda: Parliament voted an Illegal Employment and Undeclared Work Bill. The Social Partners convened a round-table conference on undeclared work in 1996 based on a joint paper by the Labour and the Justice Minister. In 1999 the Labour Minister devoted a memorandum to her vision on fighting illegal employment (Maeter, 2003). Many of her proposals were reiterated in the Gembloux Paper and the strategic note from the State Secretary for the Modernisation of Finances and the Fight against Fiscal Fraud. Both documents consider all policy measures as part of a wider strategy to promote employment and fight fraud.

Creation of environment favourable to declaration of economic activity

In Belgium a number of initiatives have been taken in order to remove incentives for undeclared work. In order to simplify the administrative obligations imposed upon self-employed workers, a Crossroads Bank for Enterprises (KBO) and business one-stop shops have been established. KBO attributes a unique identification number to every enterprise and every entrepreneur, and records the necessary identification data. This unique number provides a link to all institutions. It simplifies many administrative procedures and facilitates a faster and more efficient exchange of information between Government and entrepreneur. The Shops enlist new companies with KBO, fulfil all the necessary formalities, and check other paperwork. About ten private non-profit organisations have been recognised by the Government, and operate 200 Shops throughout the kingdom. Waiting times and administrative delays have been cut accordingly. A new Electronic Single Starter Notification (DEUS) eliminates further time-consuming formalities for start-ups. As an add-on to the Shops, the Flemish Government founded a counselling Agency for Entrepreneurship. Once registered, a company can communicate electronically with the Government and declare its employment electronically (DIMONA). The immediate declaration of who is working when for a company has been compulsory since 1998. Controls are further sharpened by the establishment of a Crossroads Bank for Social Security (KSZ) in 1991 and by the Social Identity Card (SIS), which was handed out to every Belgian in 1999. This enables inspection agencies to check immediately whether a person combines a social security benefit with a normal salary.

Incentives to declare work

The Government has undertaken two types of initiatives in order to provide incentives to declare work. Firstly, it has facilitated access to the formal labour market for typical undeclared household work by means of Local Employment Agencies (PWA) and service vouchers. Secondly, it reduced social security contributions and taxes so as to make undeclared work unattractive.

The PWAs, first established in 1987, functioned as agencies that

drew together the supply of labour of long-term unemployed and the demand for household services, policing tasks and seasonal work in the agricultural sector. A worker was allowed to keep his/her earnings as extra cash alongside his/her allowance. In practice, mainly 35-45 year-old women were active in the PWA scheme. In June 1999, a total of 120,904 unemployed were registered at a PWA, working on average 30 hours a week. The PWA system has had its critics as well as its supporters. Because almost half of the PWA jobs were formerly clandestine, PWAs obviously helped to fight undeclared work (De Sutter, 2000). The system was, however, criticised for “imprisoning” beneficiaries in the scheme. Nowadays just over 4% of the former PWA employees hold a regular job, whereas 22% are unemployed (WAV Arbeidsmarktflits 45).

Service vouchers were introduced as a follow-up on PWAs, and should generate 25,000 new jobs by 2007. Introduced in March 2003, the system has been modified a number of times. It aims at fighting undeclared work, financing the social security system, and responding to the demand for reasonably priced household services (such as housecleaning, preparing meals, etc.). The net price of a voucher equals the market price for an hour's work in the underground economy. The remainder is subsidised. Hitherto, the Government has certified 652 firms that function as middlemen between workers and households. These companies first hire someone with small and flexible contracts but are obliged to offer a hiring contract of unlimited duration for at least a half-time job after a number of months. A recent Government enquiry states that companies conclude unlimited contracts faster than they are obliged to and that two-thirds of the voucher jobs are (at least) half-time (FOD, 2004). Since the system was implemented, 6,773 employees and 65,709 households have used over 3 million vouchers (mainly in Flanders). In June 2004 this translated into 5,462 jobs. Although the service vouchers earn a lot of credit internationally (Renooy, 2004), the unions and some scholars remain sceptical about their effectiveness but it is perhaps too early to judge this.

Secondly, social security contributions and taxes are being lowered with the intent of inducing people to declare work. Seasonal and occasional employment has been administratively simplified and made flexible in the catering, horticultural and agricultural sectors. On top of that, lower social contributions have to be paid. Workers hired via “temp” agencies also enjoy lower social contributions. The social contributions of student jobs and the status of artists were attuned along the same lines.

Enforcement and surveillance

The Government wants to monitor the reinforcement of laws and procedures centrally and impose a global vision. This vision is not isolated but goes hand in hand with a policy of controlling and counselling the unemployed. Enforcement and surveillance of the Belgian social security system is spread over two ministries and a dozen semi-governmental institutions. Each of these has its own inspection agency, reinforcing the laws they are responsible for. In all, a complex system of up to eighty inspection agencies has come into being over time (De Tijd, 24-11-2003). The various agencies only work together occasionally, which implies inefficient exchanges and data analysis. Although Pacolet (2003) summarises some figures on the number, time-span etc., of the investigations, he admits that the effectiveness of policy initiatives cannot be assessed properly (this is a European trend; Mateman, 2001).

A “Federal Board for the Fight against Illegal Work and Social Fraud” aims to solve this lack of co-ordination. The Board is also supposed to work out a global vision on fraud control and put an end to a failing national enforcement policy. It aims to facilitate and

improve anticipative enforcement, provide policy recommendations and promote the exchange of information between government services. The Board counts representatives from all relevant institutions. A "Federal Co-ordination Committee" has also been created as a permanently-manned bureau to the Board. In practice, the Committee will guide the inspection agencies in the fight against undeclared work. In light of the founding of the Board, the Government has decided to extend the number of inspectors of the four main agencies by eighty. Moreover, the techniques of inspection have to improve by means of strategic risk analysis and data gathering. This should uncover fraud cases but also yield preventive measures or recommendations for changing laws.

Following a successful pilot in March 2003, a data warehouse project of the four largest inspection agencies called OASIS (Organisation Anti-fraude des Services d'Inspections), will be fully implemented. Once completely operational, welfare recipients will be monitored more closely because OASIS will facilitate targeted reinforcement actions by means of "fraud indicators". In the years to come OASIS and MERI (Mensenhandel en Risicosectoren), a knowledge database for trade in humans and illegal employment, will be integrated in the common electronic platform of the four largest agencies that is currently under construction. The management of the agencies will, moreover, be enhanced by means of a registry of (current) investigations.

Transnational co-operation

Belgium is involved in little transnational co-operation in the field of undeclared work. The Co-ordination Committee is supposed to function as an international liaison office in the fight against undeclared work. Up to now, an agreement that specifically targets illegal employment has been signed with France. A cross-border taskforce has also been put in place (Maeter, 2003).

Awareness raising

In 2001 the Labour Minister launched an information campaign directly targeting undeclared work. The slogan "undeclared work: a steep bill" was spread via hand-outs, advertisements in newspapers and on radio stations. Nowadays, awareness of the issue is only raised indirectly (e.g. as a side effect of the promotion of service vouchers). Recently, however, the Cabinet itself has decided to communicate its Gembloux Paper more clearly to the population. It also encourages inspection agencies to publish the results of their controls so as to deter (potential) perpetrators. Internet websites and other information campaigns also raise confidence in Government initiatives (like KBO). Some associations (such as the construction sector federation) also raise awareness of the problem with their members.

Other measures

The Gembloux Paper lists a number of outdated labour laws, regulations, and concepts that have been or will be simplified, harmonised or plainly updated. Since this point was put on the political agenda in the mid-1990s, progress has been piecemeal. The social penal code is still in the process of being reorganised: a commission has been active on this since 2001. Special correctional courts are (to be) established. Currently, there is agreement that cases of heavy social fraud will be met with penal actions. Small violations will, however, be handled by newly established chambers in civil or administrative courts and settled quickly by applying (heavy) fines.

Conclusion

This review proves that undeclared work not only ranks high on the political agenda, but is also treated accordingly. Estimates of undeclared work range from 3% to 22% of Belgium's GDP depending on the author and the definition. The most realistic estimate is 12-16% of GDP with the number of undeclared workers ranging between 420,000 and 560,000. The phenomenon usually occurs in sectors with deregulated and local economic structures, mercurial demand, labour-intensive production and low profits (construction, catering, etc.). The typical undeclared Belgian worker is young and male.

The determinants of undeclared work in Belgium are: high taxes, a rigid labour market, several current socio-economic factors, the state of some public goods and services, and low tax morality. The Government fights/prevents undeclared work by means of establishing an environment friendly to the declaration of economic activity (Crossroads Bank for Enterprises, One-Stop Shops, Single Starter Notification, etc.); by introducing Local Employment Agencies and service vouchers in order to white-wash classical undeclared work, by centralising and stepping up enforcement and surveillance (including proper data management and exchange), and by thoroughly reforming the judicial system.

Reginald Loya

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Czech Republic

Introduction

Undeclared work became an issue for public debate in the Czech Republic in the late Eighties and early Nineties and has grown increasingly topical over recent years. The national understanding of the concept of undeclared work has always been very close to the definition proposed by the European Commission: "productive activities that are lawful as regards to their nature, but are not declared to the public authorities, taking into account the differences in the regulatory system between Member States" (Renooy 2004: 8).

Early attempts to define and measure undeclared economic activities (Fassmann 1988, Zelinka 1989, Hanzl et al. 1989) were stimulated by the fact that these activities represented a crucial component of command economies – not only as a supply of necessary services (for example when building and repairing houses), but also as a solution for the failures of the formal economy.

In 1991, a task group was established at the Federal (Czech and Slovak) Statistical Office in order to examine the possibilities for the measurement of undeclared economic activities. The aim was to use a broad definition which went wider than the simple measurement of "undeclared activities" (in the sense of the EC definition). The statisticians aimed to identify declared but not statistically recorded activities on the one hand, and illegal/criminal activities on the other. The method used corresponded to a large extent with Eurostat's exhaustive research methodology which has since been adopted in the Czech Republic (Ondru 2001).

In addition to studies by international experts, several independent economists from the Czech Republic have contributed to developing an understanding of the concept of undeclared work. Their studies incorporated both the "ILO approach", which emphasises non-compliance with legal obligations associated with labour contracts, and the "World Bank approach", which emphasises undeclared Value Added Tax and other tax evasion. In 1998, the Czech Ministry of Labour and Social Affairs initiated a study by Strecková and Fassmann on *"Institutional Possibilities to Minimise the Influence of the Shadow Economy on the Labour Market"* which summarises the existing knowledge held by public officials' on this problem (Strecková et al. 1999). Recently, a comprehensive study on undeclared work in the Czech Republic was published (Fassmann

2002, 2003), together with another pioneering study on tax evasion based on a direct measurement method (Hanousek and Pulda 2002).

Because of these efforts and due to the rich historic experience held by the public (undeclared work originated under the former regime and was further increased during the transition to a market economy), it is not surprising that public officials and politicians have a good understanding of the concept of undeclared work in all its contents and forms (compare Strecková et al. 1999). However, measuring the scope of undeclared work has been a difficult exercise due to a recent restructuring of the statistical monitoring system in the Czech Republic and the cancellation of several earlier monitoring tools. Another difficulty is the general opposition of the public and new entrepreneurs to sharing personal data on income and related issues.

At the beginning of the transformation to the market economy in the Czech Republic, when undeclared work was proliferating, the political elites and public officials did not pay much attention to the problem of undeclared work. Such "political neglect" could be considered to be an expression of the liberal approach to marketisation which occurred within the Czech Republic (the "Wild East" hypothesis). The high degree of tolerance towards undeclared work activities originated under communism, as well as in assumptions about the possible positive impacts of undeclared work, i.e. the "accumulation of capital" and the provision of a "survival strategy" (compare discussion in Kleer 1994, Fassmann 2002 and 2003, Renooy et al. 2004). An exception to this rule, however, was the involvement of unemployed people in undeclared work – this has historically been criticised by both public officials and the media, mainly because the misuse or fraud of social benefits by the unemployed has been considered to be an economic as well as a moral problem.

In the second half of the Nineties, things started to change, as politicians and public officials learnt from the negative experiences of privatisation and marketisation. Important economic losses within the national budget due to "tunnelling" practices and the importing of undeclared goods caused them to revise their policy. At the same time, the left-wing parties (the Social Democrats and the Communists) emphasised the problem of undeclared work in their political campaigns. Politicians recognised the close link

between undeclared economic and illegal/criminal activities and corruption, and the issue of undeclared work entered the political debate. The focus was mainly on tax evasion, but this was not the only topic. While unemployment was very low in the Czech Republic until 1998, it reached 10% in 1999 and illegal work by foreign workers (mainly from the Ukraine) became a “hot” topic. Following the reform of public finances in 2002, the effectiveness of tax collection and the general elimination of undeclared activities have become Government priorities. Both these issues are strongly emphasised in the Governmental Declaration of August 2002. It will be important that these declarations and commitments are translated into actions, however.

Prevalence of undeclared work in the economy

The scope of undeclared work

As it is increasingly difficult to measure undeclared work, it is perhaps not surprising that the existing estimates on the scope of undeclared work are ambiguous and vary according to the methodology used. Given the existing evidence and studies, it can be concluded that the scope of undeclared work in the Czech Republic is probably between 10% and 15% of GDP. This is lower than most post-communist countries, and also some South European countries. However, it is still much higher than in the other EU countries.

The structure of activities and participating population groups

In general, the identified structure of undeclared activities corresponds well with findings from other EU countries (Renooy 2004). Ondru (2001: 253) estimated the value-added by undeclared work in various economic sectors in 1997 as follows: 23% in agriculture, 22% in construction, 21% in hotels, restaurants and transport, 17% in finance and services for the business sector, while only 7.1% in industry and 3.8% in other services (the average was 7.4%).

Self-employed and employed people are more likely than the unemployed (inactive) to have undeclared income. As regards the forms of undeclared work, public officials and experts interviewed by Strecková et al. (1999) ranked them as follows:

1. **Tax evasion:** 70% (103 of the 147 experts interviewed) of respondents ranked this in first place with 20% placing it in second place;
2. **Profits from undeclared (non-approved) activities:** 27% of respondents ranked this in first place, 55% in second place, and 26% in third place;
3. **Illegal employment of foreigners (mainly from the Ukraine):** This was mainly emphasised by experts in large cities. In total, 7% of experts ranked this in first place, 16% in second, with the remainder placing it in third to fifth place (between 20 and 26%);
4. **Illegal labour contracts:** A majority of the experts put this in third place (25%), fourth (36%) or fifth place (19%). Experts from districts with a high level of unemployment proved to be more tolerant of this form;
5. **Undeclared second-job incomes of employed people:** The experts ranked this third, fourth and fifth, with the fifth place being most frequent at 31%.

It is interesting that a considerable percentage of the respondents (45%) considered that large enterprises/companies are most likely to engage in undeclared activities (a further 15% ranked these in second place). Small and Medium-sized Enterprises (SMEs) are also considered to be more frequently involved: 30% of the experts ranked SMEs first while 26% ranked them second. Efforts to increase profits and survive under increasing competition were identified as the main motives for undeclared activities/work.

In a different study, Hanousek and Pulda (2002: 11) analysed the gender structure of the 25% of their sample of 1,062 respondents who admitted engagement in undeclared work. They found that there were more men (67%) than women (33%). However, the age structure and family status of the men and women participating in undeclared work corresponded quite well with the structure of the overall sample. With regards to education and labour market status, all categories are to some extent engaged in undeclared work, with a higher incidence among entrepreneurs and unemployed persons.

Table 1: The structure of undeclared work in the Czech Republic by labour market status of participants (in %)

	Total sample (1,062 = 100%)	Engaged in informal sector (267 = 100%)
Full time job	60	55
Part time job	3	4
Entrepreneur (no employees)	6	12
Entrepreneur (with employees)	2	4
Pensioner working	2	2
Pensioner not working	11	4
Unemployed	6	10
Student	6	6
Wife working in household	3	2

Source: Hanousek and Pulda 2002, adapted

In 2002, only 62% of the people registered at their local PES had declared themselves unemployed according to the ILO definition (Labour Force Surveys findings). This is seen by Sirovátka et al. (2003) to be a signal of undeclared work among the unemployed¹. Sirovátka et al. analysed the gap between unemployed persons who are formally registered at employment offices and those who *declared* themselves unemployed for a series of different groups within society. The percentage difference between those registered for work and those declared unemployed is most striking in the case of men (46%) compared to women (29%). The gap was 40% for unemployed persons over 40 years, around 50% for unskilled unemployed people and people with lower secondary education, over 50% for persons unemployed for less than 6 months and over 40% for unemployed persons living in districts with a high level of unemployment. From this research, we may conclude that undeclared employment of unemployed persons (which represents a minor fraction of undeclared work) particularly concerns men with a lower level of education who live in districts with a higher level of unemployment.

The determining factors

Renooy et al. (2004) distinguish three types of factors that influence the emergence of undeclared work: socio-economic/market factors (e.g. current socio-economic trends and the structure of national

¹ More people register at employment offices than declare themselves unemployed. A substantial part of them are probably active in undeclared employment, at least on occasions, but register themselves with employment offices in order to gain entitlements to benefits and/or social security rights.

economy), institutional factors (e.g. the complex of legal and administrative regulations) and societal factors (e.g. cultural traditions and relations between the individual, society and the State).

The relevance of each of these determining factors may be characterised as follows:

Socio-economic factors:

The boom of undeclared work during the first years of the transformation of the economy after 1989 was associated with the transition to the marketisation and liberalisation of the economy, combined with an economic recession, a lack of relevant legislation and an insufficient administrative capacity within the public sector to deal with the issue. The second recession in 1997-1998 produced further stimuli for undeclared activities, contributing to a wave of bankruptcies in large companies, and an increase in unemployment.

Economic performance improved after 1999 and the GDP growth has been between 2-3% in the last four years. Direct foreign investments have considerably increased – up to 12% of GDP in 2002. The overall economic environment is becoming more stable. On the other hand, the recession in 1997-1998 brought about at least a temporary increase in undeclared work due to increasing unemployment and a worsening competitive position for large companies combined with a lack of financial resources for modernisation.

A further impetus towards undeclared employment has come from certain long-term market rigidities: the level of social contributions is high in the Czech Republic, representing 47.5% of wages (35% is paid by the employer). The corporate tax was set at 31% until 2004. There are no tax exemptions for low-paid workers. A survey by Sirovátka et al. (2003) shows that the high level of social security and taxation is perceived as a strong barrier to employment.

Table 2: To what extent certain factors represent a barrier to hiring new employees (in %)

	To a large extent	To some extent	To a small extent
Market insecurity	44	26	30
The level of social security contributions	42	18	40
The level of taxation	37	22	41
Competition	30	22	48
Unemployment insurance	20	25	55
Minimum wages	18	16	66
Modernisation	17	26	57
Labour code requirements	16	24	60
Trade unions and its power	2	10	88

Source: Sirovátka et al. 2003, sample of 1,000 employers

Unemployment benefits are not high in the Czech Republic (the replacement rate is 50% for the first three months and 40% for the subsequent three months) but the level of social assistance is relatively significant: the replacement rate for a family of four (two adults and two children) or for a single parent with two children is close to 100% for a person earning two-thirds of the average wage. This level is comparable with countries with the highest replacement rates for long-term benefit recipients, such as Sweden and Denmark

(see OECD 2002). On top of this, because of a lack of obligation for unemployed people to actively seek employment, benefit entitlements are easy to gain and retain, even for long-term unemployed persons.

Institutional factors:

The legal and institutional environment is improving in the Czech Republic. In combination with the standardisation of the economic environment and growing foreign investments, these changes would seem to have a positive impact on the scope of undeclared work. Nonetheless, as Hanousek and Pulda (2002: 14) show, the probability of being caught and prosecuted on the grounds of participation in undeclared work is still not higher than 44% on average: 20% amongst frequent participants and 30% amongst occasional participants.

Societal factors:

Some observers maintain that cultural factors remain influential and contribute to the high degree of tolerance of undeclared work, possibly giving rise to opposition towards governmental actions which aim to reduce undeclared work (Renooy 2004). Similarly, Strecková et al. (1999) found a high degree of tolerance of unemployed persons' undeclared employment in districts with a high level of unemployment.

Hanousek and Pulda (2002) confirmed the importance of attitudes towards undeclared work with their finding that only 3% of frequent participants and a mere 10% of occasional participants felt that their family and/or friends disagreed with them participating in undeclared work.

The impacts of undeclared work on the economy and society

We can distinguish direct and indirect economic impacts from undeclared work. Assuming that the scope of undeclared work is 10% of GDP or slightly higher and, given the current corporate tax rate (28% in 2004), the direct loss for the Government budget revenues may be about 2.5-3% of GDP². The indirect social effects are also profound: undeclared work undermines general discipline in paying taxes and increases propensity to contravene legal norms related to employment and entrepreneurship. At the same time, trust in the capacity of public administration bodies is decreasing and their legitimacy is at stake.

Some public officials admit that there is also a partial positive impact of undeclared work on employment possibilities and entrepreneurship, and that it becomes a form of survival strategy in times of recession, and in regions most affected by structural change. This may be a valid argument, if you take into consideration the insufficient scope of effective labour market policies. On the other hand, the illegal employment of foreign workers seems to mitigate, at least partially, against the assumed positive effects in terms of the creation of employment for Czech nationals.

Measures taken to combat undeclared work

In the Nineties, the Czech Government did not pay much attention to the problem of undeclared work and a *laissez-faire* policy was implemented from 1997. However, economic recession and emerging pressures on the government budget necessitated a more systematic approach towards economic criminality and tax evasion.

² This equals about a half of the Government budget deficit.

An increasing unemployment rate gave rise to public, media and government concerns about the problem of illegal foreign workers. In 2000, an inter-ministerial commission was established, headed by the Ministry of Labour and Social Affairs, in order to coordinate policies to combat the illegal employment of foreigners. Since 2002, a public finance reform has been under way, aiming towards the reduction of public finance deficits. It has brought an integrated package of public policies, including some policies that aim to reduce the extent of undeclared work.

The Government Declaration as of August 2002 (Programové 2002) and the Coalition Agreement (Koaliční 2002) of the ruling political parties embraced the government's obligation to combat the illegal employment of foreign labourers. A new administrative body – the Inspectorate of Labour – was also established in order to oversee employment issues more efficiently (Labour Code, collective agreements, employment conditions etc.). In addition, active measures to promote employment were to be strengthened. Consequently, the National Employment Action Plans for years 2002 and 2003 (Národní 2002, 2003) included obligations to undertake more effective actions to combat the illegal employment of foreign workers and to co-ordinate adequate measures at the national and regional levels. More support was to be given to SMEs, and measures to reduce taxation on labour were to be suggested.

The main emphasis was laid on legal and administrative arrangements to reduce tax evasion and to improve the discipline of taxpayers, in order to combat undeclared activities. Another stream of actions aimed to transform undeclared employment into more formalised activities and to dismantle some labour market rigidities. All these new policies are at the stage of initiation at the time of writing this paper. A co-ordinated and fully integrated approach has not been negotiated and implemented as yet.

Establishment of a legal and administrative environment favourable to declaring a person's economic activities through simplifying procedures and reducing costs and constraints

The legal framework for private enterprise is liberal in the Czech Republic compared to the EU countries. It was only in the late Nineties that the granting of trade licences in certain specified areas was made conditional on the achievement of qualifications and several years' practice in the field. On the other hand, the required administrative and bureaucratic procedures often lead to delays in registering new licences. Further, formal procedures are rather fragmented and access to capital/loans is very difficult. Under the framework of the public finance reform, an inter-ministerial commission was established (composed of representatives of the Ministry of Industry and Trade, Ministry of Internal Affairs and the Ministry of Labour and Social Affairs) in order to design and co-ordinate measures to support SMEs. Among other things, it was decided to elaborate measures to reduce the administrative burden for SMEs and to propose a concentration of procedures in 2004 where would-be entrepreneurs were registered and licensed by only one well-functioning administrative body.

Strengthening incentives and eliminating disincentives to declaring work in both the demand and supply side of the economy

Since 2002, attention has been focused on improving the general economic conditions for free enterprise: primarily by means of reducing the corporate tax from 31% in 2003 to 28% in 2004, and further down to 26% by 2005 and 24% by 2006. In May, 2004, the VAT level was harmonised with EU norms: the upper level decreased from 22% to 19% but the lower level increased from 5% to 19% in the case of several goods/services. This arrangement is perceived as threatening for hotels and restaurants where the level of VAT used to be 5% and has been heavily criticised by the sector's entrepreneurs. It is worth noting that this is a sector with a high share of undeclared work.

No measures have so far been taken forward to reduce social security contributions (at least for low-paid workers) and the problem of high labour costs remains unresolved³. Also, a minimum tax has been imposed on "small entrepreneurs" (self-employed persons) equalling half the average wage⁴. Their tax base has been increased from 35% to 40% of the difference between revenues and expenditures and will be further increased to 50% in 2006. Accordingly, their social security contributions are to be calculated from the base of half the average wage instead of from the subsistence minimum base (which effectively doubles them)⁵. This last measure should not only improve government budget revenues but should also halt the widespread practice of subcontracting labour by firms and entrepreneurs who thus evade standard labour contracts.

Designing adequate employer policies

Several programmes to support SMEs have been implemented since 2002 through the Ministry of Industry and Trade, with the help of special regional agencies. These include supporting access to capital and counselling programmes for new entrepreneurs. Loans for unemployed persons who start their own business (amounting to about 2,300 euro) and business training programmes are also available, in compliance with the Employment Act.

The new Employment Act, which comes into effect in the second half of 2004, will make it possible to grant unemployed people who start their own business with a contribution amounting to a half of the subsistence minimum (about 70 euro monthly) over a period of six months⁶.

Reducing the risk of unemployment and poverty traps by eliminating undesirable interactions between tax and benefit systems

Several measures suggested in the National Employment Plan 2003 have been incorporated into the new Employment Act, new Subsistence Minimum Act and new State Support Act proposals. The level of subsistence minimum for larger households will decrease (taking into account the economies of scale) and the replacement rate of benefits to wages will thus also decrease. On the other hand, it is now possible to maintain entitlement to parental benefits regardless of a person's level of earnings, and earn up to a half of the minimum wage without losing entitlements to unemployment benefit.

³ This is despite the fact that the measure was suggested in the National Action Plan for Employment 2002.

⁴ The problem was that most self-employed persons reported losses rather than profits.

⁵ The problem was that their contributions into the social security fund were too low – they approximated a third of contributions paid by employees with a comparable level of income on the average.

⁶ It must be noted that wage subsidies may be paid by PES to SMEs who hire an unemployed person.

Secondly, unemployment and social assistance benefits will be subject to stricter conditions: participation in temporary work (public works programmes), fulfilment of the tasks of individual action plans and training programmes and due co-operation with a local employment office will be required if a person is to keep their entitlements to social assistance benefits. The responsibility for payments of all social benefits will be passed to local employment offices – a measure intended to increase pressure on the employment offices to perform.

Strengthening surveillance, with active support from social partners and application of adequate sanctions where appropriate

Considering that financial losses associated with tax evasions represent a prevailing part of undeclared work and have such a negative impact on the economy and society, measures to combat undeclared activities formed the very centre of government policy in this area, especially within the framework of the public finance reform.

The Czech Ministry of Finance initiated several measures that were expected to come into effect through the legislative procedure in January 1995:

- Trading alcohol and cigarettes in open market places was to be forbidden (to reduce tax evasions in the area of indirect taxation);
- Even petty traders would be obliged to use cash-registers (to reduce their unrecorded incomes);
- In July 1994, the Finance Police were established in order to monitor and combat illegal and undeclared economic activities;
- Direct cash payments exceeding the amount of CZK 500,000 (about 13,000 euro) were to be forbidden (to halt the misuse of cash payment for the purpose of evading taxation duties);
- An introduction of property tax declarations was proposed to be implemented from January 1995 onwards (to monitor differences between individuals' wealth and declared incomes, thus preventing tax evasion and criminal activities); this proposal has been a matter for intensive political debate – so far it has not gained the support of the majority of Members of Parliament owing to the opposition of right-wing parties.

Strengthening transnational co-operation between authorities in individual Member States

Only a modest transnational co-operation has so far been established with regards to the issue of undeclared work. The Foreign and Customs Police co-operate with relevant partners on combating illegal immigration and illegal foreign labour. Similarly, the police, and especially the newly-established Finance Police, are learning how to co-operate effectively with partners from other EU countries to combat tax evasion and illegal activities.

Moreover, other specific activities that have recently emerged include a pilot project implemented by the Ministry of Labour and Social Affairs to regulate foreign labour immigration⁷. Since 2002, this has provided the grounds for initiating co-operation with several ministerial bodies within the former post-communist block. Similar co-operation has in recent years been established with other EU countries under the framework of bilateral agreements on work permits for a limited number of workers.

Raising social awareness of the costs of undeclared work

In spite of the increasing attention paid to the issue of undeclared work (mainly in the field of tax evasion and illegal foreign labour), little effort has been invested in influencing public attitudes and behaviour. For example, no information campaign has been carried out so far. Further, the necessity to define and promote “ethical norms” for the activities of public officials in this field has been neglected. This issue, however, would seem to deserve more attention in the future, since a low level of trust in relation to governmental actions in this area, and poor legal awareness on the part of the public about undeclared work represent a clear barrier to the effective implementation of relevant policies. Unless attitudes are changed, this could provide a basis for the flourishing of undeclared activities in the future.

Apart from neglecting cultural dimensions, policies also seem to be lacking an “integrated approach”, as was suggested by Renooy and Mateman (2001). At the very least, measures adopted in relation to financial and fiscal issues need to be better integrated with measures adopted in the field of employment.

At present, no evaluations are available of the effectiveness of measures designed to combat undeclared work and convert undeclared labour into more formalised working practices. Most of the measures are only just being initiated. It could be argued that it is the improving economic environment that has recently contributed to the decrease in undeclared activities. On the other hand, it is possible that the Government's efforts and measures have influenced economic actors by force of their “symbolic authority”. The main impact of the measures will only be visible in the future. Considering the strength of determining factors in this area, especially socio-cultural ones, it is likely that the issue will require both a long-term effort and an integrated multi-dimensional approach to be successful.

Conclusions

The extent of undeclared work within the Czech economy is fairly average; the Czech Republic finds itself in between other post-communist countries and southern European countries where there is a considerable degree of undeclared work, and other EU countries where undeclared work is only a minor issue. In the Czech Republic, undeclared work is concentrated in “traditional” sectors such as hotels, restaurants and construction. Nonetheless, financial and business services are also increasingly becoming affected by undeclared activities. Tax evasion by SMEs and large enterprises represents the most common undeclared activity. Undeclared employment of foreigners and domestic workers is less widespread, yet must not be neglected. It is more often men (of varying age, education and labour market status) than women who participate in undeclared work.

It could be argued that the lack of a consistent and stable economic and legal environment and adequate monitoring and administrative capacity within public bodies contributes to the spread of undeclared work. On the other hand, the overall economic environment and performance of the economy, as well as the administrative capacity of the State, are continuously improving and the share of foreign capital in the economy is on the increase.

The Czech Government has initiated the process of formulating and implementing policies aimed at combating undeclared work – both in the form of “financial fraud” and “undeclared labour”. On the

⁷ The project aims at a selection of a limited number of skilled foreign workers.

other hand, a high level of tolerance of the general public towards undeclared work represents a specific barrier to governmental efforts. The effectiveness of the proposed measures to tackle undeclared work will only be visible in the future.

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Denmark

Introduction

The concept of undeclared work – usually referred to as “black work” in Denmark – is generally defined in a similar manner to the concepts applied in the Communications from the Commission (cf. also Renooy et al, 2004). Thus the Danish tax authorities define *black work* as non-registered productive activities that are not reported and taxed according to existing legislation. The crucial element in the concept is that the productive activities are positioned in the black economy because they are not reported to the tax authorities, although they are liable for income tax, VAT or other taxes. In other respects the activities do not violate the law. If unreported activities are performed by immigrants without a work permit, they fall into the category of *illegal work*.

As will be further discussed in this article, the black economy in Denmark has been rather intensely studied over recent decades. The main concepts applied in this research have been¹:

- The *shadow economy* consists of both unreported productive economic activities (the black economy as presented above) and tax evasion involving other sources of income (e.g. interest received) or illegitimate tax deductions. Apart from the element of tax evasion, the activities are non-criminal.
- The *black economy* can, furthermore, be divided into the black economy in the narrow sense and normal tax evasion. In the former case, both the seller and the buyer of goods or a service is aware of the fact that the transaction involves tax evasion, and split the savings between them. In the latter case, only the seller takes advantage from not reporting the transaction, while the buyer is unaware of the illegal character of the activity.
- Finally, the concept of *do-it-yourself-work*, for example work around the home carried out by family members or neighbours, is similar to “black work” in the sense that it is not reported to the authorities, but differs by being legal, because such activities are normally untaxed.

In the remainder of this article the terms *black work* and *black economy* will refer to the black economy in the narrow sense: non-criminal productive activities that involve some form of tax evasion known to both seller and buyer. These terms are used interchangeably with the term *undeclared work*.

Based on theoretical considerations, one could imagine that the high level of income taxation and a VAT rate of 25% would act as a strong stimulus to the creation of a large black economy in Denmark (Gravesen, 2003). However, the empirical information presented in this article indicates that, by international comparison, the black economy in Denmark is rather small and mostly takes the form of extra activities performed by persons already employed in the “white” sector.

There can be several reasons for this. One is the way in which the Danish labour market and economy in general is tightly monitored by the use of personal identification numbers, the registration and reporting of most sources of income, and well-developed administrative procedures for controlling the work environment, product quality, etc. Furthermore, flexible rules for dismissal of ordinary employees and the absence of any significant payroll taxes

create few incentives for employers to hire workers without reporting to the authorities.

Therefore, the question of black work is not generally an issue high on the Danish political agenda. In recent years, however, some attention has been given to the illegal work performed by immigrants without work permits – a debate which has been stimulated by the enlargement of the European Union and the fear of large-scale immigration from the new Member States. Also, to an increasing degree, attention is being paid to the fact that black or illegal work seems to be concentrated in certain sectors like hotels and restaurants, which has encouraged special action to be taken in these areas. Finally, the inclusion of the new guideline on the transformation of undeclared work into regular employment in the European Employment Strategy (EES) has led to an increased focus on the subject.

Prevalence of undeclared work in the economy

The main source of information about the size of the black economy in Denmark is found in a series of surveys conducted by an independent research unit, which is funded by the Rockwool Foundation in co-operation with Statistics Denmark and has been running since the mid-1990s (most recently documented in Pedersen, 2003). Table 1 presents the main results.

Table 1: Black work in Denmark 1994-2001

	1994	1998	2001
Share of the adult population that performs black work, (%)	30.6	23.7	20.3
Average undeclared hours worked per week per black worker	2.92	3.47	5.2
Average undeclared hours per week for the population as a whole	0.89	0.82	1.2

Source: Pedersen (1998, 2003)

As shown in Table 1, in 1994 almost one-third of the adult population reported that they had conducted black work. By 2001 the share had fallen to 20%. On the other hand, the weekly number of “black” hours worked had increased from about three hours to more than five hours. As a result, the total volume of black work had increased from an average of 0.89 hours per week per adult to 1.2 hours per adult for the population as a whole.

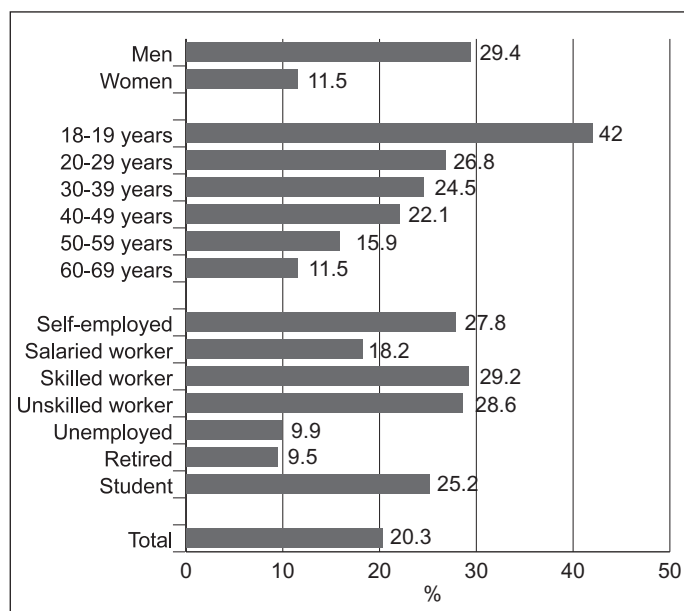
Undeclared work within different groups and sectors

There are significant differences between the extent of black work for different groups as shown in Figure 1.

While in 2001 an average of 20.3% of the adult population reported that they had conducted some form of black work, the share was much higher for men (29.4%) than for women (11.5%). Younger age groups tend to participate more intensely in the black economy. Within occupational groups, unskilled and skilled workers are frequently working black hours, closely followed by the self-employed.

¹ (Pedersen, 2003, pp. 13-19):

Figure 1: The share of persons having worked “black hours” within different social groups, 2001



In terms of sectors, black work is most common in construction, where almost 25% of the hours worked are undeclared according to the survey in 2001. Within agriculture, hotels and restaurants, one finds shares of black working hours from 10 to 15%. In sectors like the manufacturing industry, transport and other service sectors, black work seems to play only a minor role.

An interesting observation from the research is that only about 10% of unemployed persons report to have worked black hours. This is in line with previous studies and runs against the assumption that unemployed people will exploit opportunities to perform undeclared work and receive unemployment benefits at the same time to a large degree. However, the unemployed also partly lose the access to potential customers, who are normally contacted during standard working hours, and also have no opportunity to borrow tools and other equipment from their regular employer⁷. Finally, one could assume that the risk of under-reporting in the surveys is larger for unemployed people, because by doing undeclared work they violate both the tax laws and the eligibility criteria for receiving unemployment benefits.

The question of ethnicity and undeclared work is not covered by the surveys of the research unit of the Rockwool Foundation. Available case studies and media reports indicate that the informal economy can play a significant role among some groups of immigrants, but no systematic data are available (e.g. Rezaei, 2003).

Combining the information about the background characteristics for persons performing undeclared work, one can thus characterise the typical person who is active in the black economy as a younger skilled or unskilled male, who probably holds a full-time job in the construction sector.

Wages in the black sector

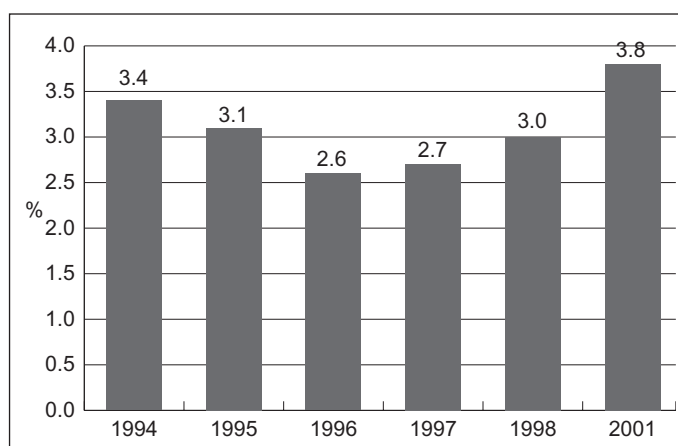
On average, in 2001 wages in the black economy were DKK 117 or 15.7 euro per hour, and were higher for men (DKK 121) than for women (DKK 104). A Danish study has taken a closer look at the wages earned in the black economy (Pedersen & Smith, 1998). When correcting for a number of background factors like age, education

and occupation, there is a wage gap of 17% between the hourly wages of men and women doing undeclared work. This wage gap is in line with recent estimates of the wage difference between men and women in the white economy of about 10% (Deding & Wong, 2004). The highest hourly wages in the black economy are found to be paid to self-employed and salaried workers.

The size of the black economy

Based on the available surveys, one can estimate the overall size and development of the black sector in the Danish economy, as shown in Figure 2.

Figure 2: Extent of black activities in Denmark, 1994-2001. Proportion of GDP



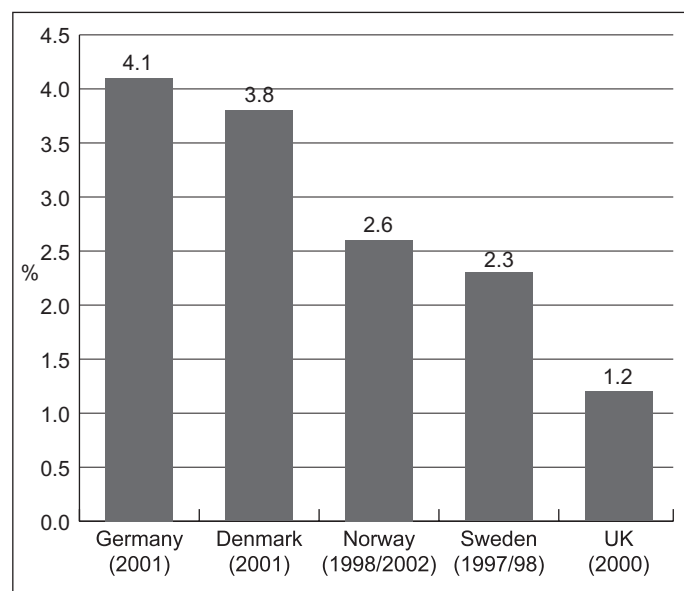
Source: Pedersen, 2003, p. 123

In Figure 2, the size of the black economy is measured by the number of undeclared hours in relation to number of “white” (declared) hours worked in the economy. It is thus assumed that productivity in the black sector is similar to that of the white sector. By this measure, the black economy in Denmark amounts to about 3% of GDP and has risen in recent years. If one instead assumed that the productivity of the black economy is reflected in its lower wage level and sets the value of its output accordingly, one finds that the Danish black economy amounted to about 1.8% of GDP in 2001.

The Research Unit of the Rockwool Foundation has also initiated comparative surveys in four other European countries using the same methodology as in the Danish survey. The resulting estimates for the proportion of the black economy are shown in Figure 3, which uses the same measure for the relative size of the black economy as Figure 2.

Based on the surveys, the black economy in all of the five countries seems to be of a minor level, although there is some variation from 1.2% of GDP in the UK to 4.1% of GDP in Germany. As is further discussed by Pedersen (2003, pp. 111-119), there could be a number of possible explanations for this divergence in the estimated size of the black economy. One suggested factor is linked to purely institutional differences, for example, a number of activities that would be taxable in Scandinavia are not taxable in the UK and this is probably an important reason for the much lower estimate for this country. One may add that Renooy et al (2004, p. 107) report the level of undeclared work in Denmark to constitute 5.5% of GDP. However, this figure includes both black work in the narrow sense and normal tax evasion.

Figure 3: Extent of black activities in five European countries. Proportion of GDP



Source: Pedersen, 2003, p. 105

As an alternative to the estimates of the black economy based on surveys, one can attempt to estimate its size by means of *monetary methods*, which are based on the assumption that the black economy (or, rather, the shadow economy) is characterised by using only cash and not other means of payments in order to hide the transactions from the authorities. A number of estimates based on various versions of this indirect method have been put forward for the Danish shadow economy. They vary from less than 2% to 18% of GDP. As discussed by Pedersen (2003, pp. 27-31), these estimates are based on a number of critical assumptions and also seem to be very sensitive to the specific data sources and estimation techniques applied.

Attitudes towards undeclared work

Finally, concerning the potential prevalence of undeclared work, the surveys can provide estimates of the willingness of the population to carry out black activities and the perceived risks of doing so. Here one finds that 45.7% of those respondents who had *not* reported that they had performed undeclared work, express the view that they would not rule out the idea in the future. Added to the 20.3% of the adult population who have actually been working in the black sector, one finds that 56.6% of the Danish population will not refrain from doing undeclared work if the opportunity is there. The figure for Norway and Sweden is 50.6% and 42.2% respectively. For Germany and the United Kingdom the corresponding figures are 25.5 and 34.4%.

With regards to the risk factor, 13.9% of the adult population in Denmark estimates the risk of discovery and subsequent tax fines to be high. This is the same level as in Norway and Sweden – and considerably lower than in Germany and the UK. Thus, compared with the data on the share of the black economy in Figure 3, there seems to be no simple correlation with either the share of the population willing to be active in the black economy or the perceived risk of being caught in the act.

Measures taken to combat undeclared work

Supported by the statistical information in the previous section, the common conception is that the black economy in Denmark is of a manageable size and has a magnitude similar to that of other Scandinavian countries. This, of course, does not preclude the fact that undeclared work is conceived as a problem and should be confronted by political action (Mogensen & Pedersen, 1998). Firstly, undeclared work limits the tax base and therefore implies a higher level of taxation, which may again stimulate the growth of the black economy. A risk of enforcing a vicious circle is thus present. Also, a large black economy may undermine the general legitimacy of the tax system and develop into more systematic fraud in some sectors such as restaurants, hotels and cleaning services. A large black sector may distort the interpretation of official statistical data, for instance concerning the level of unemployment or economic growth. Finally, a growing black sector may also lead to misinterpretations of data concerning the distribution of incomes. This may all result in misguided economic policies.

On the other hand, one can also identify positive aspects of the black economy. For example, some productive activities may be performed which would not be realised otherwise. In this case, extra income is generated, which will also stimulate activities in the white sector of the economy. One may also think of black activities as natural expressions of well-functioning social networks, where friends help each other without having tax evasion as the key motive.

However, from a more general societal point of view, there is little doubt that a black economy which grows outside the area of minor favours among friends or a few occasional extra hours of work by a young workman poses a serious challenge to the sustainability of the welfare state. As a reflection of this, Danish governments have over the years launched a number of initiatives to limit the extent of undeclared work.

The Home-service Scheme

The “Home-service Scheme” was introduced in 1994 (described in Renooy et al, 2004, pp. 172-3). The scheme implies that a wage subsidy is paid to households that buy household services (cleaning, gardening, etc.) from private firms. The subsidy was about 50% of the total costs. The purpose of the scheme was both to stimulate the demand for (unskilled) labour and to reduce the amount of undeclared paid household work.

The scheme was evaluated in 2001 (Erhvervsfremme Styrelsen, 2001). The main effects were viewed as positive. According to the evaluation, the scheme had generated employment for about 5,000 persons (equivalent to 3,500 full-time persons). One out of 10 households were users of the scheme. About two-thirds of the services supplied were cleaning and the remainder were gardening work. A special survey was conducted to assess the effects of the scheme on do-it-yourself work (DIY) and black work. The main results were:

- The main effect of the scheme was to reduce DIY activities. About three-quarters of the users reported that they would previously have done the work themselves.
- About a quarter of the users responded that they had previously had some form of external help to do the tasks that were now performed by persons working under the scheme. About half of this group had now overlooked black work in favour of white services provided under the scheme.
- It was estimated that the scheme had reduced the total volume of

black cleaning services by 5-10%, while it had only a minor effect on the volume of black gardening services.

The scheme has been gradually tightened in recent years. The subsidy has been lowered and the range of eligible services has been reduced to cover mainly cleaning services. From 2004, the type of household entitled to use the scheme has also been restricted to old-age pensioners and persons receiving disability pensions. The Government's main reasons for these changes in policy have been the significant lowering of overall unemployment since the mid-1990s and the fact that the scheme has mostly been used by high-income families. Also, there was an impression that the scheme had only minor effects on the size of the black economy as a whole.

The present strategy to combat the black economy

While the home-service scheme has been gradually rolled back as one of the main pillars of the strategy to combat the black economy, other instruments are now being emphasised as part of the Government's policies in this area. Also, the new guideline on the transformation of undeclared work into regular employment in the European Employment Strategy (EES) has probably caused an increased political focus on the subject. The present strategy is based on the following main elements (cf. also the Danish NAP of 2003):

- It is the Government's intention to further *ease the administrative costs of establishing and running private firms*, which should lower the incentives to operate in the black economy. A number of laws and regulations have been aborted or loosened, for instance when it comes to the ceiling for registering for VAT payments. Also a number of tax laws have been revised with the aim of improving the legal rights of entrepreneurs.
- When it comes to *the intensification of incentives and removing of disincentives to declare work*, the Government has taken several initiatives. As part of the reform called "More people into employment", changes have been implemented in 2003 and 2004 to increase the incentives for ordinary employment, which has also lead to a reduction in the volume of undeclared work. Thus a ceiling was set from January 2004 for the total amount of cash benefits that social clients can receive. Also, married recipients of cash benefits can now keep a higher share of an earned income before deductions are made in the cash benefits of the spouse. Furthermore, as part of the tax reform that is being implemented in 2004, marginal tax rates are being reduced and a special tax deduction of earned income is to be introduced. This should further reduce the incentives to work in the black economy.
- With regards to the strengthening of surveillance and the application of appropriate sanctions, the tax authorities have intensified their control of the sectors where undeclared and illegal work is most widespread. This includes on-the-spot inspections of hotels and restaurants in a specific geographic area, often conducted in co-operation with the Directorate of Labour and the police, who control for abuse of unemployment benefits and for the employment of illegal workers. Also, some of the laws concerning various forms of indirect taxation have been amended in order to strengthen the surveillance by the authorities.
- As a further step to reduce undeclared work, the tax authorities have launched information campaigns which, among others, informs pupils in schools about the tax system and the problems and risks related to black work.
- Methods for estimating the size and structure of the black economy are being developed. An estimate of black activities is

now included in the official figures for the national accounts and more detailed information is collected by Statistics Denmark in co-operation with the research unit of the Rockwool Foundation. Furthermore, in Autumn 2003 the Government announced its intentions to establish a special "think tank" to monitor and analyse the development of the black economy and put forward ideas for new policies.

Finally, one should mention that a special set of regulations were put into force in Spring 2004 in order to cope with the challenges stemming from the enlargement of the European Union. Workers from the new Member States will be allowed to look for work in Denmark for a period of up to six months, provided that they can support themselves. If they find a job within that period, a residence and work permit will be issued on the condition that the authorities (the Danish Immigration Service) find that the job in question has pay and work conditions according to Danish general agreements or at a similar level. The aim is thus to ensure that immigrants get genuine jobs that allow them to support themselves and their families. A special effort will be made to survey and monitor the developments in the labour market after enlargement. The results from these activities will determine how the regulations should develop during the transition period of seven years, until the workers from the new Member States fully enjoy the same status as those from the present Member States.

Conclusion

It is generally believed that the volume of undeclared work in Denmark amounts to only a minor part of the market economy. Furthermore, undeclared work mainly takes the form of extra hours performed by workers already having a full time job, for example in the construction industry. A high prevalence of undeclared work is found in the hotel and restaurant sector, where it is frequently combined with illegal work or abuse of unemployment benefits. In general, however, the widespread use of administrative registers and controls involving the use of personal identification numbers and a strict registration of private firms makes it difficult to develop a large-scale black economy in the Danish case.

This situation is reflected in the policies applied towards undeclared work, where the focus is on targeted inspections by the tax authorities and the Directorate of Labour. Also, the reduction of incentives to perform undeclared work has been an argument for the lowering of marginal tax rates as part of recent tax reforms. In general, however, it is difficult to portray the question of undeclared work as a very hot issue on the Danish political agenda.

Per Kongshøj Madsen

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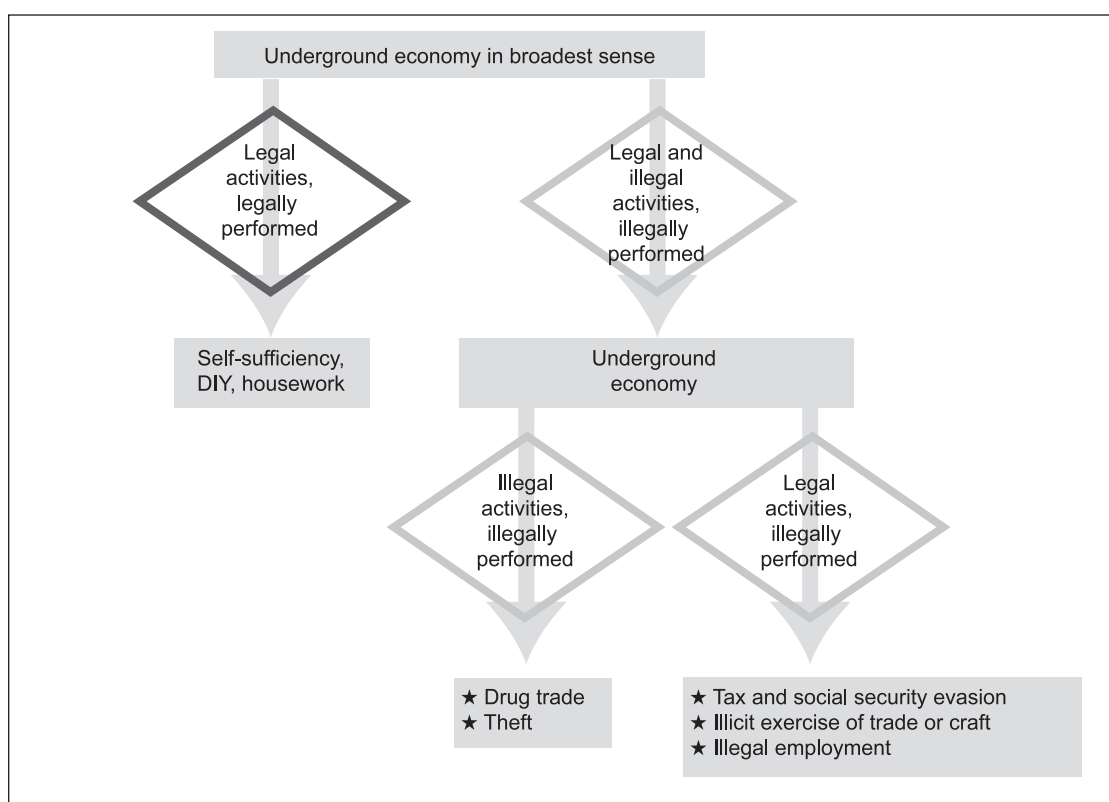
Germany

Introduction

This study focuses on productive activities that are legal in principle but which are not declared to the authorities. In the debate in Germany various terms are used to describe these activities, the most common being *Schwarzarbeit* (clandestine employment), *Schattenwirtschaft* (underground economy) and *informelle Arbeit* (informal employment). These terms have arisen out of a variety of contexts and denote a variety of forms of undeclared employment. "Clandestine employment" is usually understood as covering productive employment that is potentially subject to tax and

compulsory insurance contributions, but on which no tax or social security contributions are paid. The "underground economy" includes clandestine employment, but also many other undeclared activities, such as income from interest or from criminal activities, neighbourly assistance or the non-monetary exchange of goods and services. The underground economy also includes non-declarable activities (see Figure 1). Like "clandestine employment", the term "informal employment" relates to the activities of individuals but, depending on how the term is understood, it may also cover housework and voluntary or civic activities of various kinds.

Figure 1:
Delimitation of
Underground
Economy



Source: Min. of Economic
Affairs, Württemberg, 2000

Strictly speaking, clandestine employment and the underground economy constitute economic activities. They involve the production of goods or services and are thus productive, even if the contribution they make to the gross national product is often not fully measured or, as with DIY, is not measured at all. In the debates on informal employment in particular, there is a call for the concept of productivity to be extended. Firstly, it is pointed out that DIY in the home produces utility value that raises the standard of living. Moreover, some authors also ascribe productive functions to civic commitment. The aim of extending the concept of productivity in this way is, above all, to help to improve society's recognition of voluntary work.

In order to understand the extent and the main elements of the underground economy and clandestine employment in Germany, three particular features of the German labour market must be taken into account:

- In the case of 41 craft trades, under the German Crafts Trades Code, only skilled workers with a master craftsman's qualification in these trades are entitled to practise them. If other persons – either with no such qualification or with a comparable qualification in a different occupation – practise such an occupation, the income may be declared but the activity is unauthorised. Combating of unauthorised practising of a trade plays a substantial part in German legislation on illegal employment.
- Compared with other countries, Germany has only very limited day-nursery provision for children under three. Moreover, the fact that in Germany it is customary for children to attend school only for half the day means that mothers face restricted employment opportunities. Since in recent years there has been a considerable increase in the tendency for women to work in paid employment, owing to these framework conditions there has been an increasing demand from households with children for private household services. Owing to the lack of professional provision on the market, these services are provided in the main by paid workers in the household concerned. As a rule, these activities are not declared, since the German system of splitting taxes between spouses and of derived health and pensions insurance schemes for married women, who usually carry out these activities, offers no incentive to legalise their activity.
- As a result of opening up of borders to Eastern Europe and the implementation of freedom to provide services within the EU, many workers have been posted to the German construction industry in particular. In the wake of legal posting, illegal posting has also increased (Bosch 2004, Bosch/Worthmann/ Zühlke-Robinet 2000). This illegal posting is obviously operated, to a great extent, by criminal organisations. This has led to a drastic increase in the already high level of clandestine employment in the construction industry.

While infringement of the Crafts Trades Code has traditionally constituted one of the main areas of clandestine employment, there has been a particular increase in clandestine employment in the home and via the posting of workers in the past few years.

These three particular features of the German labour market also play a part in the measures adopted to combat clandestine employment. In the Law of 23 July 2004 intensifying the combating of clandestine employment and associated tax evasion, the legislator summarised for the first time in a single legal definition, the definitions of unauthorised clandestine employment that had hitherto been scattered among various laws (see box below). At the same time, a distinction was made between clandestine employment and permitted informal activities. It is made clear in § 1.3 of the Law

that activities performed on behalf of relatives or spouses/partners, as favours, by way of neighbourly assistance, and by way of self-help are not deemed to constitute clandestine employment if there is no profit motive. Minimal remuneration for such activities is tolerated.

Definition of clandestine employment in § 1.2 of the Law combating clandestine employment

A person who works or provides services or causes work to be done or services to be provided while, at the same time,

1. not fulfilling his obligation to declare, pay contributions or keep records and accounts under social security law ensuing from the provision of work and services as employer, entrepreneur or self-employed person subject to compulsory insurance,
2. not fulfilling, as a taxpayer, his fiscal obligations ensuing from the provision of work or services,
3. not fulfilling, as a recipient of social security benefits, his obligations to notify the organisation providing the benefits ensuing from the provision of work or services,
4. not fulfilling, as a provider of work or services, his ensuing obligation to register the commencement of self-employment in a regular trade (§ 14 of the Crafts Trades Code), or not acquiring the necessary licence for an itinerant trade (§ 55 of the Crafts Trades Code),
5. as a provider of work or services, exercising a craft subject to authorisation as a regular trade without being registered in the Register of Craftsmen (§ 1 of the Crafts Trades Code),

shall be deemed to be in clandestine employment.

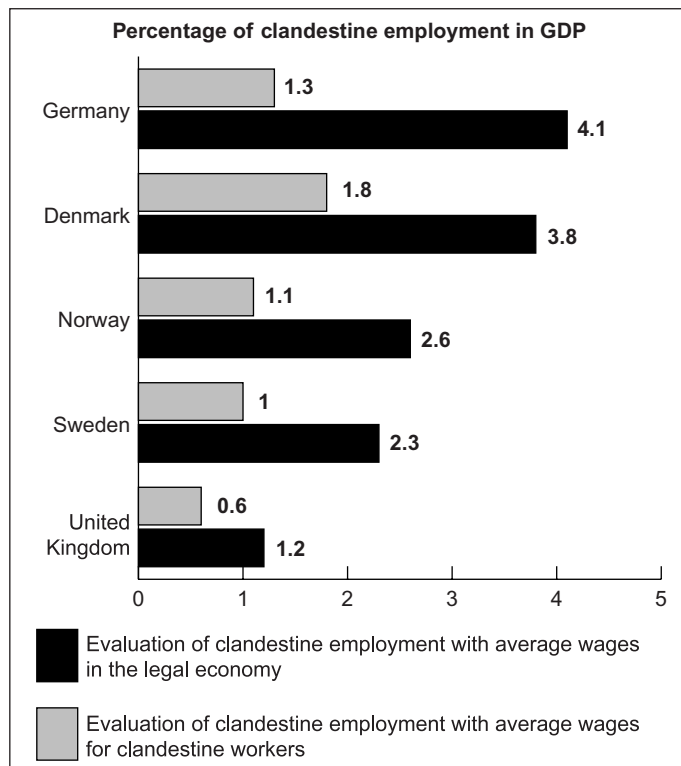
Level and nature of clandestine employment and the underground economy in Germany

No official figures are available on the level of clandestine employment and the underground economy in Germany. The Federal Statistical Office includes underground economic activities in calculating the gross domestic product since, under the production concept of the European system of national accounts, they should be recorded. Various assessment methods are used in an attempt to determine a GDP that is as complete as possible. For example, the volume of construction is determined on the basis of the materials used, or legally prohibited production (e.g. drug production) is calculated on the basis of the quantities of drugs seized and estimated domestic consumption (Federal Statistical Office 2003). In the opinion of the Federal Statistical Office, however, the underground economy cannot be accurately calculated from the total of the various "under-recording supplements" since, in addition to non-payment of tax and insurance contributions, there are also other reasons for the under-recording, such as gaps in the statistical system or statistical cut-off boundaries (Federal Statistical Office 2002).

A number of researchers have used different methods in an attempt to identify the level of the underground economy in Germany. On behalf of the Rockwool Foundation, Pedersen (2003) carried out a survey in a number of countries, using identical questions. According to this, in 2001 a total of 10.4% of respondents in Germany aged between 18 and 74 undertook clandestine employment. Hours worked in clandestine employment represented 4.1% of total hours worked. If wages in the black economy are taken as the basis, they constitute 1.3% of GDP, and if wages in the formal sector are taken as the basis, the percentage rises to 4.1% (Figure 2). Since the productivity of clandestine employment is

lower than that of the formal economy, owing to the lower capitalisation and also, to some extent, the lower skills level, the percentage of clandestine employment as measured by Pedersen lies somewhere between these two percentages. However, Pedersen points out that he did not measure all clandestine employment, since it is probable that not all respondents answered honestly. This supports an assumption that the true levels are higher. On the other hand, he stresses that in the northern European countries and Germany the level of clandestine employment is lower than is frequently assumed, and is substantially below the level in the Mediterranean countries.

Figure 2: Clandestine Employment in 2001

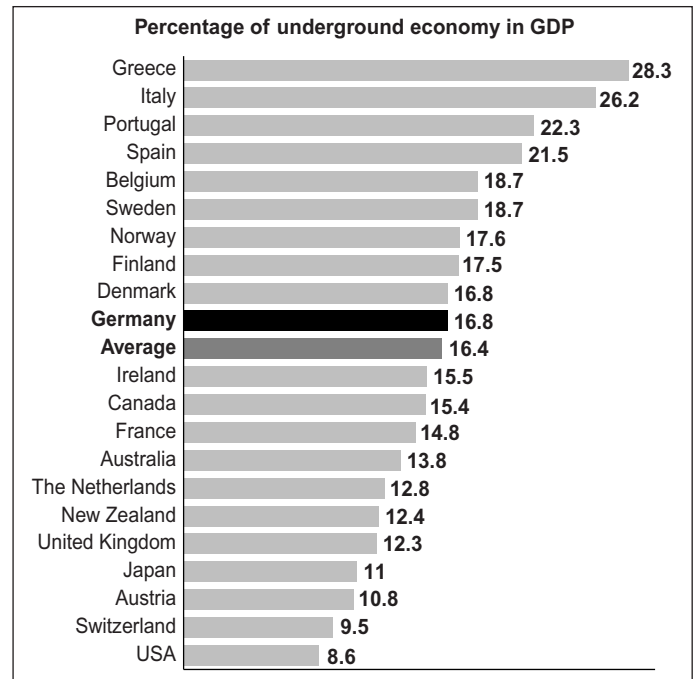


Source: Pedersen, 2003

Schneider (2003) arrives at much higher percentages, since he looks at not only clandestine employment, but also the entire underground economy, which also includes other forms of tax evasion and criminal activities. Unlike Pedersen, he does not ask directly about activities in the underground economy, but adopts the cash approach, i.e. an indirect survey method. His starting point is that, generally speaking, in the underground economy wages are paid in cash, which means that DIY and neighbourly assistance involving no monetary payment are excluded. When the amount of cash in circulation in a national economy exceeds a level deemed to be “normal”, this shows the extent of the underground economy. According to this method, the proportion of the underground economy in GDP in Germany was 16.8% in 2002 and 2003 (Schneider, quoting IG Metall, 2004), while in 1975 it was only 5.75% and in 1989/1990 it was 12.8% (Schneider 2003). This calculation method involves many uncertainties, such as determining a starting year with a normal level or taking account of the rate of circulation of money, which is why experts advise against using this method (Renooy et al. 2004). What is troubling about Schneider's calculations (e.g. in Schneider, Volkert, Caspar 2002) is that the details of the calculation method (e.g. determination of the normal level) are not laid bare and hence also cannot be checked. It

can be assumed that the proportion of the underground economy in GDP lies somewhere between the levels identified by Pedersen and Schneider.

Figure 3: Average Annual Level of Underground Economy, 2002/2003



Source: Schneider, 2003

The OECD compared actual social security contributions with theoretical liability, taking as a basis specific national average contributions and taking account of exemptions, differing contribution levels, and contribution thresholds. Moreover, public-service employees were excluded from the calculation, since civil servants do not have to pay contributions. In Germany, actual contributions in 2000 were equivalent to 90% of the contributions theoretically payable (OECD 2004: 248). This still means that 10% of potential obligations to pay contributions were not met. Even if we allow for the possibility of measuring errors (owing to underestimation of the number of mini-jobs or failure to take adequate account of the contribution threshold), social insurance schemes are suffering substantial losses. This is a meaningful figure for Germany, since social security contributions are compulsory, and supplementary insurance schemes are private. On the other hand, it is difficult to make comparisons with other countries, since in some countries voluntary contributions can be paid. Frequent use is also made of this option (in the USA, for example, for pensions, healthcare and nursing care). Consequently, in considering actual contributions, a distinction can no longer be drawn between compulsory and voluntary contributions. Nevertheless, according to the OECD's figures, in an international comparison, the level of honesty vis-à-vis contributions appears to be relatively high in Germany.

According to Schneider, clandestine employment is concentrated in the construction sector. However, he appears to underestimate the proportions of undeclared activities in nursing, the care sector, and childcare. This becomes apparent when we compare Schneider's figures with the main areas of activity in a survey of second jobs carried out by the Institute for Employment Research (IAB) in 1984 (Table 1). More recent figures, for the year 2000, were obtained on the basis of the socio-economic panel (SOEP) for the utilisation of domestic help. According to these figures, 4,349 million households

across Germany employed domestic help, representing 11.3% of all households. A total of 2.9 million households stated that this involved regular employment, and 1.4 million that they employed domestic help from time to time (Schupp 2002). Domestic help is utilised by high-income households in particular, although it is also utilised by the lower income classes. Here, older persons, often also in need of care, in one- or two-person households in particular, are likely to be involved. It is worth noting the high discrepancy between the number of households that pay for domestic help, at least occasionally, and the small number of workers in households subject to compulsory social security contributions, which has been around 40,000 for many years (Weinkopf 2004). This discrepancy indicates a high level of clandestine employment in this area.

In the course of the past 15 years, there has been a marked increase in the extent of illegal working in the construction industry as a result of the posting of workers from non-EU Member States. Workers can be posted to Germany from the other Member States in the EU of 15 in the context of freedom to provide services. Workers from the new Member States and other countries such as Serbia-Montenegro and Turkey have access to the German construction market within the framework of quota agreements. Since the early 1990s, there has been a marked increase in the number of legally posted workers, although the figure has fallen slightly since 1997 owing to the poor economic climate in the construction industry and, possibly, also the shift to illegal working (Table 2).

Posting of workers paved the way for an increase in illegal working. Many of these legally posted workers are not remunerated in accordance with German regulations (Bosch/Zühlke-Robinet 2000 and 2003). A minimum wage was set for them on the basis of the Law on the posting of workers (Table 3), but this is often circumvented. Moreover, it is estimated that for every legally posted employee, another, illegally posted, worker comes in. As a specimen calculation demonstrates, this has led to German workers being ousted from large construction sites in particular, for example in Berlin (Bosch/Zühlke-Robinet 2000).

Table 1: Structure of clandestine employment and second jobs

Percentages in the total figures for the relevant branches of economic activity		
	Prof. Schneider's calculations (2002)	IAB survey of second jobs (1984)
Construction, crafts	38	49
Commercial and industrial enterprises (automotive, machinery, etc.)	17	–
Hotel and restaurant industry	17	5
Cleaning, domestic help	15	11
Nursing, care, teaching, childcare	–	19
Entertainment and leisure industry	13	–
Agriculture	–	11
Other	–	6

Source: IG METALL, 2004, p. 15

In order to combat clandestine employment effectively, one has to understand its various forms and their causes. The German research shows a lack of adequate understanding of the situation. The best-known researchers, Schneider (Schneider, Volkert, Caspar 2002) and Ernste (2003), see the main causes as lying in taxation rates that are too high, over-regulation of the economy, false incentives in the transfer system (taking too much account of income from employment with the unemployed and recipients of welfare benefits), reductions in working hours that offer more scope for clandestine employment, and decreasing honesty among taxpayers. Their core message is that clandestine employment is a warning sign that society is going off course. Any action taken should concentrate

Table 2: Posted workers and German employees 1992-2002 (annual averages, in 1000s)

Year	Posted workers*			Employees in the building trades subject to compulsory social security contributions (total)***	Employees in the building trades subject to compulsory social security contributions (blue-collar)***	Percentage of posted workers in the total for workers in the building trades
	from Central and Eastern Europe**	from the European Union	Total			
1992	103	13	116	1,301	989	10.5
1993	70	20	90	1,343	1,016	8.1
1994	31	106	137	1,405	1,057	11.5
1995	29	132	161	1,411	1,046	13.3
1996	23	165	188	1,311	950	16.5
1997	16	165	181	1,221	869	17.2
1998	19	150	169	1,156	815	17.2
1999	19	139	158	1,110	783	16.8
2000	17	121	138	1,050	736	15.8
2001	16	111	127	954	662	16.1
2002	15	103	118	870	603	16.4

* Estimates by the *Hauptverband der Deutschen Bauindustrie* (umbrella association of the German construction industry), annual averages.

** Including commuters.

*** Data from the Federal Statistical Office, annual averages; 2002, estimates by the *Hauptverband der Deutschen Bauindustrie*.

Source: *Hauptverband der Deutschen Bauindustrie* 2002: 24.

Table 3: Minimum wage levels in West and East Germany, 1997-2004

Date concluded	Generally binding via	Duration	Minimum wage (SHR)*			
			for unskilled labour (occ. group VII 2)		for skilled labour (occ. group III)	
			West	East	West	East
2.9.1996	Coll. bargaining committee	1.1.1997-31.8.1997	17.00	15.64	–	–
17.7.1997	Coll. bargaining committee	1.9.1997-31.8.1999	16.00	15.14	–	–
26.5.1999	Statutory order	1.9.1999-31.8.2000	18.50	16.28	–	–
2.6.2000	Statutory order	1.9.2000-31.8.2001	18.87	16.60	–	–
		1.9.2001-31.8.2002	19.17	16.87	–	–
4.7.2002	Statutory order	1.9.2002-31.8.2003	10.12	8.75	–	–
		1.9.2003-31.8.2004	10.36	8.95	12.47	10.01

* Minimum wage in DM up to August 2002, in euro as from September 2002.

Source: 1996: *Hauptverband der Deutschen Bauindustrie* 1997: 464-466; 1997, 1999: *Hauptverband der Deutschen Bauindustrie* 1999: 48-54; 2000-2004: *IG Bauen-Agrar-Umwelt* 2000: 5; *Bundesgesetzblatt (Federal Law Gazette) Part I*, various references, compiled by author.

on correcting this and not on combating symptoms, something that is in any case ineffective. Other writers go so far as to play down the underground economy as being “a bulwark against too much state interventionism and fossilised structures” (Schäfer et al. 2004), without distinguishing between organised criminality and occasional clandestine employment. Schäfer et al. (2004) even go so far as to describe the underground economy overall as improving the wellbeing of poorer citizens in particular because of the lower prices, which is hardly true of the drug trade, large-scale tax evasion and similar activities. Such analyses of the causes are problematical in a number of respects:

- Firstly, they are on shaky ground as regards methodology. In its 2004 report on employment, the OECD comes to the conclusion that there is no connection between taxation rates and the underground economy (OECD 2004: 254 and also Friedman et al. 2001). High taxation rates can just as easily be associated with a high level of honesty among taxpayers, and lower taxation rates can just as easily be associated with a very low level of honesty among taxpayers.
- Secondly, in some cases only by regulation can rules for economic behaviour be established that reduce the incentives to behave illegally (e.g. laying down of minimum wages for posted workers). Deregulation and under-regulation are just as likely to cause the underground economy to expand as over-regulation. Regulations must therefore be considered on a case-by-case basis.
- Thirdly, large-scale organised criminality, particularly with regard to cross-border posting of workers, and the particular causes of clandestine employment in household services are completely omitted.
- Fourthly, the reasons for the inefficiency of the supervisory system are not addressed, since the researchers start by assuming that it cannot be made more efficient. However, there are definitely tools that can combat clandestine employment effectively.

Incentives for clandestine employment would only disappear if there were no more regulations and taxes. Since this is both unthinkable and undesirable in a complex society, the sweeping views on deregulation in the discourse on clandestine employment need to be replaced by a sophisticated debate on the causes of clandestine employment and suitable tools for combating it.

Combating illegal employment and clandestine employment

The large number of different forms of clandestine employment shows that it is not easy to stop. In the past few years many new measures combating clandestine employment have been adopted in Germany, some of them attempting to reduce the incentives for clandestine employment and others endeavouring to control it better and to punish it more severely.

Reducing the incentives for clandestine employment

The reform of the Crafts Trades Code, the promotion of *Ich-AGs* (a new, subsidised way of setting up in business) and the new rules on mini- and midi-jobs and, in particular, on mini-jobs in households, are aimed at reducing the incentives for clandestine employment. They constitute initiatives designed to legalise clandestine employment in the context of the Crafts Trades Code and household services, which is particularly prevalent in Germany.

Reform of the Crafts Trades Code

The amending statute on the crafts trades law (the Third Law amending the Crafts Trades Code and other statutory regulations on crafts trades) entered into force on 1 January 2004, incorporating the following amendments:

- The compulsory master craftsman's qualification is limited to 41 craft trades with obligatory admission requirements instead of 94. The other 53 craft trades are no longer subject to obligatory admission requirements. Under the version of the Crafts Trades Code previously in force, a master craftsman's qualification was a prerequisite for establishing or taking over a craft business in these 53 trades. This rule now applies only to dangerous and training-intensive fields. The craft trades that are now no longer subject to obligatory admission requirements include tilers, composition floor layers, and tank and apparatus constructors. However, the master craftsman's qualification can be obtained in these trades on a voluntary basis. It then becomes a quality seal for the business and its employees. Time spent as a journeyman is no longer a prerequisite for admission to the voluntary master craftsman examination.
- With only a few exceptions, experienced journeymen can also work for themselves in craft trades with obligatory admission

requirements, provided they can prove that they have been practising their trade for six years, four of them in a supervisory position. The exceptions include chimney sweeps, opticians, hearing aid dispensers, orthopaedic technicians, orthopaedic shoemakers and dental technicians.

- Engineers, university graduates and state-examined technicians can be admitted to a craft trade.
- The proprietor principle, under which a craft business should be conducted by only one master craftsman, has been abolished. Enterprises practising a craft trade subject to obligatory admission requirements may practise such a trade provided that a master craftsman has been appointed works manager.
- Occupations that can be learned within two to three months are not subject to a compulsory master craftsman's qualification. Occupations categorised as "simple" represent a suitable path to self-employment, e.g. for the establishment of an *Ich-AG*.

This amending statute is aimed, firstly, at increasing the rate of establishment of new craft businesses and, secondly, at reducing clandestine employment, above all in "simple" occupations and via the employment of persons with no master craftsman's qualification in admissible trades. Critics of the reform fear that the quality of supply will worsen, the rate of innovation will decrease, and there will be a reduction in training and continuing training owing to the establishment of mini-enterprises. There has been a marked increase in the rate of establishment of new businesses in some of the trades no longer subject to obligatory admission requirements, such as tiling. We cannot yet definitively answer the question of whether the reform has succeeded in creating more long-term jobs and not just simply short-lived mini-enterprises that are not very innovative and abstain from training, and in curbing clandestine employment.

ICH-AGs

Within the framework of the Hartz reforms, since 1 January 2003 subsidies from unemployment insurance have been available to support the establishment of what are known as *Ich-AGs*. The monthly subsidy granted to unemployed persons setting up in business is 600 euro in the first year, 360 euro in the second year and 240 euro in the third year. While they are in receipt of this subsidy, those setting up in business are subject to compulsory statutory pensions insurance and may also pay into statutory health, nursing care and accident insurance schemes. If the attempt to set up in business fails and the person concerned is entitled to unemployment benefit, this can be claimed again before the end of the three-year subsidised period.

In the first year of this scheme (2003), 93,000 persons established an *Ich-AG*. In August 2004, there were 157,000 small businesses of this kind. To date, across Germany one *Ich-AG* in six has withdrawn from the scheme. The reasons for this may be as follows:

1. The business concept has failed;
2. The person setting up in business has found a job as an employee;
3. The *Ich-AG* makes an annual profit of more than 25,000 euro and therefore receives no further subsidy; and
4. The *Ich-AG* did not take up its work, since the person concerned only wanted to receive the subsidy and never intended to become self-employed.

The *Gesellschaft für innovative Beschäftigung* (G.i.B. – Association for innovative employment) and the *Institut für Mittelstandsforschung* (Institute for research into small and medium-sized business) (2004) investigated *Ich-AGs* on behalf of the Ministries of Labour and Economic Affairs. By July 2004, a total of 29,566 *Ich-AGs* had been founded in North Rhine-Westphalia. Of these, some

20% subsequently withdrew from the subsidised scheme. In some cases, the founders of *Ich-AGs* have found a permanent job again as a result of their self-employed activity, or they are earning more than 25,000 euro a year and are accordingly no longer eligible for support. In other cases, they fail owing to bad planning. The authors of the study have therefore suggested that there should be compulsory consultation before an *Ich-AG* is founded.

Owing to many instances of abuse, in September 2004 the Federal Government decided to make support for an *Ich-AG* dependent on a "workability" certificate, which can be issued by Chambers of Trade and Industry, specialist associations or banks. These institutions have the task of examining a plan with the business concept, the capital required and the financing, as well as a forecast of turnover and profitability. Experts had already called for such a plan back in 2002, but at the time the suggestion was rejected on the grounds of unnecessary bureaucratic effort.

Promotion of small businesses

The Law promoting ownership of small businesses and improving business financing (*Kleinunternehmerförderungsgesetz – KFG*) also entered into force in 2003. It is aimed at dismantling the red tape involved in founding a business and at improving the financing conditions for small and medium-sized enterprises. For example, the thresholds for the requirement to keep accounts (simplified determination of profits) have been raised as follows:

- Turnover threshold 350,000 euro (previously 260,000 euro)
- Economic value threshold 25,000 euro (previously 20,500 euro)
- Profit threshold 30,000 euro (previously 25,000 euro)

Under the simplification rule, the small businessman may deduct half his business income as being business expenditure. Taxpayers covered by the rule need only record their business income, including their withdrawals, and are released from any obligation to keep further tax records.

Businessmen who do not exceed the income threshold may utilise these rules permanently. Owing to the rules on small businessmen in the VAT legislation, there is also no obligation to pay VAT. However, businessmen may opt at any time to adopt a different form of determination of profits (calculating the excess of receipts over expenditure/preparing balance sheets).

Mini-jobs – up to 400 euro

On 1 April 2003, the rules on marginal part-time employment were amended by the Second Law on modern labour-market services as follows:

- The earnings threshold for mini-jobs has been raised to 400 euro. The previous threshold of 15 hours' work a week, which could not be exceeded, has lapsed.
- For these mini-jobs, the employer pays flat-rate fiscal charges of 25% (12% statutory pensions insurance, 11% statutory health insurance and 2% tax).
- In the case of mini-jobs in the home, the fiscal charge is only 12% (5% each for pensions and health insurance and 2% tax). Furthermore, the costs of domestic help are partially tax-deductible. Such costs can be directly deducted from tax due as follows:
 - Where a flat rate of 12% is paid, 10% of costs up to a maximum of 510 euro per year.
 - In an employment relationship involving compulsory payment of social security contributions, 12% of costs up to a maximum of 2,400 euro per year.

- Where home-related services are used, e.g. industrial housekeeping agencies, 20% of the costs up to a maximum of 600 euro per year can be deducted.
- **One** marginal part-time job can be taken up alongside a main occupation subject to compulsory social security contributions without the former being aggregated with the latter and becoming subject to compulsory contributions.
- Introduction of a sliding-scale zone for earnings of between 400.01 euro and 800 euro, in which the employer's contribution increases linearly from 4% to the standard employer's contribution, while at the same time there is full entitlement to social security benefits as from 400.01 euro.

This Law was aimed at increasing the incentives for both employers and employees by reducing fiscal charges and by making activities in the home tax-deductible, and at legalising clandestine employment.

Since the Law was amended, there has been a substantial increase in the number of registered mini-jobs. It is likely that the majority of the 6.4 million mini-jobs first identified by the federal miners' social insurance fund in June had already existed previously as part-time jobs on the margins of the labour market. As at 30 June 2004, some 7.6 million people were working in marginal part-time jobs (Mini-Job Zentrale 2004). The number of mini-jobs in private households rose from 27,817 in June 2003 to 67,401 in June 2004.

In an interim report on the reform, the DIW (German Institute of economic research) concludes that part of the recorded increase can be traced back to the effects of replacing previous employment (Schupp/Birkner 2004). Disappointingly, despite the substantial amount of tax deductibility, there has been only a minimal increase in mini-jobs in private households (Weinkopf 2004). The majority of employment in private households still takes the form of clandestine employment. The main reason will be that, firstly, many of those doing such work have social security cover through their spouses and, secondly, that some of them have a number of these mini-jobs, which means that they will become fully subject to compulsory social security contributions if they declare them.

Controlling and punishing clandestine employment

In the past, responsibility for combating clandestine employment in Germany was divided among many different authorities (tax office, social services office, authorities responsible for aliens, customs administration, social insurance schemes, police, Federal Labour Agency, etc.). Not only were there ambiguities in the division of competences among the various institutions, but the exchange of data and information was also inadequate, so that clandestine employment often went undetected. Moreover, the authorities relied almost entirely on controlling clandestine employment after the event and not enough on preventing it from occurring.

In the past few years, the following legislation has provided a new basis for combating illegal employment:

- Law of 1.8.2002 facilitating the combating of illegal and clandestine employment:
 - In the construction sector, which is particularly strongly affected by illegal employment, the main contractor was made liable for the social security contributions of sub-contractors directly contracted by him. However, this does not include liability for the social security contributions of sub-contractors contracted in turn by the first sub-contractor.
 - Co-operation among the authorities was improved, including data exchange. For example, the customs administration or the police can call up data on the issuing of a work permit directly from the Federal Agency.

- The scope for fines and penalties was extended. For example, the maximum penalty for illegal employment of aliens, regarded as being particularly harmful for society, was increased from 250,000 to 500,000 euro.
- Companies that contravene the provisions of the Law may be excluded from public contracts for up to three years (previously two years).
- Restrictions have been placed on advertising of clandestine employment. Not only telecommunications service providers (as before), but also newspapers, must pass on customers' names to the authorities.
- If taxes and social security contributions have not been paid against illegal employment, the wages paid are regarded as net wages subject to contributions and taxes. This avoids the previous disputes as to whether the wages were net or gross.
- Law of 2.9.2001 on road haulage – this Law was designed to curb the employment of workers from non-EU Member States with no work permits, by means of the following amendments:
 - Only drivers with an officially certified work permit may be employed.
 - The transport company's customer is also bound by this obligation.
 - The scope for penalties in the event of infringement was increased.

This Law speeded up agreement on a corresponding regulation at European level (Regulation 484/2002 of 1.3.2002).

- Law of 6.9.2001 curbing illegal employment in the construction industry:
 - At the heart of this Law is the liability of the prime contractor. The contractor must withhold 15% of the sub-contractor's invoice and pay it over to the tax office, to combat tax evasion.
- Amendment on 1.1.1999 of the 1996 Law on the posting of workers (AEntG), under which minimum wages can be agreed for non-German contractors, by:
 - Improving the provisions on co-operation among the supervisory authorities.
 - Increasing the scope for penalties in the event of infringement.
 - Introducing liability on the part of the general contractor irrespective of fault in the event that a sub-contractor does not pay the minimum wage stipulated under the AEntG or does not pay over contributions to the construction industry's holiday fund.
- Law as of 1.8.2004 intensifying the combating of clandestine employment and associated tax evasion, including the following new provisions:
 - Precise definition of the concept of clandestine employment (see box in Section 1).
 - Improvement of implementation of supervision by bringing together statutory provisions that were previously divided among a number of laws, and an increase in the rights of the customs administration to inspect work and service contracts.
 - Obligation for the contractor to submit invoices for work and services rendered and, in the context of a property, also for private households, including long-term retention of the invoices. Hitherto private households were not obliged to require and retain invoices. Infringement of the obligation to submit invoices is punishable with a fine of up to 5000 euro, and infringement of the obligation to retain the invoices with a fine of up to 500 euro. Previously it was difficult to identify clandestine employment since no invoices had to be issued.

- In future, in the event of accidents in companies providing work and services illegally, it is to be possible for the accident insurance funds to assert a remedy over them.
- At international level, in 1999 on Germany's initiative the EU adopted the following code of conduct: Code of Conduct for improved co-operation between authorities of the Member States concerning the combating of transnational social security benefit and contribution fraud and undeclared work, and concerning the transnational hiring-out of workers (OJ C 125 06.05.1999 p. 1). On the basis of this Code of Conduct, an agreement was concluded with France on co-operation in these areas (German *Bundestag* 2003). In conjunction with these amendments to the legislation, more staff were taken on to combat illegal employment, particularly at the customs administration. In addition, a central office with 50 employees was established in Cologne to co-ordinate the work of the principal customs offices on combating illegal employment. A number of publicity campaigns were designed to draw the attention of employers and employees to the fact that illegal employment and benefit fraud are wrong, and to the harm they cause. These included posters and newspaper advertisements in 2002 under the motto "*legal, illegal, nicht egal*" (legal, illegal, it's not all the same) and extensive information on the Internet, at www.arbeitsamt.de/illegal and www.zoll-stoppt-schwarzarbeit.de.

Two other Federal Government initiatives for a law on compliance with standard wage rates and the introduction of a corruption register failed in 2002 owing to opposition in the *Bundesrat*, where the CDU/CSU and FDP opposition are in the majority:

- Under the draft law on compliance with standard wage rates, in future public bodies were to be able to award construction contracts only to companies that paid their employees the standard wage rate applicable at the construction location. The same was to apply to local public transport. In the Government's view, the massive deployment of low-paid workers in the construction sector leads to substantial distortion of competition, so that many jobs are put at risk, especially in SMEs bound by collectively agreed wage rates. A similar trend is to be feared in local public transport (ÖPNV), owing to imminent deregulation at European level. Companies in breach of the law were to be subject to contractual penalties. The contract could also be terminated or the company could be excluded from public contracts.
- Companies found guilty of serious offences were to be kept on a "register of unreliable companies" for up to three years. Such offences included, for example, bribery, breach of trust, prohibited price agreements, illegal exports, illegal employment, clandestine employment and infringement of the rule on compliance with standard wage rates. In this way it was to be possible to exclude these companies from the award of public contracts. The register would also have included companies that had attempted to obtain public contracts by means of bribery. In turn, public contract-placing authorities were to check whether any candidates for a contract worth more than 50,000 euro were included in the blacklist. Individual *Länder* such as North Rhine-Westphalia are currently considering introducing their own corruption registers.

The opposition regarded the law on compliance with standard wage rates as an attack on collective bargaining autonomy and freedom to provide services, and believed that the corruption register ran the risk of punishing the whole company for the misdemeanours of one of its parts.

Conclusions

The underground economy in Germany is believed to have grown, particularly owing to transnational illegal employment, changing household structures (higher demand for services because of increasing employment rates among women) and sustained unemployment. To date, the research on clandestine employment in Germany, particularly that carried out by neoclassical economists, has been too sweeping in attributing the growth in the underground economy to taxation levels and the large amount of regulation, without making an adequate distinction between organised criminality and the clandestine employment of the man in the street. Much of the research on the underground economy has been exploited by those concerned with popularising programmes of deregulation and tax reduction. This inadequate analysis of the causes has long impeded effective combating of the various forms of clandestine and illegal employment. Only in the past few years have many measures been adopted in an attempt to reduce the incentives for clandestine employment and to combat it more effectively. Overall, the various laws have tightened up the previous diversity of competences and facilitated data exchange. The customs administration has acquired key functions in the combating of illegal employment and its staffing has been increased. It is not yet possible to assess how effective the many new initiatives have been.

The liability of general contractors and that of the prime contractor for the social security contributions of sub-contractors represent measures to prevent clandestine employment at the source. However, general-contractor liability has been devalued as a result of generous allocation of certificates of exemption. Liability for social security contributions has lost much of its effectiveness by being limited to the first sub-contractor. These "design faults" in preventive action and the opposition's refusal to approve a corruption register and laws on compliance with standard wage rates show that Germany has still failed to achieve a broad social consensus on effective combating of clandestine and illegal employment.

Gerard Bosch

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Estonia

Introduction

This paper examines the prevalence of undeclared work and measures taken to combat it in Estonia. The mere fact that this kind of employment is hidden/not registered means that it is very hard to assess the size and nature of the phenomenon. Moreover, since the definitions and measurement methods used to describe undeclared work differ across countries, it is even more difficult to get comparable estimates internationally.

In the current article, the Commission definition is used. According to the definition "any productive activities that are lawful as regards to their nature, but are not declared to the public authorities, taking into account the differences in the regulatory system between Member States" are regarded as undeclared work (European Commission 1998).

The calculations of the Statistical Office of Estonia (ESA) on the size and structure of the informal economy are based on the Commission Decision on Exhaustiveness of 22 February 1994.

However, the core definition of informal employment (see the definitions by OECD 2004, p.236) is predominantly used while talking about undeclared work in Estonia. Where in broad terms this means that the focus has been on wholly undeclared work (both the employment status and earnings are concealed), under-declared work (where employers pay taxes only on the minimum wage, paying the remaining salary "under the table") and tax evasion on the earnings of the self-employed.

Undeclared work has major consequences on the labour market and economic development. The main concerns raised by the informal economy in Estonia include: tax evasion resulting in lower tax revenues which in turn exert pressure to raise tax rates; weak social protection of the workers as non-reported or under-reported earnings can lead to low social security, and unfair competition between enterprises in the formal and informal sector which may reduce the competitiveness of the private sector. Therefore, informal employment can slow down economic development.

Prevalence of undeclared work in the economy

To assess the size and nature of undeclared work in Estonia, the calculations of the Estonian Statistical Office are used as mentioned previously. In addition, survey data on “envelope wages” by Estonian Institute of Economic Research is incorporated to the analyses.

The share of the informal economy in GDP during 1997-2001 has decreased to around 7-8% (see Table 1). This is slightly higher compared to the EU's where the respective share is around or below 5% of GDP with the exception of Italy and Greece. In comparison with the new EU members, Estonia (together with the Czech Republic and Slovakia) belong to the group of countries where the share of undeclared economy is lowest (around 8-13% of GDP) (Renooy *et al* 2004).

Table 1: Share of informal economy in Estonian GDP, %

Year	At market prices, %	At basic prices, %
1997	10.4	12.0
1998	8.8	10.0
1999	8.7	9.7
2000	7.9	8.9
2001	7.4	8.3

Source: Purju *et al* 2004

Similarly, the share of undeclared employment in total employment decreased during 1997-2001 from the level of 8.0% to 6.1%. (Purju *et al* 2004)

The economic activities with the highest share of employment in the informal economy in 2001 were (Purju *et al* 2004, authors' calculations):

- Community, social and personal service activities (21%);
- Wholesale and retail trade; repair of motor vehicles, motorcycles and personal and household goods (16%);
- Real estate, renting and business activities (13%);
- Agriculture, hunting and forestry (9%).

The share of males and females engaged in undeclared work is equal. However, there are clear differences in economic activity which reflect the overall gender composition of sectors. Males dominate in agriculture, hunting and forestry and construction, while females are mostly concentrated in health and social work, hotels and restaurants and education. (Purju *et al* 2004)

In addition to the calculations by ESA, the Estonian Institute of Economic Research carries out annual population surveys on the hidden economy in Estonia. According to the 2003 surveys, about 16% of people claimed that they sometimes or regularly receive undeclared wages or so-called “envelope wages” (see Table 2). However, the share of those people has declined over the last years.

Looking at people's attitudes towards envelope wages, it becomes evident that the share of people who disapprove of undeclared payments increased from 57% in 2000 to 89% in 2003. The most important reasons of disapproval are (Estonian Institute of Economic Research 2004):

- missing health insurance;
- lower future pension;
- being unfair with respect to other taxpayers and enterprises;
- being illegal;

Table 2: Share of employees receiving “envelope wages”, % of responders

	1999	2000	2001	2002	2003
Receives regularly	8	5	8	7	7
Receives sometimes	11	9	8	6	9
Never receives	81	86	84	87	84
Total	100	100	100	100	100

Source: Estonian Institute of Economic Research “Varimajandus Eestis”, Tallinn 2004

- leading to lack of public finances which constrain the supply of public services;
- leading to difficulties with obtaining loan from bank;
- leading to insufficient financing of the social sector.

This shows that public attitudes towards undeclared work have in general become less tolerant during recent years.

The reasons behind the declining share of undeclared work are manifold. The general economic development and steady transition to a market economy, together with the development of the legal system and increased legitimacy of central government, are important factors behind this development.

Another explanation is the tight integration of the Estonian economy with Western markets and a high volume of foreign direct investment. Most of the foreign companies prefer formal employment. (Purju *et al* 2004).

The third group of explanations relate to the social security system. The reforms of the social security system where the benefits depend increasingly on personal contributions have increased the incentives to declare employment and earnings. In 1997, the Government reformed the pension system, in 2002 the unemployment insurance system came into force and in 2004 the new parental benefits scheme was launched.

The reasons often quoted behind the large informal economy in CEE countries are related to general social norms and attitudes inherited from the socialist system. Corruption, widespread infringement of norms, negative attitudes towards the role of the State and not seeing the linkage between taxes paid and social services received are mentioned among others (see e.g. OECD 2004, Purju *et al* 2004, Renooy *et al* 2004).

Despite the fact that the share of undeclared work has been declining in recent years it still remains on relatively high levels compared to the more advanced EU countries. The main causes for that include tax evasion and relatively lenient public attitudes towards the phenomenon. Furthermore, according to Purju *et al* (2004) cross border trade in North-East Estonia (close to the Russian border) could be the source of informal income.

Measures taken to combat undeclared work

The Estonian labour market and tax authorities give high priority to combating undeclared labour as a part of the informal economy. The focus has been on both encouraging formal work by keeping taxes low, relating social insurance benefits to individual contributions and increasing sanctions and controls. An important part of the policy to combat undeclared work has been the creation of relatively simple regulations for businesses and avoiding over-regulation in the labour market to ensure its flexibility and efficient

functioning. The main elements of the policy such as employment protection legislations, business regulations, tax measures, social security system and sanctions are briefly analysed in this report.

Employment protection and minimum wage

Employment protection legislation is considered one of the main reasons behind undeclared work (see OECD (2004), p. 255). When Estonia established various forms of employment protection legislation in the 1990s it chose legislation similar to continental European countries, so that, by the end of the 1990s, regulations broadly resembled those found in the EU countries.

Currently the employment relations in Estonia are regulated by the Employment Contracts Act. According to the Labour Inspectorate the most common violation of the Employment Contract Act in 2003 was the absence of written employment contracts (Labour Inspectorate 2004). Employment contracts may also be concluded orally if the term of the contract is less than two weeks. However, it has been argued by the Estonian Labour Inspectorate that oral contracts have encouraged undeclared work, because it makes workplace inspectors harder to detect *de facto* longer-term employment contracts (Narusk 2004).

According to labour force survey data only 2.3% of the employed worked on the basis of an oral agreement in 2003. The share was higher for males (3.4%) and in rural areas (4.1%). The number of people working with an oral contract has decreased from 3.8% in 2000. (Statistical Office of Estonia 2004).

Similarly to other CEE countries (see for example OECD 2004, p. 256 for Lithuania), many employers pay taxes only on the minimum wage in Estonia. Annual minimum wage increases negotiated by trade unions, have been justified by the need to reduce “envelope wages”, among other motives. During 1996-2003, the ratio of the minimum wage to the national average wage increased from 22.8% to 32.1%. Furthermore, in 2001 the social partners concluded a long-term wage agreement, according to which the minimum wage will increase to 41% of the average wage in 2008. However, according to Rõõm (2003) the increases in the minimum wage in the second half of the 1990s “had a negative effect on the employment of workers directly influenced by it, e.g. workers whose wages in the period prior to the increase of the minimum wage fell between the old and the new level of the minimum wage”. Therefore, the impact of increasing the minimum wage on undeclared labour is ambiguous: on the one hand tax revenues could be maximised, but on the other, this may exclude some workers from formal employment.

Business regulation and red tape

One of the aims of economic policy has been to simplify the creation of businesses. To reduce the costs related to red tape (i.e. all kind of administration of Government paperwork, tax administration, registration of employment contracts, requirements of obtaining licences, etc.) and to promote the creation of new enterprises, a governmental agency named Enterprise Estonia was founded in 2000 by the Ministry of Economic Affairs. Enterprise Estonia is one of the largest institutions within the national support system for entrepreneurship in Estonia. Together with 17 business advisory centres and a one-stop internet site they form a business support network that provides information on the start-up of enterprises, including consultation, strategic analyses and assistance in contacting foreign investors. Enterprise Estonia also provides start-up grants to small-and-medium size enterprises to encourage formal economic activities.

Small-scale business start-up grants for unemployed people are also provided by a programme of the Estonian Labour Market Board. However, only a very small number of unemployed have participated in the programme. The grants have been relatively low (about four times the average net wage in Estonia), so their effect has been moderate.

To reduce red tape, the Estonian Government has also emphasised the introduction of modern information technology into communications between governmental agencies and the private sector. For example, to reduce the administrative costs of taxes, in 2000 the Estonian Tax Board introduced the e-Tax Board that enables tax-payers (both enterprises and individuals) to fill-in and file tax returns and to receive information on their tax liabilities and account balances on-line. This has proved very successful as taxpayers have no added cost for using electronic services. In 2004, for example, more personal tax income returns were submitted electronically than on paper. The same is true for VAT returns and social tax returns. (Estonian Tax Board 2004).

Tax measures

Despite the fact that, in general, the tax burden on the economy is low in Estonia compared to EU countries, surveys indicate that among the main reasons for undeclared or under-declared work are high labour taxes (Estonian Institute of Economic Research 2004). The share of total taxes (including social security contributions) was 35.2% of GDP in 2002, placing Estonia 19th among the EU 25 countries (Eurostat and DG Taxation and Customs 2004, p. 239). The low general tax level is, however, mainly due to low corporate income taxes; taxes on labour (income tax and social insurance tax) are considerably higher.

The Estonian tax system is a simple proportional tax system. Since 1994 Estonia has had a single personal income tax rate at the level of 26%. Payroll taxes are also proportional: 33% social insurance tax (comprised of 20% for pension insurance and 13% for health insurance), and unemployment insurance payments (0.5% employers' contribution and 1.0% employees' contribution in 2004). Unlike some EU countries, there is no provision for lower contribution rates to be applied at low earnings levels. Neither is there an upper ceiling for social insurance contributions. Despite income tax exemptions, which make the average tax lower for low-income employees, taxes and the so-called tax wedge are still considered relatively high for low-skilled workers and discouraging employment (Rõõm 2003).

To reduce labour costs and to encourage employment, it has been foreseen that the tax exemption will rise to EEK 2000 (128 euro) per month and the personal income tax rate will decrease to 20% by 2007.

Social security system

In addition to tax cuts that should encourage formal employment, the social security system has been reformed so that social benefits are more related to personal contributions and hence give incentives to be employed formally. In recent years, there have been changes in the pension system, unemployment benefits “scheme, and parental benefits” scheme. In all cases personal contributions to the system now have a major role in determining the size of the benefits.

Since 1997, the Estonian Government has been reforming the pension system by introducing a three-pillar pension scheme: pillar I – compulsory State-managed PAYG pension scheme; pillar II – compulsory privately managed funded pension scheme; pillar III – voluntary private pension schemes. Also, since 1996 pensioners have

been able to simultaneously receive old-age pension and work which has reduced the motivation for undeclared work and together with increases in retirement age have increased employment rates in the age group 55-64. Since 1999, individual contributions of social tax payments (also for employed pensioners) have influenced future pensions under the first pillar. In 2002, pillar II started functioning, in which contributions depend fully on personal social tax payments.

The introduction of personalised social tax accounts and pension schemes is one reason behind increased regular employment and higher growth of formal wages in general.

There were also changes in the Estonian unemployment compensation system, where personal contributions started to determine the size and duration of future benefits. In 1991-2002 the unemployment compensation system consisted only of flat rate unemployment assistance benefits for 180-270 days, which depended only on having had formal employment of 180 days during the previous year. In 2002 compulsory unemployment insurance system was introduced and the payment of benefits started in 2003. In this new system, the size of the benefits depends on the contributions to the system which are proportional to the formal wages.

Formal employment status is required to be covered by health insurance, (except in certain cases that were considered of equal status to an insured person). To encourage employment the range of people entitled to health insurance was restricted in 2002. Until then a spouse dependent upon an insured person was considered equal to an insured person, but since October 2002 only a spouse with up to five years left until attaining pension age and dependent upon an insured person is considered equally insured.

In addition, there has been a shift towards the increased relationship between personal contributions and benefits also in the family benefits system. In 2004 a new type of parental benefits¹ was introduced where a parent receives her/his average wages for 365 days. The size of the benefit depends on personal social tax during the calendar year prior to the child's birth. For those who have not worked minimum benefits are guaranteed and there is an upper limit to benefits. Although the system was not designed to tackle undeclared work, it should still have a diminishing impact of undeclared labour by fertile-aged women.

Subsistence benefits and poverty trap

Subsistence benefits are the last-resort social benefits in Estonia. They are means tested and the duration is not limited. Subsistence benefits are paid to persons whose monthly income, after paying for fixed expenses for dwelling, remains below the subsistence line. Since November 1997 the subsistence line for the first household member has been EEK 500 (32 euro) per month, for other household members it has been EEK 400 (26 euro) since 1999. Although this is relatively low, subsistence benefits create 100% marginal tax rate, reducing incentives for low-income earners in certain type of families (depending on family structure and housing costs) to be formally employed (see for instance Kuddo *et al* 2002, p. 46).

Although quantitative estimates are missing, interviews with social workers and officials from local employment offices suggest that undeclared work has been common among beneficiaries of unemployment assistance or subsistence benefits (Kuddo *et al* 2002, pp 78-79).

Sanctions and control

Combating undeclared work has been one of the major tasks of the Estonian Tax and Custom Board² together with the Police Board, the Labour Market Board, and the Labour Inspectorate. The major focus of attack has been the ascertainment of the payers (employers) of concealed salaries. It means that the focus of the authorities has been regular employment and not temporary work by self-employed person for baby-sitting, housing, etc.

Fighting against concealed salaries became more systematic from the beginning of 1999 when administration of social tax collection was given to the authority of the Tax Office. In subsequent years, combating concealed salaries has been one of the Tax Board's priorities.

In December 2000 the Parliament amended the "Code of Criminal Procedure and Surveillance Act" to grant the Tax Board the rights of pre-trial investigation and surveillance. As a result, in 2001 the Tax Fraud Investigation Centre was established. Previously the investigation of tax frauds was divided between two different authorities – the Tax Board and the Police Board, but the co-operation did not yield satisfactory results. The most important activities of the centre were the detection of VAT fraud and concealed salary payments (Estonian Tax Board, 2002).

At the end of 2001 the Tax Board, the Labour Inspectorate, the Labour Market Board, and the Police Board reached an agreement to start exchanging information on tax frauds, violations of labour laws, and to organise joint operations to pursue the offenders. When carrying out workplace inspections aimed at the detection of concealed salary payment and ascertainment of illegal labour, the Labour Inspectorate verifies the existence of valid employment contracts, the police assist in identifying persons, and the Tax Board checks the accounting documents.

In the Tax Board's estimation, the controls have had a positive influence on the decrease in the percentage of the payers of "envelope salaries". This viewpoint has been seconded by several analysts who see the actions of the tax administration as one of the driving forces behind the fact that the average salaries in some industries rocketed. The Minister of Finance has also pointed out the diminishing relative importance of the concealed salary payments as one reason for the over-receipt of State budget revenue in 2002. (Estonian Tax Board, 2002)

In Spring 2004, the Estonian Tax Board chose a new strategy of combating concealed salaries by sending informative letters to enterprises that had formal labour costs remarkably lower than the average of similar enterprises in the same field and asking them to check their data on taxes and make appropriate corrections. Otherwise there would be an audit by the Board. Three sectors receiving most of the letters were construction, hotels and catering, and car sales and repair. The method has proved to be very cost-effective as first experiences have shown that about a quarter of the enterprises receiving these letters improved their tax-reporting immediately. (Äripäev 25.05.2004)

In Estonia every person has an identity number, which allows for the extensive linking of databases from social security institutions, the Tax Board, health insurance etc. Data exchange between relevant institutions should reduce to a minimum the possibility of receiving social benefits (e.g. unemployment insurance) and work formally at the same time. However, audits by the State Audit Office (2003, 2004) have revealed that data exchange between labour market

¹ Vanemahüvitis (in Estonian)

² Since 1 January 2004 the merger of the Estonian Tax Board and of the Customs Board took place and the formal name of the merged institution is now the Estonian Tax and Customs Board.

institutions and tax authorities, for example, does not work in practice and it has discovered cases where persons have simultaneously received unemployment benefits and worked.

Information campaigns, social norms

To raise both individual and social awareness of the costs of undeclared work and unpaid taxes, the authorities have initiated several media campaigns to inform both employers and employees of the risks and disadvantages of undeclared work and informal labour relations.

At the end of 2003 the Ministry of Social Affairs started an advertising campaign called “Do not be cheated, conclude an employment contract”³ to promote official and written employment contracts. The campaign is targeted both at employees and employers. The campaign introduced the mutual benefit of a formal contract, which gives security for the future to both parties. The campaign ended with a major conference on labour market issues.

In Spring 2004, the Estonian Tax Board encouraged all employees receiving undeclared payments to inform the tax authorities of these, because the employee does not get sickness benefits, severance payments, holiday pays, or unemployment insurance benefits on undeclared payments; also, future pensions and the possibility of getting a loan from banks depends on formal income.

Conclusions

The share of undeclared labour in Estonia has decreased in recent years and is currently around 7-8% of GDP according to the calculations of the Statistics Office of Estonia. Undeclared work in Estonia can be mainly found in the community, social and personal services, wholesale and retail trade and repair. As compared to the new Member States of the EU, the level of undeclared labour in Estonia is one of the lowest. However, it still remains relatively high compared to the original Member States. The main reasons for undeclared work in Estonia include tax evasion and general social norms inherited from the socialist system.

One of the dominant forms of undeclared work in Estonia is undeclared work or the so-called phenomenon of “envelope wages”. According to the survey data, about 16% of the people claimed that they sometimes or regularly received undeclared wages in 2003. However, the share of the people receiving envelope wages has decreased in recent years according to the survey. Also, public attitudes towards undeclared work have become less acceptable.

The decreasing share of undeclared work in Estonia can be explained by the general economic development accompanied by the improvement of the legal system and increased legitimacy of the central government. Furthermore, high levels of foreign direct investments have supported this trend.

To reduce the share of undeclared work, the Government actions have focused on wide ranges of policy areas. These include the creation of a competitive economic environment through simple employment protection and business regulations. Empirical analyses suggest that the strictness of the employment protection legislation in Estonia is at the average level of the older EU Member States, while the administrative regulations affecting firms' entry, exit and labour adjustments are relatively easy.

The other aspect of the policy mix has been encouraging formal employment by keeping taxes low. However, this is mainly achieved

by low corporate income taxes. Taxes on labour are on the average level of the EU but the tax wedge for low skilled workers in Estonia is considered relatively high. According to the surveys, high labour taxes are the main reason for envelope wages in Estonia.

The reforms of the social security system have given additional incentives for formal employment. In recent years the pension system has been reformed and the new unemployment insurance system and parental benefit scheme were launched. In all these systems, personal contributions have a major role in determining the size of the benefits.

Fighting against envelope wages has been at the centre of the control activities. To increase the effectiveness of these activities, various administrative reforms have been carried out and control activities have been intensified. There are no evaluations available on the possible effects of these activities, but the analysts believe that intensified controls have reduced the envelope wages.

To raise the individual and social awareness of the costs of undeclared work, several media campaigns have been carried out. However, it seems that the campaigns have been focusing mainly on individual benefits of formal work rather than social responsibility.

In general, one would expect that the overall economic development of the country will work towards reducing undeclared work and the composition of it. It is likely that the share of envelope wages will decrease and the work in households such as cleaning, babysitting, small-scale construction work, etc., will increase.

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Introduction

Undeclared work can be understood in various ways. The 1998 Commission Communication on undeclared work defined the latter as "any paid activities that are lawful as regards their nature but not declared to the public authorities, taking into account differences in the regulatory system between Member States". A somewhat broader definition has been adopted by a recently completed study on undeclared work in an enlarged Union¹. According to this definition, undeclared work is to be understood as productive activities (rather than paid ones), lawful but not declared to the public authorities. In practice, the difference between the two definitions relates to informal employment and its treatment as a component of undeclared work. Informal employment comprises not only employment in the informal sector of the economy, but also informal jobs in the formal sector, where there is no clear employer-employee relationship (e.g. unpaid family workers). For reasons explained below, this broader definition of undeclared work is more relevant in the case of Greece, and is thus adopted in this report.

Before proceeding with the examination of evidence on undeclared work, it would be useful to briefly describe the Greek employment structure, as this structure has implications both for opportunities for undeclared work and for the volume of undeclared work performed. According to the latest statistics (Labour Force Survey, 2003 Q4), the self-employed (together with employers) make up approximately 31.9% of total employment (estimated at 4076.5 persons), with family workers accounting for a further 8.6% of the total. Employees (i.e. wage and salary earners) complete the picture with a share of 59.5% of total employment. This employment structure is in stark contrast with the situation prevailing in other EU countries (southern Member States included), where wage

employment is the dominant form of employment, making up for more than 80% of total employment and where the self-employed and family workers, in particular, occupy much smaller shares. To a large extent, the large share of self-employment and family workers in Greece is the cause (and also the outcome) of a large agricultural sector which is based on very small holdings and family-based production.

Another feature differentiating Greece from the other EU countries is the massive influx of immigrants throughout the nineties. Up until the 80s, Greece exhibited unusual ethnic homogeneity, as the majority of the population was born in Greece and was Greek Orthodox. This situation has been radically altered in recent years. Following the collapse of the Soviet Union and the political and economic instability in the Balkans, large numbers of economic immigrants have chosen Greece as a destination country. The inflow of immigrants was massive during the first half of the Nineties and quite substantial during later years. Today it is believed that immigrants account for at least 10% of the total population and for about 15% of the total working-age population².

The large-scale inflow of immigrants has implications for undeclared work. Being illegal, immigrants had no other option but to look for jobs in the informal sector of the economy. Immigrants benefited from a large informal sector, which was already in existence prior to their arrival, and this informal sector has expanded and has continued growing, at least up to the beginning of the decade.

The undeclared work performed by immigrants (legal and illegal) has attracted a lot of attention in recent years. This type of employment is commonly referred to as "illegal" employment (illegal in the sense that there are no contractual arrangements,

¹ Renooy P., Ivarsson S., van der Wusten-Gritsai O., Meijer R. (2004), "Undeclared Work in an Enlarged Union", Report for DG EMPL.

² The subject of immigrants has been relatively well researched in Greece. See Cavounidis (1999), Cavounidis (2002), Petraki Kottis (1999), Tzortzopoulou (2002).

payment of social security contributions, etc.), and often as “black” employment. The latter term is used mainly by the press and the media. Greece is currently modernising its immigration policy and, as part of this process, immigrants are being regularised and given incentives to work in the formal economy. Combating undeclared work performed by immigrants, has raised public concern on the future employment prospects of certain native groups competing with immigrants in the labour market and thus on the future development of the unemployment rate in the formal sector of the economy.

Prevalence of undeclared work in the economy

Quantitative estimates on the volume and structure of undeclared employment are non-existent in the case of Greece³. Hence, this section relies on indirect evidence in order to establish an impression of the size and the characteristics of those engaged in undeclared work.

Indirect evidence on undeclared employment can be provided, first and foremost, by estimates of the size of the informal economy. Such estimates have been recently provided for a large number of countries around the globe including Greece, by Schneider (2002). According to this piece of information, Greece exhibits the highest level of informal economy, expressed as a share of GNP, among the OECD-West European countries examined (28.6% of GNP in 1999/2000). This proportion of GNP includes unreported income from the production of legal goods and services, either from monetary or barter transactions. It includes therefore all economic activities which would be taxable had they been reported to the State (tax) authorities. Following Greece, high levels of informal activities are reported for Italy (27.0%), Belgium (23.2%), Spain (22.6%) and lastly for Portugal (22.6%). Expressed in income terms, the informal economy in Greece is estimated at 329.2 billion USD (251.9 billion euro), with a corresponding informal economy per capita GNP at USD 3,420.60 (2,618 euro).

Schneider also provides estimates on the evolution of the informal economy during the last decade or so. According to this data set, the informal economy sector grew during the first half of the Nineties in Greece (from 22.6% in 1989/90, to 24.9% during 1991/92 and from there on to 28.6% during 1994/95), while it has remained relatively stable since then and until the beginning of the current decade. In conclusion, Greece appears to exhibit the highest share of informal economy among a number of West European countries. Further, the informal economy sector seems to have grown considerably during the early nineties, a finding that may well be associated with the influx of immigrants mentioned in the introduction.

Turning to undeclared employment, a definition of the term relevant for Greece would include both paid and non-paid employment activities⁴. This is both because the informal sector provides the necessary ground for undeclared work to flourish and because there is high mobility and substitution between undeclared paid employment and undeclared non-paid employment, to the degree that separating these two sectors would not be intellectually defensible.

As direct estimates of undeclared employment (paid and unpaid) are not available, the next best thing in order to obtain a picture on the size and structure of undeclared employment is to provide evidence on sectors of economic activity classified according to the

status of those employed. As a rule of thumb, undeclared employment is bound to be higher in activities with a high incidence of family workers, self-employed and immigrants. Conversely, undeclared employment is taken to be inversely correlated with wage employment.

Table 1 presents the latest information on sectoral employment by economic position (status) of the employed population. Starting with family workers (typically the wife and children of the household head), these represent a respectable segment of those in employment (351,600 persons or 8.6% of the total). Their absolute majority (192,800 persons or 54.8% of the total) is active in agricultural employment. A large number of family workers are also found in distributive trades, tourism, manufacturing activities and construction.

The self-employed (without any employees) comprise a much more sizeable portion of the total employed population (1 million persons, 24.6% of the total). Two sectors appear to be particularly important for this category of the labour force: agriculture and distributive trades. Taken together, 612,100 self-employed persons, or 61% of the total, are to be found in these two sectors. Self-employment, however, appears to be more dispersed than family work. Hence, the self-employed are numerous in manufacturing activities, business and financial services, construction, transport and communication and, lastly, in tourism.

The combined incidence of self-employment and family work is particularly severe in farming, where 88.7% of those engaged are either self-employed or family workers. It is also important in distributive trades (41.3%), in business and financial services (34%) and in tourism (31%). Lastly, lower but substantial shares combining self-employed and family workers (around or above 20% of the total) are to be found in transport and communication, in construction and in manufacturing activities.

Regarding immigrants, the principal source for assessing migratory trends is currently the latest Population Census (2001), conducted by the National Statistical Service of Greece. According to the Census results, non-Greek nationals were just under 800,000 at the beginning of the decade, or 7.3% of the total population. It is believed, however, that the Census has underestimated the total number of immigrants and that their real number is close to, or above one million persons (roughly 10% of the population). Of all non-Greek nationals, 54.2% stated employment as the main reason for immigration.

Information on the labour market situation of immigrants is collected by the Labour Force Survey, which distinguishes between EU and non-EU nationals. According to this set of data, in 2002, non-EU nationals exhibited employment rates significantly higher than those for EU nationals (68.4% in relation to 56.3%). During the same year, non-EU nationals residing in Greece suffered less from unemployment than EU nationals (9.6% in relation to 9.9%). During the last ten years or so, employment rates for non-EU nationals appear to have grown faster than those for the EU nationals. The employment rate for non-EU nationals has risen from 55.3% in 1992 to 68.4% in 2002 whereas, during the same time period, the equivalent rate for EU nationals increased from 53.6% to just 56.3%. In addition, unemployment appears to be falling among non-EU nationals (from 14.2% in 1992 to 9.6% in 2002). In contrast, the unemployment rate for EU nationals rose from 8.0% in 1992 to 9.9% in 2002. On the basis of these estimates, one would conclude

³ One exception relates to second job holding. According to Eurostat and to information drawn from the 2002 LFS, only 3.1% of those in employment held a second job in Greece, compared to 3.5% for EU-15.

⁴ Activities such as work provided within the household by women are of course excluded from having to be reported to the authorities.

Table 1: Employed population, by economic sector and economic position, 2003 Q4, in thousands of persons

	Total	Employers (self-employed with employees)	Self-employed (with no other employees)	Employees (wage and salary earners)	Family workers
Agriculture, horticulture and forestry	658.6	42.4	391.6	31.8	192.8
Fisheries	13	0.8	7.7	3.1	1.4
Mining	11.7	0.1	0.3	11.3	0
Manufacturing	535.8	46.3	73.1	389.3	27.1
Electricity, gas and water	38.1	0.2	0.1	37.7	0.1
Construction	333	40.1	56.5	226.5	9.9
Wholesale and retail trade	712.3	74.8	220.5	342.9	74
Hotels and restaurants	266.9	36.6	51.2	147.4	31.6
Transport, storage and communications	244.2	7.8	51.8	180.2	4.4
Financial services	102.7	1.8	8.6	91.7	0.5
Business services and real estate	227.8	25.9	72.8	124.3	4.8
Public administration	299.6	0.5	0.9	298.3	0
Education	264.9	7.1	13.3	243.5	0.9
Health and social work	172.5	3.9	24.6	143.5	0.4
Other services	140.5	7.1	28	101.7	3.6
Employment in private households	54.6	0.3	2.2	52	0
Ex-territ. Organisations and bodies	0.4	0	0	0.4	0
Total	4,076.60	295.9	1,003.10	2,425.90	351.6

Source: National Statistical Service of Greece, Labour Force Survey

that immigrants have been integrated into the labour market successfully.

Although immigrants are not homogenous as a group, employment is concentrated in three sectors: agriculture, construction and personal services. It is estimated that seven out of ten immigrants work in one of these sectors. Of the immigrants in employment, 17.5% work in agriculture, as opposed to 14.1% of natives working in this sector. Almost one quarter of all employed immigrants are employed in construction (compared to just 6.9% of natives), whereas more than one quarter (27.6%) in miscellaneous, mostly personal, services. In agriculture, the arrival of immigrants coincided with the long-term decline in agricultural production and the unwillingness of young farmers to work for low wages under difficult conditions. Immigrants have helped to revitalise production by being willing to work for wage rates the farmers could afford and by substituting for family workers and other groups of seasonal workers, such as Roma workers. In construction also, rather than causing displacement effects, the immigrants are thought to have contributed to the expansion of the sector, favoured by the large public infrastructure projects, financed by the Structural Funds and, more recently, by the projects for the preparation of the Olympic Games. Finally, it is thought that by providing domestic help, immigrants have indirectly contributed to increasing the labour force participation rates of native Greek women.

In trying to account for undeclared work, two explanatory factors of major importance have been identified in academic literature: the institutional and regulatory conditions of the economy and the existence of a “culture” for activity in the informal economy.

The institutional and regulatory set of factors relate to the level of tax burden on labour, to the level of social security contributions, to regulations concerning overheads and, finally, to regulations concerning the so-called new and flexible forms of work. As regards

the taxes and social security contribution levels, the bigger the difference between the total cost of labour and the disposable earnings, the greater the incentive to work in the informal sector of the economy. Thus a high level of tax and social security contributions may act as a stimulus for the labour supply in the untaxed sector of the economy.

Schneider (2002) has compared the overall tax and social security contributions level with the size of the informal economy in a number of OECD countries for the year 1996. In trying to provide an explanation for differences in the size of the informal economies in these countries, Schneider did in fact find a certain degree of correlation between the two variables, in the sense that the countries with high overall tax and social security burden often exhibited high levels of informal economy. Thus Greece, the country with the highest share of informal economy among those examined (28.5% of GNP), was found to exhibit one of the highest burdens of tax and social security (calculated as the sum of average direct tax rate, Value Added Tax rate and social security contributions): 72.3%, lower only to that of Sweden (78.6%), Belgium (76%) and marginally to that of Italy (72.9%). The rate of social security contributions, calculated on the basis of the annual gross earnings of an average income earner in particular, was found to be the highest among the countries under examination (43.3%), with the exception of France (44%). On the basis of these findings, there is little doubt that the high non-wage cost in Greece stands among the factors accounting for the presence of undeclared work.

Regulatory burdens are thought to constitute another influential factor for the prevalence of undeclared work. In general, regulations increase labour costs with the end result to drive individuals and firms into the informal economy, where these costs can be avoided. Although there are no studies to substantiate it, Greece must be one of the more regulated economies in the EU. The Employment Protection Legislation (EPL) in particular appears to be among the

strictest in the EU and this may have something to do with the large share of self-employment as well as with the size of the informal sector (OECD, 1999). Again, however, there are no empirical studies to verify or dismiss these claims.

A decrease of the tax and social security contribution burdens as well as a decrease in the intensity of certain regulations (such as licence requirements, for example) may help decrease the level of undeclared work, but it is unlikely that the latter will cease to exist. This is because a “culture” of informal economy can be said to exist in Greece. Against such a background, administrative regulations can only have a limited impact. People often view undeclared employment as something legitimate, and this might perhaps explain why sanctions against employers employing illegal immigrants are never enforced, despite the fact that they are envisaged by legislation.

With respect to the impact of undeclared work upon individuals and upon production, productivity and competition, very little is known. One notable exception, however, concerns the impact of undeclared work upon revenue losses from social contributions. Public finances suffer from the non-declaration of work and the curtailment of receipts is in its turn reflected upon the level of services the State offers. In this frame, Tatsos (2001) has, among others, attempted to estimate the level of revenue losses from the non-declaration of the work performed by indigenous Greeks as well as from non-regularised immigrants (i.e. immigrants having applied unsuccessfully for permit) for the year 1997. According to findings, the loss for IKA, the largest of the Social Insurance Funds, amounted to almost 30% of the total receipts for the same year. It should be mentioned that this is an underestimate of the total loss in revenue, as the total number of illegal immigrants far exceeded those that applied for residence permits.

Measures taken to combat undeclared work

With respect to efforts to reduce undeclared work, Greece has taken a number of measures in the last few years on a variety of policy areas. Some of these measures, such as the procedures for regularising undocumented immigrants, have had a real impact on undeclared work.

As regards the business environment, Greece scores rather poorly in the field of entrepreneurship, in relation to the number of procedures to start a business (16 in relation to OECD average 7), duration in days (45 compared to 30), cost as % of GNI per capita (69,6 compared to 10,2) and minimum capital required, as % of GNI per capita (145.3 compared to 61.2). Greece also scores poorly in relation to flexibility in hiring and firing workers. The flexibility of hiring index is estimated at 78 in Greece (compared to the OECD average of 49), while the flexibility of firing index, is at 43 (OECD average 28)⁵.

Given that public sentiment towards entrepreneurship is strong in Greece (for cultural reasons, among others), there is a “window of opportunity” here for transforming traditional self-employment and undeclared work into business activity. In this respect, a new law of 2001 went some way to simplifying the registration and licensing procedures for new businesses. During 2002 also, a new law envisaged the creation of a Guarantee Fund Facility Scheme for Small Enterprises (TEMPME). This organisation is to cover one half of the guarantees small enterprises need in order to get bank loans. The continued simplification of the administrative and regulatory environment and especially the easing-up of restrictions

on working hours, can strengthen incentives to transform undeclared work to declared work.

Apart from improving the climate for entrepreneurship, the lowering of the tax rates and the lowering of the high social security contributions paid on labour incomes can also have a positive effect on formal employment.

With respect to the tax system, 2003 has seen the implementation of a second wave of tax reform, which abolished a large number of reductions, exemptions and allowances (while simplifying the remaining ones) and lowered the personal income tax (through increased tax-free allowances).

Social security contributions remain high in Greece in relation to European averages, accounting in 2001 for more than 34% of total gross labour cost, excluding supplementary contributions for hazardous work (OECD, 2002). Further, the contribution rates increased during the nineties by 4 percentage points, compared with a rise of 2.1 percentage points in the EU.

The Government introduced legislation in 2000 (law 2874/2000, in effect since April 2001), envisaging a 2 percentage point reduction of the employers' social security contributions for low-wage workers (defined as those whose monthly wages do not exceed 587 euro). It is estimated that the reduction amounts to a 1.6% cut in total labour costs for those workers. In addition, the government is subsidising minimum-wage earners' own social security contributions by paying the part going to the pension account of IKA (6.7% of gross pay).

More recently (2003), the Government introduced a new package of labour market measures, aiming to increase employment by reducing non-wage costs for jobless women with children, as well as for unemployed youths and people over 55 years. Thus, women working as farmers are exempt from the payment of social security contributions for one year after the birth of their second child and employers who hire unemployed youth (up to 25 years of age) or unemployed aged 55 and over are to be granted a reduction of 50% of the employer's insurance contribution. The 2003 labour market package attempted also to improve the employment opportunities for the registered unemployed by subsidising the firms that hire such workers with an amount equivalent to the unemployment benefit.

The cumulative impact of the above measures, as well as of a number of other measures, mentioned in the NAP 2003 (such as the modernisation of the key organisations IKA, which is a social insurance institute; OAED, the Greek Public Employment Service; and the Labour Inspectorate), is certain to be positive, yet limited. The effective combating of undeclared work would require more far-reaching changes in the field of non-wage labour costs and possibly in the field of employment protection legislation. It is understood, however, that further cuts in the rate of social security contributions are prevented by the severe revenue losses incurred because of the existence of a large undeclared work sector, which is a vicious circle.

But if recent changes in the institutional and regulatory framework are modest and of limited impact on undeclared work, the modernisation of immigration policy can be said to have a real impact upon the issue.

Greece was the last of the southern European countries to implement a regularisation programme for undocumented immigrants (Cavounidis, 2002). The first regularisation programme took place in 1998 enabling workers without papers to obtain a temporary residence permit (“white card”), followed by a “green

⁵ See: <http://rru.worldbank.org/doingbusiness/>

card”, i.e. a temporary permit valid for up to 5 years. By April 1999, out of the 369,000 immigrants that applied for the white card, 211,500 submitted the documentation necessary to apply for the green card⁶.

Following a new Bill in 2001, the responsibility for economic immigrants (exercised until then by the Ministry of Public Order) was transferred to the Ministry of the Interior. The new law contains provisions for the integration into society of both foreigners and returning Greek ethnic migrants. Following this, a second regularisation programme started in June 2001, whereby all undocumented immigrants were invited to visit one of the 1,300 bureaux specifically set up for this purpose by the local authorities, and apply for a temporary (six month) residence permit. In order to apply for the permit, immigrants were asked to submit a variety of documents which involved substantial costs to gather. It is estimated that 377,000 persons applied for the residence permit, but the outcome is unclear (Tzortzopoulou, 2002). As the required documentation involved a substantial cost, it is likely that many undocumented immigrants were not in a position to meet it, implying that this new regularisation programme (extended to 2004) once more failed to register the whole of the immigrant population.

Although the number of immigrants involved in the two regularisation programmes and the drop-out rates are far from clear, it is estimated that, thanks to these two programmes, roughly half of the illegal immigrants residing in Greece were regularised and given incentives to work in the formal market.

Conclusions

This report has been exploratory, in the sense that the subject of undeclared work has not as yet been analysed in detail in Greece. But the material reviewed enabled a number of observations to emerge.

There seems to be a large informal sector in Greece, comprising both paid and unpaid employment with a high degree of substitution between the two. According to indirect evidence, the income generated in the informal sector approximates 30% of GNP. The existence of this informal sector is associated (both as a cause and as an outcome) with the structure of economic activity in Greece and more specifically with the large share of self-employment and family work. Production in many activities is organised along the lines of very small units, usually managed and run by members of the same family. Although there is some evidence that this traditional undeclared work in the informal sector is contracting, it is still noticeable in tourism (restaurants and hotels), petty trade, construction, transport, traditional manufacture and, above all, in agriculture, where it constitutes the majority of employment. Even if it is currently impossible to estimate the number of persons engaged in this type of employment, there is little doubt that their number runs to several hundred thousand.

This informal sector has been utilised by immigrants who entered

Greece in large numbers during the Nineties searching for a better future. Especially during the early years of the Nineties, by being illegal, immigrants had no other option than to look for and find jobs in the informal sector. Thus the informal sector grew in size and with it, of course, the numbers engaged in undeclared work increased substantially. Although immigrants are far from homogenous as a group, their presence is particularly noticeable in agriculture, construction and home services.

The tax and regulatory environment, and especially the high non-wage costs, appear to be among the factors explaining the prevalence of undeclared work in Greece. It is estimated that the loss from the non-declaration of labour incomes amounts to almost 30% of total receipts.

In the policy field, Greece has taken measures to modernise its immigration policy, including two major regularisation exercises. Although the results of these programmes have not yet been analysed and evaluated, there is evidence that they were only partially successful and that they have failed to register the whole of the immigrant population. Hence, it is believed that at least half of the total immigrant population (estimated at around 1 million persons) is still undocumented and working illegally. It should be noted that this is only a conservative estimate of the size of undeclared work, as an unspecified number of regularised immigrants may still be working illegally.

Dimitris Karantinos

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⁶ These are OECD estimates. Cavounidis estimated that the number of white card applicants was 371,641 persons and the equivalent number for green card applicants, 212,680 persons.

Spain

Introduction

Following a growing interest in tackling the underground economy, both the European Union and the Spanish Government have financed a number of research projects on this topic in the last decade. The first task in this type of research is always to define the concept in order to limit the field of study and, secondly, a methodology needs to be devised to quantify the underground economy and to highlight its main causes, effects, types and scope. Finally, recommendations can be made regarding policy measures to address the problem.

However, to quantify the underground economy is not an easy task since, by its very nature, such activities are not easily identifiable in existing statistics. There are no official data sources and every approach to this phenomenon must essentially be indirect, based on signs of its existence and not on the real object of analysis. To make things more difficult, there is no widely agreed definition of what constitutes undeclared work and different terms are used (such as the “black”, irregular, undeclared, clandestine, hidden or unofficial economy) which do not necessarily refer to the same types of economic activities.

This paper deals with undeclared work. All workers in the undeclared economy do undeclared work but the opposite is not true. Some workers in legally declared activities may not declare the work they do for various reasons, mainly to avoid taxes, red tape and social security costs. There is also the inverse phenomenon: undeclared unemployment. Some inactive or unemployed individuals declare that they work in activities that enjoy special benefits or subsidies. For example, some people declare that they work in agriculture in order to benefit from subsidies when they cease production a few years later. These two types of irregularities can cancel each other out and sometimes it may look as though there are no problems in some sectors or at the aggregate level because positive and negative figures are being summed up.

This article considers “undeclared work” to be any “*paid activities that are lawful as regards their nature but not declared to the public authorities, bearing in mind that differences in the regulatory system of Member States must be taken into account*” following the definition used in the 1998 Commission Communication on undeclared work. This definition fits the one used by the Spanish Government perfectly, which states that undeclared work are those paid activities that are not declared to the fiscal authorities. The definition used by the Spanish Government stresses the fiscal opacity of undeclared work, and also emphasises the point that undeclared work has a cost to the public purse resulting from losses in tax or social security revenue it would otherwise collect from these workers.

However, societal interest in undeclared work also results from other reasons relating to the fact that undeclared workers are usually ill-paid, have low quality jobs and do not benefit from the social protection system as regular workers do. This often means they face poor health and safety conditions, do not benefit from social security or dismissal protection and do not receive the training regularly employed workers would receive. This makes competition among firms unfair and results in greater risks of accidents at work and work related illnesses. Some experts think it is the natural response of developed countries to competition from firms located in countries with lower levels of labour standards; others tend to blame the high cost of the welfare state and some others consider it just another free-riding problem. Therefore, we

need to study the causes of this phenomenon, establish its typology and quantify it to design policy measures to combat it.

The rest of the report is structured as follows: the next section deals with the prevalence of undeclared work in Spain where available figures attempting to quantify the importance of undeclared work in the Spanish economy will be presented, as well as the sectors where it is most prevalent and the types of individuals most likely to be involved in undeclared work. Furthermore, the report will look at policy measures taken to combat the underground economy and, finally, draw some conclusions on the nature and scope of the phenomenon and the policy measures necessary to address it.

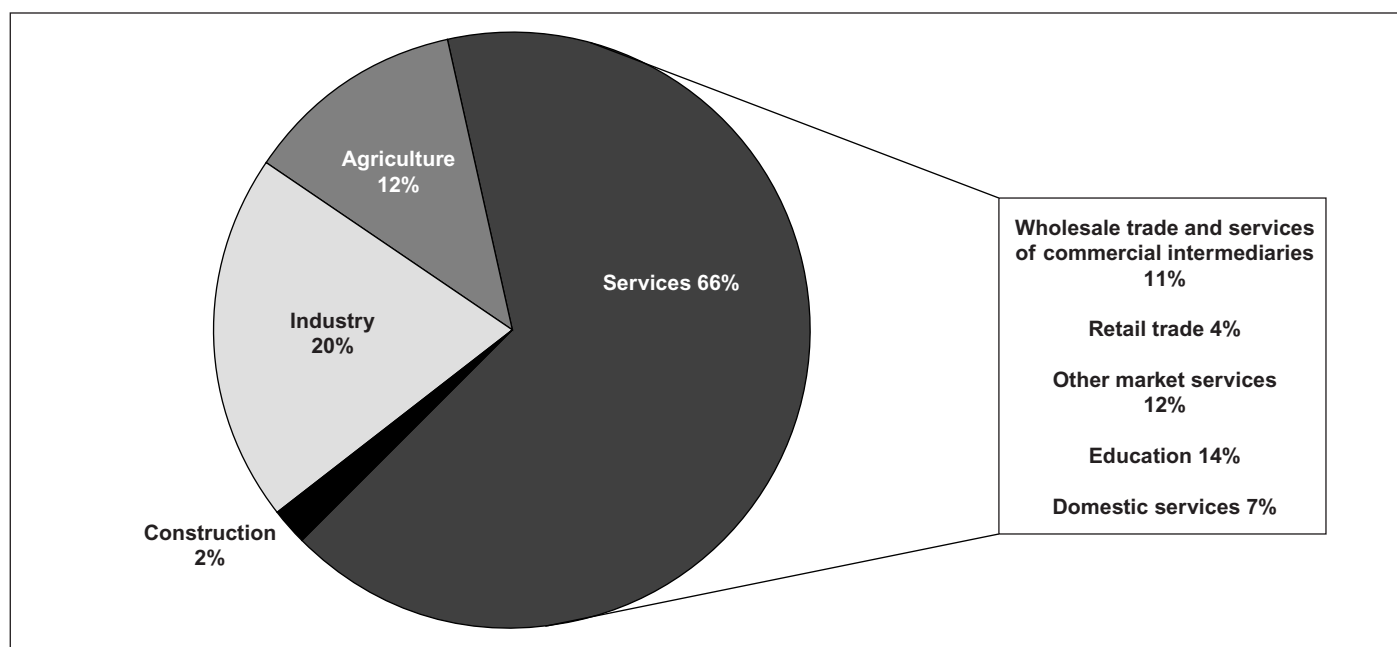
The prevalence of undeclared work in Spain

Figures regarding the level of undeclared work in the Spanish economy vary depending on the source and method used to estimate it. In 1985 the Spanish Government estimated that undeclared work amounted to 15-20% of GDP and that many unemployment beneficiaries and illegal immigrants were involved in such activities. Since then, this figure appears to have diminished and today undeclared work amounts roughly to 15% of employment in Spain. Since not all economic sectors are equally labour intensive, undeclared work as a proportion of employment is usually greater than the undeclared economy as a proportion of GDP.

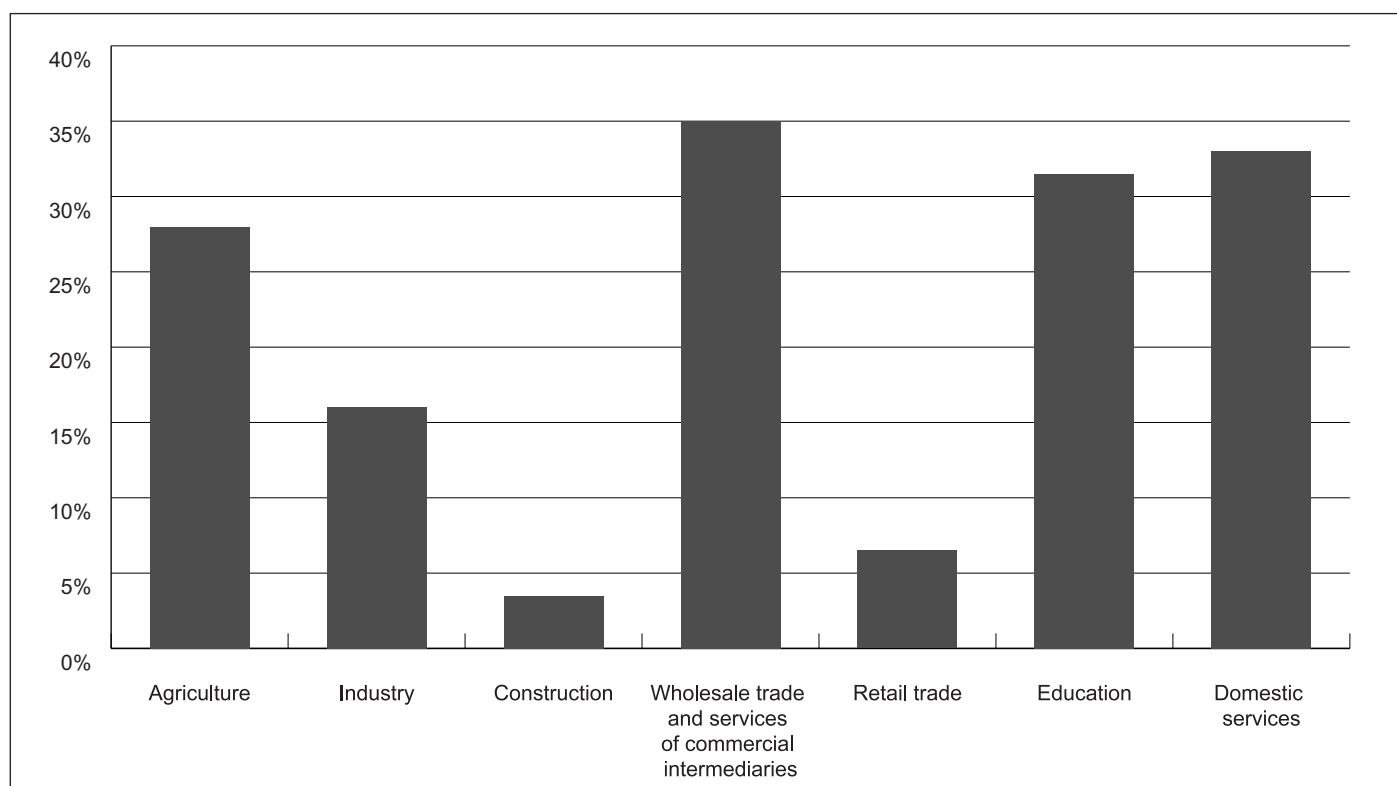
Even though figures of undeclared work must always be taken with a hint of caution, a comparison between the Survey of the Economically Active Population and work declared to the National Employment Service may shed some light on the distribution of undeclared work in the economy. This data comes from official sources and in that sense it may be regarded as the best data available but it measures many different facts and figures and, as any with other data measuring a hidden phenomenon, should be handled with care. Around 15% of the total active population, three million workers, do not declare their work and most of these people, almost two million, work in the services sector, just over half a million in industry and almost a hundred thousand in construction. Paradoxically, in the agriculture sector the reverse may be true: many people declare they work in agriculture to have access to some form of public subsidies or pensions. Considering both phenomena, undeclared workers are distributed as follows (figure 1).

Most undeclared work can thus be found in the service sector. Domestic services, trade (whether wholesale or retail) and education are the sectors within services with more undeclared workers. Undeclared work is usually used by small firms or private individuals.

However, a different approach may shed some new light. Instead of considering how many, or what proportion of undeclared workers can be found in a given sector, it may be useful to analyse what proportion of total workers in a given sector do not declare the work they do. In the first case we calculate how many of the total number of undeclared workers work in certain sectors, and then compare it to the total number of workers in each sector. For example, if 5,000 workers from a total of 10,000 undeclared workers in the overall economy are working in the domestic service sector then domestic service can be deemed very relevant when talking about undeclared work. However, if there are 2 million workers in domestic service those 5,000 are relatively unimportant. Figure 2 shows the proportion of undeclared work in the sectors where it is most concentrated.

Figure 1: Distribution of undeclared work among sectors

Source: Economic Active Population Survey (INE) and INEM

Figure 2: Proportion of undeclared work in different sectors

Source: Economic Active Population Survey (INE) and INEM

Illegal immigrants

This section will assess the kind of workers found in the so-called irregular labour market. Many studies carried out in Spain by different institutions conclude that the undeclared economy is the main entrance gate to the Spanish labour market for immigrants.

Here, they are mainly concentrated in domestic services, agriculture and building and construction. A cross-referencing of the figures from the “Insertion in the Labour Market Survey¹” and INEM registered employment shows that 29% of immigrants do undeclared work, almost double the figure for undeclared work

¹ The date of this survey is 1996 – therefore it may have lost some informative power with respect to the actual situation.

found among Spanish nationals. Since they face many administrative barriers to be able to work on a regular basis, this proportion seems too low and must be considered as a “*minimum*”.

Table 1: The probability of different groups undertaking undeclared work

Variable	Relative Probability	T-Student
Male	0.8374	0.97
Age 26-35 years old	1.8339	*2.72
Age 36-45 years old	3.1866	*4.35
Age 46-55 years old	2.1246	*2.5
Age 56-65 years old	0.2338	*-2.97
Industry	15.3968	*4.71
Agriculture	0.6666	1.28
Construction	1.2099	0.63
European	0.1434	*-5.1
Latin American	0.4634	*-2.74
Years living in Spain	1.1189	*2.61
Understands Spanish	2.7384	*2.64

Reference group = age 18-25 years old

Asterisks denote significant figures

Source: Survey for Labour Insertion

If we consider what the characteristics of immigrant workers are which push them into the irregular labour market we find the following evidence:

The t-student ratio test (a statistical measure of one variable against another) tells us that, in this case, if a value is greater than 2 we have a significant explanation of undeclared work. The relative probability figures show that, for example, the probability that

someone aged 26-35 does not declare the work they do is 83.4% greater than the probability of a person aged 18-26 performing undeclared work. .

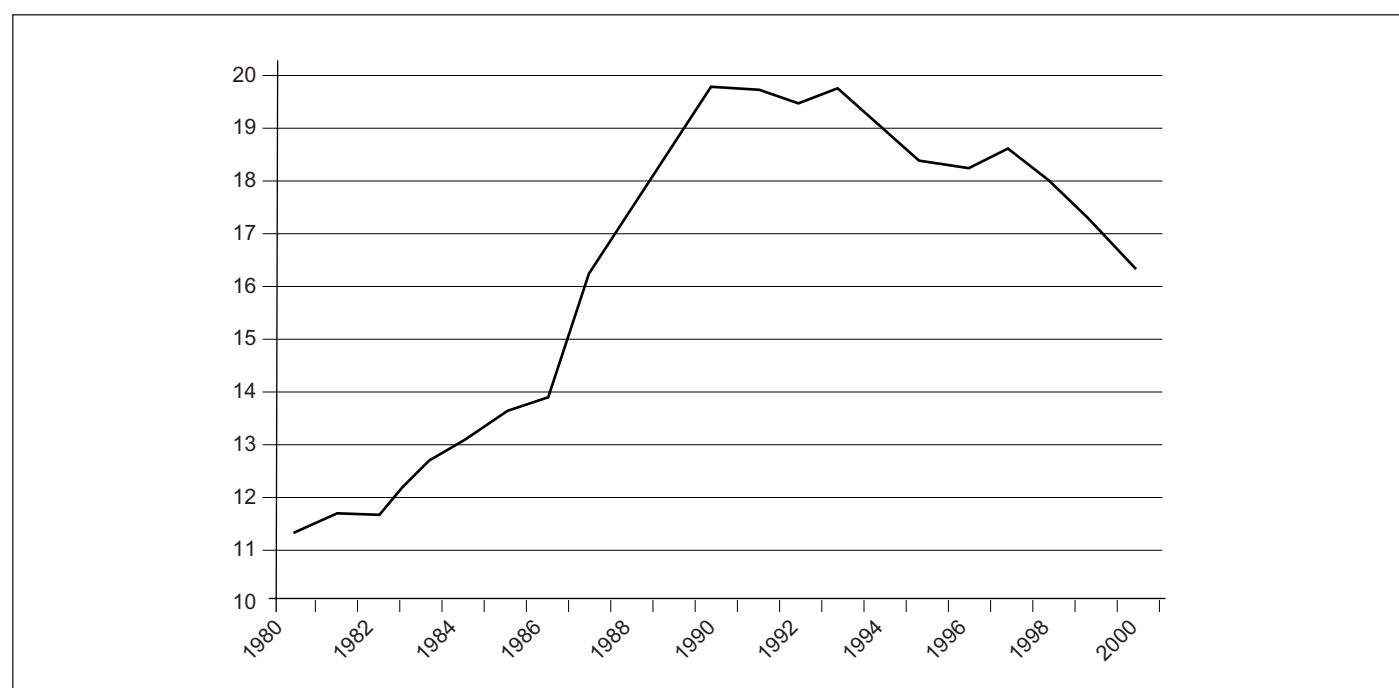
According to these figures, young workers under 25 and those over 55 are less likely to work in the underground economy. Also, workers who found their first job in industry have 15 times more chance of working in the regular market than those who found their first job in the services sector. This variable may be explained by the fact that workers need to be more skilled to work in industry than in services and this gives them more negotiating power. Also, industrial firms tend to be more unionised and be of a bigger size than those in the rest of the economy. Speaking Spanish is another factor that increases the possibility of finding a job in the regular labour market. Immigrants from Eastern Europe find it almost seven times harder to find a job in the regular market than immigrants of Asian origin. Immigrants from Latin America have the least difficulty in finding employment. Finally, as the undeclared labour market is generally an entry gate into employment, the likelihood of obtaining regular employment increases with the length of time spent in the country.

The undeclared economy

Whenever we study undeclared work it is natural to relate it to the size of the “undeclared” economy. Many different ways to measure the undeclared economy have been used and, among them, is the comparison between the money flowing around in the economy and GDP growth. If the quantity of money grows faster than the declared economy it is assumed that the difference comes from growth in the undeclared economy. Following this methodology Campillo et al. give the figures for the undeclared economy as shown in Figure 3.

Since the size of the undeclared economy is smaller than that of undeclared work, we may conclude that the latter is concentrated in those economic sectors which are labour intensive².

Figure 3: The undeclared economy (per cent)



² However, there is so much variation between the figures provided by different authors these conclusions must be addressed with caution. For instance, Moltó states that the size of the hidden economy was around 1.8% in 1980 while Lafuente considered it to be around 22% in the same year.

Measures to combat undeclared work

Once we have analysed the size of the “unofficial labour market” in Spain and what the main characteristics of undeclared workers are, we can assess the measures which have been used to combat undeclared work. Some recent measures may be very favourable to the emergence of undeclared work (that is, the shift of a part of the economy that was previously undeclared to becoming declared in a given year) even if they were not implemented for that purpose. Among them is the reduction in income tax (1999 and 2000), as the motivation to perform undeclared work to avoid taxes is lessened, and presumably the undeclared economy will shrink.

However, stronger effects were expected from measures targeted specifically to combat undeclared work or to boost employment. Among them were:

- The legalisation on governing temporary employment agencies (1994).
- A reduction in Social Security costs for new contracts (1997).
- New types of part-time contracts (1999)

The first of the three measures put an end to the monopoly of the Spanish Employment Institute as a mediator in the labour market between employers and workers. Shortly after its introduction, when the Government decided to lower Social Security costs, employment grew faster than GDP and, considering a negative productivity shock is unlikely to have been the cause, this is most likely due to the regularisation of previously undeclared work.

Figure 4 shows that GDP traditionally grew faster than employment but from 1994 onwards this tendency inverted and from then on it was employment that grew at a faster pace.

This anomaly in the rates of growth of production and employment took place both in the construction sector and in services. In both cases it was after 1998 and we may conclude that the 1997 reform had the effect of bringing some undeclared labour into the regular labour market.

Control measures

Surveillance and tougher inspection services have, on the other hand, proved to perform poorly. Appropriate inspection services and the corresponding sanctions, however, are related to fairness and social justice not only because undeclared activities do not compete fairly with firms that fulfil their legal duties but also, and above all, justice and appropriate protection for the victims of undeclared work implies sanctions to those who organise or benefit from clandestine labour, sometimes putting their lives in peril.

Campillo et al. interviewed a group of experts and asked them to score some measures (from 0 to 4 according to their effectiveness) they could utilise to combat undeclared work, and obtained the results shown in Figure 6.

There is still a long way to go in increasing coordination among public agencies. Sharing information among different administrative bodies could be very helpful in spotting undeclared work. The remaining measures point to the strong relationship between all aspects of tax compliance and undeclared work. A policy mix consisting of making it easier for tax payers to fulfil their legal duties and reinforcing sanctions seems appropriate to fight undeclared work. Also, campaigns to change public opinion would be helpful.

Conclusions

Undeclared work is difficult to detect and to quantify. There are huge differences between the different studies regarding its size and the sectors where it is located. However, a better knowledge of this phenomenon seems necessary to fight it effectively. Some recent measures have proved highly effective but their potential seems somehow exhausted seven years later.

José Antonio Poncela Blanco

Figure 4: Employment and GDP

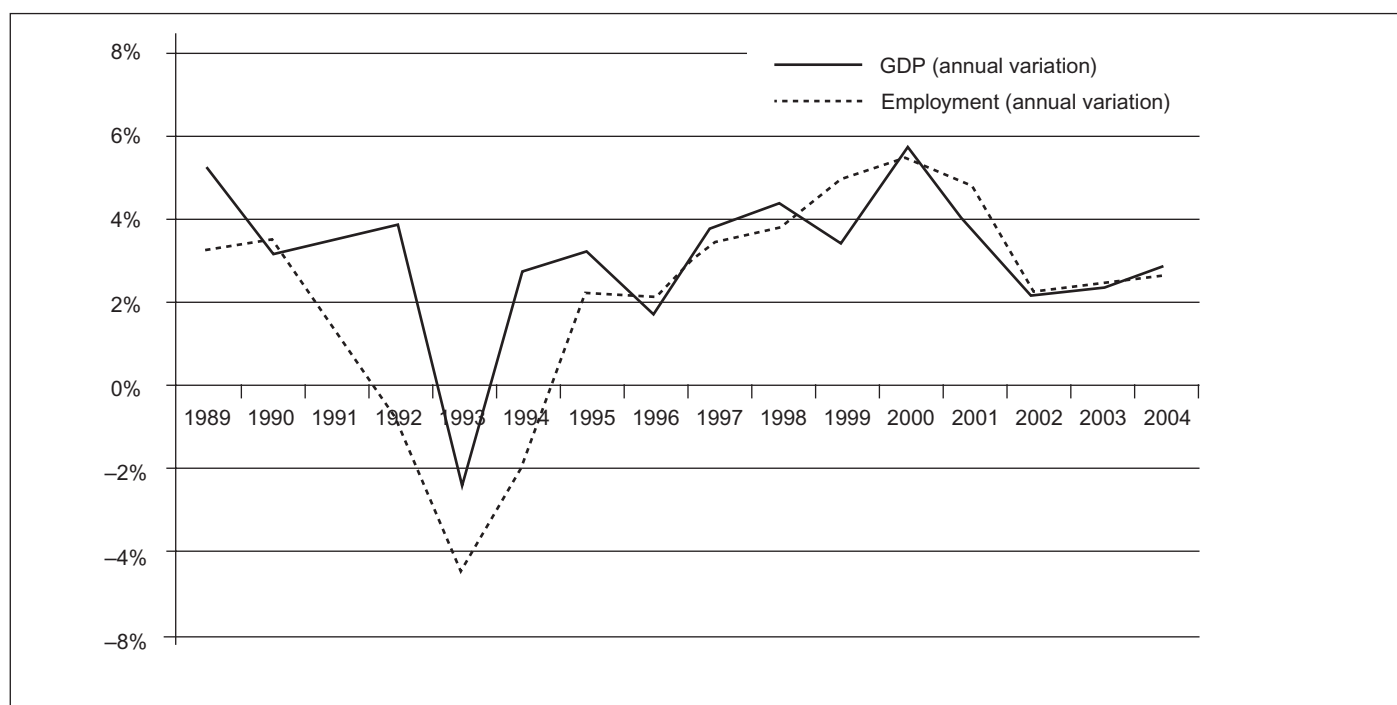
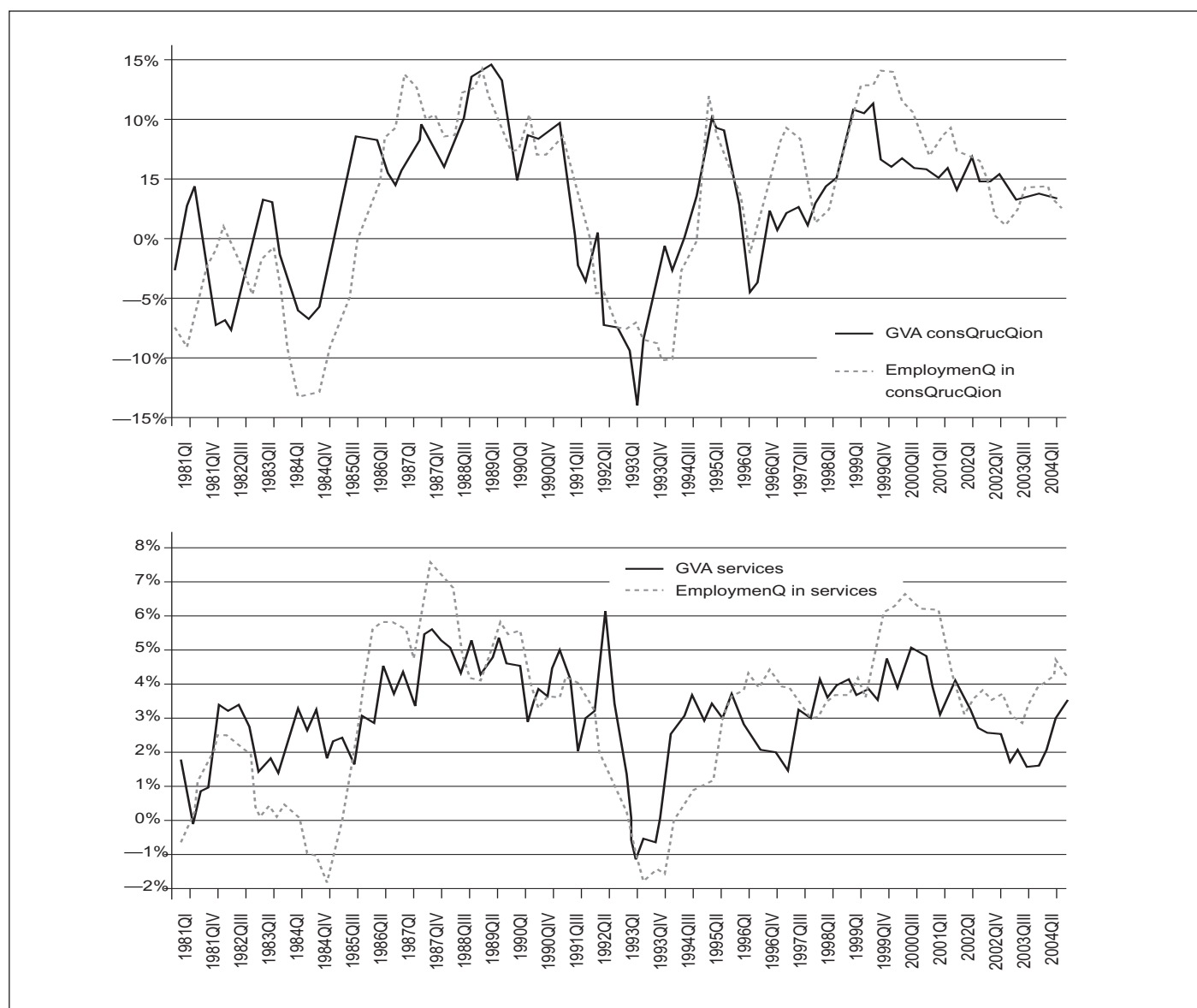
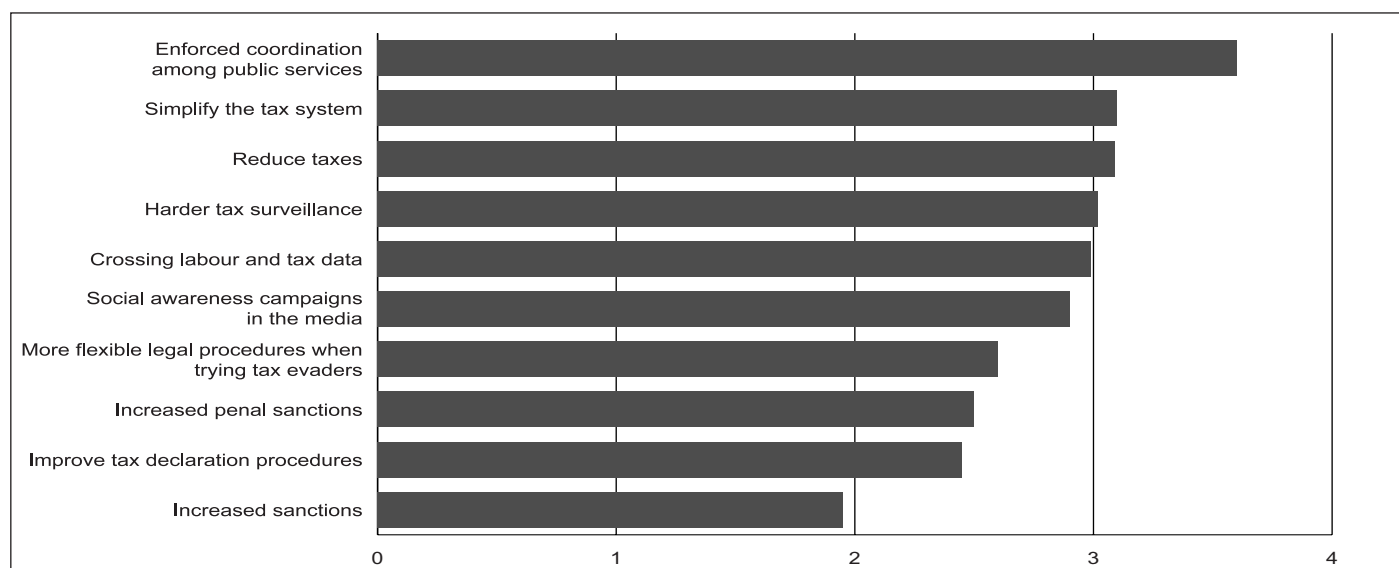


Figure 5: Employment and Gross Value Added in construction and in the service sector**Figure 6:** Effectiveness of Policy Measures

France

Within French legislation, undeclared work comes under the heading of illegal work, which covers:

- the notion of concealed working, defined as follows: “the person who carries on an economic activity without having declared his business is guilty of concealed working, as is the employer who conceals all or some of his employees either for all or part of the hours of work actually performed by them.” Since the law of 11 March 1997 was passed, this notion of concealed working has replaced that of clandestine working, so as to avoid, in particular, confusion between employees concealed by their employers and foreign nationals in breach of immigration laws (without residence or work permits);
- and commerce in, or the direct or indirect employment of, a foreign national without authorisation to work; the hiring-out of illicit labour; violation of the rules governing temporary work; paid job-placement; multiple job-holding and benefit fraud.

The legal definition of concealed working, which corresponds to the notion of undeclared employment as defined by the European Commission, specifies the two forms of fraud that are to be penalised: the concealment of economic activities and the concealment of employees. There is concealment of activity when the company “has not requested registration in the trade or commerce register when this is obligatory, or has not made the necessary declarations to the social security bodies or tax authorities (article L 324-10 of the Labour Code). There is concealment of salaried employment when the employer “deliberately omits carrying out one of the formalities laid down in articles L 143-3 and L 320 of the Labour Code”, that is, fails to make a declaration to the URSSAF¹ prior to engaging the employee or fails to issue a payslip to the employee. Lastly, entering a number of hours lower than the hours actually worked on the payslip also

constitutes concealment of salaried work. Among recorded instances of illegal working, concealed working is the commonest offence (77.6% in 2002).

The scale of undeclared work in the national economy

By its very nature, the underground economy is a phenomenon that is difficult to quantify. This is why various methods (based on investigation, fiscal auditing, national accounting, demand for money, demand for electricity and volume of transactions) have been developed so that the scale of the problem can be estimated. Assessments by the national statistical office, INSEE, dating from 1989 were based on the so-called “national accounting” method and, solely in respect of undeclared legal forms of economic activity, showed a black economy equivalent to 4-4.5% of GNP. In 1995, estimates based on adjustments for tax fraud and illegal working showed the impact of the black economy as being also of the order of 4% of GNP (which would represent a loss for the state coffers in 2002 of 55 billion euro). According to an analysis carried out by the Statistics and Planning Directorate of ACOSS², the demand-for-money approach frequently used to evaluate the underground economy shows that in 1999 it represented (all activities included) 14.7% of GNP.³

For France, estimates made in 2000⁴ produced an assessment that between “6 and 12% of persons aged 20-69 [had] worked on the black market in 1998.” In 2003, ACOSS evaluated the phenomenon of under-declaration of social security contribution liabilities: “a first, rough calculation obtained by applying the rate of adjustment of contributions reviewed to the total of social security contributions due, comes to somewhere in the region of 4 billion euro. Undeclared contributions would, therefore, represent something like 2% of total contributions owed by the companies registered with URSSAF”, a calculation which, according to ACOSS, underestimates the degree of evasion by leaving certain factors out of account.

Evaluation of the scale of concealed working on the basis of reported violations

Though not much different now from ten years ago (5,873 in 2002, 5,200 in 1992), the numbers of violations reported by the Interdepartmental Delegation in the battle against illegal working have nonetheless varied greatly over this period: the introduction of the procedure of prior declaration of employment in 1994 explains the virtual doubling of recorded breaches between 1994 and 1998. Since then, the figures have fallen, as a result of the greater sophistication of the offences and the difficulties of identifying them, as described by the last DILTI Assessment (presented as part of the National Plan for Combating Illegal Working in June 2004) which identifies three major characteristics in the development of illegal working in France:

Table 1: Typology of offences recorded in 2002 in descending order

Type of offence	Incidence in %
Concealment of employees	50.7%
Concealment of activity	24.7%
Employment of foreign nationals without work permits	10%
Other	8.5%
Illicit hiring-out of labour or trafficking in labour	2.4%
Concealment of hours	2.2%
Benefit fraud including defrauding Assedic*	1%
Multiple job-holding	0.2%
False sub-contracting	0.2%

* Assedic is the French unemployment insurance agency.

Source: DILTI – figures presented to the National Commission on Illegal Working, June 2004.

¹ The URSSAFs are the bodies responsible for collecting social insurance contributions in France.

² Central Agency for Social Security Organisations (*Agence centrale des organismes de Sécurité sociale*). ACOSS is the national fund of the Collection branch, comprising 103 URSSAFs in mainland France and 4 General Social Security Funds in the overseas departments.

³ ACOSS STAT ÉTUDE no. 8, *L'évaluation de l'économie souterraine : un recensement des études*, September 2003.

⁴ By Schneider and Enste.

- An increase in abuses of employment status: the use of placement agreements to conceal real work or to bring in young foreign nationals; abuse of voluntary work arrangements or the wrongful declaration of an employee as self-employed. Young people coming from the vocational education sector are particularly vulnerable to such abuses.
- Use of “bogus or dummy companies,” making it impossible to bring the employer to account: this involves a multi-layered outsourcing of labour from a large number of companies, a practice that makes it possible to erect a legal screen behind which employers seeking to evade their social obligations can hide.
- A new type of “transnational” economic and social delinquency by the temporary posting of workers as part of service provision across Europe or internationally: false offshoring, which enables a French company to use the services of a (French or foreign) worker while evading national fiscal and social legislation, under-declaration of obligatory prior formalities on the part of foreign companies wishing to operate in France. According to the DILTI, this seems to represent some 30-50,000 jobs a year in France on postings of the order of 4-5 months in unattractive occupations with difficult working conditions and low pay (welders, waiters, lorry-drivers, carpenters, etc.).

The sectors most affected by illegal working are the services excluding the commercial sector and hotels and catering, followed by building and public works, commercial and hotels and catering, which together represent almost 80% of violations. The remaining 20% are spread over agriculture, transport, and the garment and other industries. Over the last ten years, appreciable changes have occurred, with a considerable reduction in the building and public works sector. This is now no longer the leading sector for illegal working, whereas the hotels and catering, commercial, and transport sectors have seen their share increase. Among the service industries, it should be noted that the broadcasting, cinema and stage sector is particularly affected by concealed working, particularly by the total lack of declaration, or the under-declaration, of periods of activity, as a result of which the unemployment insurance scheme pays out benefits that are not properly due.

In agriculture, the most frequent breach of the law is concealed or partially declared work. The employees concerned are often foreign nationals from outside the community who do not have permission to work in France, or illicit seasonal workers who have remained on French soil improperly after being brought in legally for the preceding season. The seasonal activities of arboriculture, vine-growing, market-gardening, oyster farming, forestry and, to a lesser extent, the maintenance of parks and gardens and rural tourism, are the most affected by the new illicit practices. This form of illegal working is, however, tending to diminish while other forms have grown, most notably with recourse to – French or foreign – service companies whose mode of operation tends to involve the illicit hiring of labour. In the hotels and catering sector, the practice of concealed working – the concealment of activity and the concealment of employees – is very widespread. But the use of false sub-contracting, in parallel with the outsourcing of certain tasks such as cleaning, is increasingly frequent, as is the fraudulent use of trainees or the development of transnational fraud. Lastly, new sectors – particularly security and computer services – are now affected by concealed working practices.

In 1992, URSSAF, which has the power exclusively to deal with breaches of the rules on concealed working, made contribution adjustments for illegal working totalling 33 million euro, 31.3

Table 2: Violations by sector

	1992	1995	1997	2001
Agriculture	7.7%	8.4%	7%	7.2%
Construction and Public Works	31.4%	25.5%	24%	19.1%
Hotels and Catering	13.2%	14.7%	15%	18.6%
Commercial	16.2%	20.3%	21%	18.4%
Transport	3.4%	4.6%	6.3%	7.9%
Garment sector	4.5%	3.1%	4%	5.1%
Other services	19.1%	19.7%	19.7%	20.6%
Other industries	4.3%	3.6%	3%	3.2%

Source: DILTI – figures presented to the National Commission on Illegal Working – June 2004

million of which related to contributions due on employed workers and 1.6 million to contributions owed by employers and the self-employed. Over the last five years, the average amount of adjustments stands at 32 million euro; the provisional assessment for 2003 shows a marked rise in adjustments, the total exceeding 41 million euro. This is a significant result by comparison with the preceding years and is due to an increase in monitoring activity.

The type of organisation brought to bear against undeclared working

In France the law of 11 March 1997 represented a significant advance in this field. Not only did it reinforce the resources brought to bear, but also clarified the offence of concealed working and began an interdepartmental campaign which, on the one hand, grouped together all the institutional actors concerned (labour inspectors, police, gendarmerie, tax and customs authorities, the judicial system, and also the social services) and, on the other, all the social partners – and did so at both national and local level. This law provides the foundation for the current organisational structure of the campaign, which is built around the following bodies:

- **At the national level, an Interdepartmental Committee on Illegal Working**, which brings together all the ministers concerned, a **National Commission on Illegal Working**, made up of all the heads of the central administrative directorates and of the bodies responsible for collecting social contributions, which is tasked with laying down guidelines, both in terms of prevention and repression, in association with other partners, such as the representatives of elected local politicians, of consular chambers or of the national professional organisations of employers and employees, who are invited to participate on it, and the **Interdepartmental Delegation on Illegal Working (DILTI)**, which provides a secretariat for the National Commission on Illegal Working and co-ordinates the action of the relevant services and bodies.
- **At the local level**, on the one hand, the **Département Commissions on Illegal Working**, chaired by the Prefect, which elaborate local prevention programmes on the basis of national guidelines and bring together all the local actors, the representatives of the public authorities, such as professional organisations and consular chambers, and on the other, the **Operational Committees (COLTI)** on which, in each department, the different accredited monitoring bodies are represented, and which assure inter-departmental co-ordination of action.

Measures taken to combat undeclared working

Apart from the fiscal policies brought to bear (reduction of the VAT rate, tax credits etc.), the measures aimed at combating concealed working have two strands to them, the one preventive, the other repressive. **In terms of taxation**, France has chosen to take part in the experiment proposed by the European Commission on the reduction of the VAT rate, by applying this reduction from 2000 to 2005 to two sectors of activity: the building sector (renovation and repair work relating to private residences completed more than two years ago) and personal services (including window-cleaning and cleaning in respect of private dwellings and personal care services). An assessment carried out by the Government in October 2002⁵ made very positive findings in this connection. These were more optimistic than assessments at the European level, where the Commission takes the view that most of the results remain as yet hypothetical and have not succeeded in demonstrating a possible causal relation between a lowering of the VAT rate and a reduction in the underground economy.

In respect of domestic services, the report estimates the increased turnover linked to the lowering of VAT in 2000-2001 at 130 million euro. The measure is also said to have created 3,000 jobs, **this figure corresponding essentially to a re-direction of concealed work into enterprises**. It is in the building sector that the effects seem most significant. The assessment concludes that the lowering of the VAT rate proper has brought about an increased turnover of 1.3-1.5 billion euro and has enabled 40-46,000 jobs to be created. As for the reduction in the underground economy, the report estimates that around **one third of the increased turnover related to the lowering of VAT comes from the redirection of concealed working. This amounts to around 0.5 billion euro per year**. Among the professional organisations, in 2002 the Confederation of Craftsmen and Small Building Companies (CAPEB) had an independent firm carry out a study on the impact of the measure, which found that some 34,000 jobs had been created directly and a further 20,500 indirectly.

The possibility of applying reduced rates of VAT to hotels and catering, a sector where there is also considerable concealed working, is a point that has recurred regularly in recent months in national debate, with a strong consensus on the part of the present Government and the professional organisations that the measure should be applied as soon as possible, particularly as it seems likely to create a number of jobs estimated at 40,000 over 18 months and 120,000 over two to three years, according to the partners, though these are estimates which some economists and experts feel are overstated. Though the cost to the national budget is estimated by the Union of Hotel Trades and Industries (UMIH) at 1.8 billion euro (the Ministry of the Economy and Finance say 3.3 billion), this will rapidly be compensated for, according to this body, by “the additional tax receipts produced by the creation of new jobs, the increased turnover, the increased investment, the reduction of concealed working and the stabilisation of the market (traditional restaurants then being put on the same footing as take-aways and fast-food outlets).” While awaiting the possible application of a 5.5% VAT rate to restaurants, the Government has significantly alleviated social contributions for restaurant owners, in keeping with commitments made to them, and these may be contributing at the present time to reducing the phenomenon of concealed working.

So far as prevention is concerned, the policies brought to bear are

based mainly on the simplification of administrative formalities that was initiated with the **Service Employment Cheque Scheme** and, in the agricultural sector, with the Simplified Agricultural Employment Document. The establishment of the Service Employment Cheque in 1996 enabled private individuals employing a person in the home (for housework, childcare, gardening, etc.) to simplify the administrative formalities very greatly (and did the same for agricultural employers with seasonal labour) with a significant impact on concealed working: “in the year following its creation, 140,000 employers used the system” and it has been an undeniable success since then (900,000 users today). This policy was extended with the establishment of Centres for Business Formalities (a kind of one-stop-shop for start-up companies) and is currently being further extended with the introduction of the Non-profit Organisation Employment Cheque (*Chèque emploi associatif*)⁶ or the **Enterprise Employment Document (Titre Emploi Entreprise)**, which will come into use gradually and in different sectors during 2004 in the hotels and catering, building and public works and commercial sectors, among others.

Also in the area of prevention, the law combating exclusion that was reinforced in 2001 by the programme for combating exclusion, which allowed recipients of the Minimum Integration Income (RMI) to draw benefits and income concurrently and in full, has reduced the “unemployment trap” phenomenon and played an indirect role in the battle against concealed working,⁷ as did the introduction in 2001 of the employment premium, by helping to stimulate the re-entry of low-income households into economic activity. Recently, the introduction of a national plan for combating recruitment difficulties has played a part in the battle against concealed working, as it is recognised that the recruitment difficulties encountered in certain sectors encourage clandestine immigration and undeclared working.

Policies of a repressive type revolve mainly around workplace checks and the application of sanctions. Over the years, we have seen increased monitoring by the public services and the other bodies responsible: the URSSAF, for example, are supposed to devote 10% of their activity to workplace checks, a level they have gradually managed to attain (the number of such actions has risen by a factor of 3.3 in 10 years). As far as sanctions are concerned, new decrees and laws relating to the co-ordination and intensification of the campaign against illegal working have considerably widened the areas of employers’ responsibility. Concealed working exposes its perpetrator to sanctions of a penal, administrative or civil character.

Penal sanctions are targeted both at physical persons (a maximum fine of 45,000 euro and three years’ imprisonment) and legal entities (maximum fine of 225,000 euro and an operating ban). Two types of administrative sanctions may be applied: on the one hand, refusal to grant public-employment or vocational-training aid and, on the other, denial of the right to tender for a public procurement contract. Lastly, the civil sanctions for concealed working laid down in the Labour Code involve the indemnisation of the employee who is the victim of the offence, for which certain third parties are held jointly and severally liable – mainly the beneficiary of the work performed (the client or contractor).⁸ Agreements signed at the national level between the DILTI and the professional organisations (most notably in the Building and Public Works sector) are often constructed around two types of policy, preventive on the one hand and repressive on the other. Lastly, with the development of

⁵ *Rapport de la France à la Commission relatif à l'évaluation des baisses ciblées de TVA sur certains services à forte intensité de main d'œuvre.*

⁶ Measures simplifying the recruitment, wages-management and social contribution declaration formalities of non-profit organisations employing more than the equivalent of three full-time employees in any one year.

⁷ It may, in fact, be more comfortable for a recipient of RMI to work in the black economy to complement his allowance than take the risk of re-entering the labour market on the basis of a temporary contract, which is generally what is on offer.

transnational fraud and the difficulty the French authorities have had in controlling it, the campaign against undeclared working has also been based on a gradually developing European co-operation and on bilateral agreements signed with Germany (May 2001), Italy and Spain (2002) and Belgium (2003). More recently, there have been contacts between the DILTI and some of the new Member States (Poland, the Czech Republic and Slovakia).

Conclusion

Though the administrative organisation put in place to combat concealed working seems relatively well-conceived, it is, in practice, subject to many more vagaries than are immediately apparent: the National Committee on Illegal Work has met on very few occasions since it was created (barely three times in seven years); the same applies in the case of the National Commission and the *Département Commissions*, half of which meet scarcely once a year. The same observation applies to the COLTI. As long ago as 1999, an assessment of the role of the URSSAFs and the Agricultural Mutual Welfare Funds in the battle against concealed working⁹ noted the lack of co-ordination between the actors responsible for combating illegal work at the local level and between the local level and the national. This report identified weaknesses in the implementation of the repressive strand of the policy. The DILTI for its part argues that the system lacks resources – particularly human resources to carry out the monitoring.

In the last few months, however, there have been several signs that the French Government has given new impetus to the battle against concealed working: for example, the establishment in October 2003 of a structured plan of action in the broadcasting, cinema and stage sector, following the re-negotiation of the special regime of unemployment insurance for the sporadically-employed entertainment workers, and the first national meeting of the secretaries of the COLTIs. But, most importantly, in June 2004 the First National Plan for Combating Illegal Working for the year 2004-05 was presented by the National Committee. “A relentless war has been declared. We shall be absolutely uncompromising on this, as national cohesion is at stake,” asserted the Minister of Labour at the press conference. This plan¹⁰ is structured around four sectors of activity that have been identified as priorities (live and recorded entertainment, agriculture, building and public works, hotels and catering) and around three lines of action: increasing the resources for labour inspections; extending co-operation between monitoring agents and the bodies managing public aid; and

discontinuing all public aid (and not just employment and training aid) to companies found to be in breach. The repressive strand is thus coming to assume a major presence in national politics. It should be complemented by an intensification of monitoring among job-seekers – both those who come under the general unemployment insurance scheme and those who come under the scheme for sporadically-employed entertainment workers. It may simply be regretted that this national plan for combating illegal work is not based on an evaluation of the strengths and weaknesses of the arrangements that have been implemented up to now and that it is not accompanied by quantitative objectives and monitoring indicators enabling it to be properly steered and evaluated, since these features would have increased its effectiveness.

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⁸ On the initiative of the Conseil Général of the Bouches-du-Rhône, the building sector in that *département* has introduced a professional identity card for the 37,000 workers in the sector. The card, which is intended to combat concealed working, has to be presented when sites are inspected.

⁹ *Rapport annuel au Parlement sur la sécurité sociale* (Annual Report to Parliament on Social Security) : this is the only document so far to propose an evaluation.

¹⁰ Available on <http://www.travail.gouv.fr>.

Ireland

Introduction¹

Undeclared work is defined as any paid activities that are lawful as regards their nature but not declared to the public authorities. It excludes criminal activities as well as work that does not have to be declared. This definition fits in well with how the concept is interpreted in Ireland. However, there are no published estimates of the number of people engaging in undeclared work because such work is mainly done by people already in employment and they actively try to conceal some part of their activities from the attention of the tax authorities and official statisticians. In recent years there has been an increase in illegal immigration to Ireland and many illegal immigrants have been involved in undeclared work. However, there are no estimates yet of how many illegal immigrants are working in the Irish labour market. Most undeclared paid work involves tax evasion of one sort or another. Consequently, attempts to measure the size of the hidden economy in Ireland have focused on indirect methods of identifying the financial flows on which no tax is paid rather than on estimating the number of workers involved.

Prevalence of undeclared work

Within the last ten years there have been three studies that have attempted to estimate the size of the hidden economy in Ireland. Two were done by Fagan (1994 and 1997) and the other by Dillon (2004). These studies provide estimates from the mid-1960s up to 2002. Fagan's concept of the hidden economy is adapted from work done by Smith (1986) on the shadow economy in Britain.

The relationship between the formal economy and the shadow economy is shown in Table 1. Total economic activity comprises the formal economy and the shadow economy. The formal economy consists of market and non-market activities, both of which enter into official estimates of GDP. The shadow economy consists of the hidden economy and the non-market shadow economy; the latter is excluded from the measurement of GDP by convention. Fagan's estimates of the size of the hidden economy include criminal activities and activities which result in tax evasion. Consequently,

they include a component, crime production, which is excluded from the definition above. This is unavoidable as the monetary approach used by Fagan operates at the level of the economy as a whole and does not allow a distinction to be made between undeclared income and criminal activity.

Fagan's monetary approach is adapted from the work of Tanzi (1983) and others. It uses currency holdings to estimate the size of the hidden economy. It relies on the idea that cash is the main medium used for transactions that people wish to conceal from the tax authorities. Hence, an increase in transactions in the hidden economy will result in a greater increase in the demand for cash than can be accounted for by the increase in transactions in the official economy. Using the standard relation between income and money via the velocity of circulation, the monetary approach argues that if an estimate of the monetary holdings of participants in the hidden economy were available, it would be possible to estimate their total income by assuming that the velocity of circulation is the same for them as for participants in the regular economy. Fagan therefore devised an equation in which currency holdings relative to the stock of money (currency plus current account deposits) held by the public are determined by income (GNP), the interest rate on long-term government bonds, the tax burden (total tax revenue/GNP) and a time trend.

Fagan (1997) assumes that in a given base year the size of the hidden economy was negligible and that currency holdings by hidden economy participants thereafter are a function of the difference between the tax burden in the base year and the current year. Applying this method to Irish data for the period 1963 to 1995 suggests that the hidden economy grew from 0.5% of GNP in 1964 to nearly 11% in 1995. Fagan's earlier estimates of the size of the hidden economy are lower than his later estimates by 2-3 percentage points of GNP due to modification of the estimating equation and some instability of the parameter estimates. The difference between earlier and later estimates based on the same method underlines the uncertainty surrounding estimates of a significant part of national economic activity that is largely concealed from view.

Table 1: The Shadow Economy, the Formal Economy and the Hidden Economy

Formal Economy			Shadow Economy			
Non-Market Economy		Market Activity	Hidden Economy		Non-Market Shadow Economy	
Imputed items	Government spending	Goods and services included in official GDP	Tax evasion	Crime Production	Household economy	Voluntary work
Measured GDP			Activities that should be included in GDP but which are hidden		Activities excluded from GDP by convention	
Total economic activity						

¹ We are grateful to Aidan Dillion of the Revenue Commissioners, Colm McDermott of the Department of Social and Family Affairs, Mick Lucey of the Central Statistics Office, Aebhric McGibney of the Irish Business and Employers Confederation, and Fergus Whelan of the Irish Congress of Trade Unions for providing information which helped us to write this report. However, the authors alone are responsible for the contents of the report.

Fagan's estimates have been updated to 2002 by Dillon (2004) using an equation from Fagan's earlier study (Fagan, 1994). Dillon concludes that the size of the hidden economy fell by about one percentage point between 1990 and 1995 largely due to a reduction in the tax burden from 32% of GNP in 1990 to 30% in 1995. Although there were significant reductions in income tax rates thereafter the overall tax burden remained fairly constant at around 29% of GNP as indirect tax rates increased to maintain revenue. Consequently, the size of the hidden economy did not change very much during the era of the Celtic Tiger². Dillon estimates that it amounted to about 8% of GNP in 2002.

On the basis of Fagan's earlier and later estimates and Dillon's updating of Fagan's earlier estimates, it appears that the value of undeclared income in Ireland in 2002 lay between 8 and 11% of GNP. In monetary terms, therefore, the size of the hidden economy in 2002 is estimated to lie between 8 and 11 billion euro. The percentage estimates put Ireland in the same group as the United States (which has a low tax burden), Japan, Austria and Switzerland according to currency demand estimates that were made for these countries in the mid-1990s.

It is difficult to translate these estimates of undeclared income into estimates of the number of undeclared workers. In the early 1990s the Revenue Commissioners compared the number of self-employed workers shown by the Census of Population with the number of income tax returns submitted by the self-employed. The comparison was made at the NACE sector level. Whilst no estimate of the number of undeclared workers was published, the comparison showed that the sectors in which they were most likely to be concentrated were construction and distribution. More recently a study by the Immigrant Council of Ireland (2003, p. 43) noted that there were illegal immigrants working in Ireland, but that "it is impossible to put a figure on their numbers in the absence of any studies."

Preventative measures

Tax amnesties and voluntary disclosure schemes

In the 1960s the Pay As You Earn (PAYE) system of taxation was introduced for employees but not for the self-employed. Employees' income was reported to the revenue authorities by the employer while direct assessment continued to be used by the tax authorities for the self-employed. This meant that there was wide scope for the self-employed to avoid paying tax, but not for employees. There were suggestions, almost from the inception of the PAYE system, that the self-employed were not paying their fair share of tax. This case was made by trade unions representing industrial workers and individual taxpayers who argued regularly in the media that self-employed farmers in particular were not paying enough tax. In the early 1980s the trade union movement organised a series of public demonstrations to protest at the unfairness of the tax system. The Government eventually introduced a tax amnesty in January 1988. This amnesty brought in 635 million euro in back taxes where only 40 million euro had been expected. Some years later, in 1993, the Government announced another tax amnesty to try and bring those who were still not paying enough into the tax net.

Despite these amnesties, tales of widespread tax evasion continued to surface in the media in the late 1990s, particularly in relation to many Irish residents allegedly avoiding payment of deposit interest

retention tax (DIRT) on their bank deposits. It was alleged that some financial institutions colluded in tax evasion by accepting at face value statements by customers who were living in Ireland that they were legally resident outside the country. In 2001 the Revenue Commissioners offered a voluntary disclosure scheme to holders of bogus non-resident bank accounts to bring undeclared bank deposits into the tax net. Under the scheme, interest and penalties were capped at 100% of the tax due. The number of bogus non-resident accounts was higher than expected: 8,500 compared with 6,500 estimated by the Revenue Commissioners. Most individuals who availed themselves of the voluntary disclosure scheme held two bogus accounts.

Subsequently, there was a detailed probe into bogus non-resident accounts. This resulted in the Revenue Offshore Assets Group announcing in early 2004 its intention to conduct a comprehensive investigation into accounts and investments held outside the State by Irish residents. Holders of undisclosed accounts or investments were invited to notify the Group of their intention to make a "qualifying disclosure".

The benefits of making a "qualifying disclosure" in the context of the proposed investigation are substantial mitigation of penalties (10% of the tax unpaid as compared to 100%), the Revenue Commissioners agreement not to publish names in the Tax Defaulters List and their agreement not to prosecute for tax evasion. The Revenue Commissioners' annual report published in June 2004 documents that the revenue outcome of this scheme is 500 million euro to date.

Tribunals of inquiry into tax evasion

The amounts yielded by the two tax amnesties showed that tax evasion was widespread among certain groups of tax payers. When this information was combined with other information which came to light during the mid-1990s about alleged corrupt payments to politicians and involvement of financial institutions in tax evasion, a number of inquiries were set up to look into the nature and extent of tax evasion. Table 2 shows the commencement date for each tribunal set up since 1997 together with an estimate of how much tax has been recovered to date partly as a consequence of the relevant tribunal.

The Moriarty Tribunal arose out of the report of an earlier Tribunal of Inquiry (Dunnes Payments) (1997) into irregular payments to some members of the Houses of the Oireachtas (Parliament). The Tribunal was requested to examine the independence of the Revenue Commissioners and whether the Revenue Commissioners "availed fully, properly and in a timely manner in exercising the powers available to them" in collecting tax. In addition, it conducted inquiries into deposits made by Ansbacher (Cayman) Ltd., to ascertain whether any payments were made to politicians from these deposits and, if so, from where the money was obtained. To date the revenue yield attributable to the Moriarty Tribunal amounts to 6.3 million euro in back taxes and penalties.

The McCracken Tribunal was the first to uncover what became known as "the Ansbacher accounts". This led to the discovery of evidence suggesting that numerous revenue offences were committed by some leading politicians and business people in the last thirty years who were taking advantage of a system "whereby Irish depositors could have their money offshore, with no record of their deposits in Ireland." Inspectors were appointed to investigate

² This is a punning reference to the longer-established term *tiger economy*, which has been used for about fifteen years to describe the more successful small Asian economies. The Republic of Ireland has benefited greatly from membership of the European Union. As a result, Ireland claims to have been the fastest-growing economy in Europe over the past decade, admittedly from a low base.

and report on the affairs of Ansbacher (Cayman) Limited in 1999. The inspectors published their report in 2002.

The Ansbacher Report (2002) concluded that the affairs of Ansbacher were conducted with intent to defraud a creditor of some of the bank's clients – that is, the Revenue Commissioners. In addition, a Special Project Team within the Revenue Commissioners began investigating the Ansbacher accounts in October 1999. To date, 42 million euro has been collected by way of settlement. Table 2 shows the accumulated yield from the special investigations that have been carried out since 1997. The bogus non-resident accounts and offshore assets programmes between them brought in almost 95% of the total yield of about 2 billion euro. Most of these accounts were held by the self-employed.

The scale of tax evasion revealed by the tax amnesties has resulted in a much higher political profile being given to the ways in which the legal and administrative arrangements for tax collection are working. The complexity of the steps taken to avoid declaring taxable income, revealed by the various tribunals of inquiry, have led to considerable strengthening of the Revenue Commissioners' powers to investigate compliance with tax law. The use of amnesties and mild penalties for tax evaders willing to make voluntary disclosure of their financial affairs has brought many individuals and businesses into the tax net who might otherwise have continued to conceal their economic activity. It is quite possible that the amnesties and tribunals have also changed the climate of public opinion from one in which people turned a blind eye to non-payment of taxes to one in which there is far more public support for heavy penalties, including prison sentences, for tax evasion.

Strengthening incentives and removing disincentives to declaring work

Callan and Nolan (1997) used micro simulation models to compare replacement rates in Ireland and the UK, using consistent definitions. They found that a higher proportion of the unwaged – whether unemployed or unoccupied – in Ireland faced replacement rates above 60%. Tax and social welfare policies in Ireland have since become more focused on improving the incentive to work.

The Programme for Government adopted by the Coalition Government in 1997 included a commitment to reducing the standard and higher marginal rates of tax. This has resulted in a

reduction in the standard rate from 26% on the first 12,573 euro in 1997 to 20% on the first 28,000 euro in 2004 and in the higher rate from 48% on the remainder in 1997 to 42% on the remainder in 2004. These reductions in the standard and higher rates of tax are believed to have improved tax compliance and the motivation to work.

The Department of Social and Family Affairs is responsible for the development and administration of a number of social welfare benefit schemes. Some of these schemes were criticised by economists and employers in the past on the grounds that the level and qualifying conditions for unemployment, sickness and other benefits act as a disincentive to work by creating unemployment and poverty traps. The need to structure benefits in ways that would avoid creating welfare dependency has been addressed by the Department in a series of measures designed to make work pay.

Introduction of disregards and tapers

The official disregarding of earnings and tapered withdrawal of benefits are mechanisms used to develop social security programmes in ways that are responsive to the needs of the unemployed and other disadvantaged groups while simultaneously providing opportunities to assist people to become less welfare dependent. Many measures are used to make social security benefit schemes more employment friendly by removing disincentives to taking up employment for people returning to work, these include:

- One Parent Family Payment weekly earnings disregards ranging from 100% of the first 146.50 euro to 50% of earnings from 146.51 euro to 293 euro;
- Unemployment Assistance disregard of 40% of net earnings from part-time work;
- Retention of Rent/Mortgage Interest Supplement and other secondary benefits on a tapered basis in certain circumstances;
- Tapered withdrawal of adult and child benefit as earnings from employment increase.

Gradual (tapered) withdrawal of social security payments and other benefits helps to ease the transition from welfare to work. While the financial savings of individual measures are difficult to quantify, these initiatives are designed to ensure that there is no sudden loss of social security benefits that might influence the decision to take up, or return to, employment.

Table 2: Yield from Special Investigations of Tax Evasion Since 1997

Date Established	Official Name	Popular Name	Revenue Yield € million
1997	Tribunal of Inquiry (into irregular payments to politicians and offshore accounts)	Moriarty Tribunal	6.3
1997	Tribunal of Inquiry into Certain Planning Matters and Payments	Flood/Mahon Tribunal	18.7
1998	Parliamentary Inquiry into DIRT	DIRT inquiry (1999) (bogus non-resident accounts)	749.0
1998	High Court Inspectors Inquiry into National Irish Bank Clerical Medical Insurance Scheme	NIB Inquiry	50.4
1999	High Court Inspectors Inquiry into Ansbacher (Cayman) Ltd.	The Ansbacher Accounts (2002)	42.0
2001	Revenue Commissioners' Voluntary Disclosure Scheme	–	500.0
2003	Revenue Commissioners' Offshore Assets Investigation	–	651.0

Note: Some of these tribunals are still sitting so their reports have not yet been published.

Source: *Annual Report of the Revenue Commissioners for the year ending December 2003*; *Irish Times*, 17 June 2004, "Revenue Nets 650 million euro from Offshore Accounts"; *Irish Independent*, 17 June 2004, "Tide Turns on Tax Dodgers and Brings in Bounty"; *Irish Times*, 20 November 2001, "£1 billion Collected in Amnesties Over 13 Years".

Active labour market programmes

Back to Work scheme

The Back to Work scheme was introduced in 1993 to encourage long-term unemployed people to take up opportunities for employment or self-employment. It allows for retention of a reducing portion of the social security payment over a number of years, whilst retaining secondary benefits for the period. Employees can retain welfare payments over a period of three years at rates of 75%, 50% and 25% respectively. The self-employed can retain welfare payments over a period of four years at rates which decline in steps of 25% from 100% to 25%. The Back to Work scheme is implemented on a flexible, non-statutory basis and it has been developed and extended to other disadvantaged groups, e.g. people with disabilities and lone parents.

There are approximately 5,600 participants in the employees strand with approximately 8,000 in the self-employed strand. In September 2002, a survey was carried out among 1,000 randomly selected former Back to Work participants who had completed the programme between 1997 and 1999. This survey showed that nearly 90% of cases were no longer receiving social security benefits and that 80% of cases did not return to claiming benefits after completing the programme.

Back to Education scheme

The Back to Education Allowance scheme facilitates the long-term unemployed and other disadvantaged groups in gaining access to second chance education, at either secondary or tertiary level, by payment of a weekly allowance. The objective here is to raise education and skill levels among the long-term unemployed and other disadvantaged groups to meet the requirements of the modern labour market. There were 7,648 participants on the Back to Education Allowance scheme in the 2003/2004 academic year.

Income support for low income families

Family income supplement (FIS) is designed to provide cash support for those employees with families who are on low earnings. This preserves the incentive to remain in employment in circumstances where the employee might only be marginally better off than if he or she were claiming other social welfare payments. FIS is paid on a weekly basis over a period of 52 weeks, taking into account a family's net earnings and the number of children under age 18 or aged between 18 and 22 years and in full-time education. FIS is payable to qualifying families at a rate of 60% of the difference between the weekly income (net of tax and PRSI) and the income limit for that family size which ranges from 407 euro for one child to 584 euro for eight or more children.

Significant progress has been made by the authorities in eliminating unemployment and poverty traps through the earnings disregards and benefit tapers, Back to Work and income support schemes. A criticism that has been made of one aspect of the Back to Work schemes is that the income threshold for the retention of secondary benefits has not kept pace with increases in earnings.

Improving surveillance of those who benefit from undeclared work and improving protection for victims of undeclared work

Following the tax amnesties and inquiries into offshore accounts, documented above, the Revenue Commissioners were given increased powers of surveillance including the power to access information, previously denied to them, relating to classification of

individuals in banks and other financial institutions. One of the groups for which these powers have been used are holders of non-resident bank accounts. Almost all of the tax that has been recovered is attributable to offshore accounts held by the self-employed.

In addition, the Revenue Commissioners have received increased powers to levy severe penalties on non-compliant taxpayers; in some cases the penalties have amounted to two-thirds or more of the final tax bill. These powers are now being used extensively. As part of the social partnership process, the Revenue Commissioners established a Revenue Partnership (2001) group, consisting of management and staff, to consider measures that might be taken to identify those in the hidden economy and to bring them into the tax net. This group said that it "does not consider that there are a significant number of taxable persons outside the net." (See Revenue Partnership, p. 27). However, it identified a number of high risk sectors where individuals could avoid paying tax on their undeclared earnings because most of the transactions are made in cash. These sectors include bars and restaurants, private transport, and retailing of tobacco and alcohol. A number of measures, including risk profile analysis and simplified administrative procedures to facilitate compliance, were recommended to tackle non-payment of tax in these sectors.

Strengthening international co-operation to combat undeclared work

The preventative measures taken to bring non-compliant tax payers into the tax system showed that one feature of tax evasion in Ireland was the deposit of funds in so-called non-resident accounts in Irish banks or in foreign banks, whose activities are outside the jurisdiction of the Irish authorities. The discovery of relatively large numbers of people involved in hiding their financial assets resulted in increased co-operation between the revenue authorities in Ireland and their counterparts in foreign jurisdictions. According to the Annual Report of the Revenue Commissioners for 2003, this co-operation has increased the likelihood of individuals being caught who try to hide their money by depositing it in domestic non-resident accounts or in offshore banks. Instruments such as the Mutual Assistance Directive 77/799/EEC and Regulation 218/92, which facilitate the exchange of information and joint action with other tax administrations, are kept under review to see if there are other actions that can be taken to strengthen international co-operation between different tax authorities.

Raising social awareness of the costs of undeclared work

The Government established a working group in the early 1990s, under a partnership agreement with employers and trade unions, to make recommendations about how to reduce the size of the informal economy with particular reference to the construction sector. The construction sector was identified as a problem because of the use of sub-contractors on building projects by the main contractors who, often, did not register their businesses for tax purposes. The working group recommended the introduction of tax-compliance certificates for all contractors, and also for firms in other sectors. This requirement has resulted in some success in reducing the problem of undeclared income in not only construction but many other sectors in the economy.

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Italy

Introduction

Undeclared work and the hidden economy has been a constant feature of the Italian economic system. The phenomenon is not confined to the weaker economic areas, being spread throughout the national territory. The issue takes on a particular importance in these less developed areas, namely in the south, because these areas display the highest rates of unemployment and the lowest rates of economic activity. This observation is reinforced by the fact that, in the present phase, the largest share of informal work is found in economic sectors producing the lowest value-added: agriculture and construction. These are key sectors of activity for many regions of southern Italy, and have always been characterised by precarious contracts and seasonal work, and the low-skilled services (personal services, tourism and, more generally, commerce). Undeclared work is present, but to a lower degree, also in the manufacturing sector and in craft production.

The National Institute of Statistics (ISTAT) is responsible for providing official estimates, at national level, according to a definition of "undeclared work" that coincides with productive activities that are not observable, but which fall within the confines of the national system of accounting. The latter comprises all the productive activities that contribute to the creation of goods or services satisfying human needs, regardless of whether they are directly or indirectly "visible" to official bodies.

In addition to regular forms of work, this system also embraces activities that are classified, by international bodies, as illegitimate, informal or hidden. Illegitimate work includes productive activities that are carried out by persons who are not authorised. Informal work, by contrast, comprises productive activities that are carried out primarily by productive units with a low level of organisation, little or no co-ordination of production factors and work relationships based on family or personal relationships. Finally, productive activities that are not directly observable, due to either

technical difficulties in detecting them, or to firms' attempt to avoid tax and social contribution burdens, are referred to as "hidden".

In this sense, it is possible to distinguish between activities that are *statistically hidden*, which occurs when firms are not detected due to a lack of information, and activities that are *economically hidden*, due to the underlying attempt to avoid paying taxes and social contributions, to circumvent contractual minimum wages, working hours, safety standards and so on. The Italian system is characterised by the relevance of productive activities that are hidden from both the tax-collector and the social insurance institutions.

The approach followed by ISTAT in estimating the overall entity of this sector enables us to calculate the number of labour units by category (regular, irregular, non-resident irregular foreign workers and multiple jobs), by comparing different data sources and by using indirect estimation methods. The basic assumption is that "each source, if appropriately standardised (in terms of time period, classification, population of reference), can be linked with others, enabling us to identify quantitative differences to which it is possible to attach an economic meaning. The procedure of integration and comparison enables, above all, the inclusion of statistically hidden firms within the category of regular work and to isolate only the component of undeclared work that is attributable to economically-hidden firms" (ISTAT, 2002, p. 9).

In this way, undeclared work may be defined as that which is carried out without respecting the prevailing tax norms, and which is therefore not directly visible within companies, institutions and administrative data sources. The following work roles fall within this category: (a) continuous; (b) occasional, carried out by persons who declare themselves to be inactive, e.g. students, housewives or pensioners; (c) foreigners who are not resident and irregular; (d) persons with more than one job, not declared to the tax-collector.

Undeclared work and policies of intervention at institutional level

The relevance of the hidden economy in Italy, at policy level, depends on various factors. One of these factors is believed to be the relationship, in certain areas and sectors, between the undeclared economy and criminal organisations which invest part of their income from illicit activities in non-declared economic activities. The presence of companies which operate completely in the black economy or which employ a large number of undeclared employees also represents a factor distorting competition with respect to firms respecting the prevailing laws. This unfair competition has effects on the dynamics of the labour market itself, both because it depresses the labour supply, especially in areas of high unemployment, and because it generates a generalised reduction in wage levels, reducing the contractual power of employees and the respect of legal provisions in relation to work, hours, professional grade, health and safety, etc.

In Italy, conversion of undeclared work into regular forms of economic activity has had an increasing importance in public debate. The issue is relevant to companies operating in a regular fashion; to trade unions, who are unable to defend the employees directly involved, except via individual negotiations; and to the State, unable to account for a share of the national wealth, which avoids taxation and thus subtracts a significant amount of resources from the public budget.

Nevertheless, as a result of growing interest in economic policy interventions, a commission, known as the “National Committee for the Emergence of Undeclared Work” (article 78 of law number 448/98), was created in 1999 under the auspices of the Presidency of the Council of Ministers (Department of Economic Affairs) and it was later transferred to the Ministry of Labour. The Committee, comprised of an extensive network of “tutors” (experts in the sector of the emergence of undeclared work and the promotion of company development), was founded with the aim of encouraging the “emergence” of undeclared work.

The tutors, in addition to assisting the activities of the local commissions, are involved in sustaining small firms, promoting, for example, forms of alliance between companies. This involvement is also linked with research activities that do not follow any set methodologies, but seek to explore specific contexts via targeted investigations, helping social and economic actors to understand phenomena that were previously unknown to them, placing established preconceptions in discussion (Meldolesi, 2000).

Undeclared work: methods of measurement and distribution of the phenomenon according to economic activity

At the moment, the only available estimates of the number of undeclared work units are provided by ISTAT and by SVIMEZ (the association for development of industry in the Mezzogiorno region), and are derived from national accounts. The Labour Force Sample Survey – periodical investigation carried out by ISTAT, every three months up to last year and subsequently on a weekly basis – does not aim to detect the share of undeclared work. Other information provided by institutes such as INPS (National Institute of Social Assistance), INAIL (National Institute for Workplace Accidents) and the Ministry of Labour, essentially refer to their own internal checks; these latter data will be discussed later on in this section.

The estimates supplied by ISTAT relate both to the extent of undeclared work and to the economic value of the hidden economy. The first estimate is based primarily on a comparison between the three-monthly measurement of the labour force (family survey) and the questions addressed to firms, although this does not permit the identification of second jobs and the work of non-resident foreign workers. In order to resolve these difficulties, ISTAT estimates the number of multiple jobs via a comparison with other sources of information and by drawing on the data on the work situation of foreigners, provided by specific research carried out by the Ministry of Internal Affairs (Calzaroni, 2000 and ISTAT, 1999). Starting from these estimates of undeclared work, the value of the hidden economy may be calculated by attributing to undeclared workers the same productivity as that of those who have regular contracts and, by correcting company accounts, by attributing to self-employed workers an income that is almost equal to that of employees (Pascarella, Pisani, 2000).

As shown in Table 1, between 1992 and 1999, irregular labour units increased in absolute terms across all forms of occupation, but above all amongst foreign workers.

The adoption of a new system of national accounts by ISTAT in 2001 (SEC95¹, substituting SEC79) led to a revision of the estimates of the extent of undeclared work. In 2001, undeclared work units represented 15% of all occupations at national level (up from 14.5% in 1995), equal to roughly 3.5 million work units, with variable rates of undeclared work in the South and in the North, at 23% and 12% respectively (equal to 1.5 and 2 million undeclared work units), confirming the strong dualism characterising the Italian labour market.

Table 1 : Undeclared labour units by type of occupation, 1992, 1996, 1999

Year	Irregular workers	Multiple jobs	Foreigners	Total
Absolute values				
1992	1,995,800	746,300	395,700	3,137,800
1996	1,966,600	787,400	533,800	3,287,800
1999	2,076,400	844,000	566,000	3,486,400
Composition %				
1992	63.6	23.8	12.6	100.0
1996	59.8	23.9	16.2	100.0
1999	59.6	24.2	16.2	100.0

Source: ISTAT (1999).

¹ The estimates previously provided by ISTAT relied on a concept of the hidden economy that included the three components of the “invisible” economy, namely the statistically hidden, the economically hidden and the informal sector. In the revision carried out using SEC95, these three components are estimated independently and only the economically hidden component is treated as the irregular dimension of work.

This estimated increase involved all sectors, with the exception of construction, which in the case of the Mezzogiorno region is in decline, from 29.3% in 1995 to 27.5% in 2001. This variation is essentially attributable to fiscal provisions relating to the renovation of houses, which favour the regularisation of construction firms, although in other regions of the Centre-North there was an increase of 0.7% in the same period (Table 2).

In 2001, the percentage of undeclared work in the Mezzogiorno, represented by “irregular workers in the narrow sense” (i.e. workers who were not declared to the tax-collector as well as resident foreign nationals) was equal to 78%, which implies that only 22% were involved in irregular second jobs, as compared with 45% in the Centre-North regions. This reveals, once again, the chronic weakness of labour demand in the South, and the poor quality of employment opportunities, the latter being the result of many contextual factors: the reduced efficacy of labour market policies; an excessive incidence of small firms, concentrated in traditional manufacturing sectors; the lesser efficiency of public administration, etc. But the weakness of economic development that structurally distinguish the southern regions and the inadequate demand for labour, strongly contribute to creating the

conditions for the development of firms remaining at the margins of the labour market and relying on irregular workers in order to survive.

The irregularity rate is highest amongst employees, generally in those sectors with lowest value-added, such as the wooden product industry and the furniture sector (16%), construction work (22%), hotels and shops (25%), various real estate and company services (28%), social and personal services (22%). Amongst the self-employed, the highest rates of undeclared work are observed in private instruction teaching (57%) and the health and social services (26%).

Other information that is relevant for our analysis relates to the foreign workers who are present within Italy but lack work permits. These individuals accounted, in 2001, for roughly one sixth of the total number of irregular workers. It is thought, however, that the last immigration amnesty (“*sanatoria*”) that occurred in 2002, enabled roughly 700,000 immigrants without work permits to regularise their situation.

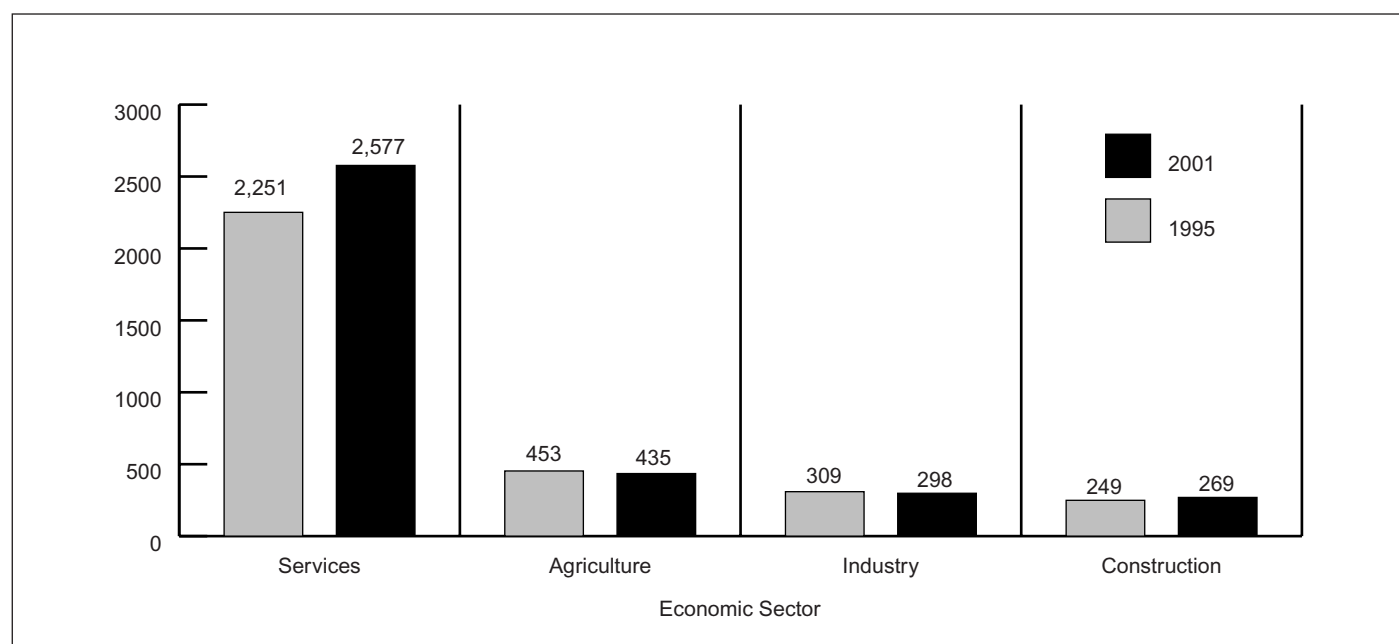
In 1998, the share of GDP that can be linked with the hidden economy oscillated between 14.7% and 15.4%, with the tertiary

Table 2: Rate of undeclared work by economic sector and region

Sector	Mezzogiorno			Centre-North			Italy		
	1995	1999	2001	1995	1999	2001	1995	1999	2001
Agriculture	34.8	38.4	40.0	21.0	22.6	24.0	27.9	30.4	32.0
Industry	19.7	19.4	19.5	5.4	5.1	5.3	8.3	8.0	8.2
<i>Industry</i>									
<i>(excluding construction)</i>	14.7	14.5	15.0	4.1	3.9	3.8	5.9	5.7	5.7
Construction	29.3	28.8	27.5	10.7	10.3	11.4	16.5	15.9	16.4
Services	18.2	21.2	21.5	14.9	15.1	14.4	15.9	16.9	16.5
Total	20.7	22.6	23.0	12.1	12.2	11.9	14.5	15.1	15.0

Source: SVIMEZ (2002).

Figure 1: Undeclared workers by sector, 1995 and 2001 (absolute values, in thousands)



sector generating the greatest value-added within the irregular economy, at 75%. In fact, 2.5 million undeclared workers, out of a total of 3.5 million workers, are employed within this sector (Figure 1).

The services sector, besides accounting for more than two thirds of the undeclared work units, also had, between 1995 and 1999, the highest rate of growth in the number of undeclared workers, as compared with the overall number of labour units, displaying an even higher figure for the southern regions (Table 3).

The impact of the services sector, when calculating the number of irregular labour units, depends not only on the fact that it is the only sector where there have been increases in the number of jobs (above all in the form of self-employment), but also on the highly fragmented commercial structure and, as in other countries, the growing presence of small commercial activities of foreign origin in the large urban areas.

The most recent estimates provided by the European Commission, for Italy, indicate that the share of GDP subtracted from the regular economy, between 1998 and 2001, was equal to 16-17%, one of the highest percentages observed in the EU, with the exception of countries such as Greece, Latvia and Hungary, in contrast with the much lower rates, around 2%, observed in Austria and the UK. Undeclared work is a product of various factors, which the European Commission lists as the rigidity of the labour market, the influence of the tax burden and the lack of trust in the functioning of the State. Yet, in the Italian case, the introduction of greater

labour market flexibility has not produced a significant reduction in undeclared work.

A factor specific to Italy is the distinct distribution of the irregularity phenomenon at geographical level. The differentials between the rates of undeclared work depend on differential sectoral specialisation (in the southern regions the most exposed sectors – agriculture, construction and low-skilled services) and the varying tendency of local labour markets to use irregular workers. In the regions of the South, the incidence of undeclared work is particularly high in agriculture. In 2001, 40% of labour units were irregular, with above-average rates in Calabria, Sicily and Campania (Table 4).

Other data that shed light on the phenomenon of undeclared work relate to the checks carried out in 2000, in various sectors, by the Ministry of Labour, by INPS and INAIL. A total of 234,428 companies and self-employed individuals were inspected throughout Italy, 127,990 of whom were completely hidden or irregular (CNEL, 2001).

These inspections show that, in general, one third of the companies have some irregularity, rising to a higher level amongst agricultural and industrial companies, especially those which are small in size; lower rates of irregularity are found amongst artisans. The overall picture of different forms of irregularity resulting from the public inspections carried out in 2000 reveals the prevalence of non-registered workers, those who are paid in cash “under the counter” (*fuori busta*) and foreigners (Table 5).

Table 3: Index numbers for irregular labour units (LUs), by economic activity 1995-1999 (Base 1995 = 100)

Geographical area	Total		Agriculture		Industry		Industry (excluding construction)		Construction		Total services	
	Irregular LUs	Total LUs	Irregular LUs	Total LUs	Irregular LUs	Total LUs	Irregular LUs	Total LUs	Irregular LUs	Total LUs	Irregular LUs	Total LUs
South	111.2	101.6	91.8	83.2	98.4	100.5	100.1	101.4	96.9	98.7	123.1	105.5
Italy	106.9	102.6	92.1	84.5	96.7	100.4	96.5	100.3	96.9	100.7	112.4	105.7

Source: ISTAT (2001)

Table 4: Rate of irregularity by region, 2001

Region	Agriculture	Industry			Services	Total
		Industry (less construction)	Construction	Total		
Abruzzo	29.7	4.5	16.3	8.0	16.0	14.4
Molise	28.7	15.0	17.8	16.0	17.0	17.7
Campania	40.5	16.8	26.5	19.9	25.4	25.3
Puglia	40.1	10.3	25.3	16.8	18.7	21.1
Basilicata	32.2	14.8	19.0	18.2	19.4	20.7
Calabria	47.6	29.8	40.0	34.7	23.8	29.5
Sicilia	40.8	20.2	33.0	25.6	21.5	24.2
Sardegna	26.0	10.6	23.0	25.9	20.6	20.2
South	40.0	15.0	27.5	19.5	21.5	23.0
Centre-North	24.0	3.8	11.4	5.3	14.4	11.9
Italy	32.0	5.7	16.4	8.2	16.5	15.0

Source: SVIMEZ (2002)

Table 5: Outline of the irregularities detected by public controls in Italy in 2000

Forms of irregularity	Absolute values	%
Total number of workers (and % of irregularities detected)	2,066,399	(5.4)
Workers not registered on company books	49,120	43.6
Other cases	29,432	26.1
Workers paid in cash ("fuori busta")	20,688	18.4
Foreigners	9,276	8.2
Minors	1,576	1.4
Pseudo-artisans	645	0.6
Pensioners	541	0.5
Students	397	0.4
Workers receiving unemployment assistance (CIG)	454	0.4
Workers receiving unemployment assistance	256	0.2
Workers on sick or injury leave	77	0.1
Multiple jobs	100	0.1
Total number of irregular workers	112,562	100.0

Source: Ministry of Labour and Social Policy, "Vigilanza ordinaria", 2000.

INPS has supplied information on the duration of the periods of irregularity and the age of the workers concerned, on the basis of research carried out in 2000. There appears to be a tendency on the part of those interviewed (80% of the total) to declare, perhaps in agreement with their employers, a period of irregularity of less than one year. The age composition of undeclared workers confirms the greater incidence of people under 30 years of age, who account for more than half of the total.

Policies to tackle undeclared work

Despite the fact that the theme of the irregular economy is receiving greater government attention, the measures that have been adopted up to now have not produced appreciable surfacing results. At the end of the 1990s, some results were obtained using the so-called "Realignment contracts" in the agricultural sector, a measure that was geared towards a gradual regularisation of workers, with the aim of avoiding both a penalisation of the firms concerned and the immediate equalisation of the wages of the workers involved to the levels set by national contracts. This experience, which developed with the involvement of the union organisations and employers, had varying and uneven levels of success across Italy, which explains why it was not repeated.

The weakness of measures to combat the hidden economy is confirmed by the recent experience of Law 383 (2001), which introduced a system of fiscal incentives and attenuation of sanctions with the aim of favouring an automatic or progressive surfacing of companies. At the end of February 2003 (the final deadline set by the Government) only 2,000 firms had presented "Emergence Plans" to the organism responsible at local level (CLES), covering

just 4,000 workers. This was clearly a failure, demonstrating that it is not sufficient to intervene in terms of labour costs and fiscal benefits only in a once-and-for-all fashion.

More effective measures were instituted by national and regional laws which promoted the creation of new firms using formulations such as the *prestito d'onore* (cheap credit), an experience which was pursued at the end of the 1990s and which permitted the creation of numerous small firms through a simplification of the procedures for setting up a new company and for obtaining financing.

A reform of the labour market is currently under way in Italy. It began with Law 30 (2003), with the aim of increasing employment levels and encouraging the surfacing of undeclared work, for example by providing for the regularisation of small parcels of "auxiliary work". In reality, this law covers a rather extensive range of forms of work which have notably increased contractual flexibility. There is a risk of generating an even greater precariousness within the labour market, above all in the absence of a safety-net of social assistance capable of sustaining unemployed individuals. ISTAT has recently stated that the tendency towards greater flexibility in terms of hours, the duration of work and new forms of contract do not appear to have checked the growth of the hidden economy, as the growth in regular work has been lower than that in *undeclared* work, which expanded continually between 1992 and 2000. Although the reform of the labour market was approved (despite the opposition of the largest trade union in Italy), the unions' opposition to the proposal to reduce taxes for new employees (taking account of the fact that many consider the high cost of labour to be an important source of irregularity) led to its abandonment.

Once Law 383 (2001) expired, in June 2003 the Ministry of Labour and the Committee for the Emergence of Irregular Work created sectoral discussion tables on undeclared work, in order to plan mechanisms to provide incentives for companies to encourage them to respect labour laws and to reduce the unfair competition of irregular firms. Another aim is to generate consensus around the need to construct surfacing policies by adopting a bilateral approach during the design phase and the "certification" of fair behaviour by companies and workers. To this end, sectoral discussion tables have been organised for construction, agriculture, tourism, commerce and artisan activities. Building on this experience, the practice of "common warnings" was initiated and in construction work (December 2003) this led to the adoption of the following provisions: (a) a single document testifying to the regularity of a firm; (b) fiscal relief on tax payments of 41%; (c) incentives of 11.5% in relation to contributions; (d) removal of certain additional payments fixed by collective contracts; (e) contribution reductions for the *Cassa Integrazione Ordinaria* (short-term working allowances to employees belonging to firms experiencing economic difficulties); (f) communication of recruitment decisions; (g) security in the workplace.

In recent years, there has been an increase in the number of inspections by the bodies in charge, with the aim of more effectively contrasting undeclared work via preventive actions, information and the creation of a new culture of legality. Despite this action, the need is felt for the permanent training of inspectors, who are still insufficient in number (Italy has the lowest number of inspectors in Europe).

As stated in one of the last reports on the hidden economy published by CNEL, "inspections cannot be occasional and sporadic, but must be widespread and perceived by public opinion as an integral part of the overall strategy of emergence of undeclared work, geared towards the diffusion of a culture of

legality, both in the field of the appropriate management of work relationships, and in those relating to the prevention of accidents and to safety in the workplace” (CNEL, 2001, p. 52). The recent reform of inspection services was nevertheless oriented towards the attribution of a conciliatory function to the bodies of control, thus weakening their sanctioning powers.

Conclusions

The picture drawn in the previous sections has shown the diversity of instruments used to tackle the irregular economy in Italy, and reasons why actions must remain multiple in type and approach. These interventions must lead to: a relaunching and improvement of inspection services (without attenuating their role in sanctioning); a reform of the legal procedures relating to tax evasion (especially avoidance of sanctions and provisions); a modernisation of the prevailing legislation and incentives, for example, by promoting alliances between firms, credit policy and the obligation of acquiring tax certification from firms situated at the peak of the production network; and tools for assisting firms with their “bureaucratic” responsibilities, such as the experience of the CUORE centres that were promoted within the National Committee for the Emergence of Undeclared Work.

A comprehensive strategy for integrated services and policies is required, with the involvement of the various actors (employers’ associations, trade unions, local authorities, etc.) and with the aim of encouraging the emergence and upgrading of those firms and workers who are currently “irregular”. It is necessary to create special funds, such as those for the emergence and consolidation of surfaced firms, and to spread and promote a “culture of legality” by reinforcing inspections.

Specific actions for targeted firms and workers are also required, with the aim of improving social insurance provisions, and of fostering the respect of environmental and health and safety legislation. The reform and strengthening of sectoral studies is also important, in order to facilitate a more transparent relationship

between public administration and companies, but also to achieve a better understanding of the local context and to facilitate the work of the inspectors. New laws need to be promoted in relation to contracts, services, construction work, sub-contracting and agriculture. Finally, clearer and more streamlined forms of documentation of foreign workers are required, following a policy whereby integration is pursued not only within the workplace, but also more generally, for example by maintaining a permanent possibility for regularisation and the conversion of temporary permits.

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Cyprus

Introduction

In 1998, the European Commission issued the *Communication of the Commission on Undeclared Work* (Brussels, COM (1998), launching a debate on the causes of undeclared work and on ways to combat it. The European Parliament followed up with the *Report on the Commission Communication on Undeclared Work* (Brussels, Committee on Employment and Social Affairs, A5 – 0220/2000), urging the Commission to review measures taken by Member States and to take further action. The Commission funded a study by Mateman and Renooy (2001), called *Undeclared Labour in Europe*, which reported on a number of aspects of this issue for seven Member States (France, Germany, Italy, the Netherlands, Spain, Sweden and the United Kingdom). Another recent study was that of Renooy *et al* (2004), which, however, contained little information on the Republic of Cyprus (Cyprus). The present article addresses similar issues for Cyprus.

The definition of undeclared work adopted in the *Communication of the Commission on Undeclared Work* and in the other studies mentioned above encompasses “... any paid activities that are lawful as regards their nature but not declared to the public authorities, bearing in mind that differences in the regulatory systems of Member States must be taken into account”. Thus the first point to be addressed is how the issue of undeclared work is viewed locally.

In a recent study carried out by AKEL (2003), the country’s largest political party, the shadow economy, or “para-economy” as it is termed in Cyprus, is defined to consist of three general classes of activities:

- a) The “informal” sector, including production of goods and services for own use, including home repairs and construction, sport fishing and hunting, as well as “tips” for services offered. In both 1997 and 2000, this was estimated to amount to 2.3% of GDP;

- b) The “underground” sector including production units which are not registered, production units which are registered but which under-report, and self-employed individuals who under-report. This, in both 1997 and 2000, was estimated to amount to 2.4% of GDP; and
- c) The “illegal” sector (private tutoring by teachers, private account medicine by Government-employed doctors, gambling, prostitution, copyright violations such as illegal copying of books and music, cigarette smuggling and drug trafficking) whose size is thought to have increased as a proportion of GDP from 3.6% in 1997 to 4.5% in 2000. The study concludes that the total size of the para-economy was approximately 8.3% in 1997 and 9.2% in 2000.

The definitions in the AKEL study (2003), as described above, are not entirely in line with the approach adopted by the Commission, which refers to “lawful” and “paid” activities that are not declared. The AKEL study’s “informal” sector includes many activities that are not paid and should, therefore, be excluded from the present definition of undeclared work. Only “tips” come under the category of “paid activities that are lawful”. The activities in the “underground” sector can be viewed as undeclared work. Finally, AKEL’s (2003) “illegal” sector contains private tutoring and medical services which are not in fact illegal even though they may violate the employment terms of the individuals involved. There is no explicit mention of work by illegal immigrants, though it may be captured thematically in the various categories discussed – e.g. in “underground” construction work. In this article, the Commission’s definition of undeclared work will be used, namely, the definition used here will include “tips” (from AKEL category [a]), the whole of the “underground” sector (from AKEL category [b]) and private tutoring and medical services (from AKEL category [c]).

It is worth noting that the task of combating undeclared work has not been given very high priority in light of the country’s other problems. The accession process, the long process of negotiation of UN plans for the island, the fallout from the rejection by the Greek Cypriots of the Fifth Annan Plan, the subsequent efforts to contain the damage from this rejection, and the attempts to deal with the burgeoning Government deficit, all limit the energy and thought that can and have been given to the problem of undeclared work.

In general, there is no political appetite for dealing with the “informal” sector. Activities in the “underground” sector are certainly frowned upon but it is often taken for granted that few self-employed individuals will pay income tax. Similar tolerance is displayed for “illegal” private tutoring and medical services. It is only the remaining illegal activities in category (c) that attract the ire of the authorities. However, this is directed at essentially criminal activities and does not amount to a concerted attempt to curb the phenomenon of undeclared work as defined by the Commission.

Perhaps, the only systematic attempt to deal with undeclared work is directed against work by illegal immigrants. Increasingly, illegal immigrants are rounded up and deported. Recently, some employers of illegal immigrants have also been charged. There are serious attempts to deal with illegal entry into Cyprus. This entry occurs through the Turkish area in the north and the illegal crossing of the green line separating the Turkish and Greek sides of Nicosia, through illegal disembarkation at beaches, and through legal entry at ports and airports (as tourists or students, for example) followed by subsequent disappearance into the community. There is no attempt to prevent slum landlords from offering shelter to illegal workers.

It has to be said that, in this regard, Cyprus faces a difficult problem.

It is the easternmost end of the EU and closest to the “hot spots” of the Middle East, Iran, Iraq, and other sources of illegal immigrants such as Pakistan and Bangladesh. It is an island with a coastline that cannot be fully patrolled due to the Turkish occupation of the north part of the island. The green line does not always stop individuals who enter the north in one way or another. Finally, the phenomenon of fraudulent asylum seeking is challenging both the existing procedures and the resources available to deal with it. United Nations officials co-operate with local authorities to improve the system but often express frustration with the progress achieved.

The prevalence of undeclared work in the economy

Individuals who engage in undeclared work in Cyprus include: those among the self-employed who do not report some or all of the transactions in which they are engaged; illegal immigrants who are employed; paid workers (including teachers, doctors and other public servants) who hold second jobs that are not declared; retirees and students who are gainfully employed but who do not declare these activities; and those receiving unemployment benefit and social security who hold jobs. Though no hard evidence is available, it is likely that the categories above are in descending order of importance, with the self-employed and illegal immigrants being the most important categories and individuals who participate in the labour market while drawing some kind of benefit the least important. These categories are now examined in more detail.

The incidence of self-employment in Cyprus is higher than in some of the larger Member States but lower than in Greece and much lower than in Turkey. The sizable rate of self-employment for Cyprus means that, if there is any tendency to under-report income for tax-avoidance purposes, then the amount of undeclared work would be sizable. Self-employment does not only include tradesmen (electricians, plumbers, painters, construction and repair people) but also professionals such as lawyers, doctors and other service providers.

It is perhaps not surprising that, of the 2004 projected revenues from direct taxation, 30% will come from income tax for paid workers but only 1.75% will come from the self-employed (Polites, May 30, 2004).

Illegal immigrants are estimated to be of the order of 40,000 people, or just over 10% of the gainfully employed. They are likely to be distributed among the various sectors of employment in roughly the same proportion as the legal foreign workers. If so, the most important concentrations would be found in home services, construction, in the food and restaurant sectors, in the hospitality business, in retail trade and in other services. If one were to assume that they are employed at CYP 300 (521 euro) per month, an amount that is probably an underestimate, then their annual earnings would constitute approximately 2.4% of GDP. Another way to estimate the proportion of GDP due to illegal work is to take standard estimates of the share of labour in GDP (say 66%) and multiply it by the proportion of illegal workers to the gainfully employed (10%). The result gives a figure in the order of 6.6% of GDP.

A number of individuals are engaged in dual job holding. Some of them are public servants who, generally, work from 7.30 a.m. to 2.30 p.m., leaving most afternoons free for self-employment, income from which may not be reported. Another category is high-school teachers, many of whom run evening private tutoring businesses. Doctors employed in the public sector are also engaged in private medical practice.

The activities of teachers and doctors contravene their terms of employment and create serious moral hazard problems. That is, the system provides clear incentives to both teachers and doctors to under-perform during regular hours in order to boost their private businesses (the moral hazard problem). The resulting time wasting and inefficiency means that the cost of this undeclared work is not only the loss of tax revenue on undeclared incomes but, more importantly, they have detrimental effects on the national education and medical care systems. If unscrupulous individuals are involved, pupils may be left under-taught and patients under-treated. At the least, these forces may be at work, to a greater or lesser extent, throughout the chain of supply for these critical services. These mechanisms may also have distributional effects if the poor are under-provided. Another subtle cost of private tutoring by teachers is the cynicism that it engenders among the young if they come to believe that moral hazard processes are at work, even though the possible loss of idealism and the implications of this are hard to quantify.

The size of private tutoring and parallel private medical services' activities (excluding the effects of moral hazard) was estimated by AKEL (2003) to be approximately CYP 27 million (47 million euro) in 2000. Most of this was due to private tutoring rather than medical services and works out at about 0.5% of GDP. The quantitative significance of the moral hazard problem can be put into perspective if it is supposed that a fraction of the relevant expenditures do not in fact result in the production of the services for which they were made. Thus, a fraction of the expenditures on public schooling may be going to waste.

To the extent that they carry on working, retirees are likely to be self-employed and they may under-declare their income. There were also some abuses of the unemployment insurance scheme until recent corrections to the system were made. Previously, individuals were apparently able to refuse work, continue to collect benefits while undertaking some form of self-employment, in parallel. However, such abuses are rare and pale relative to the under-reporting that is estimated to be done by the self-employed and the work carried out by illegal immigrants. One noteworthy category that is currently being targeted in attempts to reduce the budget deficit is public sector employees who, retiring at 60, are able to collect unemployment insurance for six months. There may well be cases of individuals collecting social assistance while being engaged in gainful employment. These cases are likely to be small in number and not comparable in importance to those noted earlier.

As noted earlier, the AKEL (2003) study summed the total size of the "para-economy" to 9.2% of GDP in 2000. Using the Commission's definition of undeclared work, described earlier in this article, an overall estimate for undeclared work based on the AKEL (2003) breakdowns would be of the order of 3.5-4%. The figure of 9.2% based on the AKEL (2003) para-economy definition is broadly in line with the estimate made by Georgiou and Syrichas (1994), of 8.8% of GNP during the 1980s. They relied on the Tanzi method which uses the demand for currency as a proxy for "underground" activity and so their methodology is broadly consistent with the definitions in AKEL (2003). On the other hand, the estimate of 21% of GDP for 1989-90 reported by Schneider (2000) may be too high. Given the growth in the number of illegal immigrants in recent years, there is no doubt that the importance of undeclared work has increased substantially and may now be approaching 10% of GDP. This would make the broader para-economy as large as 15% of GDP and closer to Schneider's (2000) figure. A figure mentioned for Cyprus by Renooy *et al* (2004) was actually taken from a website of the self-proclaimed Turkish Republic of Northern Cyprus and cannot be considered credible.

Measures taken to combat undeclared work

Until fairly recently, undeclared work did not trouble the national psyche. It was virtually taken for granted that self-employed individuals would not pay income taxes. Indeed, the problem may go deeper than that because many personal expenses (e.g. personal use of a company car) are probably treated as a company expense, thereby reducing possible revenues from the taxation of profits. Profit management, that is the use of company before-tax earnings for the benefit of senior management is possibly not effectively monitored.

The incentives for the self-employed to under-report are related to the tax system, the penalties for fraudulent reporting, and inadequate reinforcement efforts on behalf of the authorities. The tax brackets for individuals have been altered substantially in recent years. In the 2002 tax year, income up to CYP 9,000 (15,600 euro) was tax exempt. Between CYP 9,001-12,000, the marginal rate was 30% and above CYP 12,000 (20,500 euro) it jumped to 40%. These were fairly high rates, particularly given the size of the publicly provided services in Cyprus.

In 2004, the marginal tax rate became zero for taxable income up to CYP 10,000, 20% between CYP 10,001-15,000, 25% between 15,001-20,000 and 30% above CYP 20,000 (34,200 euro). The income tax schedule in 2002 imposed a stiff marginal tax rate on income above CYP 9,000 but the 2004 changes reduced the marginal tax rate on incomes between CYP 12,001 and 15,000 (20,500 euro and 25,700 euro) significantly, thus reducing the incentive to under-report.

On the other hand, the VAT rate increased to 15% from substantially lower levels in recent years. It was also extended, on 1 May 2004, to a number of goods that were formerly either not taxed or taxed at lower rates. These increases are likely to work in the opposite direction, increasing the tendency for undeclared work.

In addition to tax rates, it is important that the tax system be effectively run, if undeclared work is to be kept at low levels. The penalties for fraudulent declarations and the extent to which monitoring and spot checks are done appear modest. Authorities are still processing tax declarations for 2001, thereby failing to convey a sense of urgency.

The use of illegal immigrants is widespread, given that their number is estimated to be over 10% of the gainfully employed. Many employers are complicit and many landlords make accommodation available to illegal immigrants. Clearly, illegal immigrants are a source of cheaper foreign labour than can be obtained legally. The differential arises because, due to their weak bargaining position, illegal immigrants may be hired at lower gross wages (in any case, they are not likely to be earning enough to be taxed) and because employers and employees avoid paying social security contributions for them. This is fixed at 6.3% of insurable earnings for each side of the market – the Government contributes an additional 4% (total of 16.6%). Incidentally, in the public sector, the employer/Government contributes 9.4% while the employee pays 3.2% (total of 12.6%) but the Government hopes to shift 3.1 percentage points to public servants as a cost-cutting measure. Thus, the root cause of illegal work is the fact that it is cheaper for employers to employ illegal workers. The "cost" of employing illegal workers can be increased through tighter enforcement of the regulations.

There are some indications that the Government is clamping down on the employment of illegal workers. Raids on workplaces are increasing and employers are being prosecuted. However, the mindset needs to change more broadly on all these issues, a point

also raised by Mateman and Renooy (2001) for the EU.

There is the intention, within current budget deficit reduction measures, to declare a tax “amnesty” so that individuals involved would be able to buy their way into legality. The hoped-for revenue would be substantial, if it is in line with the CYP 55 million (95.5 million euro), as estimated by Polites (2004) for the period 2004-2007. This is about 20% of the additional revenue that the Government plans to raise through its deficit reduction campaign. Nevertheless, the incentives offered may encourage non-compliance in the future. In general, insufficient thought has been given to the incentives built into the tax system for compliance. This is true both in a static sense and in terms of what policies such as a tax amnesty might involve for compliance in the future.

There have been no real attempts to educate the public on the problems involved in undeclared work. Efforts to reduce illegal employment are hampered by the societal mindset and the amount of resources that relevant ministries can devote to dealing with this issue. Since what efforts have been made so far to reduce undeclared work are both recent and modest, there have been no attempts made to evaluate the effectiveness of policies such as the recent income tax reductions, in discouraging undeclared work.

Conclusions

Based on the little evidence available, it can be said that the extent of undeclared work in Cyprus is probably in the region of 10% of GDP and that it has been increasing recently due to the increasing importance of legal work carried out by illegal immigrants. Other important types of undeclared work involve under-reporting in the large self-employed sector, some of which involves groups such as teachers and doctors employed in the public sector, which should not be running parallel private businesses. In addition to the loss of tax revenue, undeclared work by the last two groups may undermine (because of moral hazard reasons) the integrity of the publicly-provided services in these vital areas.

Society has not been sufficiently averse to the notion of undeclared work to seriously attempt to curb it. The costs have not been explained and the benefits are all too evident to tax-avoiding self-employed individuals and to employers who have come to rely on cheap labour. Until now, the Government has been relying on growth to fund its own activities and budget deficits have been manageable and within the EU norms. There has, therefore, not been a very strong reason to try to raise tax revenues through tighter enforcement of the tax regulations.

There are some indications that the tide may be turning. Illegal immigration has reached high proportions at a time when labour supply is increasing due to the participation of Turkish Cypriots and other EU citizens in the labour market. Unemployment has been rising somewhat. Illegal immigrants are, therefore, more dispensable and it may well be that their numbers will gradually decline. The police now claim that a large proportion of offences is

being committed by illegal workers and there is increased stress on the possible social problems that may accompany imported and, particularly, illegal labour.

The budget deficit has become more of a problem and, as a result, measures to reduce it are being considered. Tax amnesty at a cost is one such measure but its implications for future compliance have not been fully considered. The thorny and politically unpopular issues of making the self-employed contribute their share of the tax burden and stopping senior management from using company revenues for personal purposes have not been addressed. Instead, current measures to reduce the budget deficit are directed at public sector employees. This is widely viewed as an advantaged class and it may well be that austerity has to begin at home. However, if it stops there, it will not offer a long-term solution. The Government machine faces many challenges and it must be made to work more efficiently. If it does not, then not only will the budget deficit continue to rise, but undeclared work will increase further.

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Latvia

Introduction

In the recently published EU report, *Undeclared Work in an Enlarged Union*, it is recognised that undeclared work goes by a variety of different names and is sometimes distinguished by correspondingly different criteria. The report takes “work” as its main focus and “registration according to national requirements” as its criterion for the distinction between what is regarded as declared and undeclared work. Thus “undeclared work” is taken to mean “any paid, productive activities that are lawful as regards their nature but not declared to the public authorities, taking into account the differences in the regulatory system between Member States”.

In Latvia the Ministry of Welfare has recently published guidelines “On measures to combat undeclared work in Latvia” (accepted by the government in January 2004) that define undeclared work on the basis of the Commission’s definition. Thus the Latvian definition reads:

“Undeclared workers are those who have not formed a legal work relationship in accordance with Latvian regulations (that is, those who do not have an employment contract and do not make social insurance and income tax payments; or those who do have an employment contract but the contract does not show the true level of earnings)”.

Foreigners who work in Latvia without a work permit are also regarded as undeclared workers.

It should be noted that this definition explicitly includes Latvian concerns about under-reporting of income in the form of the widely prevalent “envelope wage” phenomenon, whereby a worker is registered to work at or near the minimum wage (currently 80 LVL, or just over 120 euro) but in practice receives an additional cash payment in the “envelope”.

The guidelines on undeclared work, and hence the definition given by the Ministry of Welfare, have emerged only recently reflecting on the fact that undeclared work as a separate phenomenon of the informal economy was not widely addressed before. Most previous studies and statistical data in Latvia have employed the term informal or shadow economy rather than undeclared work. The most frequently used definitions are as described below.

The Central Statistical Bureau of Latvia (CSB) follows the EU methodology and includes the following activities in its definition of the informal economy: all legal activities (manufacturing, services) which are not registered and are not accounted for fully or partially. This definition of the informal economy includes both formal and informal parts of underground production as defined in the System of National Accounts 1993. It excludes illegal production and most production for personal final use (unaccounted).

Another definition used by the Ministry of Finance (MoF) is from the OECD Handbook on Measuring the Non-Observed Economy, which is also generally consistent with the EU methodology.

The lack of studies on undeclared work in Latvia is an indication that it has not been viewed as a national priority before. However, considerable importance has always been attached in political circles to aspects of the informal economy, such as the evasion of social insurance and income tax payments resulting from under-reporting

of income. It should be mentioned that the general public is not much concerned by this – in a recent survey just over 44% of respondents believed that in current circumstances the existing regime of partial tax evasion was justified and this opinion has been steadily rising from 35% in 2001.

However, with entry into the EU, the government has started to pay more attention to undeclared work *per se* and this has resulted in the recently published guidelines. A policy paper and an action plan for 2005-2009 are in the process of being worked out. These are expected to contain an assessment of the prevalence of undeclared work in the economy as well as proposals for measures to combat it.

Prevalence of undeclared work in the economy

Level of undeclared work

The CSB is the main State institution engaged in measuring the informal economy. To estimate the size of informal economy in money terms they make adjustments to enterprise accounts (used for GDP estimation) for activities, which are partially hidden to avoid income tax and social insurance tax. To estimate the size of the informal economy and the number of people involved, the Labour Force Survey (LFS) is used to provide data on employment and is later compared with the employment numbers reported in the Enterprise Survey (ES). The discrepancy captures unreported labour. The CSB estimate of the size of the informal economy in 2000 was 18% of GDP and, in a statement at the beginning of 2004, the CSB claimed that the informal economy remained at 16-18% of GDP, although there have been changes in incidence in different sectors. As for the number of persons engaged in undeclared work, the CSB 2000 data shows that just under 9% of the work force are unregistered.

The MoF uses several methods, including the monetary method, the “method of five indicators” (akin to the “electricity consumption approach”), data on the discrepancy in collection of social and personal income tax in public and private sectors (under the assumption that public sector employees do not evade taxes), and also data on discrepancies between Latvian trade statistics and those of its major trading partners. Using these methods, the MoF has estimated the informal economy in 2001 as 23.2% of GDP, although in the past their estimate has been as high as 45% of GDP (1995).

Using the DYMIMIC Method, Schneider (2002) has estimated that the shadow economy in Latvia in 2000/2001 was close to 40% of GDP. Local economists also believe that the shadow economy in Latvia is 40% of GDP or more, largely on the grounds of Latvian business links with the CIS countries.

Most of the above-mentioned estimates are of a “broadly defined” informal economy. Some measures capture different parts of the informal economy – for example, the estimates calculated by the MoF and Schneider include the illegal economy.

Evaluating different attempts to estimate the informal economy is difficult, since all of them have serious drawbacks. For example the MoF estimates are based on the unproven assumption that the size of the informal economy in GDP was 25% in 1993. The CSB’s

estimate is especially sensitive to the reliability of data from the sources used to identify under-reporting of income and salaries. Typically, no clear detailed methodology is publicly available, but it appears that many assumptions are made in the process and good data is often unavailable (expenditure data, for example).

Sectoral analysis

The methodology of measuring the informal economy in Latvia is quite basic and hence little is known about the detailed characteristics of undeclared work. The CSB has performed a sectoral analysis of Latvia's economy. However, neither the CSB data nor the data published by any other institution provides an analysis in regional, demographic or gender dimensions.

Using the methodology of comparing LFS and Enterprise Survey data, the CSB found that in 2000 around 9% of the employed workforce (employed in companies plus self-employed) were unregistered. The sectoral distribution of unregistered labour is shown in Figure 1, where it can be seen that the "leading" sectors are: agriculture (with 30% of the unregistered total), manufacturing (28%) and construction (18%).

The incidence of unregistered labour by sector is shown in Figure 2 which shows that the highest proportions of unregistered labour is in construction, where 26% of all labour is not registered, followed by agriculture (18%) and manufacturing (14%).

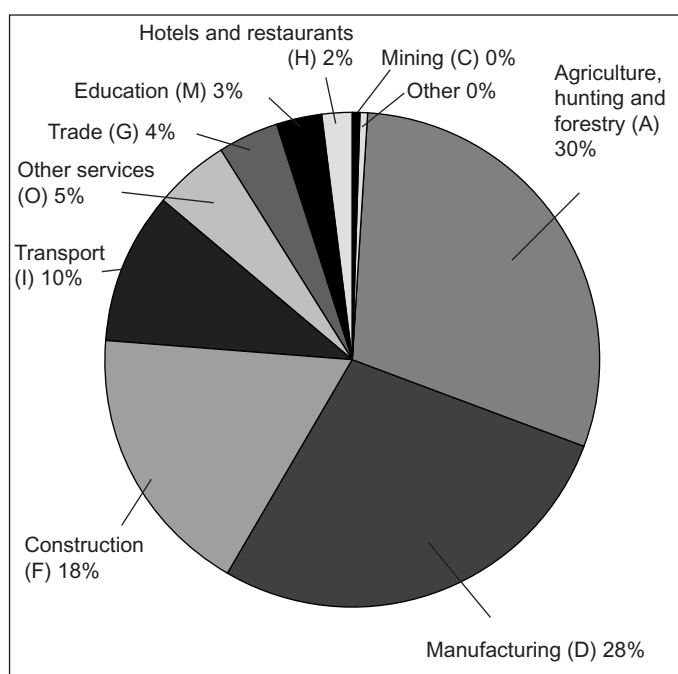
Reasons behind the prevalence of the informal economy

It should be stressed again that the phenomenon of (narrowly defined) *undeclared work* in Latvia is not what arouses the most public interest in the country. Rather, it is *under-reporting* of income that is more prevalent and generates the greater public interest.

The major motive for under-reporting of income is likely to be tax evasion. The determinants of registration status, however, are probably different. In developed countries the stringency of labour regulations may be an important factor. Thus, illegal immigrant labour is likely to be unregistered. If labour regulations are too cumbersome for firms (for example, it is difficult to lay off official workers), they may choose to hire "unregistered labour". If labour is not registered it automatically implies that incomes are not reported. Non-registered labour with non-reported incomes is likely to characterise informal economies in many EU-15 countries, where labour codes are costly to comply with, and are strictly enforced. In developing and some transition countries, some parts of the economy may simply exist outside the formal system because of the small scale and primitive organisation of production.

In Latvia and some other transition countries the situation is different. Labour codes are not so cumbersome and not as strictly enforced as in Western Europe and there are very few illegal migrants. Thus the developed economy type of the informal economy is not widespread. In the Latvian agricultural sector, there are around 75,000 farms of less than 5 hectares and more than 67% of all farms produce nothing for the market. This corresponds to the developing country type of informal economy. However, by far the biggest share of undeclared income/work arises in enterprises that are registered and is undertaken by workers that are also registered. The typical form of informal economy is a worker who gets a small wage (subject to minimum taxes) and the rest "cash in hand". Firms have little motivation to seek unregistered labour because that way they may arouse the suspicions of the tax office (too few workers relative to turnover) and become subject to a tax audit.

Figure 1: Distribution of unregistered labour by sectors

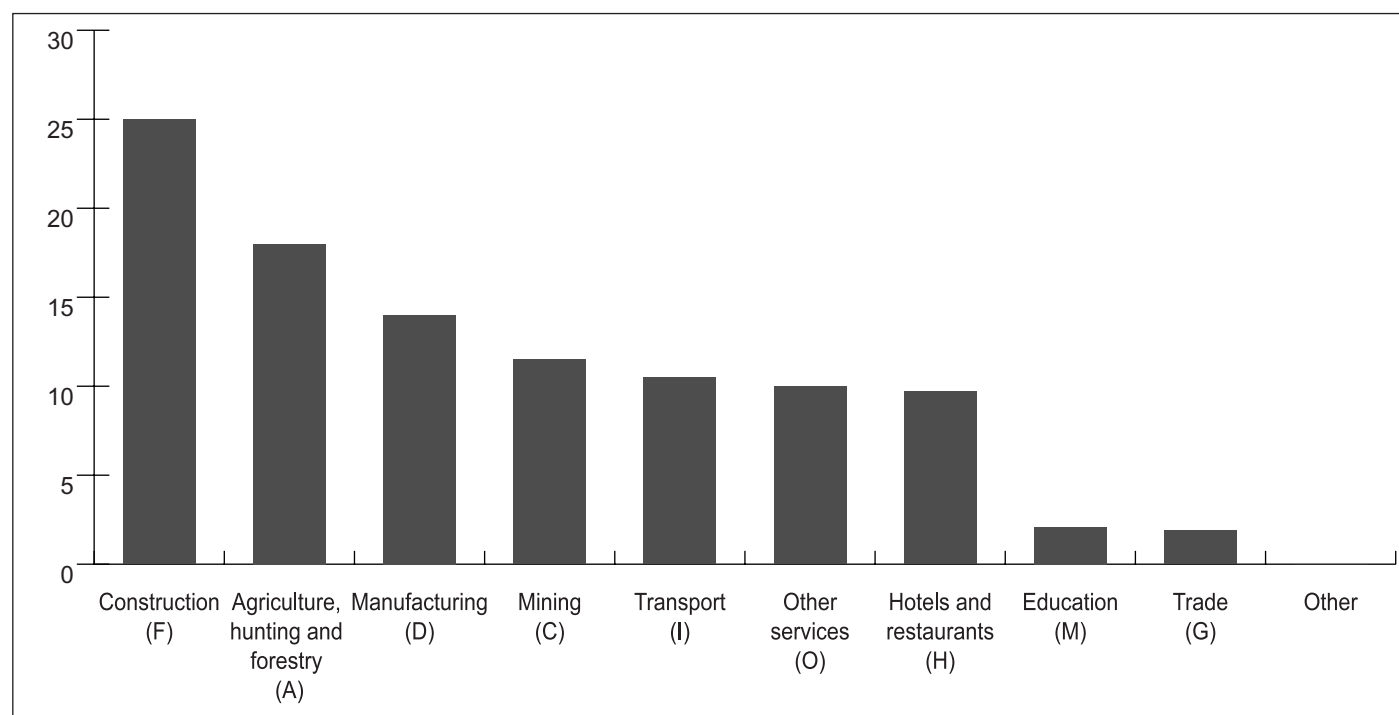


Source: Latvian Central Statistical Office 2000.

There are no in-depth studies that can help to identify the possible causes of the informal economy in Latvia or to assess the relative significance of alternative hypotheses. We can only rely on economic theory, interviews with public officials and "anecdotal evidence". Some hypotheses on the causes and persistence of the informal sector are:

- Tax evasion: for firms, the perceived "cost" of getting caught is smaller than the benefit of not paying certain taxes such as corporate tax, social tax and income tax.
- A combination of high social tax rates, structure of intertemporal preferences (current consumption is preferred to future – pensions) and low incomes create incentives for widespread tax evasion for employees. It must also be stressed that evasion of social and personal income tax is a result of collusion between employers and employees in which both have the motivation and the possibility to evade.
- One reason for the widespread prevalence and persistence of the system is that once a (possibly quite small) critical mass of firms practise tax evasion, this will exert pressure on other firms to evade as well. High inter-firm labour mobility means that non-evaders would have to incur much higher labour costs to ensure the same post-tax wages.
- It is possible that registration and compliance costs (e.g. accounting) discourage some very small businesses from registering, but this component is likely to be very small.
- There are many non-citizens living in Latvia (about 1/5 of population). Most of them are employed in the private sector. It is plausible that part of population feels little or no commitment to comply with social rules, such as paying taxes.
- It is also often argued that the Soviet past, where evasion from the pervasive regulations of the State was a norm, has played a role in the persistence of the informal sector in Latvia.

To date the State has not put much effort into explaining to the general public what tax revenues are used for. Many businesses do

Figure 2: Share of unregistered labour in specific sectors

Source: Latvian Central Statistical Office 2000.

not feel compelled to support the government budget as they consider it is spent inefficiently.

It has to be stressed that the above mentioned are only theoretical hypotheses, which have not been subjected to rigorous empirical testing. Therefore, little can be said about their relative and absolute significance.

Measures to combat undeclared work

Existing measures

Until the end of 2003 there was no policy in Latvia specifically designed to transform undeclared work into regular employment. However, policies indirectly influencing undeclared labour, i.e. fighting tax evasion and envelope wages, have always been at the centre of discussions and efforts have been largely focused on improving tax administration and reducing the rates of some taxes. Such measures were expected to increase the level of open economic activity.

The following specific measures have been aimed directly or indirectly at reducing the level of the informal economy:

Improving the legal and administrative environment

The State Revenue Service (SRS) works on improving legislation and patching up loopholes as they are identified, to make tax evasion more costly for businesses and individuals. There is an ongoing discussion about the need to simplify tax administration for SMEs. At present SMEs are subject to the same tax declaration procedure as large businesses, which could be a reason for avoidance of open activity. The SRS has attempted to improve the situation by providing consultation and informative leaflets for enterprises.

Creating incentives to declare work on both demand and supply sides

In the last three years the corporate tax rate has been reduced from 25% to 15%. However, this has been dictated by the need to attract more foreign investment. One of the motives was also tax competition with Estonia and Lithuania. Reduction of the corporate tax rate may have improved compliance, as tax revenues in the year following tax reduction have actually increased. Although reduced corporate tax rates might have provided some incentives for large enterprises to openly declare labour, this does not apply to single individual firms (self-employed) and small family ventures. These enterprises are subject to personal income tax, which has remained unchanged.

There has been a reduction in the social tax rate from 35% to 33.09%. However, it is likely that the reduction has been too small to result in any noticeable effect on tax compliance.

A move towards more equal shares of employee and employer social insurance tax contributions was a measure intended to motivate enterprises to avoid undeclared work, but the shift to a higher share of social insurance tax is an additional burden on low-paid employees, which undoubtedly increases their incentive to collude with tax evasion.

In 2003 the government announced a policy of a gradual increase in the minimum wage and implemented an initial increase from 70 LVL (102 euro) per month to 80 LVL (116 euro). This was in part motivated by the belief that it would reduce the incentive to pay the minimum wage plus cash in hand. However, the gap between the minimum wage and the minimum level of subsistence (which is calculated at 98 LVL or 143 euro) undermines the effectiveness of this measure.

An important step in Latvia to curb evasion of social tax payments was taken by the implementation of a complete overhaul of the

pension system. The main feature of the pension reform is a gradual transition from a traditional PAYE system to a partially funded three-pillar system. Linking taxpayers' contributions to benefits was thought to improve morale and to reduce under-reporting.

There is a general feeling among government officials that pension reform had a substantial impact on individual motivation to avoid social tax. On the other hand, it is only persons of above average income that really benefit from the system; for the rest, the level of savings is too low to even participate in the third pillar. Many argue that, given the instability of the social insurance system, they do not see any motivation to put possible future gains (from making tax and social contributions) before present gains from evading taxes.

Surveillance and sanctions

The State Labour Inspectorate (SLI) in co-operation with the State Revenue Service undertake surveillance of enterprises to identify those that employ workers without work contracts, i.e. who work without paying taxes to the government. In 2003, 717 enterprises from different business sectors were inspected. 477 cases were catalogued where work contracts were not in place, and 182 employers were penalised, with fines totalling 12,660 LVL (nearly 19,000 euro) or just over 100 euro per firm.

Most recently, efforts have been intensified in the fight against "envelope wages". Several companies have been "caught in the act" and these cases were widely publicised in an effort to discourage other companies. According to the SRS, between April and November of 2003 there were 11,546 inspections in this context and in 391 instances it was found that companies were paying envelope wages.

However, existing surveillance measures are inadequate. Both the SRS and the SLI recognise that both the administrative capacity and the number of inspectors is far too low to achieve significant results. Even though the number of inspectors has grown each year, the effective improvement has not been great.

Administrative barriers and contradictions in regulations can also make it complicated for inspectors to carry out inspections in sectors (such as construction or manufacturing) that are known for a high incidence of undeclared work. For example, the existing regulations allow construction engineers or factory managers to deny access to inspectors if they regard conditions on the site as unsafe or if an inspection would disturb sanitary conditions at the plant. Clearly, such practices make it difficult for the inspectors to do their job.

An additional problem is posed by the fact that business owners and managers cannot be levied personal fines and held responsible even when an inspection finds unregistered workers in their firms. At present only corporate fines can be levied.

Moreover, there is also a problem of enforcement in Latvia, as is the case in most other transition economies in this region. Hence the policies relying on fines are unlikely to be very effective, as enforcement of such fines is weak. The MoF has noted that the number of court cases against tax evaders is low, and that many cases of tax avoidance dating as far back as 1996 remain open, with tax payments and fines still outstanding.

Interestingly, there seems to be some evidence that fiscal decentralisation has the effect of curbing tax evasion. In Latvia, local governments receive 71.6% of personal income tax revenue and therefore have a stake in improved collection of this tax. Officials have reported that local governments sometimes exert pressure on large enterprises in their jurisdiction to stop paying

wages in envelopes. However, as admitted by the SRS, local governments could help more in identifying unreported activities. Local governments have mixed motivations – often they have informal ties with the enterprises operating in their jurisdiction and are therefore unwilling to provide serious help to the tax authorities.

Transnational co-operation between different Member States

The State Revenue Service has established successful co-operation with other EU member countries. There is regular exchange of information regarding cases of undeclared work, and both planned and spontaneous exchange of information occurs. The SRS is also conducting simultaneous inspections of enterprises together with other Member States.

Raising social awareness

The State Labour Inspectorate is the institution responsible for the dissemination of information regarding labour law and raising social awareness of the negative aspects of unregistered work. In 2003 the SLI generated 499 informative items, including booklets and informative programmes in the mass media. Most of these (34%) covered legal aspects of work relations. The large share of this theme can be explained by an active interest from society on employee rights and obligations. For the future, the SLI also envisages information campaigns for taxpayers.

Effectiveness of existing measures

Unfortunately, it is not possible to give definitive answers on the effectiveness of specific policies. In the first place, a culture of thorough policy evaluation has not yet taken root in Latvia. In Western countries, academic research often plays the role of disciplining governments by evaluating the results of their policies. This is not the case in Latvia, as academic research at the required level is virtually non-existent. Secondly, many measures have been in place for a relatively short period of time and it is too early to get informative data. For both reasons, there has been no formal analysis of the effectiveness of the policies mentioned above.

Therefore, any evaluation can only be conjectural, based on informal interviews and anecdotal evidence. There is no firm empirical evidence to support or reject any particular view.

In general, both the CBS and the MoF believe that over the last two years the size of the informal economy in GDP has decreased. As official GDP has also grown, it could indicate a trend towards transformation of undeclared work to "regular employment". It is not clear, however, whether any such effect is due to government policies or other independent factors.

New policies

At the beginning of 2004 the Cabinet of Ministers accepted the guideline paper "On Measures to Combat Undeclared Work". This represents a new policy initiative and the Ministry of Welfare and the Ministry of Finance are together working on a policy paper which will stipulate a set of specific measures to fight undeclared labour. The proposed measures outlined in the draft of the policy paper are as follows:

- Changes in the legal base and improvement of the tax system
 - The Ministry of Finance is planning changes in the Administrative code, with larger fines for tax evasion, as well as for under-reporting of income. The fines will be 5 LVL (7.20 euro) per each undeclared worker in an enterprise. The

finances for repeated instances of undeclared work in an enterprise will range from 500 to 1000 LVL (730 to 1450 euro).

- Changes in the Criminal Law will make owners and managers of enterprises criminally liable if they provide fraudulent information to the State authorities with the aim of hiding illegal activities.
- The minimum wage in the country will be gradually raised to the minimum subsistence level.
- Improvement of surveillance measures
 - More inspections by the State Revenue Service and the State Labour Inspectorate in industries and activities where the risk of illegal employment is believed to be high.
 - The number of inspectors in the SRS and the SLI will be further increased and more attention will be devoted to the education and motivation of staff.
 - A common database will be set up for the institutions in charge of implementation of measures against undeclared work, which is expected to ensure fast and timely exchange of information and to reduce the number of overlapping monitoring programmes.
- Raising social awareness and promotion of legal awareness and compliance
 - More resources will be channelled for dissemination of information about labour law.
 - Increased attention will be devoted to the explanation of the tax system and the uses to which taxes are put.

The proposed new policy measures in many ways represent a “beefing up” of existing measures. However, a positive aspect as compared with the present is that much more attention and resources will be allotted to raising social awareness of the harmful aspects of illegal work and motivating open economic activity, rather than just increasing sanctions and fines.

Conclusions

The concept of undeclared work as understood by the Commission is rather new for policy-makers in Latvia but, prompted by EU accession, has been addressed in the recent guidelines on undeclared work and accepted by the Cabinet of Ministers at the beginning of 2004.

Estimates of the size of the shadow or informal economy range from 16-18% by the CSB to 40% or more by private commentators. Official estimates suggest that unregistered work *per se* is about 9% of the workforce.

To date there have been few policies explicitly aimed at undeclared work. The exception here are surveillance policies undertaken by the State Revenue Service and the State Labour Inspectorate, but the evidence suggests that these have produced rather meagre results in relation to the perceived scale of the problem. Other than this, most measures have been in the sphere of tax, pension and minimum wage policy that have indirect effects on undeclared work.

Unfortunately, practically no studies have been carried out on the effectiveness of the measures taken to eliminate the informal economy. Although the Ministry of Finance claims the size of the informal economy in recent years has decreased, the CSB claims that it is unchanged. In any case, there is no indication as to how far policy has had an influence.

A new policy paper, developed by the Ministries of Finance and Welfare, promises to address specifically undeclared work issues. The plan can be viewed positively as it focuses on the elimination of the economic benefits gained from under-reporting taxes, as well as education of society on the negative aspects of avoiding open economic activity.

Alf Vanags

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Lithuania

Introduction

The category of “undeclared work” is not used in Lithuania. Regulations on labour law use the definition “illegal work”, whilst in scientific research and publications by the Department of Statistics, the definition “unofficial employment” is used.

Unofficial employment is defined as non-legalisation of employment relations and non-payment of relevant taxes.

Illegal work is defined as business, economic, financial, professional activities carried out without the incorporation of an appropriate legal entity and without obtaining an appropriate business licence, where a percentage of the salary is paid as “cash-in-hand”, when persons operate in legal companies without employment contracts or when the duration of work exceeds the period officially fixed in employment contracts.

The Lithuanian definitions of “unofficial employment” and “illegal work” exclude criminal activities, and concentrate on potentially legal employment that should have been declared.

The aforementioned definitions will be used accordingly in this article. Whilst analysing material from the State Labour Inspectorate, the definition of “illegal work” will be used. Definitions of “unofficial employment” and “undeclared work” will be applied in the analysis of data from the Department of Statistics and scientific research.

The first research into the extent and structure of undeclared work was carried out in 1993-1994. This gave rise to a more active analysis of this labour market phenomenon and its impact on the employment and welfare of the population.

Undeclared work is addressed in the Labour Code (2004) and other enactments.

The *Code of Administrative Violations of Law* (2004) contains a specific article on Illegal Work (*Article 41⁽³⁾*) as follows:

Illegal work –

Brings a penalty on employers or their authorised persons from three thousand to ten thousand litas (870-2900 euro) per illegally employed person.

The same acts taken by a person with a history of previous penalties for the violations set forth in the first paragraph of this Article –

Brings a penalty on employers or their authorised persons from ten thousand to twenty thousand litas (2900-5800 euro) per illegally employed person.“

To support the prevention of illegal work, the Government of the Republic of Lithuania has adopted two additional resolutions “*On the Approval of the Conditions and Procedure of the Performance of Assistance*” (2001) and “*On the Approval of the Organisation of the Procedure for Voluntary Work*” (2001), as employers would often declare to the State Labour Inspectorate that persons working without employment contracts were in fact relatives or friends that were helping out on a voluntary basis.

The State Labour Inspectorate, together with the Board of Social Insurance SODRA, the State Tax Inspectorate, the Financial Crime Investigation Service and the Police Department at the Ministry of

the Interior, are responsible for the formation of the uniform control of undeclared work; the collaboration of officers from controlling authorities and institutions in the organisation of joint inspections, and the drafting and analysis of methodological material required for improvement of the legislation.

To tackle the aforesaid issues, an annual Action Plan for the Reinforcement of Prevention and Control of Undeclared Work has been adopted to seek to minimise the spread of illegal work.

In addition, measures to minimise undeclared work have been implemented in Lithuania through implementation of the national Programme on Increased Employment of the Population, 2001-2004. These measures are discussed in the National Action Plan being drafted for the year 2004.

Prevalence of undeclared work in the economy

Undeclared work began to flourish in Lithuania in 1991-1993 during the transition into the market economy. Undeclared work could be seen to increase real employment and reduce the unemployment of the population. On the other hand, it reduces social security for employees, increases the possibilities for contravening employment relations, and negatively impacts on the national budget and the implementation of labour market policy. Official information about employment and unemployment in Lithuania does not reflect undeclared work. Therefore, specific research has been carried out to identify its scope and structure. In 1995, such research was conducted by the Institution of Labour and Social Research. In 1995-1996, the Department of Statistics developed a study of the “unaccounted for economy”, with participation from experts from the World Bank. In this study, undeclared work was addressed as a separate subject. A similar study was implemented under the PHARE programme in 2002-2003 with the participation of experts from the Italian Institute of Statistics. This analysis covered undeclared corporate income, unofficial employment and pay, the turnover of unaccounted trade and services. In addition, efforts were made to estimate the extent and nature of illegal businesses operating in Lithuania. We present below a brief discussion of the outcomes of the research.

A fairly large percentage of Lithuanian companies fail to report some of their earned income in their financial and statistical statements. This was first revealed in 1995 and confirmed in 2003 by research estimates based on the records of officers of the State Tax Inspectorate (STI) and official statistical sources.

Employees from regional units of the STI gave their opinions concerning the share of corporate income omitted by legal entities in official financial and statistical accounts in 2002. The summarised information provided a basis for the definition of the share of undeclared income by the type of business activity, form of ownership and size of legal entities.

According to STI experts, private enterprises (in particular smaller enterprises), often fail to declare some income from sales. The research revealed that the scope of sales declared in 2002 should be amended and corrected in official statistical estimates, applying correcting factors from 1% in energy to 25% in textiles, 35.6% in forestry and 50% in fishery businesses. On average, about 14.3% of

income is not declared by non-financial companies (including individual enterprises attributed to households) (see Table 1).

Table 1: A share of undeclared income in 2002 (%)

	Share of undeclared income
Forestry and logging	35.6
Fishery	50.0
Manufacturing	9.1
Electricity, gas and water supply	2.8
Construction	18.3
Wholesale and retail trade	15.0–16.5
Sale and repair of vehicles, retail trade in fuel	22.7
Repair of personal and household supplies	26.6
Hotels and restaurants	20.3–21.1
Road transport	19.2
Real estate operations	24.1
Rental of machinery and equipment without operator; rent of personal supplies	29.9
Other business	35.9
Education	15.1
Healthcare and social work	25.0
Wastewater and waste removal business	10.7
Organisation of recreational, cultural and sports events	10.3
Other service business	32.9
In business activities on average	14.3

As for the manufacturing sector, which creates about 20% of the national gross added value in Lithuania, the largest share of undeclared income may be attributed to companies engaged in textiles (25.2%), publishing and printing (17.8%), manufacture of clothing, dressing of fur (16.5%), the furniture trade (15.4%), the manufacture of food products and beverages (13.3%), and the manufacture of wood and wood products excluding furniture (13.2%). As for other types of manufacturing business, the share of undeclared income is thought to be under 10%, and the average in all groups is 8-11%. In addition to the research on the opinions of the STI employees, managers of manufacturing enterprises and associations were also anonymously polled as experts. In essence,

they confirmed the evaluations of the STI experts.

In the given group of business activities, the share of undeclared income varies according to the form of ownership. For examples, the share of undeclared income in individual enterprises engaged in the production of chemicals, production industry and production of plastics is found to be from 28.5% to 11.7% respectively, while in State enterprises engaged in the same activities the share equals zero. However, the difference in the share of undeclared income in private limited companies, public limited companies and individual enterprises engaged in manufacturing seems to be very insignificant (see Table 2).

It should be noted that the research omitted companies providing agricultural products and services, and financial and managerial services, due to peculiarities in the calculation of their production and added value in the national accounts.

The research shows that fishery and forestry companies may have the largest share of undeclared income (up to 50% and 35.6% respectively). However, the added value created by these businesses accounts only for 0.1% of the national gross added value. On the other hand, the share of undeclared income may be over 15% in wholesale, up to 18.3% in construction and around 22.7% in motor repair and fuel trade business.

Experts from the largest trade companies provided additional information, through the mediation of the Association of Lithuanian Trade Companies. The synthesis of this information and comparison with the results of STI employees' poll led to the conclusion that in excess of 0.463 billion euro (or 14.6%) of retail trade turnover was not declared through official sources in the year 2002. The research also confirmed that small enterprises fail to declare a larger percentage of their turnover compared to large enterprises (see Figure 1).

Unaccounted for trade and turnover in second-hand cars was estimated separately. Opinion polls and estimates from car markets showed that the unaccounted share of the turnover could reach from 20 to 30% or about 144.8 million euro in 2002.

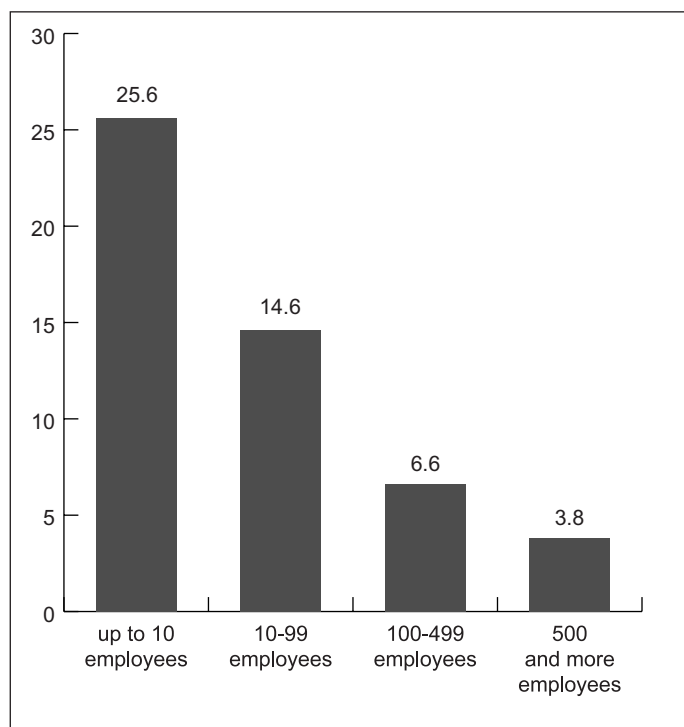
In other service companies, the established share of undeclared income was also quite large. In service sectors that employ a large number of smaller companies, the level of undeclared income is higher regardless of whether they provide services to business or individual customers.

In addition, the fields of healthcare and education services were analysed in order to estimate unofficial remuneration for medical services in state healthcare institutions as well as extra-unaccounted earnings of teachers for tutoring services. The analysis showed that unofficial remuneration paid to medical professionals in 2002 may amount to LTL 59 million (17.1 million euros), whilst services unofficially rendered by education professionals may amount to

Table 2: A share of undeclared income in manufacturing enterprises in 2002 (%)

	Private limited companies and public limited companies	Individual enterprises
Production of foodstuffs and drinks	13.3	13.9
Textiles manufacture	24.9	32.5
Manufacture of clothing	16.3	17.8
Manufacture of wood and wood products (except furniture)	12.8	15.6
Manufacture of furniture	15.0	20.0

Figure 1: A share of undeclared turnover in aggregated turnover of retail trade companies in 2002 (%)



LTL 27 million (7.83 million euros). It would be beneficial if these figures were also included in the national GDP.

The above polls lead to the conclusion that small enterprises are more likely to fail to declare all their earned income. Therefore, it could be argued that in future statistical data presented by such enterprises should be corrected through estimations of actual production and added value.

One part of the research was targeted at the analysis of unofficial employment and pay. Through the comparative analysis of official statistical sources, the researchers sought to estimate and define the

number of unauthorised hired employees. The results showed that the number of unauthorised hired employees may have been approximately 104,000 people in 2002 (see Table 3). Construction and manufacturing account for the largest number of such hired employees (23% each). They are followed by agriculture, hunting and forestry business accounting for 20% each. The results of the analysis of unofficial employment confirm the results of the research into undeclared income that was carried out in parallel. This is not surprising, given that these two segments of the unrecorded economy are directly interrelated.

According to the Institute of Labour and Social Research, in 2002 unofficial employment may have reached 190,000 (13%) and fallen to 150,000-170,000 of the employed in 2003, i.e. 10-12% of the total number of employed individuals.

Taking into account the different data sources, we can define the likely margins of the range of undeclared work in 2003: this index may fluctuate from 100,000 to 170,000. The top estimate is based on the research carried out by the Institute of Labour and Social Research. The bottom estimate is based on the data from the Department of Statistics. The variation may be explained by the approximate nature of the estimations and differences in the methodology used.

Measures taken to combat undeclared work

Regulation of the phenomena of undeclared work

The Government of the Republic of Lithuania makes various efforts to minimise the extent of undeclared work, to increase social guarantees for the employed and to improve labour market statistics. A central co-ordination group for the analysis of origination and control of illegal work has been functioning within the State Labour Inspectorate since 2002.

The number of detected cases of illegal work has recently increased. According to the State Labour Inspectorate (SLI), 1,422 illegally employed persons (i.e. persons without employment contracts) were identified in 2003, compared to 1,266 in 2002. Analysis of the detection of illegally employed persons by economic sector conducted by the SLI shows that most cases of illegal work were

Table 3: Distribution of unauthorised hired employees by types of businesses

	Number of employed	Comparative part in %
TOTAL	104512	100.0
Agriculture, hunting, forestry	20518	19.6
Fishery	0	0.0
Mining and quarrying	1543	1.5
Manufacturing	24190	23.1
Construction	24383	23.3
Wholesale and retail trade, repair of motor vehicles, rent of personal supplies and household appliances	5463	5.2
Hotels and restaurants	3102	3.0
Transport, warehousing and communication	3452	3.3
Education	6326	6.1
Healthcare and social work	3818	3.7
Other utility, social and individual service business	7100	6.8
Private households with hired labour force	4507	4.3

found in the following sectors: construction (511 illegal employees identified in 204 economic entities, leading to 35.94% of all detected illegally employed persons), manufacturing (293 illegal employees in 133 entities, leading to 20.6% of all detected persons), agriculture (120 illegal employees in 47 entities leading to 8.44% of all detected persons) and wholesale/retail trade (139 illegal employees in 94 entities leading to 9.77% of all detected persons). As before, the largest share of illegal employees is found in companies, with an overall total of 913 people (64.2%).

Employees were issued with 241 protocols of administrative violations of law in 2003 (593 in 2002) concerning 499 illegally employed persons (722 in 2002) based on Article 41-3 (Illegal work) of the Code of Administrative Violations of Law (CAVL). On the basis of protocols of administrative violations of law issued by officers of the State Labour Inspectorate, the courts heard 185 proceedings (76.8%) compared to 234 (70.1%) in 2002.

When imposing milder penalties than is specified in the CAVL, the courts often take into consideration attenuating circumstances as set out in the law, in addition to other criteria such as:

- no history of administrative penalties;
- responsibility for minors/children;
- financial difficulties;
- very short employment period;
- no damage caused by the violation;
- loan burdens, etc.

Considering prevention of illegal work to be a key priority, the State Labour Inspectorate widely informs the population about cases of illegal employment and consequential problems. The largest regional publications have released about 70 announcements on this issue, informing people about a relevant help-line, and identifying the damage caused by illegal work and consequent liability. Some units of the SLI published information on court actions issued against employers and penalties imposed by the courts. Announcements were broadcast 150 times on the Lithuanian radio station and roughly 500 times on other radio stations. In addition, national and regional publications released about 70 articles and interviews. Information and counselling was published in publication *Lietuvos Profesajungos* (*Lithuanian Work Unions*). The website of the SLI is also regularly updated.

Important prerequisites for minimisation of undeclared work

In implementing its tax and labour market policy, the Government of the Republic of Lithuania seeks to maximise the facilitation of new job creation and the development of SMEs. The policy includes the following objectives:

- to increase overall employment of the population;
- to increase employment flexibility;
- to improve social security of employees in the employment sphere.

All these efforts contribute to the minimisation of undeclared work.

Having regard to these national objectives, the system for the facilitation of creation of new job opportunities includes:

- specific national, regional and local incentives to develop a network of business development support, including the improvement of the competence and capacities of these organisations;
- the minimisation of barriers to business development, and the

creation of favourable and equal business conditions for all market operators;

- the improvement of measures to support entrepreneurship and the minimisation of differences between regions in the development of new job opportunities.

Within the framework of the national employment programme 2001-2004, a system for supporting small to medium businesses was created. This system has positively influenced the process of job creation and the minimisation of undeclared work.

Improvement of the system for facilitation of creation of new job opportunities. In order to achieve the strategic national goals in this area, the Law on Profit Tax of the Republic of Lithuania lays down special provisions for the facilitation of small and medium enterprises:

- Small enterprises have the opportunity to apply a lower rate of profit tax, i.e. in entities where the average number of listed employees does not exceed 10 persons and income over the taxable period does not exceed 500,000 LTL (144,800 euro), taxable profit is levied a 13% tax rate (instead of 15%).
- The first business year after their registration, entities are exempted from advance profit tax. In addition, a small enterprise shall be released from payment of advance profit tax for the taxable period if its taxable income over the last taxable period did not exceed 100,000 LTL (29,000 euro).

The Law on Value Added Tax also sets forth a threshold for obligatory registration for VAT, i.e. a person is entitled to abstain from registration as a VAT payer and withhold VAT for the goods supplied (except for brand new vehicles supplied to other member states) and/or services rendered, if gross earnings received for the services or goods supplied over a year (the last 12 months) do not exceed 100,000 LTL (29,000 euro).

The Law on Value Added Tax also provides for the opportunity to increase the taxable period, i.e. to consider a calendar semester as a taxable period instead of one calendar month.

One more important issue in relation to the minimisation of undeclared work through the development of self-employment and small businesses is that the law does not require the establishment of a legal entity for business activities in all cases. A legal entity must be established only in such cases when laws governing conditions of relevant activities specifically identify that the carrying out of particular activities requires establishment of a legal entity.

The Law on Personal Income Tax provides for flexible rules of taxation of income generated from individual activities, i.e. it is up to individual to select the taxation rules to be applied. Furthermore, it is set forth that individuals may engage in individual activities after payment of a fixed income tax defined by the Municipal Councils, i.e. after obtaining a business licence to engage in the approved types of individual business activities.

Facilitation of small and medium business. The business services infrastructure in Lithuania is being developed as part of an ongoing process to ensure the high quality and accessible provision of business services and the opportunity for small and medium businesses to gain subsidised access to premises, technical equipment and loan facilities as well as office services. These activities should hopefully encourage unofficially employed individuals to legalise their activities. By the year 2003, business incubators were established in nearly all counties, providing premises for in excess of 120 companies which established 315 new job opportunities. LTL 2.8 million (0.81 million euro) was invested and in excess of LTL 4.3 million (1.25 million euro) was paid in taxes

to the State. In addition, 13 new business information centres were established. In 2003, business incubators offered accommodation to 76 new companies, which offered 403 new job opportunities.

Improvement of attractiveness of and stimulus to work. When tackling the issue of improving the attractiveness of employment and the minimisation of undeclared work, Lithuania emphasises two basic and highly interrelated problems: increasing interest in employment and pay, and providing sufficient social support to ensure acceptable living conditions.

Lithuania takes forward various targeted measures to improve the attractiveness of employment, including increasing the non-taxable minimum threshold, reducing the tax burden, increasing the minimal wage, and providing tax privileges to encourage self-employment. On the other hand, the system of social support has also been regularly improved, with an increase in the variety of social benefits and forms of social assistance. Because of these simultaneous improvements, the difference between maximal social benefits and minimal and equivalent pay from employment remains very slight and this has had a negative impact on the attractiveness of taking up employment.

Reduction of tax burden. In order to reduce the tax burden, the basic levels of non-taxable income were increased in 2003. Permanent residents of Lithuania were not only given the right to a basic non-taxable income value (BNTIV) every month of LTL 290 (87 euro) per month instead of LTL 250 per month (72.4 euro). In addition an additional tax-free income threshold was awarded to permanent residents of Lithuania with one or two children (including adopted children) under 18 years old.

In 2004-2006 further efforts will be taken to minimise the tax burden. The Tripartite Council of the Republic of Lithuania has discussed reducing income tax from 33% to 29-27%.

The incentive to exchange illegal work for normal work should also be increased after measures are implemented to simplify business and taxation conditions for individuals.

The legal employment of individuals is encouraged by a provision of the Law on Personal Income Tax of the Republic of Lithuania entitling repayment of some income tax. Life insurance premiums, pension contributions to pension funds, interest for loans taken to acquire housing, payments for studies as well as acquisition of a PC and installation of Internet access may be deducted from income.

Regulation of minimum wage. Though minimum wages (MW) were not increased until September 2003 (from 1998) and amounted to LTL 430 (125 euro), the number of employees paid minimal monthly wages or less has been increasing as a percentage of the total number of employed. In 1998, persons receiving the minimum wage accounted for 16% of all employees, whilst in 2003 the figure was 19%. In the private sector MW is paid to about 30% of employed people, whilst in the State sector it is received by approximately 11%.

The increase of the MW is one of the ways to improve the attractiveness of employment for individuals with lower levels of qualification. However, before increasing the MW, the Government has sought to maximise their consultation with the social partners, taking into consideration real economic conditions and the economic potential of employers. In 2003, ideas began to develop in relation to the differentiation of the MW by economic activity. On September 2003, the MW was increased to LTL 450 (130 euro) and on May 2004 it was increased to LTL 500 (145 euro). Despite such a rapid increase of the MW (16% in less than a year), this value remains one of the lowest in the EU countries.

Poverty minimisation programme. A large number of unofficially employed individuals belong to disadvantaged groups of the population who need social support. Therefore, the motivation to engage in unofficial employment depends on the implementation of measures relating to the improvement of social support and poverty minimisation. On November 2002, Lithuania adopted a programme for the Implementation of the Poverty Reduction Strategy in 2002-2004. The programme gives priority to active poverty minimisation measures, such as an increase in the human resources available for professional training, in addition to education, employment opportunities and economic activities. Providing direct support in the form of funds to the poor or individuals on the verge of poverty is considered to be a last resort, when there is no other way to strengthen the working capacities of an individual and his/her chances to earn a sufficient income.

Conclusions

Though the definition "undeclared work" is not applied in Lithuania, definitions of "illegal work" and "unofficial employment" are used instead which do not contradict the concept of the 1998 Commission Communication on undeclared work.

Undeclared work originated and flourished in Lithuania in 1991-1993 under the conditions of transition into the market economy. The privatisation of companies, employee redundancies, reduced labour and financial control within the public sector, high rate of inflation and associated decline in living standards encouraged unemployed people to get involved in illegal economic activities. At the beginning, the Government did not see this process as necessarily negative, as undeclared work was felt to be better than unemployment and poverty. However, according to various surveys and studies, by the year 1995 undeclared work had reached 300,000-400,000 individuals. Most of them were people operating on a legal basis (under employment contracts), but only declaring part of their income. In 1996-1997 undeclared work started to decrease, and according to various surveys and studies, amounted to 100-170 in 2003, i.e. 7-12% of the total number of employed individuals.

Before 2000, the Government mainly used administrative measures to minimise undeclared work. *The State Labour Inspectorate*, the Board of Social Insurance SODRA, the State Tax Inspectorate, the Financial Crime Investigation Service and the Police Department at the Ministry of the Interior organised raids on employers, controlled the movement of employees and imposed relevant penalties on lawbreakers. Since 2000, primary attention has been paid to:

- prevention of undeclared work (public awareness, training, co-operation with social partners);
- facilitation of small and medium business development;
- reduction of wage taxation;
- financial issues relating to legalisation;
- improvement of social support and social services.

Efforts are taken not to penalise people for undertaking undeclared work, but to improve the attractiveness of legal work as far as possible.

In 2004-2006, various incentives are planned for further legislation in the field of motivating people to access work. These efforts will be implemented through:

- a) development of knowledge and skills of individuals;
- b) development of economic incentives to access work.

It should be noted that the Lithuanian system of general education and professional training only provides a limited amount of information about the negative consequences of undeclared work and opportunities to legalise employment relations, etc. On the other hand, it has to be pointed out that the development of mechanisms for increasing the attractiveness of legal work and providing support to SMEs are only just beginning. Within the framework of the implementation of these measures by 2006, it is expected that greater priority will now be given to increasing mechanisms for SME support and motivating people to seek legal, rather than illegal/undeclared work.

Overall economic growth, and the growth of the average wage in particular, should have favourable effects on the minimisation of undeclared work. The government policy to reduce income tax should also minimise the economic incentives to avoid the declaration of work.

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Luxembourg

Introduction

In this report we shall review the legislative arrangements within which illegal working is defined, detected and sanctioned by the law in Luxembourg. We shall then look at the case law that has developed to deal with it, before examining the current focal points of debate in this area. We shall end with an examination of some concrete results in the battle against undeclared working and will formulate a number of conclusions.

The legal framework on undeclared work

Clandestine working is prohibited by article 1 of the law of 3 August 1977. In addition to this simple prohibition, the same law also includes (within the concept of clandestine working) the pursuit, on a self-employed basis, of one of the listed occupational activities or the formation and management of companies without possession of the required authorisation. This same law also applies to the performance of paid work when the person performing that work knows the employer does not possess the authorisation required under the law of 2 June 1962 or that his/her position as a salaried worker does not properly conform to the legislation on deductions from wages and salaries or to social security legislation. In this way, the two classic patterns of occupational activity – paid employment and self-employed working – are covered in the law.

So as fully to understand these legal provisions, the occupational activities mentioned in article 1 of the law of 2 June 1962, which are referred to here, are as follows:

- traders and industrialists;
- representatives, agents, brokers and commercial travellers;
- carriers transporting persons or things, and the owners of machines or devices, who are involved in industrial hire on a professional basis;
- craftsmen;
- freelance architects and engineers;
- landscape gardeners and persons who perform work within that occupational category for others, horticulturalists, florists and horticultural seed-growers;
- self-employed accountants.

The law of 3 August 1977 lays down some further prohibitions. It is, for example, forbidden to use the services of a person or group of persons for the performance of clandestine work as understood in Article 1 of the same law, to employ salaried staff for the performance of work external to the household or external to the object of the employer's business when the said work falls within one of the occupations listed in Article 1 of the law of 2 June 1962 indicated above.

Further, the 1977 law indicates what does not constitute clandestine work. Within the meaning of the law, clandestine work is not:

- an activity carried out personally for one's own benefit without the aid of others;
- an occasional activity of minor importance carried out for another person;
- an isolated activity carried out for someone else that does not exceed the bounds of the mutual aid common between relatives, friends or neighbours.

A new law on the right of establishment, dated 28 December 1988, further reinforced and specified the conditions of access to certain occupations. The occupations in question are those of trader, manufacturer, craftsman and a number of others. The law also specified the range of qualifications and authorisations required for a person to be able to pursue these particular occupations. This raising of the level of occupational entry requirements provided a new barrier against undeclared working.

As various legal decisions have been made, case law has introduced the extra-legal notions of pursuit of profit, ignorance or otherwise of an illegal situation, and services delivered significantly below market price, and has provided examples of which activities may be counted as "isolated" or "of minor importance"¹.

Undeclared work in the national economy

In an "Action Programme for Craftsmen" of May 2000², the Chamber of Trades and Federation of Craftsmen, referring to the Communication from the Commission of 7 April 1998 on Undeclared Work³, indicated that in the economic context of the 1990s the free operation of competition was constantly hindered by

¹ Schintgen and Faber (1996).

² *Programme d'action en faveur de l'artisan* (2000).

³ COM (1998) 219.

clandestine working, breaches of the law governing establishment, social dumping and bankruptcies. The impact of clandestine work lay in a range between 7 and 15% of the GDP of the European Union and between 10 and 28 million work units, i.e. between 7 and 19% of the total of declared jobs. Adapting these figures for Luxembourg⁴, this gave a range of between 37 and 80 billion Luxembourg francs (i.e. between 0.91 billion euro and 1.98 billion euro) and between 15,000 and 42,000 jobs. The checks carried out in 1999 by the gendarmerie showed that 14% of the workplaces visited were in breach of the legislation on clandestine working and the law on establishment.

Unfortunately, it is not possible to provide precise, recent figures on the place non-declared work occupies in the national economy. We know this type of work exists, but it is not really possible to quantify it at the present time. It is, as a consequence, impossible to state with certainty which groups and sectors of activity are most concerned. However, this type of work certainly exists and copious press coverage regularly reminds us of it. It could be mentioned, as an example, that the phenomenon is well-known in the transport sector and that this sector has been criticised on these grounds by a major national trade union⁵.

In January 2002 the press reported on the “Kralowetz affair”⁶. This road transport company with its head office in Luxembourg employed more than 600 drivers from Eastern Europe. The company paid no social security contributions and neither paid the hours nor declared the activity of these drivers.

Undeclared activity also occurs as an effect of clandestine immigration, but the government of Luxembourg has tackled this problem by procedures of regularisation or expulsion, where necessary⁷.

Measures for detecting, combating and sanctioning undeclared work

The measures for combating illegal work have developed as the legislation has evolved. The relevant laws are presented in chronological order before looking at some figures on the results achieved.

The Law of 3 August 1977

The law of 3 August, mentioned above, also has a section laying down legal sanctions for undeclared working.

Article 4 of this law, for example, states that those using the services of a person or group of persons to carry out clandestine work within the meaning of Article 1 are jointly and severally liable for the payment of the contributions due to the social security authorities as a result of that work.

Article 6 states that breaches of the law are investigated by the officers and agents of the police and gendarmerie, as well as by the competent agents of the Inspectorate of Labour [*Inspection du travail et des mines*] on the one hand and, on the other, by the agents and employees of the department delivering authorisations of establishment duly mandated to that effect by the competent ministry.

Article 7 adds that the investigating agents are to inform the tax authorities and the social security bodies of the violations they

record. Article 8 specifies that breaches of the law are punished by a fine and, in cases of re-offending within five years, by a penalty of imprisonment ranging between 8 days and 6 months and a fine of up to twice the maximum penalty, or one of these penalties only. In all the cases specified in Articles 1 and 2, the cessation of the illegal working is ordered.

Article 9 creates the possibility of an agreed settlement. The minister qualified to grant authorisations of establishment has the power to settle on a fine whenever he takes the view that the payment of a sum of 25,000 Luxembourg francs (620 euro) or less represents sufficient punishment. Compromise settlements may be reached so long as the case has not been brought before the courts. The minister may delegate the power to arrive at a compromise fine to one or more civil servants. The document recording the settlement fine specifies the charges made against the person concerned, relating these to Articles 1 and 2 of the law. Where a settlement fine is agreed, the court action lapses.

The law of 28 December 1988

The law of 28 December 1988 on the right of establishment states, in Article 22, that breaches and attempted breaches of the provisions of the law are punishable by a term of imprisonment of between eight days and three years and a fine or by one of these penalties only.

The grand-ducal regulation of 4 November 1994

A grand-ducal regulation of 4 November 1994 indirectly created one means for detecting undeclared working. For building sites where the presumed duration of the works is longer than thirty working days and more than twenty workers are employed at any one time, or where the number of workers is more than 500 per day, the project manager or the contractor must communicate a certificate of prior notice to the Inspectorate of Labour before the work begins.

This certificate must state, among other things, the presumed maximum number of workers on the site, the number of companies and self-employed persons expected on the site, and must identify the companies already selected. This enables the Inspectorate of Labour to carry out the appropriate monitoring.

The Law of 19 June 1998

With regard to social security in particular, the simplified procedure introduced by the law of 19 June 1998 on nursing-dependency insurance should also be mentioned. This procedure allows employers, where relevant, to declare the net remuneration agreed with the persons whom they employ in their private life for household tasks, childcare and for providing them with the assistance and care necessitated by their state of dependency. This procedure, which makes for simpler relations with the administrative bodies, is used in 1.2% of declarations of employees/workers.

The monitoring service of the Common Centre for Social Security also takes part in the workplace monitoring co-ordinated by the Inspectorate of Labour.

⁴ Source: Luxembourg Central Statistical Service (STATEC), 1996.

⁵ *Le Quotidien indépendant luxembourgeois*, 26 April 2004, p. 3.

⁶ *Le Quotidien indépendant luxembourgeois*, 6 June 2003, p. 2.

⁷ *La Voix du Luxembourg*, 9 January 2003, p. 5; *Le Quotidien indépendant luxembourgeois*, 6 June 2003, p. 2.

The Law of 12 February 1999

The law of 12 February 1999 introducing the National Action Plan for Employment adds a very important element, as it modifies Article 22 of the law of 12 February 1999 by adding that police officers and officers of the gendarmerie are responsible for seeking out and reporting breaches to which legal sanctions are applicable. Moreover, the Director of the Customs and Excise authority may charge his agents, from the rank of sergeant upwards, with this same task.

In carrying out these missions, the agents of the Customs and Excise authority, from the rank of sergeant upwards, have the status of police officers. As a consequence, they possess the authority to record breaches of the law by filing reports which, failing proof to the contrary, count as evidence. Their competence extends across the whole territory of Luxembourg.

The same law introducing the National Action Plan for Employment goes even further down the repressive route, since it modifies Article 6 of the law of 3 August 1977 by specifying that breaches of this law shall be detected and reported by the officers and agents of the police or the gendarmerie, by the agents of the Customs and Excise from the rank of sergeant upwards, by the inspection staff of the Inspectorate of Labour and Mines from middle-ranking officers upwards, and by the agents, from the rank of *commis adjoint* upwards, of the department delivering authorisations of establishment, duly mandated to that effect by the competent minister.

The Law of 20 December 2002

A law of 20 December 2002 relating to the posting of workers within the context of the provision of services, which carries a European directive into Luxembourg law, constitutes a very effective tool in the battle against social dumping by its economic impact on the companies doing the posting and the contractors established in Luxembourg. In fact, a targeted procedure allows the authority responsible for applying this law to put a stop to any work that has not been declared in advance. This law also provides for the inspection of the E101 form and the wages records of all the companies operating on the national territory. Under this legislation, failure to possess an E101 form may be considered a type of clandestine working.

Article 6 of this recent law plays a role in organising transnational co-operation. The Inspectorate of Labour is designated as the competent national authority for the application of the law. In fulfilling this role, it is called upon to co-operate with the authorities of other States undertaking tasks similar to those defined in the law. Within the framework of this co-operation, the Inspectorate of Labour replies to well-founded requests for information on the transnational supply of workers where those requests originate from other public authorities designated as liaison bureaux or competent national authorities. These requests also relate to manifest abuses or cases of transnational activities presumed to be illegal or such as to endanger the security and health of workers at work.

Among the range of legal measures taken, the co-ordination achieved between the various different departments of state in order to detect clandestine working and combat it should be highlighted.

The political debate

To see the place undeclared work occupies in national debate in Luxembourg, we should first distinguish between the purely political debate within the legislative and executive institutions and the debate within the consultative institutions.

The political debate within the Chamber of Deputies and the Government

At the political level, a number of parliamentary questions relating to illegal working have been addressed to sitting governments over the last twenty years. In 1985, 1993, 1998 and 1999⁸, questions were asked regarding the results of the so-called “crackdown operations” as part of the attempt to mount an effective offensive against clandestine working. The problems which emerged from this were the absence of authorisations of establishment, the non-observation of safety measures, the absence of residence authorisation and work permits, together with non-affiliation to the social security system. Other questions related to the role of the Inspectorate of Labour in combating undeclared work. Over twenty years the Government has been questioned on this subject by the Chamber of Deputies on five occasions.

National governments have planned, in successive governmental accords, to tackle the problem of illegal working. For example, in the coalition agreement between the CSV⁹ and DP¹⁰ parties in 1999,¹¹ combating illegal working was declared a priority for two different ministries. The coalition agreement in fact stated that the Ministry of Labour and Employment would “intensify its campaigning efforts against social dumping and illegal working, as well as reinforce the oversight of the rules relating to labour legislation.” Where the Ministry of the Middle Classes, Tourism and Housing is currently concerned, it is specified that: “It (the Government) will pursue its efforts to prevent any distortion of competition in the national market on the part of companies operating on the territory of Luxembourg which are breaching our regulations on social security and labour law. To this end, it will intensify its “crackdown operations” and modify the legislation on unfair competition and competition law.”

The most recent National Action Plan for Employment,¹² negotiated by the State and the social partners (the trade union and employers’ organisations), also speaks of provisions for combating illegal working and social dumping within the framework of Guideline No. 9, “Transforming Undeclared Work into Lawful Employment.”

The Debate in the Chamber of Trades

The Chamber of Trades, invited to give its opinion¹³ on the Bill that will lead eventually to the law of 20 December 2002 on the temporary posting of workers within the context of the provision of services, formulated some important remarks, which seem of relevance here.

For example, the Chamber takes the view that the law of 3 August 1977 on clandestine working, though it is not entirely obsolete, needs a certain number of adjustments and modifications if it is to become a more effective means for combating clandestine working.

⁸ www.chd.lu, 30 June 2004.

⁹ Christian Socialist Party.

¹⁰ Democratic Party.

¹¹ www.gouvernement.lu/gouvernement/programme/accord_coalition_1999_fr.html#4, 1 July 2004.

¹² *Plan d'action nationale pour l'emploi, rapport national 2003*, Luxembourg, October 2003, p. 55.

¹³ *Chambre des métiers, avis du 28 novembre 2000*, J-2000-0-0760.

In the first place, particularly in so far as the essentially repressive measures are concerned, the Chamber of Trades believes it would be best:

- to introduce a presumption of payment. Given that the lucrative character of an activity (which, alongside its clandestine nature, makes up illegal working) is difficult to prove, there are grounds for creating a presumption of payment. With this in place, the following circumstances would be such as to lead to a presumption concerning the nature of the work: the frequency or extent of the work done, the nature or extent of the equipment used, the professional knowledge required to be able to perform the activity, and the use of advertising in whatever form for the purposes of finding custom;
- to create a legal basis establishing a special commission whose role would be to assist the minister responsible for authorising establishment in his capacity to decide on settlement demands, as laid down in the law of 3 August 1977. The establishment of such a commission, bringing together the various competent authorities and agencies responsible for sanctioning instances of clandestine working, is necessary if they are to be able to act and react effectively in combating it;
- to raise the ceiling for settlement fines. Given that breaches of the legislation on clandestine working are essentially driven by economic and financial considerations, a substantial raising of the ceiling for settlement fines would be in order. The level of this fine is certainly no longer commensurate with the harm caused to the community and to legally established companies, on the one hand, and with the illegal profits derived by those engaged in clandestine working on the other.
- to modify the level of fines prescribed in the law of 3 August 1977. Given that the law of 12 February 1999 concerning the implementation of the National Action Plan for Employment 1988 amended Article 22 of the 1988 law on establishment which relates to penal sanctions, there are grounds for adjusting the fines laid down in Article 8 of the law of 3 August 1977 to those specified in the aforementioned law on establishment: namely, a sentence of imprisonment of between eight days and three years and a fine or one only of these penalties.

Results

A working group named the “Social Dumping Working Group” was set up in 1995 within the Ministry of the Middle Classes, Tourism and Housing to combat unfair competition on the part of companies operating on Luxembourg soil who are in breach of the legal and regulatory prescriptions with regard to the law on establishment, labour law and social security. This group is made up of representatives of the Ministries of the Middle Classes and Tourism, of Public Works, of Labour and Justice; of the Common Centre for Social Security; of the Customs and Excise, Registry, Contributions and Employment authorities, and of the Inspectorate of Labour. The gendarmerie, the police, the Chambers of Commerce and Trades, the Confederation of Commerce and the Federations of Craftsmen and Industrialists are also members of this group.

In 2003, workplace inspections by “social dumping” investigators and “crackdown” operations against illegal working intensified by comparison with 2002. Several of these operations were carried out

in 2003 on large sites, involving the Inspectorate of Labour, the Office of Social Insurance, the forces of law and order and the full range of actors mentioned in relation to the legislative changes cited above. During these inspections, the following breaches of the law were found: failure to respect the legislation relating to authorisation of establishment, to work permits, to residence permits, to affiliation to the social security system, to hours of working and to safety measures.

In a very significant number of “social dumping” investigations carried out at small and medium-sized companies and worksites across all regions, the grand-ducal police found 220 breaches of the regulations. The police forces laid more than 380 charges in relation to these inspections, many of which took place at weekends.

The offensive against breaches of the law on establishment has been reinforced by checks carried out by agents of the Customs and Excise authority, who have been trained in recent years in the area of the law on establishment and clandestine work.

Since these investigations and operations have been carried out systematically, the figures for breaches of the law have been considerably reduced and the average number of violations found per worksite has fallen. These results reveal the effectiveness of “crackdown” operations and these will now be continued systematically.

Sanctions applied have included closing down sites where companies are in breach of safety laws and the law on establishment, stopping workers without work permits from working and expelling those without residence permits from the country. Charge sheets have been drawn up for the breaches committed.

Conclusions

It can be concluded that the definition, detection, combating and sanctioning of undeclared work in Luxembourg is covered jointly by legislation that has been in a constant state of development since 1977 and by a case law that has complemented those developments. The so-called “crackdown” operations have been the most effective instruments for enforcing the legal provisions. Co-ordination between the various services of state in carrying through these operations has further reinforced their impact and effectiveness.

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Hungary

Definition of the non-observed economy and undeclared work

The OECD (OECD, 1986) defined “concealed employment” as “employment which, while not illegal in itself, has not been declared to one or more administrative authorities...”. OECD (2002) defined the “non-observed economy” and distinguished five main components of it, as follows:

- Statistical underground production;
- Underground production: those activities that are productive and legal but are deliberately concealed from the public authorities to avoid payment of taxes or complying with regulations;
- Informal sector production: those productive activities conducted by unincorporated enterprises in the household sector that are unregistered and/or are less than a specified size in terms of employment, and that have some market production;
- Illegal production;
- Production of households for their own final use.

The OECD claims that the non-observed economy is already estimated into the published or measured GDP.

The European Union defines “undeclared work” as “any paid activities that are lawful as regards their nature but not declared to the public authorities, taking into account differences in the regulatory system of Member States. Applying this definition, criminal activities would be excluded, as would work not covered by the usual regulatory framework and which does not have to be declared.” (EC 1998) The EU definition seems to match categories 2 and 3 of the OECD definition. However, the EU definition is broader than these since it takes into account those parts of the underground and informal production which are not inputted into the official GDP.

In the case of Hungary there is no “official” definition of the non-observed economy or undeclared work. Recently prepared government documents and their background materials apply the EU definition while, both in the media and in academic literature, there is a mixture of divergent terms, definitions and interpretations used.

Prevalence of non-observed economy and undeclared work in Hungary

International comparisons

Despite the fact that non-observed activities are rather extensive in Hungary, there are very few reliable estimates on their size in different sectors of the economy during recent years. Nevertheless, the available results confirm the existence of a sizeable undeclared economy.

The most comprehensive analysis calculates that 15-20% of GDP is generated in the informal economy (Lackó 1992, 1998, 1999, 2000). These shares are similar to those estimated by Lackó for the Czech Republic, Poland and some western EU countries including Greece, Italy and Belgium, and far lower than estimates for Turkey and Mexico. In a recently published OECD comparison (OECD 2004) containing national accounts-based estimates, the estimate for

Hungary (1997) is at 15.4% of GDP, while it is 5.6% for the Czech Republic (1998), 7.3% for the Slovak Republic (1998), and 16.0% for Italy (2000). The data referring to Hungary comes from 1997 and unfortunately are much older than data for other countries.

One of the most recent analyses (Renooy et al, 2004) identified three groups of the EU Member States and accession countries according to the size and chance of prevalence of undeclared work in the economy. These are: a) countries with low and decreasing levels of informal activity (8-13% of GDP); b) countries with a medium and decreasing level (14-23% of GDP); and c) countries with a high and increasing level (21-22% of GDP). Hungary falls in the second category.

OECD (2004) also contains calculations for the year 2000 for many countries, with the help of the theoretical tax liability method. They estimated theoretical tax liability for compulsory social security contributions based on wages and salaries in the national accounts. These estimations were compared with actual receipts of contributions. These calculations show that the actual social security receipts in the non-government sector are close to 100% of the theoretical liability in six countries: the Czech Republic, Japan, Luxembourg, the Netherlands, Norway and the Slovak Republic. The shortfall in receipts is about 20% in Italy, Poland, Spain and Turkey. The shortfall in receipts is 30% or more in Hungary, Mexico and Korea.

Christie and Holzner (2004) followed the Household Income Taxation Method. In this method, the estimation of income declaration rates and corresponding undeclared household income are computed using household consumption data as well as detailed data on household taxation. Authors calculated the share of household income which should be subject to taxation, but is not, despite the fact that it is captured by the official measure of GDP. Table 1 shows undeclared household income as a percentage of GDP in the investigated countries in 2001.

Table 1: Undeclared household income as a percentage of GDP (2001)

Countries	Undeclared household income
Albania	52%
Bulgaria	34%
Croatia	19%
Macedonia	39%
Romania	46%
Kosovo	45%
Czech Republic	18%
Estonia	17%
Hungary	21%
Latvia	26%
Lithuania	25%
Poland	31%
Slovakia	21%
Slovenia	17%

Source: Christie and Holzner (2004)

Hungary: standalone analysis

Estimations of the time path of the share of the non-observed economy in the GDP

Results of estimations of the size of the non-observed economy in Hungary show a continuous increase during the pre-transitional period (1970-1990). This expansion was accelerated during the years of transitional crises (1990-1993). Analysis of the post-transitional period (1993-2003) shows that, in line with the completion of the legal and institutional framework of the market economy, the integration of Hungary in the world economy (and especially in the European Union) and the expansion of foreign businesses, the size of the non-observed economy began to decrease.

One of the first attempts to calculate the time path of the size of the informal economy was carried out by Lackó (1992, 1999, Dezséri et al. 1998). According to the results, the informal economy increased from 13% to 18% of GDP between 1970-1987. This expansion accelerated in the pre-transition years. The share of the informal economy was estimated to as much as 34% in 1990. Most of the analysis for the years of the transitional crisis estimated the share of the informal economy at between 25 and 27% (Dezséri et al. 1998, Kállai 1993). Árvay and Vértés (1994) used sector specific representative samples and estimated that 27% of GDP was produced in the informal economy. Their estimations were carried out in different sectors and found that the share of the concealed economy was 10% in the public sector, 88% in the domestically-owned private sector and only 2% in the foreign-owned private sector.

A number of empirical studies in the field of the non-observed economy investigated the time path of the intensity of tax avoidance practices of Hungarian enterprises. According to Semjén (1998), tax reports reveal that a large proportion of unincorporated firms are established to evade taxes on wages, while two enterprise surveys (of 300 small and medium enterprises in 1994 and 1996) suggest that small firms are more likely to hire employees at minimum wage (combined with other forms of remuneration such as sub-contracting). Small firms are also more likely to sell goods without paying VAT but the effect of changes in VAT rates would be difficult to link to specific groups of economic units. The corporate income tax rate was gradually reduced over the years from 50% in 1989 to 40%, and then to 18% in 1996.

Available evidence from Hungary suggests that administrative control matters in the case of tax avoidance. Semjén (2001) notes that, although the volume and efficiency of the supervising activity of the Tax Authority is rather unpredictable, on balance it is improving. Increased effort has been devoted to checking large firms rather than smaller firms, hence improvements in the tax compliance of smaller enterprises may be slower. Semjén and Tóth (2002) also report that tax evasion decreased in larger firms and was partly due to an improvement in tax administration.

Tóth and Semjén (1996, 2002, 2004) made survey-type investigations about certain aspects of the hidden economy in Hungary. The authors combined data from three consecutive enterprise surveys taken in 1996, 1998 and 2001. The investigation offered a survey-based empirical analysis of changes in contractual and tax discipline amongst medium sized and large firms in Hungary during the time span. Changes in the occurrence of some phenomena related to the undeclared or hidden economy were also covered. It turned out that the scope of the hidden economy significantly diminished within the analysed segment of the economy. There was a reduction in the occurrence of sales without a receipt both for the business partners (suppliers, sub-contractors)

and for the competitors of the surveyed firms. Contractual and tax discipline improved, and the soft budget constraint syndrome lost ground within the enterprise sector. The authors' estimations, based on the randomised response technique, suggest that there was a further reduction in the occurrence of tax evasion amongst medium-sized and large firms between 1998 and 2001. According to the authors, improving business expectations and an increased level of integration into the European economy have been key factors in the reduction of the share of the hidden economy.

Scharle (2002) looks at tax evasion in small businesses in Hungary, using data from 1992-2000. The paper examines the effect of changes in taxation and social security contributions on outflows from self-employment using data from the labour force survey, and attempts to measure the correlation between the volume of unofficial activities and the density of small businesses using small region data on electricity consumption and tax reports. Results suggest that the survival of small businesses is significantly influenced by changes in tax rates, that small businesses contribute significantly to unofficial wealth accumulation and that unofficial activities tend to be tied to official ones, as was customary in the second economy of the socialist system. Semjén, Szántó et al. (2001) explains how the amount saved from not paying social security contributions can be divided between employers and employees when the firm uses sub-contracting instead of employing a worker.

A special survey of the Hungarian Central Statistical Office (HCSO, 1998) approached the hidden economy from the consumers' and clients' perspective. The objective was to find out how much money households pay in one month and in one year for goods, services and rents without receiving any kind of formal receipt. In relation to this, the giving of tips and gratuities was studied. According to HSCSO estimates, in 1997, at least 11% of household expenditures were transferred to the hidden economy. The survey also collected personal and spontaneous opinions of households on the hidden economy. The survey showed that the majority of people, regardless of their age, gender, education or income position (both in Budapest and in the countryside) regard the presence of the hidden economy as natural. (Only 7% had an openly negative attitude and 12% a latent negative. Moreover, a significant part of citizens, 29%, openly approved of the hidden economy). It was shown also that the respondents believe that high taxes and social contributions play a crucial role in the preservation of the hidden economy.

Estimations of the prevalence of undeclared work in Hungary

The extremely high inactivity rate in Hungary implies that, among the inactive 15-64 year-olds, the proportion of people who gain some kind of income through undeclared employment could be significant. There are approximately 440,000-450,000 persons who are inactive but are not in education, and do not receive pension, childcare or unemployment benefits. Meanwhile, the number of employed (3,900,000 persons) measured by the Labour Force Survey is at least 500,000 higher than the number of those who pay income tax (including the self-employed). Based on the above-mentioned figures, it can be assumed that 15-20% of the employed are not declared to the public authorities. Ádám and Kutas (2004) compared the number of employed people with the number of tax payers in 2002, and found that the share of undeclared employment was 13% in 2003.

The relatively high undeclared employment in Hungary is often presumed to be behind the low levels of formal employment and job-search activity. Nevertheless, there is no straightforward linkage between the size of a country's informal economy and its level of

employment or job-search intensity. The question of whether formal and informal jobs are substitutes or complements, and whether people's engagement in informal employment is conducive to lower search intensity, are difficult ones and require disaggregate data in order to be properly addressed. Such data is scarce and all conclusions drawn from existing data are tentative.

Köllő and Nacsá (2004) present some rough calculations addressing how employment and some proxies of the local informal economy were correlated in Hungary's micro-regions, in 2000. Results of the estimations show a statistically significant inverse relationship between employment (as well as labour force participation) and the indicators of the informal economy. Regions with a sizeable informal economy have lower *employment* rates. However, as soon as the equations were controlled for the level of education – considered a proxy of a region's level of development and ability to absorb capital investments – all relationships between the informal economy and labour market outcomes became statistically insignificant. Hence, variations in the size of the informal economy actually do not explain variations in formal employment, unemployment, or search intensity once human capital endowments are controlled for. According to the authors, the observed correlations are consistent with the expectation of no causal relationship between informal and formal employment, or between informal employment and search intensity. The informal economy is widespread in regions with low levels of education and a number of related endowments conducive to low levels of job creation and employment. In this sense the informal economy is an effect rather than a "cause" of low formal employment.

Measures taken to combat undeclared work

In recent years, undeclared work has become a major issue in the political debate in Hungary. Several measures have been taken to reduce its level and an inter-ministerial working group elaborated an action plan to introduce further measures and action in this field.

Measures to create a more favourable legal and institutional environment conducive to the declaration of economic activity and employment

Undeclared work is highly concentrated in sectors characterised by temporary or seasonal labour (e.g. construction, agriculture, catering and tourism). Therefore, a number of measures had been taken to prepare a new labour legislation, adjusted to the peculiarities of seasonal employment. A specific "labour certificate" for temporary workers was introduced, which made it possible for employers to meet their payment obligations by purchasing a "tax and contributions voucher".

In order to consolidate taxpaying discipline, governments occasionally introduce tax types and rates making tax fraud pointless, such as the simplified business tax which replaced several former kinds of tax in 2003 and set a 15% rate for sales returns of up to HUF 15 million (58,000 euro). The new system generated a far bigger income for the central budget than planned.

Strengthening incentives and removing disincentives to declare work on both the demand and the supply sides

Hungary has one of the highest tax wedges on labour. Thus, it can be said that low formal employment is a result of tax avoidance by both employers and employees. Wage related taxes and contributions have decreased substantially in recent years: the rate

of employers' contributions dropped by 6 percentage points in 1999, and by a further 2 percentage points in each of the years 2001 and 2002, that is, by a total of 10 percentage points. However, the amount of the fixed component of the employers' contribution to healthcare increased in 2003.

In 2001, the modification of the Labour Code extended the list of formal criteria concerning employment contracts. Employment contracts must be settled in written form and include certain elements, such as the amount of the basic wage, a job description and the location of the work.

Strengthening surveillance and the application of appropriate sanctions

During the 90s, one of the main forms of undeclared work was the so-called "double contract" consisting of a formal contract providing for pay at the national minimum wage and an informal contract reflecting actual pay. After the late 1990s, new forms of undeclared employment, the so-called "bogus" civil law contracts became increasingly widespread. The "bogus" civil law contracts are contracts not governed by labour law. Instead of making employment contracts, employers conclude service contracts with self-employed people acting as micro-enterprises, who are in fact in a position of dependent employment ("forced entrepreneurs"). Given that employment attracts a considerable tax and social security contribution burden, and that there is a lower tax and social security payment regime for enterprises, it is in the short-term interest of both employers and employees to avoid normal employment contracts. Additionally, employers gain important flexibility advantages in using informal agreements or civil contracts instead of employment contracts.

It is the task of the National Labour Inspectorate (OMMF) to supervise how employers follow legal regulations on employment relationships. In 2003, the OMMF found that in 21% of inspected cases, employers had not signed correct legal statements to establish employment relationships with their employees. The most frequent forms of irregularities were: employment (sub-contracting, assignment) based on a false contract; employment without an employment contract, based on a verbal agreement of the parties concerned; or irregularities stemming from an employment contract concluded with shortfalls in formal requirements or substance. The tasks of labour inspection have grown substantially during recent years, while labour and safety at work inspections cover approximately 3 to 5% of employers annually.

One of the most important steps to strengthen the information background of the OMMF was the creation of the Hungarian Unified Labour Database (EMMA). Since May 2004, employers have to report any changes in the status of their employees to this central database. Employers must report the hiring of a new worker before the employee starts work, while the ending of an employee relationship will have to be reported within one day after the termination of the contract. In theory, the database contains up-to-date information on the employment status of Hungary's employees who fall under the jurisdiction of the Labour Code, as well as all of the employers in the country. EMMA creates the necessary conditions for a more effective labour inspection system, contributes to the transparency of the labour market and increases the legal security of employees. Employers are able to meet their reporting obligations not just through the traditional mailing method, but also through a PIN number-protected telephone number and through the Internet. At the same time, employees are also able to access the database through the Internet to check their employment status.

Nevertheless, EMMA, as it functions now, provides fewer services for users than was initially anticipated. For example, EMMA gives no access to information on social security registration and contributions which would have been an important service for employees. These data are available from the database of the National Pensions Office which holds this kind of information dating back to 1958, the National Health Insurance Fund and the Tax Bureau. According to experts in the field of labour law, who support the original goals for which EMMA was created, it could have been achieved by the development of the already existing information systems. HUF 1.6 billion (6.4 million euro) was invested in EMMA which now seems to be a high cost borne for such modest output. Nevertheless, the OMMF could in future use EMMA as an effective tool for the investigation of undeclared employment.

Strengthening the role of social partners in combating undeclared work

EIRO (2004) gives a brief overview of the industrial relations aspects of undeclared work in Hungary. It looks at the activities and views of the social partners, and the partnerships between social partners and the public authorities to tackle undeclared work. According to this evaluation, collective bargaining hardly deals with issues related to undeclared work as such. The decentralised nature of Hungarian collective bargaining, the weak administrative capacities of employers' associations and trade unions at the sectoral and national level and their highly fragmented nature inhibit any major joint action to combat undeclared work. Nevertheless, in several sectors, most importantly in the food industry and the construction industry, the main employers' associations and trade unions have initiated joint efforts to reduce undeclared work, and to improve health and safety standards. In these industries, the main employers' associations are aware of the negative impact of using undeclared work on the competitiveness of the industry and thus are seeking to co-operate with unions to combat it. Those involved hope that the consolidation of sectoral collective bargaining through recently established sector-level bipartite social dialogue forums, and the extension of voluntary multi-employer collective agreements, will open new opportunities for joint regulation and effective joint institutions to reduce undeclared work.

Future prospects

In 2003, the government decided to modify the legislative framework of employment in order to adjust regulations to the changing employment pattern of recent years. According to the decision, the following actions will be implemented before the end of 2005:

- As part of the comprehensive review of the Labour Code, the legal forms of employment will be reviewed;
- A comparative analysis will be drawn up about the regulations concerning taxes and contributions and credits related to the various forms of employment;
- Finally, a joint evaluation will be carried out with the social partners and a joint proposal will be prepared on the necessary amendments to the regulations.

In 2004, the Ministry of Finance established an inter-ministerial working group to assess the causes and consequences of the undeclared economy, to identify major challenges and to prepare a package of proposals on policy responses for the Economic Cabinet. The first report of the working group was prepared in May 2004. Based on this report, a work programme will be prepared

defining the tasks in the field of regulation, tax and social security.

The Hungarian National Action Plan (NAP) on Employment provides a detailed assessment of undeclared work in Hungary and provides a list of planned policy responses. Three major policy responses are listed in the document: reducing and harmonising the costs of employment; improving the efficiency of labour inspection; and creating an interest for paying social security contributions. Over the past few years, the Hungarian Government has started to decrease and unify the tax burden on employment. Most of the focus is, however, on employer contributions. Legal employment would also be promoted by decreasing the tax burden on employees (e.g. by further shifting tax revenues from income to consumption). The NAP also highlights the importance of raising the awareness of citizens concerning compliance with the law. The most interesting and quite promising proposal aims at creating an interest for paying social security contributions. To strengthen the insurance principle for cash benefits (e.g. pension, sick-pay, childcare pay), the Hungarian Government is considering a system to register an individual's eligibility. In principle, such a system would give stronger incentives for employees to pursue legal forms of employment. However, the details of the proposed system are not clear at the moment.

Summary and conclusions

Hungary's sizeable informal economy is often assumed to play a key role in keeping the level of formal employment and search activity low. The available results confirm the existence of a sizeable repressed economy, but estimates are not the highest, by international comparison. Furthermore, there is no straightforward linkage between the size of a country's informal economy and its level of employment or search intensity.

According to recent estimates, some 15-20% of total employment is not registered. Most of the analysis identifies the high tax burden as the major reason behind firms hiring undeclared employees. Social security and personal income tax contributions are extremely high by international comparison. The recent documents on the planned government actions against undeclared work list the necessary measures for further increasing the burden on the employers: coverage of non-standard employment, and unified costs for different kinds of employment contracts. These measures are indeed necessary in order to make the different forms of employment bear the same burden. The key challenges concerning undeclared work are correctly identified by the government, as being to create an employment-friendly environment and to reinforce labour market inspection.

Károly Fazekas

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Malta

Introduction

The 1998 Commission Communication states that undeclared work is taken to mean “*any paid activities that are lawful as regards their nature but not declared to public authorities*”. Its importance is highlighted in the employment guidelines specified by the EU to foster the three overarching objectives of full employment, quality and productivity at work; and social cohesion and inclusion in the spirit of the Lisbon Agenda. Guideline nine: “Transform Undeclared Work into Regular Employment” calls on Member States to address undeclared work. More specifically, “*Member States should develop and implement broad actions and measures to eliminate undeclared work, which combine simplification of the business environment, removing disincentives and providing appropriate incentives in the tax and benefits system, improved law enforcement and the application of sanctions. They should undertake the necessary efforts at national and EU level to measure the extent of the problem and progress achieved at national level.*”

The above definition is in line with the Maltese interpretation of undeclared work. When local authorities make statements about or take action on undeclared workers, they are usually referring to people who earn money in the pursuit of a lawful activity but who do not declare such activity to the public authorities. Thus, work which does not have to be declared, such as housework, is excluded.

Three main policy-making and implementation bodies tackle the issues involved in undeclared work in Malta: the Inland Revenue Department; the Department for Social Security and the Employment and Training Corporation (ETC). The Inland Revenue Department implements the Income Tax Act and is responsible for revenue collection from personal and corporate tax, and social security contributions. The Department for Social Security, within the Ministry for the Family and Social Solidarity, operates the Social Security Act (1987) which operates both contributory and non-contributory arms. The ETC has the mandate, under the Employment and Training Services Act (1990), to maintain a register of persons in employment and of those seeking employment. Employers are obliged by law to submit engagement and termination forms to the ETC when recruiting or releasing employees.

Political debate on undeclared work generally takes the form of parliamentary questions on the number of registered unemployed working illegally and on the number of foreigners found working without a permit. However, the debate on undeclared work will soon take a more structured form, when it is included in Malta's first-ever National Action Plan for Employment, to be published soon.

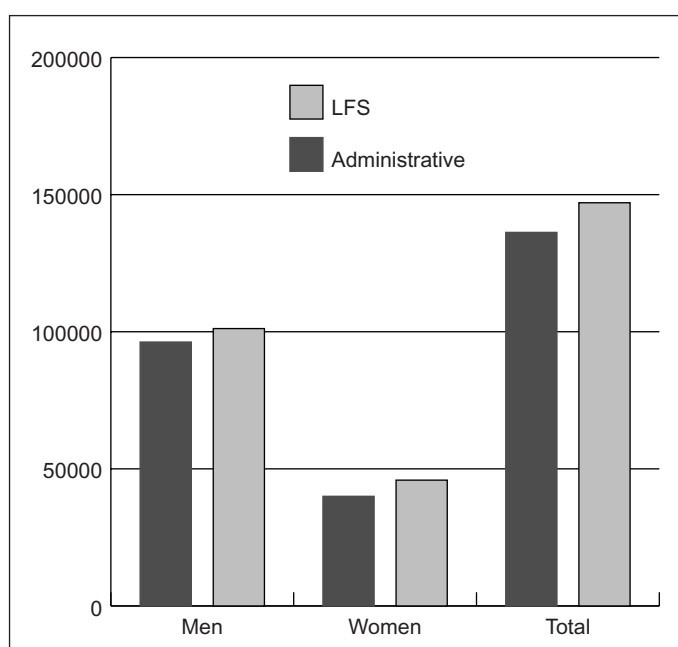
Prevalence of undeclared work in the economy

The extent of undeclared work in Malta has not been officially measured, although it is generally believed to be significant in particular trades and services. There have been two recent attempts at quantifying the Maltese underground economy (Briguglio, 1989 and Cassar, 2001). Measures of the underground economy are not indicative of undeclared work as they also include illegal activity and work that does not have to be declared such as housework. That

said, Briguglio's study, which makes use of an indirect estimation procedure, based on the amount of currency in circulation, estimates the underground economy at around 25% of GDP, while Cassar's index of underground economic activity indicates that underground activity in Malta tripled, albeit at a decreasing rate, over the period 1971 to 1997. The motives for such transactions were identified as a lack of confidence in the government and in the fiscal system and a strong family-oriented business culture. The lack of confidence in the government is deeply ingrained in the sociological and cultural background of the Maltese economy. This is based partly on a history of foreign occupation, and the existence of a large and centrally-led public sector forming a barrier to a free entrepreneurial market, and partly on what is perceived to be unclear governance. The strong family culture engrained in society justifies a wide range of means of improving the well-being of one's family, including earning undeclared wages.

Further attempts to calculate the level of undeclared economic activity have been limited. No direct methods are currently utilised to gauge the size of undeclared work, though indirect methods may also be applied. By using a common indirect discrepancy method to determine undeclared work, and comparing the findings of Labour Force Surveys with demand-side data (in the case of Malta, employment levels according to employers' submission of engagement and termination forms), administrative data tend to show lower employment levels than the Labour Force Survey. Data for December 2003 is depicted below. This discrepancy method therefore indicates that undeclared work is prevalent in Malta; however it should not be relied upon to derive exact figures.

Figure 1: Employment in Labour Force Survey and administrative data, December 2003



In Malta, undeclared work generally occurs among employed and unemployed men and women, rather than among self-employed or retired people for example, although among men it is more likely to occur in construction and trades, while among women it is more likely in crafts and in personal and domestic services. Both men and women are thought to undertake undeclared work in the hospitality and catering sectors, particularly in the summer months.

In recent years the number of law infringements detected among people carrying out unreported work, and among people working and registering for employment benefit, has fallen considerably. However, this is largely the result of a falling number of Law Compliance Inspectors within the ETC. Table 1 indicates infringement by category for the years 1999/2000 to 2002/2003 in absolute figures. As the table shows, the majority of infringements generally consist of employment not being reported to the ETC, followed by people working and registering for work, employment of foreigners and employment of minors.

The Training and Employment Exposure Scheme (TEES), an ETC training scheme to help the unemployed over-forties find employment, was only taken up by 81 out of 1,200 eligible. This low response level could be due to engagement in the black economy. The scheme, which offered a wage of 55 Maltese Lira (127 euro) per week plus bonuses, vacation and statutory sick leave entitlement, also encouraged employers to offer permanent employment to TEES participants after the one-year period. Besides a public notice about TEES in the media; a personal letter was sent to all eligible people claiming unemployment benefit for at least six months. The low take-up despite these factors indicates, among other things, that people may already be working but not informing public authorities.

Research by the University of Malta's Workers' Participation Development Centre (WPDC), on the factors affecting women's formal participation in the Maltese labour market, indicates that undeclared labour among women is significant. In fact, the study indicates that for every four Maltese females declaring work in the labour market, there is (at least) one more who works but does not declare it¹. The study suggests that the female participation rate in the economy at the beginning of 2003 was 41.7%, 7.2 percentage points higher than that reported by the Labour Force Survey (LFS) during the same period.

The key reasons behind the prevalence of undeclared work are high marginal tax rates, tax distortions, social security contributions, possible loss of benefits, an inefficient public sector and the current system of "transfer payments". These issues will now be discussed in turn.

The highest marginal rate of personal income tax in Malta is 35%. The average tax rate – or the amount of tax paid out of income – by Maltese tax payers is 8.6%, while the marginal tax rate, or the rate of tax paid on income earned, is on average just over 19%. When compared to the EU-25, the highest marginal rate of personal

income tax and the average tax rate compare favourably, indicating that Malta is not among the countries with the highest rates. However, a comparison of tax rates paid on the last Maltese Lira of income earned puts Malta among countries with the highest rates. Thus, the income tax system in Malta is one of the most progressive in the EU and may be acting as a disincentive to work in the formal market.

Distortions exist between tax rates on normal employment, overtime work and part-time work. At present normal and overtime work are taxed at generally higher marginal rates than part-time work (taxed at 15%), provided that such part-time work is not undertaken with the same employer. A further distortion occurs whereby a couple opting for a married tax computation cannot benefit from the lower part-time work rate if such work is undertaken by the partner who does not have a full-time job. This is perhaps the most likely reason for the absence of declaration of activity by females.

Women also refrain from disclosing income earned when working beyond the family household unit to avoid paying social security contributions. These are statutory for people working a minimum of eight hours per week. Reporting economic activity would also cause women to lose out on benefits such as rent subsidies. Furthermore, some women are not remunerated when working within the family household unit. Undeclared work among women is also becoming more common among single or separated women who claim social benefits while performing remunerated work.

In Malta, public sector employment is often inefficient. A significant proportion of public sector workers participate in undeclared activity during working hours due to a lack of supervision. Privatisation of some public sector organisations may, to some extent, have reduced the number of workers who take up undeclared work.

The current system of "transfer payments" may also cause people to perform undeclared work in order to remain below the necessary social benefit threshold. The Malta Chamber of Commerce and Enterprise believes that social benefits which "disincentivise" work should be removed to eliminate their undesirable consequences. By the same token, deserved cases should be entitled to benefits which adequately reflect today's realities. It is also understood that some pensioners may be performing undeclared work so as not to affect their entitlement to the government pension once they reach the minimum wage level of 543 euro per month.

Besides undeclared labour, there is perceived to be a high level of *under-reporting* income, which is as important as non-reporting. In fact, use of "envelope wages" (paying cash in hand) is deemed to be widespread as an easy way to avoid taxes. Moreover, there tends to be undeclared activity by small businesses who give clients the option to pay VAT or not. Despite government efforts to reduce this undeclared activity (such as setting up campaigns to encourage

Table 1: Employment Infringements

Infringements processed by ETC Law Compliance Unit	1999-2000	2000-2001	2001-2002	2002-2003
Unreported employment	2,878	1,558	1,191	1,316
Working while registering	728	534	373	215
Employment of foreigners	161	77	46	96
Employment of minors	134	37	6	11

Source: ETC Annual Report 2003

¹ The margin of error for this study was 3.1%

people to ask for VAT receipts, monthly lottery and refunding VAT payments on some purchases), this type of under-declaration is still practised. More random checks by inspectors and more stringent sanctions are required.

Measures taken to combat undeclared work

Through the ETC, Malta is already working within the European Employment Strategy. This means that Malta will be tackling the issue of undeclared work with even greater determination. Awareness of undeclared work is also increasing at the political level. The Prime Minister, Dr Lawrence Gonzi, recently stated that the government recognises the fact that there are inbuilt mechanisms preventing female participation and in some cases pushing females into undeclared work. The Prime Minister singled out rules regulating part-time work and National Insurance contributions. The government intends to reduce the incidence of undeclared work, mainly through measures proposed in the National Action Plan for Employment.

The National Action Plan for Employment will follow a four-pronged strategy to reduce the incidence of undeclared work. Efforts will be made to: make formal work more attractive; reduce the administrative burden for employers and combat labour market rigidity; measure undeclared work using reliable methods and strengthen mechanisms to control undeclared work.

Measures undertaken and planned to reduce undeclared work

Definition and measurement

Direct methods to estimate undeclared work, when carried out in a comprehensive and sensitive manner, are generally thought to be the best way to gather reliable and valid information on undeclared work. In the second half of 2005, a direct survey will be launched among Maltese households to obtain estimates of the magnitude of employment in the undeclared economy. This survey will be conducted jointly by the National Statistics Office and the Employment and Training Corporation and technical assistance will be sought from the Danish Rockwool Foundation which has already carried out similar surveys in Germany, UK, Sweden and Denmark. This initiative will utilise highly qualified and carefully instructed interviewers.

Co-ordinated enforcement

Over the years, the ETC has developed and implemented broad actions and measures to eliminate undeclared work. The Law Compliance Unit was set up to identify and act against job seekers registering for unemployment whilst working, employers employing persons of compulsory school age, foreigners working without the necessary work permits, and employers failing to inform the ETC about the engagement of new employees. The ETC informs the police of every case for action to be taken and the police fine employers for employing workers without the necessary permit. There have, however, been cases where foreign workers have been found working illegally but ETC officials were not brought in.

Furthermore, the Unit forwards a list of employment infringements to the Department of Social Security for further investigation. On a monthly basis, the ETC also submits medical certificates (received from unemployed persons as reasons for non-registration) to the Department of Social Security for further investigation.

In 2003, the inspectorate section of the ETC was heavily criticised in

parliament by a Labour MP, for finding too few violations. He said that the number of persons found working while registering for employment and the number of foreigners caught working without a permit was too low to reflect reality. This was attributed to depletion of staff from the Law Compliance Unit and the lack of co-operation sometimes experienced with other departments. The latter problem has since been addressed and better results are now being registered. In fact, the Law Compliance Unit now has an established network with the Tax Compliance Unit, the Value Added Tax Department, Malta Enterprise, the Financial Intelligence Analysis Unit, and the Commissioner of Police. Furthermore, the Unit's officers work in teams in order to address specific groups of job seekers who are suspected of working illegally. The Compliance Unit has also launched a free phone service for reporting illegal employment.

The ETC is also working on improving its profiling system to better assess the availability for work of job seekers. Those who are identified as abusing or trying to abuse the system are struck off the unemployment register.

At present, the Employment and Training Services Act (1990), which defines the rights and obligations of employers and the unemployed, as well as the processes both should follow, is being revised to ensure, *inter alia*, greater transparency and efficiency in the control of work during unemployment. A revised Act will be proposed to the government by January 2005.

In August, 2003, a committee made up of representatives of the ETC, the Ministry of Social Policy, Ministry of Finance and Economic Services and the Ministry of Education, was set up in order to draw up and plan a national campaign against undeclared work. The committee ensured that data which help each organisation fight undeclared work, tax evasion or fraud in social benefit claims are being exchanged. As part of this data exchange exercise, the Ministry of Social Policy passed on to the ETC a list of 56 persons found working by inspectors of the Occupational Health and Safety Authority on several worksites. Out of these 56, the ETC found that one had been registering as unemployed, four were found to be unemployed but not registering, while another four could not be traced in the employment register (possibly due to falsification of personal details). This data exchange came after the ETC gave the Ministry of Social Policy a list of persons found illegally working in Gozo. Two of the persons found working illegally were receiving invalidity pensions which completely precluded them from working.

Strengthening of law enforcement

With effect from October 2004, the staff complement in the Law Compliance Unit within the public employment service will be increased from six to ten inspectors. This is intended to increase infringement detection. Furthermore, in 2005, all Law Compliance Officers will be trained in investigative and reporting skills. Administrative co-ordination between control authorities in various Ministries will be reinforced. The ETC held a training seminar for its Law Compliance Inspectors and clerical staff to aid understanding of the reality of undeclared work. Officials from the Malta Tourism Authority, the Department of Social Security, the Tax Compliance Unit, the VAT department, the police force and the National Employment Authority were invited to address those present on the pertaining realities that they meet during their inspections.

Sanctions

The current penalty of 25 Maltese Lira (58 euro) for employers employing staff without declaring their employment – irrespective

of the number of persons employed – will be raised significantly, coming into force in January 2005. On payment of the fine, the employer will be compelled to complete the ETC engagement form.

Recently, a worker who had collected unemployment benefits for a whole year was fined 586 euro. The court also awarded a two-year jail term and suspended four-year sentence. The worker was found guilty of defrauding the government and making false declarations under the Social Security Act and the Employment and Training Corporation Act.

Fiscal measures

Distortions in the tax system will be removed, encouraging second-earner spouses working on a part-time basis to move into the formal economy.

Awareness raising

In 2005, the ETC will be conducting a campaign to inform workers of their rights and responsibilities with regards to the declaration of employment, as well as the implications of not doing so in terms of related issues such as social security contributory records and entitlement to other benefits.

Domestic service vouchers

In October 2004, a feasibility study will be launched concerning the introduction of service vouchers for the provision of household services. Recommendations will be made by July 2005 to be considered during the budgetary process in late 2005. It is envisaged that such a scheme will involve the establishment of a managing company to recruit workers offering household services, including care of children, disabled and elderly people, domestic work, and minor household repairs. Households will purchase service vouchers from local councils. The managing company will deploy its recruits according to demand, and manage the settlement of their social security contributions and income tax where applicable. This project is intended to formalise domestic work, create social economy jobs that also assist with increasing the female participation rate, ensure domestic workers are trained (particularly in health and safety), and allow such workers to amass a social security contributory record. The benefit for those already using domestic services to switch to such a scheme have yet to be studied, and incentives will be designed accordingly.

Conclusions

It is envisaged that turning undeclared to declared work will improve the overall business environment in Malta, social cohesion and the sustainability of public finances, as well as social protection systems. Measures needed to confront the problem of undeclared work should include labour-tax incentives, better controls and sanctions, better co-operation between the various authorities and greater awareness of the rights denied to undeclared workers. Lower levels of taxation and lower time thresholds for the payment of social security contributions would raise the incentive to declare income, thus bringing unreported economic activity to light.

Changing public attitudes towards undeclared work is vital. There is a need for more detailed public information campaigns against undeclared work, especially directed towards the younger population who will ultimately lead the transformation. Households should be encouraged to use formal labour rather than undeclared labour. Transforming undeclared work into legal labour voluntarily should be made more attractive and individuals should also be given an amnesty for a specific time period, offering incorporation into the formal economy without fear of retribution. There is also the need to encourage small-scale entrepreneurs to announce undeclared work. This should be made attractive in economic terms and not hindered by bureaucratic obstacles.

Gordon Cordina

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The Netherlands

Introduction

In recent years many of the institutions responsible for tax and benefits have faced drastic reorganisation. One of the aims of this reorganisation has been to create a national system that is capable, through information sharing, of fast and efficient fraud detection and prevention. The latest step in Government policy is the formation of a national network of inspection and intervention teams, which fight fraud in a more effective way than the previously existing regional teams.

Although the Government seems determined to combat all types of fraud in the labour market, the extent of that fraud is unknown. Due to its illegal nature, a phenomenon such as undeclared work is difficult to trace and most existing figures on the subject only apply to those who have been caught and this can be problematic when trying to quantify the extent and impact of paid informal work. Firstly, figures are not representative of the actual incidence of undeclared work. Secondly, in the Netherlands, these numbers describe fraud, which is a broader term than “undeclared work” and also involves minor violations such as workers who report too late that they are on sick leave. Nevertheless, in this article we shall attempt to give some indications of the scale of undeclared work in the Netherlands. Furthermore, we shall describe the various measures that are taken to combat undeclared work.

Prevalence of undeclared work in the economy

In this section we present findings on the total amount of fraud in the labour market, wherever possible, broken down for undeclared work. We distinguish between fraud committed by employers, fraud committed by employees and illegal employment.

Fraud by the employer

Fraud is defined as giving incorrect or incomplete information as well as withholding relevant information. In the case of employers, this usually results in not paying or partly paying premiums (Lisv., 2001). For the Netherlands, there are only figures about fraud cases that have been detected. The real incidence of fraud by employers is hard to estimate, because a fraud investigation is only conducted if there is a suspicion of fraud. In 2002, 841 employers were investigated, leading to 481 detected cases of fraud. In total 34

million euro worth of premiums was not declared. Table 1 gives an overview of the top five economic sectors in which fraud was detected.

Table 1: Number of investigations for employer fraud and fraud cases at employers, total and top five Dutch sectors, 2002

Sector	Investigations	Fraud cases
Hotel, restaurants, snack bars	212	140
Employment agencies	82	57
Construction companies	100	52
Transportation of goods land/air	51	34
Agriculture	32	28
Total	841	481

Source: UWV, 2003

It is noteworthy that fraud is not only committed in low-skilled professions, but also in high-skilled professions. In 2003 fraud has been detected in the ICT sector as well as in the healthcare sector (SIOD, 2004).

Fraud by employees

Employees can commit fraud in numerous ways. Lisv (2001) makes a distinction between unjustly receiving benefits and concealing income. Simple fraud occurs when a person unjustly (partly) receives benefits. This is usually caused by giving incorrect or incomplete information or by withholding relevant information and involves hiding income, which can be easily traced through administrative systems, such as when a person simultaneously receives benefits and has a registered salary with an employer. Complex fraud involves concealing income in such a way that it cannot be detected through administrative systems such as cash-in-hand working. Table 2 gives an overview of the detected fraud cases from 1997 to 2000. For the year 2001, another source counts 34,857 cases of detected fraud; however, being from a different source, this figure cannot be fully compared to the figures in Table 2. Moreover, some further nuances concerning the displayed figures should be

Table 2: Benefit fraud (number of investigations and cases of fraud), simple fraud and complex fraud, 1997-2000

Benefit fraud				
Year	Fraud investigations	Cases of fraud		
1997	17,531	15,295, of which:	simple fraud: complex fraud:	11,987 692
1998	18,751	15,911, of which:	simple fraud: complex fraud:	3,972 1613
1999	20,021	17,954, of which:	simple fraud: complex fraud:	12,711 764
2000	29,447	26,734, of which:	simple fraud: complex fraud:	13,162 806

Source: Lisv., 2001

kept in mind. Although all reported cases involve fraud, this does not necessarily mean that it involves undeclared work; it may also involve workers who were on sick leave and did not report in time that they had resumed working.

All figures in Table 2 involve detected cases, which, of course, means that they do not represent the actual number of people involved in fraud. In research amongst (anonymous) benefit recipients and fraud experts, estimates have been made regarding the scale of deliberate fraud committed by those in receipt of benefits. Experts produced higher estimates of the percentage of people involved in benefit fraud than the benefit recipients themselves. Experts estimated that 32 to 39% of benefit recipients – depending on the type of benefit – receive income without notifying the authorities. Those in receipt of benefits estimated that 20 to 35% of benefit recipients deliberately withhold information about receiving earnings (CMC/T11 Company, 2002).

Most employees who have been detected working in the shadow economy, work via employment agencies (UWV, 2003). Other investigations reveal that fraud is mostly committed by men (63.5%), people aged 25-35 (32.3%) and people who receive either unemployment benefit (41.4%) or are on sick leave (36.2%) (UWV, 2002). In addition to these general figures on fraud, there is some specific information regarding the occurrence of undeclared work within the various benefit schemes.

Disability benefit recipients (WAO)

In 2002, a small percentage of disability benefit recipients (*WAO*) were involved in various forms of undeclared work (TNS-Nipo, 2003). An estimated 16% did small chores for money via or on behalf of acquaintances without notification. Mostly men, main earners of a household, and people expecting greater advantages by violating the rules, were involved in this kind of fraud. Another 8% worked on the side whilst receiving disability benefits. Here, the employment history seems to play a large role in explaining the behaviour of disability benefit recipients. Notably, people who used to work on call were tempted to work on the side from time to time (TNS-Nipo, 2003).

Unemployment benefit recipients (WW)

Fraud by doing undeclared work is more extensive amongst those in receipt of unemployment benefit (*WW*) (TNS-Nipo, 2003). Estimations are that 11% of people work whilst in receipt of unemployment benefits and 1% have a job or work via an employment agency without notifying the authorities. An additional 15% of claimants carry out small chores for money via or for acquaintances without declaration, especially men and people who, prior to becoming unemployed, were in either a low-skilled job, a temporary job or were at work on probation. Next, 26% of the unemployment benefit recipients do unpaid (voluntary) work without notifying the authorities. This is not undeclared work in the sense of the definitions used across Europe, as it is unpaid; however, by doing unpaid work, benefit recipients are in violation of the rule that they have to be available for the labour market on a full-time basis. Doing unpaid work tempts mostly men and people who are the main earners of a household. Moreover, people who have a high level of education, and people who have had a highly skilled job before becoming unemployed, are likely to do unpaid work without notifying the authorities (TNS-Nipo, 2003).

Welfare recipients

Welfare recipients mostly (23%) do small chores for money via or for acquaintances without notifying the authorities. Working on the side whilst receiving unemployment benefits is done by some 13%. Both violations are more likely committed by people who formerly worked via an employment agency. About 3% of the welfare recipients have a job or work via an employment agency without notification (TNS-Nipo, 2003).

A typical activity that accounts for a large amount of undeclared work is cleaning for private employers. There are only rough estimations about the number of people who do such work, ranging from 200,000-400,000 in 1995 (SER, 2000) to 250,000-300,000 in 2001 (Van der Veen, 2001). Based on the latter figures, an estimated 1 to 1.5 million households make use of such cleaners. Mostly, these cleaners are low-skilled women who clean on a part-time basis (SER, 2000). It is suggested that in large cities in the west of the Netherlands, these cleaners are mostly female illegal immigrants. In other Dutch cities and in the countryside, these women are usually housewives whose men are the main earners of the household (Van der Veen, 2001).

Illegal employment

One particular form of fraud is illegal labour. Usually, this concerns labourers who work in the Netherlands without a permit. This illegal labour is usually arranged via employment agencies that operate in various economic sectors. Fighting such practices is not easy, for once an illegal worker is detected and punished in one sector, he or she is often simply sent by the agency to work in another sector (FNV, 2003a). There are no exact figures on illegal employment in the Netherlands. The estimation is that about 70-150,000 people reside illegally in the Netherlands, of which two-thirds work without a work permit or permit of residence (FNV, 2003b). The sectors “hotel, restaurants, snack bars”, “horticulture” and “construction”, have the highest incidences of illegal workers. In 2002 the Labour Inspectorates investigated 797 companies in the “hotel, restaurants, snack bars” sector and found that 28% of the companies violated the Foreign Nationals Employment Act (*Wet Arbeid Vreemdelingen, WAV*); in 2001 this was 30%. Of the 2,294 employees who were checked, more than one third (789 people) were not Dutch nationals. Of this group 160 worked without having a work permit and another 188 resided in the Netherlands illegally (Arbeidsinspectie, 2003a). In the agriculture and horticulture sector, 654 organisations were surveyed of which 18% (119 cases) violated the Foreign Nationals Employment Act. In these companies 425 employees were from outside the European Economic Area (EEA)¹, of these 64 had asylum seeker status and 75% of these non-EEA nationalities were male (Arbeidsinspectie, 2003b). In construction, an estimated 15% of employees worked illegally, of which 40% were of Polish nationality (Arbeidsinspectie, 2003c).

A large investigation into the practices of employment agencies also revealed the widespread use of illegal employees in the Netherlands. The Labour Inspectorates pre-selected 344 employment agencies for investigation, of which 304 were monitored. Of these agencies, 26% were charged for illegal employment of foreigners or forgery. In total, 565 people were found to be working on an illegal basis, of which 152 originated from Central or Eastern European countries (Poland, Bulgaria) and 86 from Turkey (Arbeidsinspectie, 2004). It must be noted that these are only statistics for those who have been caught and actual figures are undoubtedly higher.

¹ At that time still excluding the newly-acceded Member States.

Measures taken to combat undeclared work²

In this section we describe some of the measures that are in place to prevent undeclared work and other forms of fraud in the labour market. First, we give an overview of the organisations responsible for preventing and detecting fraud and their main activities. Next, we describe the co-operation between those organisations and their European counterparts in a common effort to fight international fraud. We end this section with an explanation of an initiative to transform undeclared work into legitimate work.

Organisations responsible for preventing and detecting fraud

The Ministry of Social Affairs and Employment has developed an Enforcement Programme spanning four years, 2003-2006, to tackle the ongoing problem of benefit fraud. The activities implemented under the Programme include:

- Investing in better methods and techniques to detect fraud, e.g. by risk analysis;
- Improving co-operation between organisations, i.e. forming a national network of intervention teams;
- Recruiting more people to enforcement roles.

From this Enforcement Programme, the Ministry has devised a yearly Detection Policy Plan. This strategy directs the plans for execution and enforcement by each organisation that is involved in fraud detection. These organisations are the Social Insurance Bank (*SVB, Sociale Verzekeringsbank*), UWV (the agency for workers' insurance), the municipalities and the Labour Inspectorates. They are not only involved in detecting undeclared work, but also in seeking out other forms of fraud that are the responsibility of the Ministry of Social Affairs and Employment, such as identity fraud, complex fraud and international fraud. In 2002 the Social Intelligence and Prosecution Agency (*SIOD, Sociale Inlichtingen- en Opsporingsdienst*) was formed to undertake general investigations into serious and organised crime in social security. Usually such crimes are international and involve identity fraud. Trying to detect all forms of fraud regarding social security – large or small – various organisations work together by linking and exchanging information. Three organisations that are important in preventing and detecting undeclared work are described in more detail in the remainder of this section.

UWV

The UWV is the agency responsible for social insurance (e.g. unemployment schemes, disability benefits). It provides social security benefits to 1.2 million beneficiaries and collects premiums from 4,000,000 employers. The UWV fraud policy distinguishes between the collecting process (employers) and the distributing process (employees). The agency is involved in numerous projects to prevent and detect fraud, a few of which are described below.

To prevent fraud by employers, the UWV takes steps to raise awareness of the existing regulations. Moreover, regular check-ups, intensive investigations and strict execution of fine payment are used as deterrent measures. To enhance the effectiveness of the check-ups for fraud, the UWV has developed a risk analysis strategy to identify those employers most likely to be vulnerable to bad practice. With the help of such analysis, profiles are made of employers likely to commit fraud and this process increases the chance of detecting fraud by 13%. Furthermore, the UWV monitors organisations to detect indicators of complex fraud. Employers are

selected for monitoring through risk analysis and the monitoring is preceded by a dossier investigation. The UWV and the SIOD have established protocol regarding the transfer of fraud cases and mutual co-operation and support. The UWV also co-operates with the tax department by linking their information systems to highlight employers suspected of deception. In addition to this activity, special operations have been launched to trace illegal employment agencies.

To investigate the extent of deception by workers, the Ministry of Social Affairs and Employment executes periodic research under the title POROSZ. It gives information on the nature, extent and background of the fraud and the people who commit fraud. To prevent fraud the UWV gives information to benefit recipients about their obligations and rights. Additionally, the UWV has trained its personnel to make them more aware of suspicious practices. To make check ups for fraud more efficient, the UWV developed a risk model for unemployment benefit recipients and disability benefit recipients. These models feature a number of criteria that generate an expected higher propensity to commit fraud. Based on these criteria, a search is done in the client database of the UWV. Other projects by the UWV concern tracing international fraud and highlighting indications of suspected fraud.

The municipalities

Municipalities are, amongst other things, responsible for the execution of the welfare benefit schemes. This responsibility has been increased further by the new Act on Welfare and Work (*Wet Werk en Bijstand*). In a joint agenda for the future, the Ministry of Social Affairs and Employment and the Association of Dutch Municipalities VNG formalised their intention to draft an annual policy plan. This annual plan will contain quantitative and qualitative aims to prevent and combat fraud and to retrieve the funds that have been collected.

The 30 largest municipalities strive for high quality enforcement (*Hoogwaardig Handhaven*), which aims at spontaneous compliance with the law, by informing welfare recipients about the regulations, an optimisation of services, early detection and strict enforcement and sanctions. There is a knowledge database to support municipalities that provides information about risk analysis and enhancing fraud awareness. Large municipalities have their own fraud detection teams (*sociale recherche*) and smaller municipalities, who lack such facilities, generally arrange joint detection teams with other municipalities. In 2002 they jointly detected 12,770 cases of simple fraud and 980 cases of complex fraud. In the majority of cases a tax signal formed the basis to start an investigation.

Labour Inspectorates

The Labour Inspectorates oversee the execution of the Foreign Nationals Employment Act (*Wet Arbeid Vreemdelingen, WAV*), legislation which covers much of the illegal employment that occurs. Employment is considered illegal when an employer hires labour from outside the European Economic Area, without having a permit to do so. Illegal employment disadvantages inhabitants of the European Union (plus Norway, Iceland and Liechtenstein) and is generally connected to low pay for workers, inferior working conditions and non-payment of social security premiums. In the agriculture sector, the Labour Inspectorate gives certificates to certain labour intermediaries (*handmatige loonbedrijven*) to prevent fraud. Furthermore, they support employers in finding competent employees. This strict reinforcement of rules and preventative ID

² The information in this section is derived from the reports by the Ministry of Social Affairs and Employment (2004).

check-ups should lead to a lower fraud rate, but figures are currently unavailable.

The Labour Inspectorate reserves about 19% of its capacity for investigating illegal employment at employment agencies, focusing investigations around the use of false identity papers or false social-fiscal numbers. One third of the capacity is used to conduct checks in the agriculture and horticulture sector. The employers' association, LTO Nederland, co-operates with the Labour Inspectorates to combat illegal employment in these sectors.

Co-operation between organisations

In the previous section we mentioned some of the joint initiatives between organisations to fight fraud. The Ministry of Social Affairs and Employment encourages co-operation in order to make fraud detection more effective and efficient. Detection is much easier when the databases of the various organisations are linked, especially when it involves simple fraud that can be traced through these administration systems. However, not every database is yet accessible to all agencies, but results have thus far been encouraging, with many agencies working together. In a recent case of illegal employment in the poultry industry, the SIOD co-operated with the Labour Inspectorates, the intelligence service of the tax services (*FIOD-ECD*), various regional police forces, UWV, Immigration and Naturalisation Services, and the Royal Army (Ministry of Social Affairs and Employment, 2004).

Some employers' and employees' associations are also involved in fraud prevention and detection and usually work with one or more of the official agencies. The employers' association for agriculture and horticulture, *LTO Nederland*, co-operates with the Centre for Work and Income (*CWI*) in the Seasonal Labour project (*Project Seizoenarbeid*), helping companies in these sectors to fill their temporary vacancies. One of the aims of this project is to decrease illegal employment caused by labour shortages in peak production periods.

International fraud

Most of the organisations involved in fraud detection also concern themselves with international fraud. The UWV has an export team that investigates disability benefit recipients who live abroad. Such research has been conducted in Belgium, Italy, France and Germany (UWV, 2002). The Dutch Municipalities have an agreement with Morocco that allows them to investigate Social Insurance and Welfare recipients living in that country. In Morocco and Turkey investigations of welfare recipients have been conducted based on the suspicion of people having property there whilst receiving welfare. The Labour Inspectorates investigate employers who are situated in a foreign country. It also co-operates with foreign Labour Inspectorate agencies, although this is primarily in the field of working conditions.

Initiatives to make cleaning for private persons into regular employment

In 1998 an experiment to transform undeclared private cleaning work into legitimate employment was conceived. This is known as the Arrangement of Cleaning Services for Private Persons (*Regeling schoonmaakdiensten particulieren, SVP*), and means that cleaning companies can hire unemployed people who are interested in cleaning work for private households. This company pays their salary, and receives a subsidy for this from the Government. Originally, this arrangement was meant for the long-term unemployed (> one year) who were willing to work at least 15 hours per week and was not a great success. At the end of the decade and

in first years of the new millennium, the Dutch labour market faced shortages of workers, causing a lack of unemployed people who were willing to clean under the conditions of this scheme. Over the last few years the Dutch labour market has become less strained, resulting in a larger group of potential cleaners able to work via the SVP scheme who may be attracted by the fact that the Dutch Government has made the rules in the SVP arrangement less rigid. People can now make use of the arrangement if they have been unemployed for a minimum of six months and the amount of hours they are required to work is brought down from 15 to 12 hours per week. Currently, approximately 1,000 people work via the SVP arrangement (SVP, 2003, Van der Veen, 2001, SER, 2000).

Conclusion

The Dutch Government is determined to take action against undeclared work and other forms of fraud in the Dutch labour market. Although some reports on the progress of fraud prevention and detection are rather optimistic, it is still too early to draw solid conclusions concerning the fight against fraud. Dutch organisations in this area have undergone drastic reorganisation over recent years, and some organisations, like the SIOD, were only established a few years ago. However, existing organisations increasingly try to co-operate by exchanging information and linking databases. Some also co-operate with foreign services to detect international fraud. Moreover, the use of risk analysis seems to improve the efficiency of fraud detection.

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Austria

Introduction

The phenomenon of the “black economy” is known by a wide variety of terms and expressions. Generally, the black economy or “clandestine employment” is taken to mean those activities which, although they do not appear in the official statistics, nevertheless represent the creation of added value for the purposes of national macro-economic accounting, even in the absence of any associated monetary transaction.

According to Friedrich Schneider (2004a), “underground” economic activities can be divided into the following categories:

- Illegal activities associated with monetary transactions: trading in stolen goods, drugs production and trading, prostitution and human trafficking, gambling, smuggling and fraud.
- Criminal activities without monetary transactions: barter trading in drugs, stolen and smuggled goods, the production or cultivation of drugs for personal use, theft for personal use.
- Legal activities which involve the evasion or avoidance of taxes and fiscal charges and which are associated with monetary transactions: non-declared income from self-employment, non-declared wages and salaries from employment related to the production of legal goods and services.
- Legal activities not associated with monetary transactions but which involve the evasion or avoidance of taxes: these include the barter trading of legal goods and services and “DIY” work, neighbourly assistance and honorary activities.

Underground economic activity does not include essential economic activities within a household (housekeeping, bringing up children, etc.).

A recently presented study produced by the European Union entitled “Undeclared Work in an Enlarged Union” defines “illegal working” as a significant part of the black economy as follows: “Productive activities that are lawful as regards their nature but are not declared to the public authorities...”. The same definition is adopted in this report.

Measurement and valuation methods

Direct and indirect measurement methods

Inherent in the very nature of the black economy in general (and illegal working in particular) is the fact that those involved have a strong incentive to conceal their activities or at least that there is no

particular interest in making public the economic details of the work they carry out. Herein lies the difficulty encountered in measuring the volume of the black economy. However, even black economy activities leave traces in various areas. These traces can be measured and analysed using both direct and indirect methods.

Surveys

Direct methods include surveys of those in employment, the unemployed and the economically inactive on black economy activities (in the context of statistical socio-economic surveys, for example). The results of these surveys can provide information on the ratio of “official” to “black economy” employment activity at individual and household level as well as on the distribution and concentration of illegal working in particular sectors and regions. The problem with surveys of this type lies in the fact that there is no way of verifying the actual extent of illegal working, the number of respondents refusing to provide information or the accuracy of the information provided.

Tax evasion surveys carried out by the tax authorities

Another “direct” method of measuring illegal working is tax evasion surveys carried out by the tax authorities. The random sampling of individual and corporate taxpayers reveals incomes higher than those declared in tax returns. The difference between actual and declared income can be used to draw conclusions as to the extent of the black economy activities of the individuals and businesses concerned. In certain countries the results of such random sampling are extrapolated to estimate the size of the black economy in relation to the national economy as a whole. However, since they are based on a random sample of identified instances of tax evasion, they represent no more than a lower limit.

Comparison of income and expenditure

In addition to direct methods, there are also a number of indirect measurement methods which can be used to measure activity in the black economy. For example, the difference between “consumption plus investment” as calculated in the national accounting system and “income received” can also be used as a measure of the size of the black economy. (The national accounting system combines expenditure on goods and services. Income received shows the distribution of national income amongst private households, businesses and the public sector on the basis of tax statistics.) Here, however, it is important to take into account measurement errors and differences in collection methods and periods.

Measurement of currency in circulation

An important characteristic of black economy activities lies in the fact that those involved wish to leave as few traces as possible. Monetary transactions are therefore made in cash since they leave no identifiable trail (as account movements and cheques would, for example). If, over the course of time, the amount of cash in circulation increases above a level deemed to be “normal”, this may indicate the existence of black economy activity.

Today the currency method is used in almost all OECD countries and provides entirely plausible results. It operates as follows: Firstly, currency in circulation is estimated, holding constant those factors which are seen as the causes of the black economy (e.g. tax burden). The difference between theoretically determined and actually observed currency holdings is then multiplied by the currency circulation rate to determine the extent of the creation of added value in the black economy. When evaluating this method it is important to consider the fact that, on the one hand, it is based on a uniform money circulation rate in both the official and the black economy and, on the other, that it does not take into account cash held abroad (illegal money).

Other monetary methods of measuring black economy activities are based on the number of large denomination bank notes in circulation, total transaction values and the factors determining currency demand (interest rate, income, currency substitutes).

Energy consumption as a source of information

Yet another method of valuation is based on the fact that changes in the consumption of electricity can be used to draw conclusions about black economy activities. Based on the assumption that there is an almost constant ratio between GDP and electricity consumption, short-term changes in the two values can be used to draw conclusions as to changes in the black economy. When using this method of estimation, however, it is important to take into account the fact that not all activities associated with the black economy involve significant electricity consumption (personal services, for example) and that technical progress can lead to a change in the ratio between electricity consumption and GDP. Moreover, this ratio is also effected by changes in energy costs.

Complex models for estimating “unobservable variables”

The 1980s saw the development for the first time of complex models which treat the scale of the black economy as a non-observable variable. This is charted using indicator variables which depend on various factors. These factors include the burden of direct and indirect taxation, other fiscal (social insurance, for example) and public charges, restrictions enshrined in legislation and standards and available income. The indicator variables include growth in

GNP, labour force participation, hours actually worked, etc.

None of the measurement and valuation methods detailed above furnishes exact data on the extent of the black economy. However, particularly when several methods are used in combination, they do provide a certain indication as to the approximate size and the development of the black economy over the course of time.

The scope of the black economy in Austria

Continual expansion of the black economy

The black economy in Austria has increased continuously over the last 25 years. Whereas in the 1970s the value of “undeclared work” in Austria stood at less than 1,000 million euro, according to Friedrich Schneider’s estimate obtained using the currency method, in 2004 the black economy in Austria is worth some 23,100 million euro or approximately 11% of “official” GDP (see Table 1). This puts the size of the black economy in relation to official GDP below that of Germany (16.7%), but above that of Switzerland (9.4%).

Table 1: Size of the black economy in Austria 1975 to 2004 calculated using the currency method

Year	Size of the black economy	
	1000 million euro	% of official GDP
1975	0.9	2.04
1980	2.0	2.69
1985	3.9	3.92
1990	7.2	5.47
1995	12.4	7.32
1996	14.6	8.32
1997	16.0	8.93
1998	16.9	9.09
1999	18.2	9.56
2000	19.8	10.07
2001	21.1	10.52
2002	21.8	10.69
2003 ¹	22.5	10.86
2004 ¹	23.1	11.00

¹ Estimate/forecast

Source: Friedrich Schneider. 2004a.

Sectors with a high level of black economy activity

A sector by sector analysis shows clear focuses of black economy activity. More than one third of black economy activity takes place

Table 2: Division of the black economy into economic sectors 2004

Sectors	Division of the black economy	
	1000 million euro	percentage
Building trade and craft businesses (incl. repairs)	9.0	39.0
Other trade and industrial sectors (motor vehicles, machinery)	3.7	16.0
Service businesses (hotels, restaurants, etc.)	3.7	16.0
Entertainment and leisure sector	2.8	12.0
Other trades and services (private tuition, hairdressing, babysitting, etc.)	3.9	17.0
Total black economy	23.1	100%

Source: Friedrich Schneider 2004a.

in the building and building-related trades and craft businesses. Approximately one sixth takes place in the manufacturing, tourism and personal services sectors and one eighth in the entertainment and leisure industry. This distribution by sector corresponds largely to that encountered in any other European country (Germany, for example).

Within the “building trade and craft businesses” category, the building trade accounts for almost nine tenths of activity (3,700 million euro turnover in the building trade, 2,700 million euro in the building-related trade, 1,400 million euro in craft businesses in the building industry). The remaining 13% relate to the repair of electrical and domestic appliances.

Table 3: Division of the black economy in the building trade and craft businesses 2004

Sectors	Division of the black economy	
	1000 million euro	percentage
Building trade	3.7	41%
Building-related trade	2.7	30%
Craft businesses in the building industry	1.4	16%
Other repairs (televisions, electrical appliances, domestic appliances)	1.2	13%
Total building trade and craft businesses (incl. repairs)	9.0	100%

Source: Friedrich Schneider 2004a.

Workers in the black economy

The black economy employs a considerable share of the potential labour force available in Austria. If the volume of work carried out in the black economy is converted into units equivalent to a full-time job, the model calculations developed by the University of Linz show, firstly, that between 1995 and 2004 the number of “full-time illegal workers” active in Austria rose from some 575,000 to almost 789,000. Further, during the same period, the ratio of this figure to the total volume of paid work performed in Austria also increased from some 14% to almost 18%.

This figure for “full-time domestic illegal workers “ is purely fictitious. In actual fact, the volume of employment performed in the black economy is distributed over an ever greater number of individuals who vary greatly in their relationship to the labour market. The section of the population active in the black economy is very varied and comprises the following groups:

Fully integrated employees (i.e. those working full-time and paying full social security contributions) who perform their black economy activities as a sideline to their main jobs.

Self-employed individuals who perform part of their business activity as undisclosed paid employment in order to avoid paying tax and social security contributions.

Unemployed people for whom income from the black economy activities plays a significant part in achieving an acceptable standard of living.

Those not in gainful employment (students, housewives, those having taken early retirement and pensioners) who are flexible in terms of time and for whom illegal working is often the only source of income (except for social security benefits).

Foreign nationals and those present illegally in Austria for whom black economy activities are often the only access to paid employment.

During the same period, the number of foreigners employed illegally (in black economy activities) increased from 75,000 to some 114,000. This corresponds to approximately one fifth of working foreigners in Austria. This percentage increased continuously until 2000 since when it has fallen slightly.

Causes and consequences of the black economy

The causes of the consistently high level of black economy activity can be found, on the one hand, in the burden of taxes and fiscal charges, particularly in relation to the work factor and, on the other, in the inability of the labour market to absorb the potential workforce. Further causes of the shift from the “official” economy to the black economy include the over-regulation of the economy and the labour market (through trade and industry and employment legislation, etc.) and the social security system which creates negative incentives in relation to disclosed employment.

In addition to these factors, the European Commission has also

Table 4: Development of illegal working in Austria

Year	Officially working population	Equivalent full-time illegal workers	Percentage of officially working population	Officially working foreigners	Illegally employed foreigners	Percentage of officially working foreigners
1995	4,064,000	575,000	14.15	395,000	75,000	18.99
1996	4,074,100	617,000	15.14	401,900	83,000	20.65
1997	4,107,100	623,000	15.17	411,100	86,000	20.92
1998	4,190,500	634,000	15.13	423,400	89,000	21.02
1999	4,243,100	667,000	15.72	441,100	93,000	21.08
2000	4,286,400	703,000	16.40	468,200	99,000	21.14
2001	4,315,700	734,000	17.01	494,500	104,000	21.03
2002	4,344,500	746,000	17.17	518,000	109,000	21.04
2003 ¹	4,381,800	769,000	17.55	547,200	112,000	20.47
2004 ¹	4,420,000	789,000	17.85	580,000	114,000	19.66

¹ Estimate/forecast

Source: Equivalent full-time illegal workers and illegally employed foreigners: Friedrich Schneider 2004a. Officially working population and officially working foreigners: Monika Kalmár et al. 2004.

cited the small-scale structure of businesses and low levels of competitiveness in certain sectors of the economy as possible causes of the black economy. In locations dominated by a few large businesses the black economy plays a minimal role. However, the more strongly local economies are characterised by a number of small businesses, the more common is undisclosed employment, generally in the form of illegal working organised by the businesses themselves rather than individual (self-employed) illegal working. In sectors with stagnant or declining growth patterns, the undisclosed employment of workers is seen as an essential method of cost-cutting without which businesses believe they would be unable to compete in the marketplace.

The consequences of undisclosed employment can be sub-divided into individual consequences and consequences for the economy and the public authorities. Individuals working in the black economy are not insured against accident and illness, nor do they contribute to a pension fund during periods of undisclosed activity. Any illness-related costs must be borne by the illegal workers themselves unless they are performing their black economy activities as a sideline alongside disclosed employment or are insured with their spouse/parents. In principle, accident-related costs incurred while working illegally are not covered by general accident insurance and, during periods of illegal working, no contributions are made towards the general Austrian state pension ("ASVG" pension).

These contributions are lost to the public purse along with the wage and income tax contributions and wage-related employers' contributions evaded during illegal working. At the same time, some individuals working in the black economy are also claiming social security benefits which have to be financed by the public authorities (and thus from the taxes and fiscal charges paid in the official economy). Thus a rise in illegal working can increase levels of tax and fiscal charges.

Measures to combat the black economy

In principle there are two groups of measures for combating the black economy:

- Audit measures designed to identify individuals and businesses working in the black economy and the application of punitive measures;
- Measure designed to prevent the black economy.

The work programme of the Austrian Government sets out the protection of Austria as an economic location and the creation of jobs as particular focus points. In implementing this programme, on 30 September 2003 the Council of Ministers passed an action plan for the concerted combating of fraud which puts particular emphasis on combating illegal work, illegal earnings and illegally operating businesses. In this context the Federal Ministry for Finances has recently implemented a series of concrete measures.

"Reverse charge" systems

The "reverse charge" system has been introduced in the administration of value added tax. This means that in a chain of businesses only the primary contractor is entitled to deduct input tax. This method is designed to prevent sub-contractors from claiming back input tax from the tax authorities without having paid VAT and then ceasing trading or filing for bankruptcy.

Audit measures

A number of auditing bodies have been introduced to combat the black economy at operational level. The Audit Office for the Illegal Employment of Foreign Nationals (*KIAB = Kontrolle illegaler Ausländerbeschäftigung*) has been operating within the Federal Ministry for Finances since 1 July 2002 and is part of the customs administration. On the basis of the Austrian Employment of Foreign Nationals Law (AuslBG) and the 2003 Budget Implementation Law (BBG) just under 200 agencies have been set up to carry out inspections in businesses and on building sites. These audits focus mainly on firms operating in the building trade, the restaurant and hotel trade and the haulage business and on service businesses of all types on the basis of previous investigations of illegal workers by themselves or other agencies.

In 2003 the KIAB carried out over 21,000 inspections designed to combat illegal working, identifying just under 5,700 illegal workers. In total, more than 3,500 notices were served on business owners. In 2003 over 9 million euro worth of penalties were imposed by the administrative authorities.

In this area the KIAB works in co-operation with the Vienna Rapid Intervention Squad for the Building Trade (*SEG = schnelle Eingreiftruppe Wien-Bau*), which deals primarily with tax fraud, carrying out inspections on site while projects are under way. Thus it is possible to take action against outstanding debts owed by questionable firms to primary contractors by means of execution

Table 5: Audits carried out under the Employment of Foreign Nationals Law (AuslBG), notices served and illegal workers identified by *Bundesland*

<i>Bundesland</i>	Inspections under AuslBG		Notices		Illegal workers	
	Jan-Jun 2003	Jul-Dec 2003	Jan-Jun 2003	Jul-Dec 2003	Jan-Jun 2003	Jul-Dec 2003
Burgenland	1,416	1,606	81	92	154	139
Kärnten	871	1,000	136	199	159	391
Niederösterreich	1,971	2,645	188	319	352	543
Oberösterreich	1,092	1,284	148	161	233	268
Salzburg	422	502	150	133	164	185
Steiermark	1,217	1,194	299	317	444	513
Tirol	661	1,033	107	103	169	171
Vorarlberg	204	178	68	68	103	141
Vienna	2,320	1,524	570	449	863	698
Austria	10,174	10,966	1,747	1,841	2,641	3,049

Source: Federal Ministry for Finances

before these firms are wound up and disappear. In 2003 some 5.2 million euro in turnover tax and 9.9 million euro in wage tax were ordered to be paid and 32.1 million euro worth of debts were attached. Instead of paying these sums to sub-contractors, general contractors must pay them over to the tax authorities.

About one third of the notices served in the course of KIAB inspections relate to businesses in the building and building-related trades. Just under 40% of illegal employees are employed in firms in these sectors. A further third of notices affect restaurant and hotel businesses which were also responsible for one quarter of illegal workers. Approximately one in ten notices is served on firms in the services sector and one tenth of illegal workers are employed in this industry.

Table 6: Notices served and illegal workers identified by economic sector 2003

Economic sector	Notices	Percentage	Illegal workers	Percentage
Building trade	604	17.21%	1,186	20.94%
Building-related trade	562	16.02%	988	17.44%
Restaurants and hotels	1,097	31.26%	1,461	25.79%
Transport	177	5.04%	190	3.35%
Farming and forestry	209	5.96%	414	7.31%
Service industries	316	9.01%	593	10.47%
Industry	100	2.85%	166	2.93%
Others	444	12.65%	667	11.77%
Total	3,509	100%	5,665	100%

Source: Federal Ministry for Finances

An “Anti-Black Economy Action Day” was held on 22 June 2004 as part of which an army of inspection teams was deployed across the whole of Austria involving a total of 875 officials from the tax authority, the KIAB and the tax investigation office. They audited 1,958 businesses, visited 592 building sites and checked 2,875 workers. In so doing they identified 34 illegal firms, discovered 135 unofficially employed workers and served attachment orders worth 7.2 million euro. The additional costs of the action day were between 150,000 and 200,000 euro.

By strengthening auditing and prosecuting activities, the Federal Ministry for Finances hopes to achieve not only a better success rate in combating illegal working, but also an improvement in attitudes to tax and a deterrent effect on potential illegal companies and workers.

Preventive measures and options

In addition to proper auditing procedures and the implementation of the relevant legislation, reducing levels of illegal working and transferring black economy activities into the regulated economy also requires a range of other measures and strategies. These measures and strategies may cover:

- the tax system,
- the labour market,
- systems for regulating the economy,
- social security systems,

- the integration of foreign nationals,
- information and awareness-raising amongst the population.

(Excessively) high rates of tax and fiscal charges are cited as a significant cause of the occurrence of black economy activities. For this reason, the “Communications of the European Commission on Undisclosed Employment” include a call to reduce VAT rates for work-intensive services and a call for lower taxation on employment both in terms of costs to employers (non-wage costs) and in relation to the available income of the individual employees. In particular, the Austrian Government is planning a reform of the wage and income tax system and a reduction in non-wage costs as part of its work programme.

In terms of the labour market, the options range from a call for employment legislation to be tailored to the development of new forms of working to the creation of incentive systems designed to bring black economy jobs into the regulated employment market for particular services which are relevant and desirable in terms of social policy. With this in mind, some EU Member States have introduced service credit notes or cheques which can be used to pay for private services (such as housekeeping, cleaning, childcare, etc.) in particular, and which guarantee a basic level of social security for the individuals carrying on these activities without noticeably increasing the costs to the individual employers.

In the countries of northern Europe, on the other hand, tax reductions and allowances for certain services have been introduced in order to encourage households to officially register the individuals they employ. Although measures of this type have been mooted on numerous occasions in Austria by both experts and politicians (in particular employee-elected representatives), no draft laws or bills have as yet been tabled. Over recent years, however, Austria has made the inclusion of as many different (and unusual) types of employment as possible the focus of its social policy in the social security system. For example, free contracts of services and the “new self-employed” as well as marginal employment have been integrated into the social security system.

The restructuring of the supply side in certain sectors and the resulting profiling of occupations can lead to the transfer of black economy activity into the regulated economy. For example, the expansion of the network of public childcare establishments in some countries has led to the elimination of almost all illegal working in this sector. In the 1990s Austria itself elected to follow this route (albeit for different motives) for nursery education funding, childcare allowances, etc., although it then failed to pursue it in the course of budgetary consolidation.

An important area of the fight against illegal working deals with measures relating to foreign nationals. Many individuals who have no or limited access to the Austrian labour market due to their nationality feel obliged to finance their basic needs through black economy activities. Since the last major influx of immigration at the end of the 1980s and start of the 1990s, Austria has severely restricted access into the country by limiting it to certain groups.

Although certain groups of potential workers of non-Austrian nationality have been granted unrestricted access to the Austrian labour market since its accession to the European Union in 1995, access for those from the major source countries of growth in cross-border labour supply (Turkey, Bosnia Herzegovina, Croatia, Serbia as well as its eastern neighbours and Poland) is still only possible through employment authorisations, work permits or exemption certificates.

Even after EU enlargement, thanks to the transitional provisions

negotiated by Austria, states such as the Czech Republic, the Slovakian Republic, Slovenia and Poland do not yet enjoy the same unrestricted rights as individuals from the original 15 EU Member States. Over the next few years, however, during which these restrictions will gradually fall away, legal employment opportunities will open up for individuals from the enlargement states, in particular, who are currently working illegally in the black economy in Austria.

In addition, the burden of taxes and fiscal duties and the lack of flexibility in employment law, over-regulation in the field of trade and industry law and high levels of bureaucracy in relation to company start-ups are cited as further causes of the level of activity in the black economy. Austria is endeavouring to respond to this argument by simplifying trade and industry law and the administrative procedures involved in company start-ups. Were it successful in transferring areas of the black economy into the official economy in this manner, it would be able to achieve several economic goals at once, including an increase in the number of self-employed workers, the promotion of company start-ups as one of the prime producers of employment growth, and an increase in the official creation of added value and thus in direct and indirect tax revenue.

However, none of these measures will really begin to take effect until the players involved (both businesses and individuals) have been convinced that undisclosed work is not only unfair and anti-social because it damages the public sector (and legal businesses and workers via the tax system), but also disadvantageous to those working in the black economy (stringent penalties, lack of social protection, no employees' rights). Finally, it is also necessary to inform consumers of black economy goods and services that using illegal work and illegal workers represents a considerable risk since there is no possible recourse in the event of damages and no insurance protection against burglary and damage to property when using unregistered illegal businesses. The Austrian executive has failed to take any significant action in this area thus far. However, there has been an apparent increase in information activities by the social partners over recent months.

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Poland

Introduction

Until 1989, the informal economy¹ in Poland – understood as economic activity carried on outside what was permitted by the communist state, without the benefit of registration and of taxation – had a different character to that experienced in market economies, mainly because of the small number of private enterprises. Private enterprises were limited to handicrafts/small manufacturing workshops and privately-run farming operations. The State kept a firm hand on all forms of employment, and the space in which an informal economy could develop was limited. Individual households, which constituted the principal entity in the informal economy, turned to this economy to supplement their incomes and to secure goods and services that were hard to come by in the official, State-planned market. Other instances of the informal economy included the under-reporting of production in workshops, the non-registration of those workshops, speculation on goods, and the private importation of goods from abroad for resale in Poland, an underground currency market and corruption. All of these activities can be seen to have underpinned the official economy of Poland during the communist period to some extent.²

From 1990 onwards, the “grey economy” in Poland began to change. More “parasitical forms” of economic activity (such as profiteering on the basis of the scarcity of basic consumer goods) and activities contravening the basic economic order (e.g. the parallel foreign exchange market) were dramatically reduced, as they did not fulfil a purpose within the market economy.³ However, with the arrival of private enterprise, new forms of informal economic activities began to emerge, such as the avoidance of registration of employees, the non-declaration of turnover, and tax evasion.

Some commentators point to certain positive aspects of the informal economy during the early stages of economic transformation, suggesting that it provided a safety margin in difficult times.⁴ For many small and medium-sized enterprises established in the early 1990s, resorting to the informal economy was the only chance for sustained growth under conditions of runaway inflation and the dramatic reorganisation of the fiscal system. The informal economy enabled them to reduce expenses and to accumulate capital. Employment in the informal economy, meanwhile, compensated for the falling demand for labour, the emergence of unemployment as a major economic and social problem, and falling incomes in the official economy occasioned by the transformation recession. As the scale of their operations grew, many of these companies “came clean”, formalising all aspects of their business.

Prevalence of undeclared work in the economy

Proportion of undeclared work in the economy

The value of the informal economy as a proportion of the overall Polish economic output continues to be high, although the Central Statistical Office for Poland (GUS) estimates that it is gradually shrinking. According to estimates recently verified by GUS, the informal economy accounted for 14.5% of Polish GDP in 1999, 14.3% in 2000, 14.1% in 2001, and 13.4% in 2002.⁵ The pecuniary value of informal economy output in 2001 grew to 107.2 billion PLN (26.7 billion euro), making for a 3.6% increase since 2000. In 2002, meanwhile, informal economy output shrank to 104.6 billion PLN (26.1 billion euro).

Schneider, an informal economy expert from the University of Linz, estimates the value of the informal economy as a percentage of overall output at a considerably higher level, although he agrees that it is on the decline. According to Schneider, the average involvement of the informal economy in overall Polish GDP averaged 27.4% in 2000-2001, down to 26.3% in 2003 and to a projected 25.1% of GDP in 2004.

A study carried out amongst enterprises by the Polish Confederation of Private Employers in 2003 has likewise pointed to a fall in turnovers and employment in the informal economy. Survey respondents estimated that companies concealed an average 17.4% of their revenues from the tax authorities in 2003 and hired 15.4% of their workforce outside the official system. The same figures for 2002 were: 20.2% of revenue unreported and 18.6% of personnel working unofficially.

Some experts, however, point out that state claims on income in Poland have not decreased, and it is this high cost of labour that constitutes the most important contributing factor behind undeclared work.⁶ Such experts also point out that Poland has been experiencing an increase in the amount of cash in circulation to the tune of 14 to 16% every year; while cash transactions account for a negligible proportion of turnovers in the official banking systems, they predominate in the informal economy.

The estimates of the importance of the informal economy within the national accounts drawn up by GUS comply with the methodology set out in the European System of Accounts 1995. These only take into account hidden production, not illegal production.

The category of hidden production comprises the manufacture of products or provision of services which, while not proscribed by the law, are concealed in whole or in part from the State authorities (fiscal, customs, social insurance, and statistical).

¹ In Poland the term “grey economy” is commonly used in the meaning of “informal economy”.

² M. Bednarski, *Drugi obieg gospodarczy w Polsce. Kontynuacja czy zmiana?*, “Kultura i Społeczeństwo”, 1991, no 3.

³ *Ibidem*.

⁴ K. Kloc, *Szara strefa w Polsce w okresie transformacji*, Raporty CASE, Warsaw 1998.

⁵ Data adjusted by GUS, data of F. Schneider and PKPP cited after A. B?aszczak, *Powolne wychodzenie z cienia*, “Rzeczpospolita”, June 17 2004.

⁶ *Ibidem*

GUS discerns between two sub-categories of hidden production:

- Under-reporting of production, turnovers, etc., by registered economic entities;
- Unregistered economic activity pursued on a self-employment basis.

Estimates of the impact of the informal economy on overall Polish GDP suggest that, in the years 2000-2001, the largest component of informal economy consisted of commercial activity pursued by registered economic entities that did not declare their entire turnover on their tax returns. These entities accounted for roughly 10% of GDP in Poland. The greatest levels of undeclared activity occurred in businesses operating in the commercial, construction, real estate and company service fields.

Table 1: Estimated share of the informal economy in GDP, 2000-2001 (current prices)⁸

	2000	2001
	%	
Gross domestic product (without informal economy)	100.0	100.0
Gross domestic product (with informal economy)	114.6	114.3
Combined share of informal economy:	14.6	14.3
– In registered entities	10.6	10.4
– Unregistered work	4.0	3.9
Industry	1.3	1.2
Construction	2.5	2.4
Commerce; hotels and restaurants	6.2	7.2
Transport, warehouses, communications	0.9	0.4
Services for real estate and companies	2.2	2.0
Other categories	1.5	1.1

Source: National Accounts by Institutional Sectors and Sub-sectors 2000-2001, GUS, Warsaw, 2003, p. 348.

Undeclared work definitions and measures applied by the Central Statistical Office for Poland (GUS)

GUS makes use of two methods for estimating the number of people working in the informal economy, relying on three sources of information:

- Surveys of economic activity among the population (BAEL – Polish equivalent of the LFS);
- Statistics of employed persons – drawn up on the basis of records maintained by employers;
- Registered unemployment data – obtained from the State labour offices.

The method applied by GUS to gauge employment in the informal economy is based on disparity analysis. The possibility for using disparity analysis was first recognised when the BAEL – LFS survey results became known. The first round of such research was executed in Poland in May of 1992 and, since that time, BAEL studies have been carried out once every quarter.

According to GUS estimates, there were 805,000 people working in

Table 2: Total employment and estimates of unregistered employment, 1995-2002

Year	Employment (BAEL), in 000s	Estimated unregistered employment, in 000s
1995	15,486	805
1996	15,842	850
1997	16,295	870
1998	16,267	830
1999	16,009	820
2000	15,489	885
2001	14,996	895
2002*	14,924	910

* Data adjusted after the National Population and Housing Census 2002.

Source: Roczniki Statystyczne 1996-2003, GUS.

Poland's informal economy in 1995 and 910,000 people in 2002. These figures capture only those individuals for whom undeclared work constitutes their principal source of income. The number of persons employed in the informal economy began to increase as of 2000, when employment in the official economy began to lag (Table 2).

In order to fine-tune their data, GUS undertook a further two questionnaire-based surveys exclusively focused on undeclared work and incomes in 1995 and 1998⁹. Each survey extended to some 11,000 households. Another edition of this study is planned for later on in 2004.

In the surveys, GUS distinguished between work in the informal economy which constitutes the worker's main source of support and work which augments other, legal income. This survey presented the first occasion when information was solicited from:

- Informal economy workers (supply of labour), with information gathered directly from persons who declared involvement in unregistered work in the year of the study;
- Employers relying on unregistered work (demand for undeclared work); households and persons pursuing business activity (private companies) were asked about their utilisation of unofficial labour (also provided by foreigners).

According to the results of this study, more than half of the people working in the informal economy viewed this as a secondary source of income (56.7% of workers in 1995, 53.7% in 1998), (Table 3).

Employment in the informal economy as a principal source of income was more prevalent among young people aged up to 24 (64.5% in 1995, 61.6% in 1998) and among persons aged 60 and above, and also among the less educated. The jobs in question were low skilled, many consisting of simple manual labour.

Employment in the informal economy as a secondary/additional source of income, meanwhile, was more frequent among respondents aged 25 to 59. In terms of education, the most significant groups working in the informal economy to supplement official incomes consisted of workers educated to post-secondary and higher level (83.6% in 1995, 74.1% in 1998).

The most significant sectors involved in undeclared work were: gardening and agricultural work (24.7% in 1995, 20.3% in 1998),

⁸ Estimates of the scale of Poland's grey economy before the verification carried out by GUS in 2004.

⁹ The data cited below is derived from GUS: M. Kałaska, J. Witkowski, S. Kostrubiec, *Praca nierejestrowana w Polsce 1995*, GUS, Warsaw 1996; *Praca nierejestrowana w Polsce 1998*, S. Kostrubiec (ed.), GUS, Warsaw 1999.

Table 3: Numbers and percentages of workers relying on the informal economy for their principal income and for additional income, 1995 and 1998.

	Principal		Additional	
	1995	1998	1995	1998
In 000s	880	662	1,154	769
In %	43.3	46.3	56.7	53.7
Age:				
To 24	64.5	61.6	35.5	38.4
25-34	36.0	41.2	64.0	58.8
35-44	37.3	37.3	62.7	62.7
45-59	36.3	43.1	63.7	56.9
60 and above	45.7	56.5	54.3	43.5
Education:				
Elementary, incomplete elementary	51.0	59.3	49.0	40.7
Basic vocational	43.2	41.0	56.8	59.0
Secondary	40.0	42.3	60.0	57.7
Post-secondary, higher	16.4	25.9	83.6	74.1

Source: Summary on the basis of the GUS publication *Praca nierejestrowana w Polsce 1995, Praca nierejestrowana w Polsce 1998*, after M. Kabaj, *Zatrudnienie w "szarej strefie" w polskiej gospodarce. Fakty, tendencje, mity i nieporozumienia*, "Polityka Społeczna", no 1, 2004

what are known as "neighbourly services" (13.0% and 17.3%), construction and installation services (14.1% and 15.9%), and refurbishment and repair work (11.3% and 14.5%), (Table 4).

Some categories of work primarily involved men (construction and installation work, gardening and agricultural work, refurbishment and repairs, and odd jobs done on a neighbour-to-neighbour basis) while others were more typical for women (gardening and agriculture, in babysitting and care jobs, in garment production and repair, in commerce, and in "neighbourly services").

Clearly, the various categories of work performed in the informal economy required different qualifications and skills. The largest, most frequent category of undeclared work consists of simple tasks that could be competently handled by unskilled workers or by people with rudimentary skills. Persons educated to higher or post-secondary level engaging in undeclared work, meanwhile, were most likely to offer private home lessons, for instance to secondary school pupils preparing for university entry examinations. Some better-educated unregistered workers also worked in narrowly specialised capacities, such as legal or accountancy services or translations.

The largest category of undeclared worker employers in Poland for the year 1998 was comprised of private individuals (68.9%). Privately owned businesses came a low second at 16.8%, and the third largest category consisted of persons working on their own account, usually involved in additional work rather than the principal source of income (12.6%). Work in State-owned enterprises or in community/co-operative entities accounted for a mere 1.7% of undeclared work

It should be noted here that the largest category of enterprises in

Table 4: Informal economy workers, subdivided by type of work, gender, and education (as a percentage of all informal economy workers).

Type of work	1995	1998	By gender, by educational level (1998)					
			Men	Women	Higher, post-secondary	Secondary vocational and general	Basic vocational	Elementary, incomplete elementary
Commerce	8.2	5.8	2.9	12.6	2.5	8.7	5.0	5.3
Construction and installation services	14.1	15.9	22.4	0.7	6.2	9.4	17.1	19.9
Refurbishment and repairs	11.3	14.5	20.5	0.7	8.6	9.1	19.8	12.3
Vehicle maintenance and repairs	6.3	5.3	7.6	-	-	5.7	7.7	2.8
Transport services	5.2	5.2	7.1	0.7	7.4	4.7	5.2	5.0
Electronic equipment repairs	1.6	1.2	1.7	-	-	3.4	1.0	0.2
Medical and nursing services	2.3	1.4	0.1	4.4	7.4	4.0	-	0.4
Hairdressing and beauty services	1.1	0.7	0.1	1.9	-	0.3	1.3	-
Tourism and catering services	1.9	2.5	1.1	5.8	1.2	2.0	3.2	2.0
Accountancy and legal advice	1.1	1.3	0.6	3.0	8.6	4.0	-	-
Private lessons	3.8	3.2	1.8	6.5	34.6	4.4	0.2	0.9
Translations	0.3	0.1	-	0.2	1.2	-	-	-
Garment production and repairs	6.9	4.4	0.4	13.7	3.7	4.4	4.9	3.9
Household work	3.1	3.8	1.2	9.8	2.5	3.4	2.4	6.1
Care for children, for the elderly	4.3	4.5	0.2	14.4	3.7	5.7	2.9	6.1
Security – guarding property	0.7	0.6	0.8	0.2	-	0.7	0.3	0.9
Gardening and agricultural work	24.7	20.3	22.2	15.6	3.7	15.1	19.5	27.5
Production activity	3.1	3.3	2.6	4.9	-	5.4	3.4	2.4
Neighbourly services	13.0	17.3	19.5	12.3	4.2	16.4	20.3	16.0
Other work	2.7	3.2	3.9	2.5	7.4	5.0	1.3	3.7

Source: Summary on the basis of the GUS publications *Praca nierejestrowana w Polsce 1995, Praca nierejestrowana w Polsce 1998*.

Poland consists of “micro-enterprises” employing up to nine people, which account for 95% of Polish companies.¹⁰

The typical “micro-enterprise” is active in the field of commerce, transport, construction, or of services for real estate and for companies. The “micro-enterprises” provide jobs for between 3.2 and 3.5 million people, i.e. to 20% of all people working in the Polish economy. They are particularly vulnerable to shifts in the business climate, and they often have difficulty adapting to changes in the law.

Asked about the reasons for which they took up work outside Poland’s legal economy, most of the respondents cited the low incomes offered by official employers, lack of jobs, and the high labour costs exacted by Polish payroll taxes and by social insurance contributions, (Table 5).

Table 5: Opinions of undeclared workers concerning reasons why undeclared work is taken up.

	1995	1998
Insufficient income from official work	65.6	59.0
Impossibility of finding jobs	42.1	47.2
Excessive taxes	25.9	23.8
Undeclared work offers higher remuneration	18.4	22.2
High social insurance contributions	16.0	17.4
Fear of losing benefits (e.g. unemployment benefits)	9.0	7.8
Family circumstances, other predicaments	7.4	6.5
Unwillingness to commit oneself to a single place of work	1.9	2.0
Other	0.2	0.4

Source: Summary on the basis of the GUS publications *Praca nierejestrowana w Polsce 1995*, *Praca nierejestrowana w Polsce 1998*.

GUS has suggested that work in the informal economy is often of an ad hoc temporary nature rather than being part of a lifetime career path. People resorted to the informal economy because they had no job offers from the official economy or because they needed additional income to support their families. However, it should be noted that, during the periods in question, estimated wages in the informal economy were substantially lower than average remunerations in the national economy.

Household income studies, questionnaire-based surveys

Drawing on household budget studies as a basis, GUS has analysed the break-down of household incomes, expenditures and savings over the years 1998 and 1999, with informal economy earnings factored in.¹¹ The authors formulated a hypothesis to the effect that undeclared incomes occur most frequently in households whose heads engage in occupations conducive to undeclared work. These households are most likely to be those where expenditures exceed their income. The greatest probability of falling into this category arose for households whose heads belonged to the following vocational groups:

- Specialists in the natural sciences and in healthcare (49%¹²);
- Mid-level agricultural and healthcare personnel, vocational teachers and instructors (45%);
- Farmers, gardeners, foresters, and fishermen (44%);
- Office/secretarial staff (42%);
- Cash handling and customer service personnel (41%);
- Teachers, personal services and security workers (40%).

For the most part, these jobs do not attract high remunerations in Poland, but they do create possibilities of securing undeclared income; a teacher, for instance, may offer private home lessons, nurses may keep watch over bed-ridden patients at home or after hours at the hospital in consideration for money paid by the patient’s family. This group also includes farming households. Under the Polish tax laws, farmers are exempted from the personal income tax as paid by other workers.

Various polling and public opinion survey institutions in Poland also address the issue of undeclared work on a more or less regular basis. For example, a survey carried out for the “Rzeczpospolita” Daily by PBS (April 17-18, 2004) indicated that, in the space of the past 12 months, 12% of Poles had derived some manner of income from the informal economy. The greatest number of admissions to undeclared work came from the unemployed (27%), from young people aged 18 to 24 (27%), commerce workers and unskilled labourers (20%), and from employees of private companies (18%). As regards the geographic spread, undeclared work was most prevalent in the voivodships of Pomerania (27%) and Małopolska (19%) (along Poland’s coast and close to Cracow, respectively). The lowest incidence of undeclared work, meanwhile, was noted in the voivodship of Wielkopolska (2.3%).

Another survey from April 2004, by CBOS indicated that, according to 55% of the respondents, the existence of the informal economy contributes to the continuing high unemployment rate in Poland¹³. 27% of the respondents believed that pervasive unemployment pushes encourages people to take up undeclared jobs without insurance or welfare entitlements.

Taken together, the results of various surveys show some ambivalence towards undeclared work. While many Poles regard the “grey economy” as one of the causes for high joblessness in Poland, there are also many people who view undeclared work as the last resort under circumstances where no legal jobs are available.

Reasons behind involvement in the informal economy

Employment in the informal economy is encouraged by the dearth of vacancies and by the lack of a safety net for the jobless (only 15% of unemployed persons in Poland receive unemployment benefits). Such aid as is available from the social assistance system also has a limited and selective character.

It would seem that most of the adaptation strategies which generate undeclared work, in general, are observable in the Polish setting. The low level of social security and the rudimentary welfare state structure result in high incidence of the “survival” strategy.¹⁴ This is readily noticeable in the form of unregistered retail trade pursued on a large scale in the streets of Polish cities, along rural roads, and in open-air markets – often on a distinctly seasonal basis. Such commercial activity was particularly prevalent at the outset of

¹⁰ *Entrepreneurship in Poland 2004*, MGİP, Warsaw 2004.

¹¹ I. Kudrycka, M. Radziukiewicz, *Rozkłady dochodów, wydatków i oszczędności z uwzględnieniem dochodów z szarej strefy*, zeszyt 278, GUS, Warsaw 2001.

¹² Probability that a household will qualify in Group I, composed of those households whose expenditures exceeded their income.

¹³ *Polacy o rynku pracy oraz o przyczynach i skutkach bezrobocia*, CBOS, BS/68/2004, www.cbos.pl.

¹⁴ Strategy typology adopted from: A. Portes, *The Informal Economy and Its Paradoxes*, [in] N.J. Smelser, R. Swedberg (eds.), *The Handbook of Economic Sociology*, Princeton, New Jersey 1994.

Polish reforms, when it was viewed in terms of an “eruption of unleashed entrepreneurship”, but structural unemployment has caused it to continue on quite a large scale. This refers also to more “traditional” and widespread forms such as household oriented services.

The second strategy which leads Polish workers and enterprises out of the official economy and into the informal is that of “dependency exploitation”. The idea behind dependency exploitation is to seek savings and added management flexibility by subcontracting tasks to minor dependent subsidiaries and co-operating entities. Such smaller entities, given the modest scale of their operations, are less exposed to inspections, and they keep their own expenses low by unofficial hiring. In competition-intensive sectors such as construction, contracts are awarded through a bidding process, and price competitiveness is a critical issue (also ones bankrolled by the public sector). It should be noted in this context that the past few years have witnessed growing participation of small companies in the Polish economy.

The third “growth strategy” observable in Poland refers to the “parallel economy”, familiar from the communist period. This involves networks of small companies co-operating with one another and taking short cuts in order to pursue growth and the accumulation of capital which will enable them ultimately to enter the realm of official business and declared employment.

None of the strategies mentioned above is the exclusive purview of post-communist countries; they occur on a global scale, and in different social settings. An aspect which, perhaps, is unique for post-communist economies and transformation societies, however, is comprised in the element of accumulation – in the simultaneous occurrence of the various strategies in a single setting across a brief period of time.

Employment of foreigners in the informal economy

Reliable information concerning the undeclared employment of foreigners in Poland is difficult to come by. According to the GUS nomenclature, informal economy work by foreigners in Poland occurs when foreign nationals, who require work permits or similar documents, take up paid employment without completing the requisite paperwork. This includes the unofficial hiring of household help.

According to research by GUS, the scale of this phenomenon is comparatively modest.¹⁵ In 1998, only 0.6% of Polish households (approximately 8,000) admitted to retaining unregistered workers from abroad; 6 out of 10 such households were urban ones, and every fourth was a rural household. There were 18,000 foreigners working in Polish households in 1998, 13,000 of them in the cities.

The results of this particular study are clearly at odds with widespread perceptions as to the scale of the phenomenon.

Looking at the results of questionnaire-based surveys, employment in Polish households appears to be considerably larger. A CBOS survey involving a representative sample of 1,000 adult Poles carried out in 2001 indicates that 7.1% of households retained domestic help; in every tenth of these, the worker in question was foreign.¹⁶ This would mean that no less than 90,000 Polish households benefited from such services. As a norm, such work for households went unregistered and untaxed. The results of this survey point to a

high degree of tolerance and permissiveness for such practices.

According to the same survey, three quarters of the domestic workers held Ukrainian citizenship, every eighth had Belorussian citizenship, and every tenth was Russian; only one household worker in 30 hailed from a different country. Thus, Polish households usually hire help from the countries immediately to the east.

Measures taken to combat undeclared work

The business climate

All Polish employer organisations concur that there has been a steady deterioration in the general environment in which Polish entrepreneurs operate, placing barriers on the creation of legal jobs. According to Eurostat analysis of the development levels of European Union Member States, Poland is the second-poorest country in the EU after Latvia, with the average Pole earning a mere 46% of the EU average after enlargement.¹⁷ Polish companies also have to grapple with a legal and administrative environment less favourable than that taken for granted in other countries. According to World Bank estimates, the commencement of economic activity in Poland entails expenditures of US\$ 925 (718 euro) for the would-be entrepreneur. The typical business start-up cost in Slovakia, meanwhile, is US\$ 401 (311 euro), in Lithuania – US\$ 231 (179 euro), and in the United States US\$ 210 (163 euro).¹⁸

Evidence shows that Poland also experiences considerable problems relating to corruption. Surveys by GfK¹⁹ indicate that more than 90% of Poles believe that Poland is affected by widespread corruption, although 78% of the respondents state that they themselves have never offered a bribe. Only 15% of Poles declares that, were they to witness a bribe changing hands, they would report this fact to the police.

Poland has in recent years experienced a curtailing of economic freedom according to a survey by the Heritage Foundation. It is hoped that a new legislative Act regarding freedom of economic activity enacted on July 2, 2004, will curtail the influence of the State and of its various institutions on the day-to-day workings of businesses. The Act introduces limitations on the number and duration of inspections of private businesses as well as mechanisms to streamline the process of company registration, the provision of licences and the enforcement of debts and obligations.

Fiscal measures have also been introduced to promote entrepreneurship in Poland:

- As of January 1, 2004, the corporate income tax rate (CIT) has been reduced to an across-the-board 19% (down from 27%);
- As of January 1, 2004, private individuals pursuing business activity in their own name outside of agriculture are entitled to a uniform income tax rate of 19%, thus opting out of the progressive brackets system (PIT: 19%, 30% and 40%) normally applied.

These measures are regarded as a chance to cut back corruption in the economic sphere and to curtail the informal economy. On the other hand, employer circles have been expressing disquiet at the proposals for increasing mandatory social insurance contributions by entrepreneurs.

¹⁵ *Praca nierejestrowana w Polsce w 1998*, S. Kostrubiec (ed.), GUS, Warsaw 1999.

¹⁶ Z. Morecka, E. Domaradzka, *Zatrudnienie obcokrajowców w polskich gospodarstwach domowych*, “Polityka Społeczna”, no 3, 2004.

¹⁷ Cited by: J. Bielecki, *Za Polska tylko Lotwa*, „Rzeczpospolita”, June 5-6 2004.

¹⁸ Cited by: P. Cizkowicz, A. Rzońca, *Koszty, przepisy, swobody*, “Rzeczpospolita”, June 5-6 2004.

¹⁹ Study carried out in late 2003 and early 2004, involving a sample of 15,000 people from 15 countries, www.gfk.pl.

Other measures for lowering of declared work costs

Over the period 1993-2001, labour costs in Poland climbed more than in any other OECD country, with the increase of labour costs outstripping that of Polish GDP. The high payroll taxes applied in Poland are perceived by the business community as a major obstacle to increasing legal employment. An employee whose employment contract stipulates remuneration equal to the national average in Poland, i.e. 2,330 PLN (553 euro) as of the first quarter of 2004, receives a net figure of 1,540 PLN (366 euro). The monthly cost of retaining this employee borne by the employer, meanwhile, amounts to 2,850 PLN (676 euro), meaning that it exceeds the employee's net pay by 85%.²⁰

A number of proposals for the deregulation of labour relations have been advanced in Poland within the frameworks of the general debates concerning "simplification of the State" or "doing away with big government".

It is also hoped that the establishment of special economic zones (on the basis of the legislative Act of October 20, 1994) will contribute to reducing labour costs and kick-starting business development in areas afflicted by particular economic decline. Fourteen special economic zones have been delineated around the country.

The Polish Government has also endeavoured to reduce the cost of official employment through offering subsidies for the employment of jobless persons. These are partly addressed to specific target groups particularly at risk of being left without work. The First Job programme (2002) for unemployed graduates, for instance, provided various forms of subsidies including reimbursements of salaries paid to graduates, graduate internships, loans for the creation of new jobs, and special programmes.

The new legislative Act of April 20, 2004, regarding promotion of employment and labour market institutions, introduces provisions which enable eligible unemployed persons to take up paid work in a limited scope while continuing to draw a part of their unemployment benefits (the equalising benefit).

In addition, the amended version of the legislative Act regarding employment and counteraction of unemployment (originally adopted on December 20, 2002) introduced the concept of temporary work into Polish labour law. Temporary staffing agencies are treated as an instrument for introducing greater flexibility to employment, hopefully with the effect of reducing unemployment and limiting employment in the informal economy (the legislative Act regarding employment of temporary workers was passed on July 9, 2003).

The general objectives of facilitating employment of jobless persons and of promoting entrepreneurship are finding concrete expression in a number of statutory provisions. However these commitments have not always been translated into actions, partly because of insufficient funds. Financial shortages, for instance, caused the range of active labour market policy programmes (ALMP) carried out in 2002 to reach only 253,096 of the more than three million registered unemployed.

Increased oversight

At the ideological level, the Polish State is committed to counteracting employment in the informal economy, which is regarded as a breeding ground for exploitation and for the unfair treatment of workers.

Polish law²¹ sets out specific provisions concerning the formalities which must be attended to in order to work or to pursue gainful activities; failure to abide by these requirements attracts penalties. The general rule is that, wherever labour and/or services are provided, an employment contract or other civil law contract must be executed. The employer is also obliged to disburse remuneration to the employee, to provide her/him with recreational leave commensurate with the duration of her/his employment and with parenthood leave, to issue the employee with a work certificate upon termination of employment, and to abide by a number of other duties. An employer found to be in breach of any of these duties, as laid down in the Polish Labour Code, is liable to a fine. Violations of employee rights are addressed in Chapter XXIII of the Polish Labour Code and in a number of specific statutory instruments, such as the legislative Act regarding social labour inspection from June 24, 1983, or the legislative Act regarding the state labour inspection from March 6, 1981. The principles of criminal liability for such labour law violations are regulated by the general provisions of the Polish Misdemeanours Code.

Cases concerning alleged violations of employee rights are ruled upon on the basis of motions brought by the labour inspector, who acts in the capacity of the public prosecution service (although the public prosecution may also lodge motions in misdemeanour cases). A labour inspector visiting an employing operation may levy a fine by issuing a citation. Particularly flagrant violations of employee rights may qualify as full-blown criminal offences.

Separate liability occurs under the legislative Act of October 13, 1998, regarding the social insurance system. Possible offences include failure to remit social insurance contributions within the applicable deadlines, failure to report data subject to a filing duty, and filing of inaccurate data (the fine for every such offence may reach 5,000 PLN – 1,187 euro). The Polish Criminal Fiscal Code, meanwhile, issues penalties for failure to report the arising of a tax obligation.

The legislative Act of April 20, 2004, regarding promotion of employment and labour market institutions, defines a number of offences which amount to illegal employment. Cases concerning the above are considered in reference to the Polish Misdemeanours Process Code.

Control of the legality of employment is attended to by inspection units informally known as the *labour police*; as of January 1, 2002, these are subordinated to the voivod. The inspectors' mandate comprises control proceedings with respect to all employers, self-employed individuals, and any other institutions and private individuals as regards their retaining of Polish nationals as well as of foreigners. The labour police may work in conjunction with the State Labour Inspection, the social insurance institution, the tax offices, the police, and with other bodies, as appropriate.

The labour police carried out a total of 25,766 inspections in the year 2003, (24,581 inspections in the year 2002)²². These inspections revealed 7,922 cases of illegal employment. This number includes among others: 2,711 foreigners and 1,891 who were officially registered as unemployed. The inspections resulted in the legalisation of employment relations for 4,679 people; in 2,199 of these cases, employment contracts were drawn up, and another 2,480 involved legalisation by way of other contracts.

The State Labour Inspection also has a control capacity with regard to employment relations. The State Labour Inspection's report for

²⁰ Cited by: P. Cizkowicz, A. Rzońca, *Koszty, przepisy, swobody*, "Rzeczpospolita", June 5-6 2004.

²¹ Overview of the legal regulations prepared with Anna Semenowicz of the Legal Office of the Polish Senate.

²² Data from the Ministry of the Economy and Labour, www.praca.gov.pl.

the year 2002 speaks of inspections carried out at 110 employing operations with an aggregate work force of 3,476 persons²³. For 17 % of these employers, some cases related to lack of written confirmation of employment were discovered.

This data testifies to the modest success rates as regards discovering informal employment and enforcement of the pertinent labour laws. In the case of many informal economy workers, their employing entity is simply a private household; for all intents and purposes, households are beyond the reach of official inspections, and survey results suggest that many Poles take a very liberal view of the unofficial hiring of household help or nannies.

Conclusions: low security, low flexibility, high risk

The Polish Government is declaring war on the informal economy as part of the implementation of the European Employment Strategy (EES). New statutory instruments such as the legislative Act regarding freedom of economic activity, the legislative Act regarding promotion of employment and labour market institutions and the legislative Act regarding employment of temporary workers are assisting this effort, along with the recent reduction of the corporate income tax rate (CIT) from 27% to 19% and the institution of a 19% flat-rate tax for private individuals pursuing business activity (outside of agriculture) in their own name.

The weak state of public finances in Poland and the growing numbers of public debt, however, give rise to doubts as to whether these fiscal reforms can be consistently carried through. The current over-regulation of economic activity is also a key concern. Reduced but more effective regulation which is more attuned to the social and economic reality in Poland is essential. Poland also presently has what is de facto a deregulated social security system, with low unemployment benefits, the lack of a compensation system for lost earnings and the lack of security as regards medical care. The prevailing situation is therefore one of low social security and low flexibility in the labour market. Any initiatives designed to curtail undeclared work need to address both these policy concerns.

Ewa Germanowska

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²³ www.pip.gov.pl

Portugal

Introduction

In Portugal, the fight against undeclared work only recently emerged as a priority. The European Employment Strategy (EES) has helped to put this issue on the political agenda.

The goal of fighting undeclared work is frequently associated with that of combating the informal economy, especially in relation to tax evasion, and these two issues are related to efforts to reduce and eliminate illegal immigration.

Portugal does not have a specific definition or recent national statistics measuring the phenomenon, as the Employment Action Plan for 2003/2006 recognises: “the scale and nature of the undeclared work phenomenon is not known with any great accuracy” (p. 42). This situation can be related to the performance of the Portuguese labour market in the last years. It has presented one of the highest employment rates and one of the lowest unemployment rates in the European Union (EU). Some of the goals defined within the Lisbon and Stockholm European Councils for 2005 and 2010 have already been achieved. It is this performance that has allowed the Government not to place too much emphasis on fighting undeclared work so far.

Thus, the definition used in the present article will be the same presented by the European Commission (2004) – “any paid activities that are lawful as regards their nature but not declared to the public authorities” (p. 8).

The informal economy and undeclared work – an overview

The informal economy

According to data from the World Bank, the size of the informal economy in Portugal was about 22.5% in 2001/2002. In 1989/1990 it was 15.4% and since 1994/1995 the value has always been above 20%.

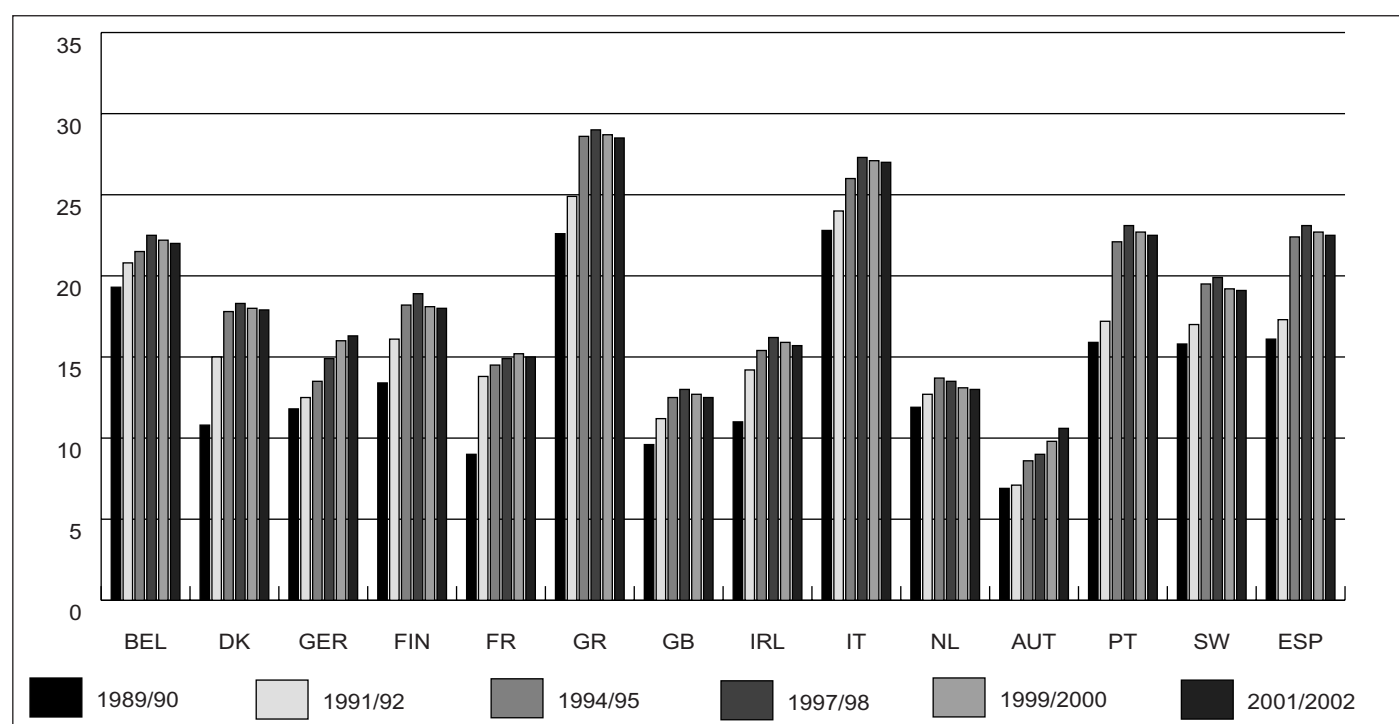
Comparing the situation with the other European countries, Portugal is one of the four countries that present the highest percentages. It is also important to note that most of these countries belong to the so-called group of Cohesion Countries (Spain, Greece and Portugal).

According to a recent study (Farrel, 2004) covering eleven countries/regions (sub-Saharan Africa, India, Indonesia, Pakistan, Philippines, Brazil, Thailand, Turkey, Mexico, Chile and Portugal), the activities where the informal economy is more significant are *construction* (more than 80%), clothing and textile, and retail.

Impact on productivity

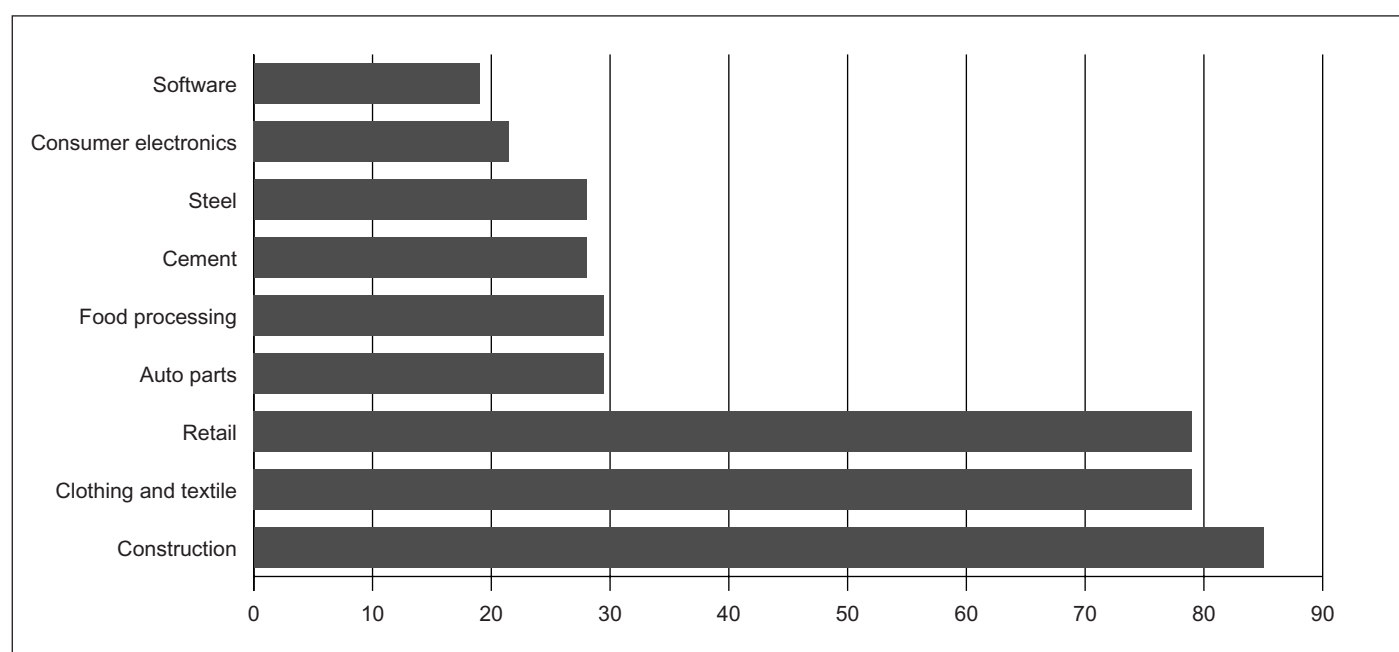
Portuguese productivity is almost half of the average of the most productive European Union countries: according to the “Portugal 2010”¹ report, the differential is about 48 percentage points. According to that report, 16 percentage points of that differential are due to structural factors and is related to the low level of the Portuguese per capita income. But the other part of the differential is explained by non-structural reasons: six main factors were identified and the most important of them is informality (fiscal

Figure 1: Size of the informal economy (in % of GDP) using Currency Demand Method



Source: Schneider, World Bank (2002)

¹ McKinsey Global Institute (2003) – “Portugal 2010: to speed up the growth of the productivity”. The report was a request from the Portuguese Government in order to make a diagnosis and to identify the necessary measures to improve the Portuguese productivity.

Figure 2: Estimated share of value-added activities that are informal, by industry, in the eleven countries (% of GDP)

Sources: International Labour Organisation; World Bank; in *The McKinsey Quarterly*, 2004

evasion; evasion of social obligations, namely, social security payments; evasion of market norms like security and quality norms on products). Indeed this factor is responsible for 28% of the total differential referred to above.

Undeclared work

Although it was not possible to obtain fully comparable international data on the incidence of undeclared work, according to the National Institute for Statistics the incidence rate of the undeclared work in Portugal was about 5% of GDP in 1996. This percentage is one of the lowest ones, when compared to the values from other European countries.

Taking into account more recent data², in Portugal about 30% of the employees who work in non-agricultural activities work in enterprises whose activities are legal but do not fulfil their tax obligations.

Table 2 compares calculations of the theoretical liability³ for compulsory employee and employer social contributions with actual receipts of contributions (reported in OECD Revenue Statistics). These results are based on detailed contribution schedules, as reported in the OECD report on Taxing Wages, taking into account the contribution floors and ceilings in cases where contributions are not exactly proportional to earnings (OECD, 2004).

In Portugal, the ratio of actual receipts to theoretical liability, either when based on wages and salaries or on labour costs, is about 0.60. This translates into a revenue shortfall of 40 percentage points. So the actual social security contributions received are below the calculation of the theoretical expected amounts. However, this situation also occurs in the great majority of the countries analysed.

Table 1: Incidence of undeclared work

Country	Year	Size (% GDP)
AT	1995	1.5
BE	1995	3-4
DK	2001	5.5
FIN	1992	4.2
FR	1998	4-6.5
DE	2001	6.0
GR	1998	>20
IE	n.a.	n.a.
IT	1998/2002	16-17
LU	n.a.*	n.a.*
NL	1995	2.0
PT	1996	5.0
ES	n.a.*	n.a.*
SE	1997	3.0
UK	2000	2.0

* n.a. = Not available

Source: European Commission (2004) – “Undeclared work in an enlarged Europe”

A possible general reason for this fact is that some Government employees do not pay contributions to the main social security scheme. Therefore, the last column estimates the ratio tax receipts to theoretical tax liability for the non-Government sector alone (OECD, 2004).

² Farrel, D. (2004) – The Hidden Dangers of the Informal Economy in *The McKinsey Quarterly*, 2004

³ Theoretical liability is calculated first on the basis of national accounts figures for wages and salaries, which approximate the true tax base, then on the basis of labour costs (with corresponding adjustments to the theoretical calculation) so as to be able to provide some results for countries where OECD National Accounts do not report wages and salaries (OECD, 2004).

Table 2: Total receipts of compulsory social security contributions compared with the theoretical liability arising on wages and salaries as recorded in national accounts, 2000

	Ratio of actual receipts to theoretical liability		
	Based on wages and salaries (employers plus employees)	Based on labour costs (employers plus employees)	Re-estimated for non-Government sector
AT	0.81	0.79	0.94
BE	0.72	0.72	0.86
DK	0.37	0.35	0.60
FIN	0.89	0.88	0.94
FR	0.76	0.76	0.90
DE	0.87	0.82	0.90
GR	0.84	0.83	1.26
IE	0.73	0.75	0.84
IT	0.82	0.80	0.80
LU	0.82	0.80	0.96
NL	1.00	0.90	1.08
PT	0.62	0.60	0.84
ES	0.78	0.78	-
SE	0.89	0.87	0.88
UK	0.78	0.74	0.78

Source: OECD, *Employment Outlook 2004*

Thus, Portugal presents a ratio of 0.84, which means unexplained social security revenue shortfalls of 16%. This value seems to correspond quite well with other measures of the size of the informal economy (see Figure 1).

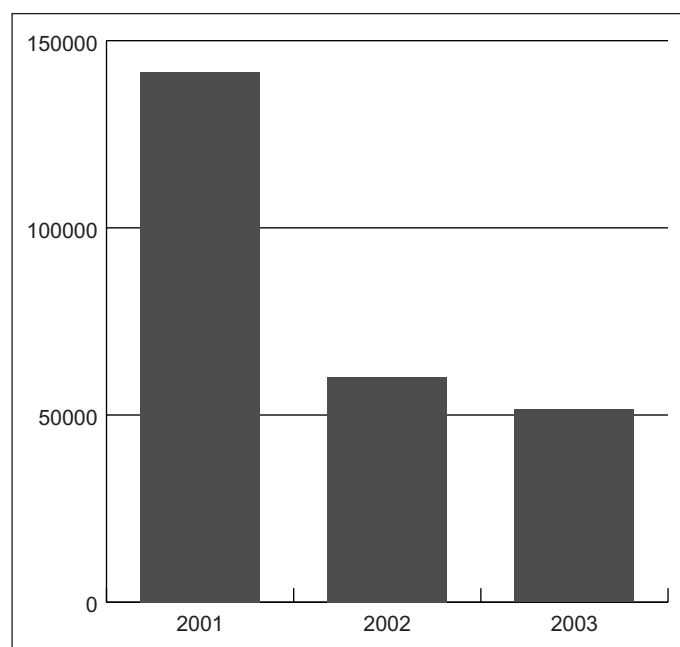
On the other hand, and remembering that 30% of employees in Portugal work in enterprises which do not pay their tax obligations, it is important to make reference to some data regarding tax evasion in Portugal. When the contributor does not fulfil tax obligations within the legal time limits foreseen by the law, the so-called coercive collection is activated. According to a recent article (Serra, 2001), the level of tax evasion in Portugal is estimated to be between 4.7% and 7.2% of GDP – this is between 10.9% and 16.75% of total tax revenue. In 2003 tax evasion continued to increase: the tax shortfall was about 916 million euro (+34% more than in 2002). This is mainly due to non-payment by companies (DGCI⁴, 2003).

The communication from the European Commission on undeclared work (1998) states that, in Portugal, the great majority of undeclared workers are illegal immigrants, women, and unregistered workers. Women are employed in less autonomous jobs, earn less and tend to have informal jobs out of economic necessity, rather than to earn extra cash on the side as men do (European Commission, 2004).

With regard to illegal immigration, in June there was another legal period in order to proceed to the regularisation of illegal immigrants and the number of requests was about 50,000. Despite this, the Government foresees that only about 20,000 requests will

be accepted. That is due to the fact that the rules became more restrictive within the new law of immigration approved in February 2003. According to the law, only immigrants who have paid taxes and social security contributions for three months and who have a current contract of employment or who have held such a contract in the past will be legalised. In face of these requirements, it is evident that the result could be the presence of illegal immigrants⁵.

Figure 3: Regularisation of foreign workers (contracts) and inflation rate 2000–2003 (% change on year early)



Source: IDICT (2004)

On the other hand, the labour inspectorate has detected many foreign workers without regular employment contracts. In light of this situation, the IDICT⁶ has tried to proceed with the regularisation of their situation, namely by demanding that enterprises offer employment contracts to such workers and communicate to the authorities that they are integrated in the labour market.

Looking at specific sectors, those more affected by the undeclared work phenomenon are the *construction* and *textile* sector and *retail trade* (European Commission, 1998). The *construction* sector presents the highest incidence of informal work. In fact the entity that regulates the sector (IMOPPI⁷) registered about 43,132 legalised construction companies, and the National Institute for Statistics states that the number of construction companies is about 60,000 (Dias, 2004). Besides this sector, informal work is found mainly in the hotel and catering sector and in personal and domestic services. The former is a sector where temporary and seasonal work predominates.

Related to the sector analysis is the false self-employment phenomenon, which is also difficult to measure. Self-employed work without employees, although in slight decline, represents, in the most relevant sectors of the economy, a substantial proportion in terms of the overall figure for the self-employed, representing nearly

⁴ DGCI – Department of taxes – Financial Ministry.

⁵ It is estimated that, at present, approximately 11% of the 450,000 immigrants who work in Portugal are illegal (Portuguese Employment Action Plan 2003/2006).

⁶ IDICT – Institute for Development and Inspection of the Labour Conditions.

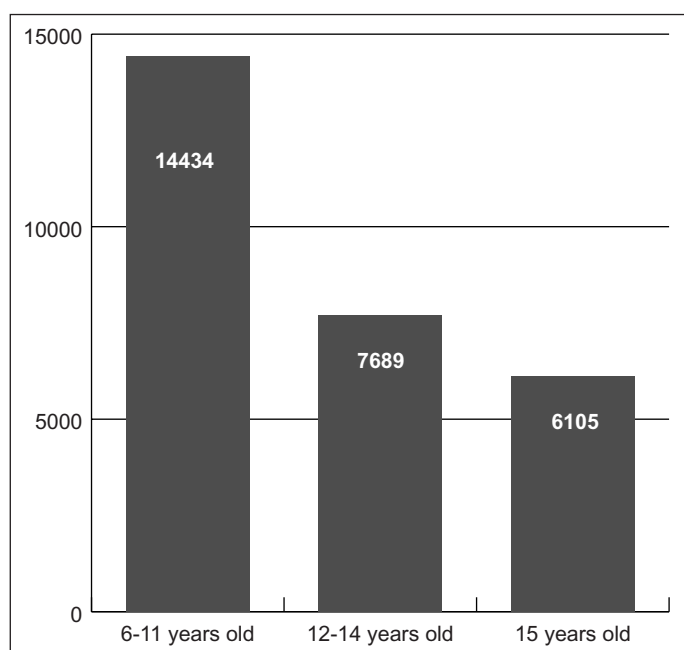
⁷ IMOPPI – Institute for Construction markets and real estate

50% in the manufacturing industry, over 55% in construction, and more than 65% in services. The self-employed are essentially comprised of workers with low qualifications (agriculture, fishing, handicraft, domestic service) – and accounted for more than 80% in 2001. The remainder includes primarily senior staff, although there has been a slight annual decline of approximately 6% since 1998. According to these data it is not possible to draw conclusions about the level of fake self-employment, but the number of self-employed workers in Portugal is significant.

Child labour

Another important aspect of undeclared work is child labour which is still significant in Portugal. In 2001, according to the Statistical System of Information on Child Labour (SIETI), the number of children working reached 28,228.

Figure 4: Number of children who were working (by age group) in 2001



Source: SIETI – Statistical System of Information on Child Labour, 2001

According to the SIETI, the industrial sector registered the highest number of child labourers. The textile sector had 36.6% of the total of working children. To address this situation, the Portuguese Government presented the PETI (Programme for the Prevention and Elimination of the Exploitation of Child Labour) in March 2004. This programme intends to provide the opportunity for working children to finish compulsory education in order to become better integrated in the labour market in future. As the present working children could be the future undeclared workers, this policy, if effectively implemented, may become a good means to prevent it.

Measures taken to combat undeclared work

Throughout the implementation of the EES, Portugal has foreseen a set of policies that intends to combat undeclared work and transform the informal economy into regular activity. According to the Portuguese Employment Action Plan for 2003/2006 efforts have been made to:

- Facilitate the licensing process for new companies and other administrative procedures;
- Strengthen the intervention of the Inspection of Labour (IGT), which has undertaken actions for the regulation of illegal situations;
- Combat illegal practices, verifiable through a decrease in fake self-employment and undeclared work.

Unfortunately, little can be said about the results and the impact of these efforts on undeclared work. However, it is possible to provide data (qualitative and quantitative) regarding two of the goals listed above.

Significant advances were made in the reduction of administrative and overhead costs in the whole creation and development process of enterprises, during the first phase of the EES. In fact, the recent Business Formalities Centres (CFE) have been increasing their role in terms of response capacity and, as the respective network of centres establishes itself, have widened their scope to complementary areas. However, there is still a need for expansion into other areas, such as dissolution of enterprises, and the reduction of the average time to set up an enterprise, as this has not yet reached the target fixed in the NAP 2002 (20 days).

Regarding the regulation of illegal immigration it is important to note that a new framework regarding immigration policy was presented in February 2003. This new law proposes to achieve three objectives: 1) to promote legal immigration according to the real possibilities of the country, 2) to integrate immigrants effectively and 3) to combat illegal immigration.

In this context, binding annual maximum limits have been set for immigration, which will be elaborated from time to time by the Government. Special work visas have also been created for specialised staff.

The Portuguese NAP for 2003-2006 contains a number of other measures aimed at tackling undeclared work:

- Providing information and raising public awareness concerning the negative effects of undeclared work and the stimulation of active citizenship;
- Removing the disincentives to declare work, minimising the effects of the tax and benefit systems that favour undeclared work;
- Minimising the tax effects that favour the creation of fake self-employment;
- Strengthening the prevention of illegal immigration;
- Providing incentives for legal hiring, starting from the country of origin to the stage of permanency in Portugal;
- Strengthening the operations of the Labour Inspectorate (IGT), in association with other inspection systems, in the area of prevention and the fight against illegal work and clandestine immigration;
- Reviewing the system of criminal sanctions which prevents and curbs illegal acts related to clandestine immigration and the exploitation of foreign labour in an unregulated situation;
- Developing a basic information system to understand and monitor the phenomenon;
- Creating a social security database and co-ordinating with other databases that prevent social security evasion.

These proposed actions can be divided into two types of measures: those aimed at combating undeclared work and those aimed at transforming undeclared activity into regular work. The first set of measures contains the following:

- Public information and awareness campaign against undeclared work;
- Inspection operations and other inspection systems, in the domain of prevention and the fight against illegal work;
- Information system in relation to undeclared work.

The second set of measures includes:

- Tax and benefit systems favourable to declaring work;
- Re-evaluation of the legislative framework governing self-employment.

Another reason for the existence of undeclared work which is frequently mentioned is the rigidity of labour legislation. In relation to this, Portugal has made significant improvements through the New Code of Labour, whose main goals are to promote collective bargaining and to make labour legislation more flexible. For example, the new legal framework increases the number of years that a worker can be working in the same enterprise with a fixed term contract. Thus, the worker can continue to hold a fixed-term contract for three years with a maximum number of two renewals but, at the end of the three years or of the foreseen renewals, the contract can be drawn out, for a period of between one and three years. On the other hand, the employer's social security contribution increases in companies where more than 15% of their workers have fixed-term contracts.

Conclusion

In Portugal, in spite of the lack of data, the available statistics point to a significant number of undeclared workers. A large proportion of these workers are illegal immigrants. This makes it more difficult to measure the phenomenon. The sectors most affected by undeclared work are the *construction sector*, the *hotel and restaurant sector* and *personal and domestic services*. This is a critical situation not only because of the revenues that the State does not receive, but also because it means weaker social protection for the workers and often constitutes a trap, offering little prospect to improve careers.

The Portuguese authorities intend to transform undeclared work into regular employment through several means, including the strengthening of interventions of an informative nature, raising awareness of its disastrous effects, removing excessive red tape and making the tax and benefit system favourable to declared work, and reinforcing inspection operations.

It is also expected that the new regulatory framework for immigration, based on a policy of working visas, will contribute towards a reduction in the illegal migratory flows. The new Code of Labour has also been significant in that some undeclared workers can now establish a regular labour relation with their employers. In this case the active involvement of the social partners will be essential.

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Slovenia

Introduction

In the first half of the 1990s, the Slovenian economy experienced rapid changes and the growth in the share of the “hidden or grey economy”. The transition to the market economy and modernisation of industry brought high rates of unemployment. One of the policy measures taken to actively reduce unemployment was helping unemployed people to become self-employed, through financial support and counselling. Many of the unemployed took the opportunity to start their own business without registering it. A similar problem occurred with people choosing to set up companies after early retirement. To begin with, this kind of economic behaviour was tolerated since it was regarded as one of the solutions for maintaining social security and social peace. The growth of small businesses was not accompanied by any changes to the legal system. Eventually the majority of the small entrepreneurs legalised their businesses and the state modernised its legal system through the introduction of VAT and the strengthening of activities to reduce tax evasions. However, regardless of these improvements, undeclared work and employment remain an unresolved issue in Slovenia.

In July 1997, the Slovenian Government adopted the “Programme for exposing and preventing illegal work and employment”¹. Under this programme numerous activities were launched to reduce the share of the hidden economy. The Government also set up a new Commission to co-ordinate the common activities of many agencies (bodies)² that are responsible for the supervision of different areas of the Slovenian economy. The Commission is based in the Ministry of Labour, Family and Social affairs. A state secretary responsible for the issue was appointed at the same Ministry. In 2000 an Act was passed on the “Prevention of illegal work and employment”.

When setting up these initiatives, the term “illegal work and employment” was used to refer to activities that are defined by the European Commission as “undeclared work”. In Article 3 of the Act, for example, “illegal” work is where:

- a legal entity³ did not register its activity with the court register or did not have all the required documents for the registered activity;
- a small entrepreneur performs an activity that is not reported to the authorities or does not have all the required documents for the registered activity;
- a legal entity or small entrepreneur performs an activity regardless of a temporary prohibition against performing this activity;
- a foreign legal entity or small entrepreneur performs an activity in Slovenia without complying with requirements or announcing the activity to the tax authorities;

- an individual performs an activity or work that is not registered or reported to the authorities according to this or other legal acts.

In Article 5, “illegal employment” is defined as when a legal entity or small entrepreneur:

- did not sign an employment or work contract with a worker according to the regulations and did not register him/her at the Health Insurance Institute of Slovenia and Pension and Disability Insurance Institute;
- employs a foreigner or an individual without citizenship in contradiction with the regulations on employing foreigners.

In Article 7 exceptions from illegal work and employment are defined as:

- mutual neighbourly assistance;
- performing work for exclusively personal needs;
- emergency work for preventing natural and other disasters;
- performing humanitarian, voluntary or charity work;
- performing personal supplementary work.

Since the Commission states in its yearly reports (for the period 1.7.2001- 31.12.2002 and for the year 2003) that the main motive for illegal work and employment is avoiding paying taxes and acquiring required documents for performing legal activities, the similarity between two definitions is further emphasised. The term “undeclared work and employment” will be used from this point onwards in the text.

Regardless of the fact that the Government and the social partners have given great significance to combating undeclared work and employment, the issue is not among the main topics that currently preoccupy Slovenian politics. It is mentioned occasionally, mostly with reference to a specific case of undeclared work and employment or a specific occasion (such as elections, or business conferences).

Most of the government activities in this area are performed “behind the scenes”. However, once a year representatives of the social partners in the Economic and Social Council of Slovenia discuss the yearly report to the Commission.

Prevalence of undeclared work in the economy

As yet, there is no official measurement of undeclared work in Slovenia. Nevertheless, there are different estimates according to which undeclared work generated from 17% to 24% of the Slovenian GDP in 2003. While the official estimate according to the European Commission (2004) and Slovenian official sources is 17%, other social partners in Slovenia still operate with much higher figures –

¹ The “Program odkrivanja in preprečevanja dela in zaposlovanja na crno”. There are some inconsistencies in terminology between the official translation of the title and the content and intent of the programme. Using official translation of the Act on Prevention of Illegal Work and Employment that was passed in 2000, the programme (and the commission) would be called “Programme for exposing and preventing illegal work and employment”. However since its content and its intention are similar to the European Commission’s definition of the undeclared work, it could be more correct to translate it as the “Prevention of undeclared work and employment”.

² Labour Inspectorate, Market Inspectorate, Traffic Inspectorate, Tax Administration, the Police, Ministry of Finance, Ministry of the Interior, Ministry of Labour, Family and Social Affairs and others.

³ Organisation, co-operative or institution.

⁴ On 16.09.2003

up to 24%. Thus, representatives of the Chamber of Crafts claimed, at a round table⁴ dedicated to this issue, that there are almost 250,000 undeclared workers in Slovenia who generate almost 24% of the Slovenian GDP. At the same time the Slovenian Minister of Labour, Family and Social Affairs estimated the share of undeclared work and employment at 20% of GDP.

Trends in the share of undeclared work and employment in the Slovenian economy show a constant decrease of such activities from the establishment of the Commission in 1997 onwards. The situation was worse at the beginning of the period of systematic work on the issue during the 1997-1998 period. In this period, cases of undeclared work were found in 68.9% of all inspected cases, undeclared employment in 35.4% and violations of the tax laws in 47% of all inspected cases.

In the past few years the Commission intensified their activities to reduce the occurrence of undeclared work and employment.

In the period 2001-2002, the Commission co-ordinated numerous joint actions in which 1,350 (847 in the year 2002 alone) organisations were inspected. From those inspections it was established that in 16.8% of inspected cases (13.1% in 2002) undeclared work was present. In 15.5% inspected organisations (15.8% in 2002 alone) undeclared employment was found. In the same period 20.7% (24.1% in 2002) of inspected organisations violated the tax and book-keeping regulations.

In the year 2003, supervisory bodies registered 2,742 cases of violation of the Act on Prevention of Undeclared Work and Employment.

Legal entities and small entrepreneurs (2,092 cases) were mainly responsible for violations of the Act, while individuals violated the Act in 650 cases. Most of the violations were related to undeclared work (1,877 cases or 68.4%), while the share of undeclared employment was 30.2%.

The Market Inspectorate has been most successful in detecting violations of the Act, identifying 1,070 cases of undeclared work. Almost half of these cases involved legal entities performing activities without documents that would prove that they were fulfilling legal requirements. The Market Inspectorate also detected 602 cases of undeclared work by individuals.

On the other hand, the Labour Inspectorate⁵ was responsible for detection of all cases (827) of undeclared employment. In 743 cases the employer failed to sign a contract with the worker and did not register the worker at the Health Insurance Institute of Slovenia and Pension and Disability Insurance Institute of Slovenia. In 77 cases

the employer employed a foreigner or an individual without citizenship in contradiction to the regulations on employing foreigners. The majority of violations were reported in trade, construction and catering.

Institutions such as the National Employment Office of Slovenia also participate in the fight against undeclared work. Out of 740 persons that worked or had been employed in undeclared work in 2002, the National Employment Office found that 198 persons were on the register of unemployed people. After reviewing the situation of each case, 90 persons were deleted from the register and 39 persons left the register of their own accord. For 69 persons the procedure was still not finalised at the end of the year 2002. The right to unemployment benefit and unemployment assistance was taken away from 19 individuals.

In 2003, supervisory bodies caught 677 unemployed persons in undeclared work and employment. The National Employment Office inspected 571 cases and found 164 persons in the register of unemployed people. From that figure, 97 persons were deleted from the register, and in 11 cases the right to unemployment benefit and unemployment assistance was removed.

The effectiveness of the fight against undeclared work and employment depends greatly on the efficiency of the judicial and tax administration systems and their responsiveness to cases of undeclared work and employment identified by the agencies on the field. In the year 2000, 2,391 cases were reported to the misdemeanours judges and from this number only 806 cases were concluded with the appropriate fine; 443 cases fell under the Statute of Limitations and 1,614 cases were classified as a "misdemeanour".

In the year 2001, misdemeanours judges received 1,826 cases from which 369 persons were found guilty, 42 cases fell under the Statute of Limitations and 754 cases were categorised as misdemeanours. In 2003 supervising bodies issued 1,296 mandatory fines (if paid immediately the mandatory fine is halved), 1,569 provisions and 1,778 proposals to the misdemeanours judges.

Based on the findings of the tax administration, 1,114,508,998 SIT, or 4.7 million euro, should have been collected in 2003 in additional liabilities (taxes and contributions) from economic subjects involved in undeclared work and employment.

As can be seen from figure 1, 75.9% of the total amount represents the additional liabilities related to undeclared work and employment. A very low share of finances is actually collected from fines issued by misdemeanours judges⁶. From a possible 138,805,000

Table 1: Violations of the Act on Prevention of Undeclared Work and Employment in 2003

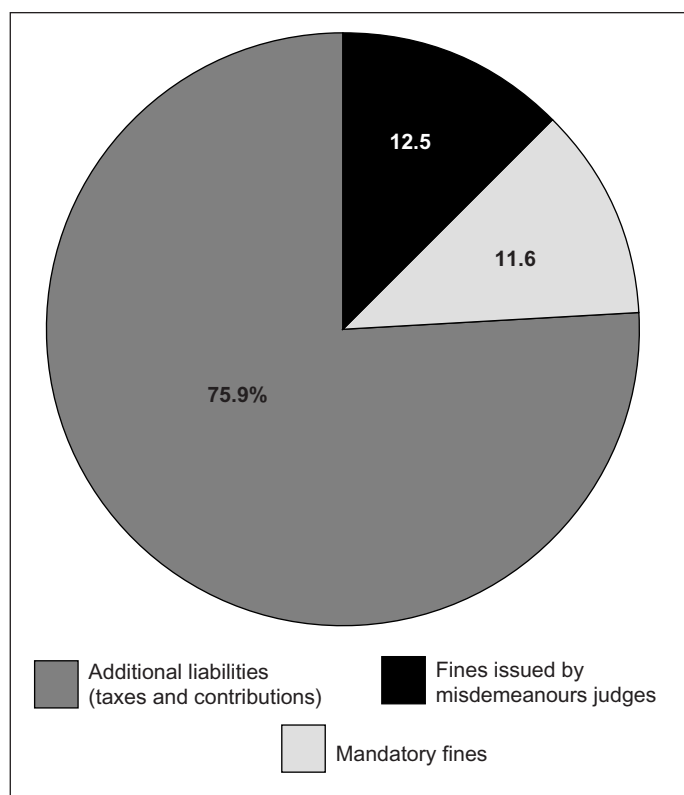
Subjects \ Violations	Undeclared work	Participation in undeclared work	Advertising undeclared work	Undeclared employment	Total
Legal entity or small entrepreneur	1253	10	9	82	2092
Individuals	624	13	6	7	650
Total	1877	23	15	827	2742

Source: MDDSZ, 2004:4

⁵ In the year 2003 the Labour Inspectorate alone performed 17623 inspections related to labour relations (9095) and to health and security at work (8528). The work was done by 76 inspectors in 14 local offices.

⁶ The President of the Senate for Misdemeanours stated that there is low financial discipline amongst those individuals fined by misdemeanours judges. However, at the same time, coercive exactions are often unsuccessful, as there is a growing number of unemployed people among those that are fined. In addition, as a rule, seizures of movable property are not implemented and, in 2003, the misdemeanours judges did not use the possibility of changing fines to imprisonment. The Senate expects that the new electronic exchange of the data within the tax administration should improve the effectiveness of the exactions. (MDDSZ, 2004:10-11)

Figure 1: Additional liabilities and fines related to undeclared work and employment in 2003



Source: MDDSZ, 2004: 10

SIT (585,508 euro or 12.5% of 4.7 million euro) the tax administration only recovered 12.5%. The tax administration was only successful in exacting payments from mandatory fines where all fines were paid immediately (thus receiving only half of the expected amount – only 273,807 euro instead of 547,613 euro).

Measures taken to combat undeclared work

The creation of a legal and administrative environment which is favourable to the declaration of economic activity

The basis of the legal and administrative framework on this issue was created in 2000 through the passing of the Act on Prevention of Undeclared Work and Employment.

In the year 2002, a Regulation on work activities identified as “personal supplementary work” and the procedure for notification of these work activities came into force. An individual can perform personal supplementary work if:

- their annual income does not exceed their annual minimum wage from the previous year;
- the work is defined as appropriate in the Regulations (household assistance, collecting and selling forest fruits and herbs, making and selling home-made products);
- the individual must perform the work alone and must be registered as a personal supplementary worker.

There were 1,928 individuals in the year 2003 registered to perform personal supplementary work. The majority of them were collecting and selling forest fruits and herbs. The procedure for registering has

been simplified; however, there is a strong move not to allow a further increase in the number of registered personal supplementary workers.

In 2002 the Commission on the Prevention of Undeclared Work and Employment also contributed to the preparation of a new General Offences Act, especially in respect of the need for rapid proceedings and the timely and relevant professional education and training of all those involved in the proceedings. Improvements related to:

- staffing of the judicial bodies, particularly increasing the number of employees;
- rewarding the judicial bodies that will take over the burden of proceedings from the judges;
- technologically and technically equipping such bodies;
- defining the execution of the transitional provisions of the Act;
- optimising proceedings, measures and co-operation between judicial bodies and bodies that are responsible for the successful enforcement of sentences and recovery of fines.

More recently, supervisory bodies have detected frequent violations of the Societies Act regarding appropriate profitable activities of societies and, in some cases, farms. These violations relate, in particular, to the catering activities that are described in Article 3 of the Catering Act, to the establishment of societies for mechanical processing in agriculture and to assistance for older people. The Commission has suggested appropriate amendments to the new Societies Act and to the Ministry of the Interior and the Ministry of the Economy.

The Commission has also pointed out violations in the field of agriculture. These are related to farm tourism, cargo transports, the mechanical processing of soil and repairs to mechanical goods. In all mentioned areas, activities exceeding the definitions in Article 7 of the Act on Prevention of Undeclared Work and Employment have been identified. The Commission has suggested more detailed specification of the conditions for performing such activities to the Ministry of Agriculture, Forestry and Food.

Strengthening incentives and removing disincentives to declare work

The draft version of the Slovenian National Action Plan on employment for 2004 (under the strategic goal of improving the quality and productivity of work) envisages the following measures for strengthening incentives and promoting employment:

- the abolition of administrative obstacles for the registering of companies, which includes changes to legislation and the establishment of an information system to make it easier for companies to register (one of the tasks is reducing the period for administrative procedures from one month to 14 days);
- changes to tax legislation in terms of collecting contributions, in order to reduce the administrative burden on companies and in particular on small companies;
- the establishment of measures to promote entrepreneurship and to develop an entrepreneurship-friendly environment;
- easing access to sources of finance for companies and making it easier to establish new business start-ups.

In Slovenia's NAP (National Action Plan for employment) it was also stated that exposing and preventing undeclared work would function not only to reduce the number of registered unemployed but also to promote the transition of undeclared work to regular employment. It was also intended that pension reform should not promote early retirement and consequent transition to undeclared work and employment.

At the same time supervisory bodies have stressed the need for additional regulations in the Value Added Tax Act to improve supervision of foreign legal entities and small entrepreneurs with headquarters outside Slovenia that wish to provide public transport services in Slovenia. Such regulations should support the registration of foreign legal entities and small entrepreneurs with the Slovenian authorities and consequently ensure the payment of value added tax in Slovenia.

Strengthening surveillance and the application of appropriate sanctions

Besides the individual actions of different supervisory bodies, the Commission for exposing and preventing undeclared work and employment co-ordinated and conducted many joint actions (267 in the year 2003) where the participation of at least two supervisory bodies facilitated the inspection of:

- more subjects in one economic activity in different locations;
- more subjects in different economic activities in a small geographical area;
- more subjects in one economic activity in a small geographical area;
- more subjects in different economic activities in a wider geographical area;
- one subject that performs one or more economic activities in different locations;
- one or more subjects in a specific environment (e.g. without interrupting the programme in nightclubs or discotheques, where up to 1,500 people could be gathered).

One of the benefits of such joint actions is that the supervisory bodies can perform two tasks simultaneously: inspection regarding undeclared work and employment can be carried out alongside other inspections relating to their own particular field of interest.

Such joint actions can involve mobile groups, which can perform “ad hoc” inspections on the spot and can move quickly to other locations or region.

The following organisations have a special role in detecting and preventing undeclared work and employment:

- The police – they have a double function: either acting as a supervisory body, especially in the case of foreigners, or simply giving assistance to other supervisory bodies in performing their tasks;
- The tax administration, which continues to perform its activities long after the other supervisory bodies have concluded their work.

Strengthening transnational co-operation between competent bodies in different Member States aimed at combating undeclared work

In 2003, in the context of Slovenian preparations for accession to the EU, special attention was given to the following areas:

- Undeclared employment of foreigners especially in construction, cargo transport, hotels and restaurants (especially Chinese restaurants), entertainment (especially night clubs) and in agriculture (especially hop growing). In areas such as construction and agriculture workers from other ex-Yugoslavian countries and from Eastern Europe often work without signing contracts or reporting to the authorities. Unemployed Slovenian people are often reluctant to perform such “dirty” work for less

than the unemployment benefit, and foreign workers are often ready to work in bad conditions for less money. In addition, there is a shortage of skilled workers in some areas (especially in construction).

- The performance of various services by foreign legal entities and small entrepreneurs on Slovenian territory.

It was concluded that Slovenian supervisory bodies were well prepared to supervise foreign legal entities, small entrepreneurs and individuals. This preparedness has also been demonstrated in the context of international actions to prevent and detect undeclared work and employment.

Raising social awareness of the costs of undeclared work

The Chamber of Crafts and Chamber of Commerce have organised several round tables on this issue. These were an opportunity for representatives of small entrepreneurs as well as of larger organisations to express their opinions on the current situation and to suggest measures and actions for reducing undeclared work and employment. Principal suggestions to the Commission and to the Tax Administration were to strengthen inspections and to impose financial discipline on those employers that use undeclared work and employment and evade tax payments, since this represents unfair competition. Some of the opinions and suggestions were accepted by the Commission and are already mentioned in this text.

At the same time it was pointed out that more information about the consequences of undeclared work and employment on employers, employees and the unemployed is needed.

In the year 2003 the Commission and the Ministry of Labour, Family and Social Affairs organised seven regional workshops to exchange the experiences of many supervisory bodies and to strengthen the co-ordination between them on a local level.

Conclusions

Despite considerable efforts and some success in tackling undeclared work and employment, the estimated share of this employment is still relatively high compared to the situation in the majority of European countries. There are still many areas where improvement is both possible and necessary.

Some recommended improvements include:

Firstly, a reliable indicator of the scale of undeclared work and employment in the Slovenian economy should be created.

Secondly, the efficiency of the judicial system and tax administration should be enhanced. Problems with the high number of cases that have fallen under the Statute of Limitations and a lack of financial discipline amongst some economic subjects have not only had a financial effect on the country's budget, but also on the country's morale. This issue devaluates the work and efforts of many supervisory bodies and gives the impression to potential offenders that there are more advantages (such as profit) than disadvantages (fines) in becoming involved in undeclared work and employment.

Finally, more efforts should be put into informing the public about activities to reduce the undeclared work and employment, and about the consequences of the undeclared work and employment for the society.

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Slovak Republic

Introduction

Undeclared work has been an important element of the Slovak labour market over the past few decades. The presence of this phenomenon, which in Slovakia is most often referred to as “black or illicit work”, is partly based on the motivation of labour market actors to earn more money or attain higher profit¹. Being involved in undeclared work brings benefits including lower costs associated with the non-reporting of productive activities, tax and payroll tax evasion, and infringement of related legal and administrative rules.

Until now no legislation has existed to define and regulate undeclared work in Slovakia. A special law on illicit work is currently under preparation by the Ministry of Labour, Social Affairs and Family (MOLSAF). The draft *Act on Illicit Work and Illicit Employment* was submitted for an inter-ministerial review process in mid-June 2004². MOLSAF has as yet not specified a date when the law should become effective³.

The main aim of the Act is to decrease undeclared labour and facilitate the regulation of employees and employers at workplaces by competent inspection authorities. The Act defines two categories – illicit work and illicit employment – which are prohibited under the law. Illicit employment is specified as a situation:

- when an employer employs somebody without an employment contract or other legal relationship specified by separate law;
- when an employer does not fulfil his/her obligation to report this employment to the Social Insurance Agency or health insurance company;
- when an employer employs a foreign worker who has no work permit and no temporary residence permit for employment purposes.

Illicit work is defined similarly. According to the draft Act, illicit work occurs;

- when a person carries out work for an employer without a concluded employment relationship (employment contract or other legal relationship specified by separate law);
- when a foreigner works without a work permit and without a temporary residence permit for employment purposes;
- when a job applicant does not fulfil his/her obligation to report to the labour office.

The most relevant existing definition of undeclared work can be taken from the *Agreement on co-operation in co-ordination and execution of illicit work inspection* (so-called 12-Agreement)⁴. The objective of the Agreement is collaboration of involved institutions in disclosing:

- employers who employ persons without a concluded employment relationship in written form, and pay remuneration for work without ensuring payment of income tax, social contributions for health insurance, sickness insurance, pension security and unemployment insurance;
- persons working without a concluded employment relationship in written form, persons registered in unemployment records who perform individual gainful activity;
- persons who carry out entrepreneurial activities without relevant certification of entrepreneurship;
- foreigners who are employed in the Slovak Republic without a work permit and residence permit for employment purposes.

In fact, the definition of illicit work proposed in the above-mentioned draft Act corresponds with the specification of the content of the 12-Agreement. In the context of these documents, illicit work is regarded as unlawful because it is not reported to the

¹ It is believed that there is a dual motivation of employers to engage in undeclared work in Slovakia. While some people work in the informal economy to seek additional/higher income, others work unlawfully merely to survive and pay for basic necessities (or pay back debts), being unable to access employment in the official labour market. On the part of the employers, a driving factor is the effort to decrease labour costs and avoid administrative restrictions.

² At present (August 2004), comments received on the draft Act on Illicit work and Illicit Employment are being processed. This information is therefore based on the wording of the draft Act.

³ It should be noted that a law on illicit work was drafted in the first half of 2002, but the legislative process came to a halt after the law was negotiated at Government level in September 2002, prior to the parliamentary election. The Act was one of the tasks set down by the Government Resolution No. 366/2001, which included a set of measures focused on fighting illicit work by means of improved labour inspection (amended Act on Labour Inspection), changes in the Labour Code and the Act on Employment. The tasks were accomplished only partially.

⁴ The 12-Agreement was signed in April 2000 by the following institutions: National Labour Office (note: since 1 January 2004, transformed to Headquarters of Labour, Social Affairs and Family), Social Insurance Agency, and health insurance companies. The agreement was effective till 31 December 2002.

relevant public institutions. This interpretation concurs with the EU concept of undeclared work, which understands undeclared work to be “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 system between Member States⁵. A recent report published by the EU Commission uses a slightly amended definition, where “productive activities” is used instead of “paid activities”, meaning that certain unpaid activities can be productive and regarded as unlawful when not declared (EC, 2004).

As undeclared work is not included as one of the priority areas of the EU *acquis*, national definitions and methods of dealing with undeclared work differ significantly between the Member States. Slovakia is at the stage of building up national legislation in this area. Evaluations of the state of undeclared work in Slovakia, and measures taken to combat undeclared work, draw attention to the fact that the existing legal framework is unable to effectively combat such activities. The number of disclosed cases of illicit work suggests the low efficiency of regulatory mechanisms in this area. The absence of a special law on illicit work, which would integrate the different institutional, regulatory and other mechanisms operating in this area, is also often highlighted.

However, relatively little attention is devoted to addressing the reasons for unlawful behaviour on the labour market, i.e. the prevention of undeclared work. A survey on undeclared work, conducted among officials from tax offices, labour offices and trade registers, confirms this fact: reinforced inspection of undeclared work (38% of respondents) and stricter sanction against such behaviour (26%) are considered more effective measures than lowering the burden of taxes and social contributions (22%) and support to entrepreneurship (14%) (Bednárík, Danihel and Sihelský, 2003).

There is a large degree of public awareness of the existence of illicit work, coupled with a high degree of tolerance and acceptance that this is as a common and even “skilful” way of improving one’s life. This general attitude also influences political debate. National policies, institutions, and legislation only address undeclared work in a limited way. The protracted process of developing a special law on illicit work from 2002 onwards is perhaps one example of the low political priority given to combating undeclared work. However, several new reforms implemented by the current Government⁶ across a wide range of policies have had a positive effect on the transparency and applicability of labour and business legislation and decreased the opportunities for misuse of the social system.

Undeclared work is not a topic currently receiving much attention from the research community. There have been several attempts to conceptualise and measure the informal economy and undeclared labour in Slovakia, notably by researchers from public institutions such as the Research Institute of Labour, Social Affairs and Family (now Centre for Work and Family Studies) and INFOSTAT (Institute of Informatics and Statistics). This research has as yet only had limited impact on the policy process. Professional organisations, employer associations, and trade unions have also not been significantly involved in actively combating undeclared work.

Prevalence of undeclared work in the economy

The phenomenon of undeclared work in Slovakia is apparently more widespread than would be suggested by the level of importance given to this issue in the political debate. Given the hidden nature of undeclared work, it is perhaps understandable that there is no precise information on the scale of the problem. Available estimates vary due to the different definitions and methods applied.

One nationally-applied methodology is *labour force balancing*, which is used by INFOSTAT as a subsidiary method for estimating the hidden economy within the System of National Accounts. The measurement is based on the comparison of numbers of employed persons on the demand and supply sides. Demand is represented by the volume of labour force in enterprises and institutions (using reports from enterprises and trades people). Supply is represented by data gathered directly from households within the Labour Force Survey (LFS). LFS data on employment is more complex and it is assumed that surveyed individuals have fewer restraints on indicating the nature of their employment, even if it is hidden. Data from the LFS is adjusted to properly reflect the real situation (e.g. inclusion of persons living in so-called collective and institutional households and those who come to work in Slovakia from abroad; exclusion of persons working abroad; adjustments concerning employees of embassies, persons on maternal leave, etc.). The comparison of the two data sets shows that LFS data on employees exceeds the number declared through the demand side by 171 thousand (2001). When adjusted to reflect methodological differences, the estimate of undeclared labour decreases to 140 thousand persons (120 thousand in 2000). The comparison does not include persons who might have a secondary job in the informal sector. INFOSTAT acknowledges that further methodological refinement of the measurement model is needed. (Bednárík, Danihel and Sihelský, 2003)

The Research Institute of Labour, Social Affairs and Family has estimated the size of hidden employment amongst the registered unemployed at 66 to 71 thousand persons, representing 12.4-13.2% of the total number of registered unemployed in 2000. The cost of undeclared work, carried out by persons who at the same time receive social benefits, is estimated at SKK 4 billion annually (100 million euro).⁷

The results of a joint regulatory action by MOLSaF, Ministry of Interior, Ministry of Finance, Social Insurance Agency, National Labour Office, and the National Labour Inspectorate, conducted in 2,929 organisations, served as the basis for a further estimate of 85,152 illegally employed persons⁸.

Table 1 gives an overview of attempts to quantify the level of undeclared/illicit work in Slovakia.

This comparison of different estimates supports the fact that caution is required when presenting unambiguous conclusions about the scale of undeclared work. Available domestic and international measurements suggest that Slovakia is a country with relatively low levels of undeclared work, especially in the regional context⁹. The estimated size of undeclared work in the country ranges from 5 to 20% of total employment, reaching around 15% of GDP. Since most of the existing estimates do not include persons

⁵ For more information see *Communication of the Commission on undeclared work*: http://europa.eu.int/comm/employment_social/employment_analysis/work_comm_en.htm

⁶ The second Mikuláš Dzurinda Cabinet (October 2002 ongoing)

⁷ “Black work: People will get work IDs”. Pravda Daily, 18 June 2004

⁸ Source: Hajnovičová, V.: *Estimation of illicit work in GDP measurement*. Presentation at the Social Discussion Forum of the Friedrich Ebert Foundation, Bratislava, 25 June 2003.

⁹ Several international sources, although admitting limited comparability, rank Slovakia among countries with a lower level and decreasing share of undeclared work in the context of Central and Eastern Europe (transition economies). See for example Schneider (2002) and EC (2004).

Table 1: Summary of estimates of undeclared work in Slovakia

Source	Year	Definition/Methodological note	Value
INFOSTAT	2001	Number of employees engaged in illicit work (labour force balancing, System of National Accounts)	140,000 (6.6% of total employment)
Research Institute of Labour, Social Affairs and Family	2000	Number of registered unemployed who work "hidden" (expert estimate based on questionnaire survey)	66-71,000 (12.4-13.2% of total unemployed)
National Labour Inspectorate	2000	Number of illegally employed persons (direct estimation method based on survey)	85,152 (4.1% of total employment)
European Commission ¹	2000	Share of undeclared work on GDP (combination of various methods, e.g. enterprise surveys, household surveys)	13-15%
ILO ²	1999	Individual entrepreneurs (small tradesmen) not registered in the Business Register, and the persons employed by them (official estimate)	450,000 (23% of total employment)
F. Schneider (2002) ³	1998/1999	Shadow economy labour force (as % of working age population, 16-65 years) DYMIMIC method	16.3%

Notes:

¹. Data provided by INFOSTAT/Statistical Office of the SR, published in EC (2004).². STAT Working Paper No. 1 – 2002: ILO compendium of official statistics on employment in the informal sector.³. Schneider, F.: *The Size and Development of the Shadow Economies of 22 Transition and 21 OECD Countries*. IZA, Bonn (2002)

with a secondary job in the informal sector (potentially a significant number), the upper-bound estimates may be considered as a more fitting picture of the actual situation.

The highest incidence of undeclared work is reported in sectors of the economy with a high share of manual, seasonal and occasional work. Such jobs are concentrated predominantly in the private sector. The National Labour Inspectorate considers business services, construction, agriculture and forestry to be the sectors with the highest concentration of illicit work. According to the recent Commission report on undeclared work (*EC, 2004*), construction (with a 17% share of undeclared work on total employment in this industry), trade (15%), hotels and restaurants (13%), transport (9%), and the real estate and business services (6%) are the most affected industrial sectors in Slovakia.

The above-mentioned questionnaire survey, conducted in tax offices, labour offices, and trade registers gives an interesting estimate of the profile of undeclared work in Slovakia (see Table 2).

The figures in the table would suggest that a typical picture of illicit

work in Slovakia would include an unemployed middle-aged person with a lower level of educational attainment, who is undertaking occasional work in the construction sector and/or small business.

The Slovak country study presented in the recent Commission report on undeclared work (*EC, 2004*) specifies three main forms of undeclared work in Slovakia:

- fully unregistered employees who are often formally unemployed and take up seasonal or otherwise temporary jobs;
- partly unregistered employees who are registered as earning a minimum wage, while in reality they have extra, cash earnings for the same job (the employee may also have a part time contract, while in reality they are working full time);
- self-employed people who undertake activities without a licence or permits.

The National Labour Office points to the fact that undeclared work mainly concerns entrepreneurs registered in the commercial register. Undeclared employment in state enterprises, budgetary and contributory organisations rarely occurs. However, it is thought that

Table 2: Selected features of undeclared work in Slovakia (in % of answers)

Sector	Percent ¹	Type of work	Percent	Type of person	Percent	Qualification of person	Percent	Age of person	Percent
Agriculture	41.0	Occasional	57.2	Unemployed	94.0	Without	11.4	- 25	6.0
Industry	13.9	Seasonal	38.6	Foreigner	1.8	Lower	81.2	25-35	59.0
Construction	96.4	Long-term	3.0	Employed ²	2.4	Medium	6.0	35-50	29.5
Transport	9.6					High	–	50+	0.6
Retail trade	54.2								
Hotels, restaurants	48.2								

Notes:

¹. Respondents could indicate three sectors.². Employed, who have a secondary job in the informal sector.

Respondents were officials from tax offices, labour offices and trade registers.

Source: Bednárík – Danihel – Sihelský (2003)

the self-employed have a high tendency to get involved in illicit work, and these groups are frequently registered with trade registers. In addition, although undeclared work may not occur frequently in the Government sector, state and public officials have the same conditions and incentives to engage in informal activities, for example in a secondary undeclared activity.

The prevalence of undeclared work in Slovakia has numerous reasons and determinants, which are typical for most countries in the region. The main factors influencing the phenomenon in Slovakia include:

- *Underdeveloped formal and informal rules* – i.e. (a) in relation to formal rules: unstable legal and institutional framework, insufficient law enforcement, missing legal regulation of undeclared work, low efficiency of labour inspection; (b) in relation to informal rules: public tolerance and acceptance of illicit activities, low trust in public institutions, insufficient knowledge of negative effects of unreported activities, discrepancy between what citizens expect to receive from public goods and how much they are willing to contribute to its financing;
- *Economic and social transition* – emergence of the private sector, unbalanced economic development, insufficient job creation in the formal sector, unstable legislation, non-transparent privatisation, social uncertainty, legacy of socialism, corruption;
- *State of business environment* – high burden of taxes and social contributions, administrative and procedural restrictions to entry the formal sector (e.g. setting up of businesses, legal restrictions on hiring and firing of employees);
- *Labour market conditions* – high unemployment, resulting in an ample supply of a potential informal labour force;
- *Social system* – particularly the demotivating relation between various social standards: average wage, minimum wage, unemployment benefit, and the social assistance benefit (notably in less developed regions with relatively low average wages), leading to misuse of the social system and disincentives to take up formal employment.

The influence of these factors is changing over time. To generalise, it is apparent that “formal” factors (e.g. changes in labour and business legislation, implementation of concrete policies to reduce misuse of social transfers) tend to change more rapidly, while more informal contextual factors change less frequently and require a longer time to develop (e.g. tolerance and lack of concern regarding undeclared employment).

Tables 3 and 4 give an insight into the motives which lead employers to make use of illicit work and employees to carry it out, using data from Bednárík, Danihel and Sihelský, 2003.

The tables confirm that employers are motivated to take on undeclared employees mainly to reduce or avoid high labour costs and administrative restrictions. They are also able to take advantage of a large supply of mostly unemployed persons who are willing to carry out undeclared work to create an income for themselves or to supplement their existing income.

Measures taken to combat undeclared work

Combating undeclared work is not a top political priority in the Slovak Republic. It is dealt with in a rather fragmentary manner by policies aimed primarily at addressing issues of broader significance (unemployment, abuse of social system, reform of social insurance

Table 3: Incentives leading employers to illicit employment

Incentive	Answer (in %)
Excessive labour costs in relation to productivity	39.8
Fierce competition	5.4
High social security contributions costs	91.0
Dependence of entrepreneur on dominant producer	3.6
Large supply of “black” labour	58.4
Low qualification of labour	7.8
Local restrictions on activity	10.8
Barriers on setting up business	4.8
Administrative restrictions, burden of legal norms	35.5

Note: Respondents were officials from tax offices, labour offices and trade registers.

Source: Bednárík – Danihel – Sihelský (2003)

Table 4: Incentives leading employees to illicit work

Incentive	Answer (in %)
Increase of income	69.9
Debt pay-off	6.0
High tax burden	6.0
Struggle to survive	69.9
To live freely and independently	2.4

Note: Respondents were officials from tax offices, labour offices and trade registers.

Source: Bednárík, Danihel and Sihelský (2003)

and pensions, business environment improvement) and measures that focus directly on restriction of undeclared work (control, sanctions). What is missing is an integrated strategy to combat undeclared work by means of legislation, institutions and policies, covering both prevention and restriction.

Existing measures that directly or indirectly seek to combat undeclared work in Slovakia can be divided into two main categories: preventive tools and restrictive tools.

Preventive tools

Preventive tools include policies and measures supporting the creation of an environment that is favourable to the declaration of economic activity in both the demand and supply sides. Several important reforms have been implemented and/or launched over the last two years in this area.

Perhaps most noteworthy is the complex tax reform, which introduced a 19% flat tax rate for all corporate and individual income. The new *Income Tax Act*¹⁰ abolished progressive taxation of individuals, removed tax bands ranging from 10 to 38%, and decreased the corporate tax rate of 25%. The Act also abolished a large number of tax exemptions and tax benefits and introduced a new system of higher deductible items, resulting in no taxpayer having to pay higher taxes than before the change (including the lowest income groups). According to the opinion of independent experts, the relatively low tax rate and simple tax system will bring new vigour to the economy, supporting healthy economic growth, rendering stimuli for local business and foreign investment,

¹⁰ Act of the NC SR No. 595/2003 Coll. on income tax, effective as from 1 January 2004.

increasing motivation to work, and discouraging taxpayers from tax evasion. (Zachar, 2004)

The new *Act on Social Insurance*¹¹ introduced substantial changes to the PAYG¹² pension scheme. Among the most important is the increased link between contributions and benefits where, contrary to the previous system¹³, the rule “the higher the contribution, the higher the pension” is applied. The new pension scheme should motivate people to work in the formal sector. The reform also brought a new division of social security contributions to various funds and a decrease of the overall rate paid by employers by approximately 3% (+0.6% for employees).

The *strategy of promoting employment growth through changes in the social system and labour market*¹⁴ outlined a new concept of social and labour market policy, based on the following principles:

- Reducing disincentive effects caused by the tax and payroll tax burden (pension and healthcare reform);
- Strengthening motivation of the individual to find and retain a job (this should also lead to transfer of a part of undeclared activities into the formal sector);
- Increasing labour market flexibility (flexibility of employment relations, simplified administrative procedures related to payment of taxes and social contributions);
- Improving efficiency of state administration and services in the labour market and social affairs (including gradual decentralisation of the social agenda to administrators who have a better knowledge of who is in need and who is misusing the system);
- Reducing social system abuse (surveillance and sanction of undeclared work carried out by the registered unemployed, abuse of social assistance, etc.).

The amended *Labour Code*¹⁵ has improved the flexibility of employment relations, mainly through giving both parties the right to more flexibly conclude and terminate an employment relationship and by deregulating working time. The law also abolished a special type of temporary work contract (the so-called “work activity agreement”), which was suspected of being abused for undeclared activities. In a survey conducted among businesses, the Labour Code was evaluated as clearly beneficial to the business environment because of improved flexibility and applicability. The respondents said that the law partially stimulates the creation of new jobs. However, the contribution to the elimination of undeclared work is relatively insignificant.¹⁶ The National Labour Inspectorate points to the fact that an employment contract does not always have to be concluded in a written form, which leaves room for illicit employment. Also, the special form of short-term contract (the so-called “work performance agreement”) is suspected of being misused for undeclared work as there is no obligation to keep records of hours worked as it is the case with a regular employment contract.

Two recent legislative measures are expected to positively influence the business environment: the *Act on Business Register*¹⁷ and the amended *Act on Trade Register*¹⁸. Both legal norms significantly simplify and speed up the process of new business registration, entering changes and deleting records in the registers. The Business Register will administer applications within a fixed term of five working days, the Trade Register within seven days (30 days for licensed trade). Insufficiently defined rules in the past led to intentional obstructions and gave rise to widespread corruption. The legislative changes should increase transparency and facilitate the entry of new businesses into the market. (Zachar, 2004)

Amendments of the *Act on Social Assistance*¹⁹ aim towards the better targeting of social assistance and reduction of its abuse. However, some experts believe that lowering social assistance benefits for people without a working income may not result in an increased motivation to work; instead, it may lead to a higher motivation to take up illicit activities, particularly for people with low education levels. These experts feel that other methods would be more effective, such as providing support for the creation of new job opportunities and lowering social contributions for part-time workers.

Restrictive tools

Restrictive tools primarily involve measures to detect, stop and penalise existing examples of undeclared work.

The *Act on Labour Inspection*²⁰ specifies competencies in the National Labour Inspectorate (NLI) and local labour inspectorates in the area of supervising compliance with labour laws governing the creation, amendment and termination of legal relations, working conditions of employees, provisions for securing safety and health protection at work and provision of wages. The Act specifies obligations of employers, entrepreneurs and employees towards the labour inspectorate and the authorisation of the inspectorate to impose penalties for violation of these laws. These include, *inter alia*, the obligation of the employer to notify in writing regarding commencement of activities, to enable free access of inspectors to the workplace and create conditions for a swift inspection, to submit upon request the identity of persons present at his/her workplace and documents proving a labour relation to such persons. Any person present at the workplace of an employer is obliged to prove his/her identity and explain the reason for such presence at the workplace. However, as reality shows, it is not difficult for employers and employees who engage in undeclared activities to avoid sanction. In many cases it is not possible for the inspector to prove that a person is not just helping out a friend (e.g. at a construction site). The NLI admits that such a form of work is not considered to be illicit work.²¹ The Labour Inspectorate has recently issued an informative brochure, which aims to draw the attention of employers and employees to the negative consequences of undeclared work.²²

¹¹ Act of the NC SR No. 461/2003 Coll. on social insurance, effective as from 1 January 2004 (certain provisions as from Slovakia's accession to the EU).

¹² Pay-As-You-Go scheme, first pillar of pension system, administered by the Social Insurance Agency.

¹³ Within the previous PAYG system even major differences in the amount of social contributions paid resulted only in minute differences in the pensions, which motivated employers to pay just a small portion of wages officially (e.g. minimum wage) and the rest unofficially.

¹⁴ Document submitted by the Ministry of Labour, Social Affairs and Family, was adopted by the Government of the SR in July 2003.

¹⁵ Act of the NC SR No. 311/2001 Coll. Labour Code, effective as from 1 July 2003, as amended.

¹⁶ Business Alliance of Slovakia, survey conducted in the 4th quarter of 2003, published on 16 February 2004.
http://www.alianciapas.sk/pas/menu_pravidelne_nazory_pas_160204.htm

¹⁷ Act of the NC SR No. 530/2003 Coll. on business register, effective as from 1 February 2004.

¹⁸ Act of the NC SR No. 455/1991 Coll. on trade licence entrepreneurship, effective as from 16 June 2004, as amended.

¹⁹ Act of the NC SR No. 195/1998 Coll. on social assistance, as amended.

²⁰ Act of the NC SR No. 95/2000 Coll. on labour inspection and on the amendment and supplement to selected laws, effective as from 1 July 2000 (certain provisions as from 1 July 2001).

The forthcoming *Act on illicit work and illicit employment* (see also the introduction to this article) will nominate the labour inspectorates as the competent authority to carry out surveillance over illicit work and illicit employment. The special law requires the amendment of several related laws, including the *Labour Code*, *Act on Labour Inspection*, *Act on Social Insurance*, *Act on Employment Services*. The most important changes in these laws concern improvements in the mutual co-operation of competent bodies in combating illicit work, the setting of penalties for illicit work (up to SKK 10,000 for a naturalised person, up to SKK 1 million for a legal immigrant; 250 euro and 25,000 euro, respectively) and the introduction of work identification cards²³.

The *Act on employment services*²⁴ specifies, *inter alia*, the obligation of registered unemployed people to actively search for jobs and produce evidence for this. Stricter conditions of unemployment support provision and the new rules of co-operation between the labour offices and unemployed people have led to a mass de-registration of unemployed people from the records. It is thought that many of those who became excluded from the register due to non-cooperation with the labour office (66 thousand persons in 2003, representing approximately 15% of the total number of de-registered unemployed) were actually engaged in undeclared activities. This undeclared labour may have included persons who worked some distance from their permanent residence (e.g. abroad) and thus were unable to present themselves regularly at the respective labour office, and also those for whom the new rules decreased the motivation to work in the informal sector.²⁵

The NLI and the Headquarters of Labour, Social Affairs and Family (former National Labour Office) have signed an Agreement on co-operation in combating illicit work. Based on a written notice from the National Labour Inspectorate, the labour offices exclude from the unemployment register persons who have carried out work without an employment contract.

The programme of *community service jobs*, realised in 2000-2001 with the aim to decrease long-term unemployment, had an

important side effect: the ex-post evaluation of this programme suggests that the public works were more efficient in disclosing illicit work than controls by the labour offices. The labour office provided mayors of the municipalities with lists of long-term unemployed recipients of social assistance benefits and asked the mayors to identify those who had expressed an interest to participate in community work. The mayors could then identify those who worked unlawfully. This was mainly relevant to small municipalities where people live in less anonymity.

Other authorities which have the competency to supervise compliance with declarations of economic activity within their field of operation include labour offices, the Social Insurance Agency, health insurance companies, tax authorities, trade licensing offices, and the police force. The total number of disclosed cases of illicit work²⁶ suggests that existing control mechanisms are unable to significantly reduce the size of the problem. The NLI detected 145 cases in 2003. Table 5 gives an overview of accomplished inspections of illicit work during the first half of 2004.

There is no reliable estimate of the number of foreign people engaged in undeclared work in Slovakia.²⁷ Published cases mainly concerned illicit workers from the Ukraine and the Balkans. During the first half of 2004, the Police Corps detected 25 cases of illegal residents and 48 people were expelled from the country due to violation of the rules of residence.

Conclusions

Undeclared work is an omnipresent problem in Slovakia. There are multiple reasons behind its existence, which reflect economic and social conditions and the formal and informal rules and regulations that operate in Slovakian society. The estimated scale of the phenomenon, its consequences for society, and current measures to address it suggest that policies are needed which recognise the importance of combating undeclared work in an integrated manner. Our recommendations to reduce the problem include:

Table 5: Results of controlling illicit work (1st half of 2004)

Institution	Number of inspections	Detected cases of illicit work	Imposed penalties	Amount of penalties (in SKK) ²⁸
National Labour Inspectorate	2,551	69	20	1,246,600
Trade licensing offices	12,996	225		5,833,700
Police Corps	961	36	37	0
Tax offices	786	7	0	0
Ministry of Health	8	0	0	0
Total	17,302	337	-	7,080,300

Source: Report on illicit work in the 1st half of 2004. (Draft document). National Labour Inspectorate, Bratislava, August 2004.

²¹ "Do you want to work 'black'?" SME daily, 17 August 2004

²² http://icop.safework.gov.sk/nip/publikacie/chces_pracovat_nacierno.pdf

²³ The work IDs will be issued by the Social Insurance Agency to every employed and registered unemployed by end of 2006. The card will contain precise data on employment, payment of social security contributions, whether the person is registered as unemployed and/or receiving social assistance. People will be obliged upon request to present the card to inspectors. The Ministry of Labour expects the cards to become an efficient tool in fighting undeclared work.

²⁴ Act of the NC SR No. 5/2004 Coll. on employment services, as amended, which substitutes the Act on employment.

²⁵ As from 1 February 2004, a differentiated periodicity of reporting to the offices was introduced: long-term unemployed who are not involved in any activity, will have to present themselves at the office every seven days; unemployed, involved in programmes and activities organised by the office, will have to report monthly; for other applicants the 14 days periodicity remains.

²⁶ Not included are insurance companies and labour offices.

²⁷ Act of the NC SR No. 48/2002 on stay of aliens and on the amendment and supplement to selected laws regulates terms of entry and stay of foreign citizens in Slovakia, including different permits. The Act on employment services regulates employment of foreigners.

²⁸ 1 SKK = 0.026 euro

In the area of prevention:

- decrease social security contributions to further reduce tax;
- simplify and integrate the obligation to report to different public institutions;
- further simplify administrative procedures necessary to enter the market, particularly for tradespersons;
- attempt to incorporate informal workers into the formal sector by granting them a transitional period;
- consider support of micro-credit schemes for low-income groups;
- decentralise competencies to local governments, which have better knowledge of local problems;
- raise public awareness of the effects of undeclared work.

In terms of restriction:

- evaluate efficiency of labour inspection from a cost-benefit perspective and promote successful methods;
- import good practices from abroad;
- refine and supplement existing legislation to make it more applicable to the fight against undeclared activities (e.g. through a special law on illicit work and illicit employment);

- improve data sharing and exchange of information between competent authorities;
- involve different stakeholders (e.g. businesses, trade unions, insurance companies) in the drafting and implementing of measures;
- further develop and improve the measurement of undeclared work.

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Finland

Introduction

The Finnish Government's interest in the prevention of economic criminality and black economy stems from the 1990s, when Finland experienced its deepest recession of the century. Concern about the informal economy and its negative effects on society surfaced and have remained a concern of government programmes ever since.

In 1996, the government of Prime Minister Paavo Lipponen made a decision-in-principle on the first Action Programme for the prevention of black economy and economic crime. It included measures to increase surveillance and sanctions, measures that raised the risk of being caught, as well as research and information campaigns. Legislative changes were made accordingly and resources for investigation of economic crimes were increased. The focus was on preventative measures, established through collaboration between different authorities.¹ To continue this work, the government made another decision-in-principle on the second Action Programme for the prevention of black economy and economic crime in 1998.

In 2001, the second government of Prime Minister Paavo Lipponen launched the third Action Programme targeting economic crime for 2001-5. The aim of the programme is to substantially reduce opportunities to commit economic crimes and to operate in the black economy and therefore to minimise the damages economic crimes cause. The programme focuses on the prevention of harmful practices that have a negative effect on public financing and on economic life.

As part of government policy, a nationwide development project to develop co-operation between public authorities against the black economy called VIRKE² was launched for 2000-5. In 2002, at the request of the Parliamentary State Auditors, VIRKE published a report on the situation of the black economy in Finland.³ In the report, the *black economy* is defined as “*economic activity that is lawful as regards to its nature, but is not declared to public authorities in order to avoid paying taxes and fees related to this activity*”. This can be called a *fiscal* definition of black economy. Compared with the definition of *undeclared work* by Renooy et al (2004), the Finnish definition of the black economy is broader, including economic activities that are not directly related to labour such as double billing in foreign trade and income from international capital investments that have not been declared to public authorities. According to Finnish legislation, if undeclared work is being performed in enterprises, it fulfils the characteristics of economic crime, even though the work as such is lawful.

In the public debate not only undeclared work but also illegal work has been a general concern. In particular, both the government and social partners have been concerned about illegal foreign workers that EU enlargement may bring about. At the beginning of 2004, as a response to this concern, a new body was set up at the National Bureau of Investigation, the purpose of which is to control the use of illegal foreign labour.

¹ Parliamentary State Auditors (2002).

² VIRKE comes from the initials from the Finnish name for the development programme (Viranomaisyhteistyön kehittämisprojekti).

³ Viranomaisyhteistyön kehittämisprojekti (2002).

Prevalence of undeclared work in the economy

In 1994, the Ministry of Finance nominated a working group on the prevention of black economy. In the final report of this working group, the size of undeclared work in Finland was estimated to be 4.2% of GDP in 1992 which, according to the tax authorities, corresponded to 80,000 person-years of labour.⁴ In 1971 it was estimated that the black economy corresponded to 5% of GDP and in the beginning of the 1980s to 7% of GDP. In 2002, VIRKE estimated that the share of the black economy has remained at the 1992 levels, which amounts approximately to 5 billion euro annually.⁵

The main sectors in which undeclared work takes place in Finland are construction, the restaurant sector, transport, shipyard industry and cleaning work. Of these, construction and restaurant sectors are the most prominent. In shipyard industry and cleaning work the share of foreign labour and subcontractors has been on the rise.

It has been estimated that 9% to 16% of production in the construction sector was undeclared in 1998, corresponding to EUR 500-840 million in the value of production. The share remained at roughly the same level between 1995 and 1999. It was equivalent to 17,000-23,000 person-years of labour in 1998. Work in construction is heavily male-dominated.

Undeclared work in construction is common in building one-family and holiday houses and in renovations that households have ordered. However, the bulk of the informal economic activity in the construction industry takes place in the chains of sub-contractors on large building sites. It has reportedly become common practice for these companies to forge receipts and outsourcing contracts in order not to disclose the true amount of work performed at their sites. This allows them to pay part of the wages illicitly.

Currently, there are no estimates of the overall involvement of legal or illegal immigration in undeclared work in Finland. In the construction industry, the Finnish Construction Trade Union suspects that only half of the estimated 9,000-10,000 foreign workers are working legally. The estimate of the Confederation of Finnish Construction Industries is, however, lower even as regards the legally working foreigners and the employers do not want to give an estimate of the amount of illegal workers.⁶

In the restaurant sector the share of the informal economic activity (in 1999) has been estimated to account for over 21% of production, which corresponds to 330 million euro as hidden wages and is equivalent to over 18,000 person-years of labour. The hidden income of self-employed entrepreneurs increases the total share of undeclared labour by 50-100 million euro in the restaurant sector. In 1995, the undeclared labour in the restaurant sector was about 200 million euro corresponding to less than 20% of its production.⁷ The restaurant sector is female dominated.

The main forms of black economy in the restaurant sector are hidden wages that undeclared sales of food and alcohol have made possible. Also, social security payments are left unpaid and entrepreneurial income may partly be hidden. According to a recent study, the hidden income of entrepreneurs increased in the 1990s.⁸

In 1999, the average hourly wages for entrepreneurs in the restaurant sector was estimated to be 3.9 euro, while an average wage-earner received 9.7 euro per hour. In 1993, the corresponding figures were much closer to one another; 5.7 euro compared to 8.1 euro.

In the restaurant sector there are firms that have not registered with the tax authorities and systematically fail to fill in tax forms and pay their taxes. Bankruptcies are commonly used to avoid taxes and, due to this, the turnover of the firms is quite high in this sector. The bulk of black economy in the restaurant sector is in restaurants offering fast food or beer but, according to VIRKE, the growing number of ethnic restaurants is becoming a problematic group as well.

In transport the black economy is concentrated in road transport, in taxis and in chartered bus transports. It has been estimated that the black economy in road transport was 100-150 million euro in 1994, and 50 million euro in 1996. According to VIRKE, this drop in the black economy is partly artificial. Part of the Finnish-owned firms in road transport have now been registered in Russia. The Finnish tax authorities have also found quite systematic concealment of incomes in the taxi business.

There is some scattered information on the share of black economy in other industries. In business services there is information on technical services, in which it has been estimated that the amount of the black economy is 15-85 million euro annually. In education and training the corresponding amount has been estimated to be 15 million euro, and in barbers and hairdressers 15-50 million euro, which corresponds to one quarter of the turnover in this industry.⁹

Measures to combat undeclared work

Legal and administrative environment for businesses

In 2002, there were about 230,000 enterprises in Finland. The majority (99%) of enterprises were SMEs with under 50 employees, and 93% employed less than 10 people. About 44% of all company employees worked in SMEs. The promotion of entrepreneurship has been an important target in the past and present government programmes.

In 2000, the second government of Prime Minister Lipponen launched an Entrepreneurship project. It involved about 120 concrete measures. These focused on the crucial stages in a company's lifecycle, e.g. market functioning, how to become an entrepreneur, the critical years of a company and corporate growth. In particular, it focused on diminishing administrative burdens on entrepreneurship. It was believed that excessive bureaucracy formed obstacles to corporate growth, to hiring new employees, and to founding new companies.¹⁰

In order to lighten the administrative burden, a new Companies Act was introduced, making it easier to found companies and enabling shareholders to make unanimous decisions without formal meetings. A new Company and Organisation Register enables companies to submit data concerning their founding, address change and dissolution to the registers of several authorities

⁴ Finnish Ministry of Finance (1995); see also Renooy et al (2004). This estimate was based on the comparison of studies on working time and earnings, and it was corrected according to expert assessments.

⁵ Lith (1997).

⁶ Kuusisto (2004a).

⁷ Parliamentary State Auditors (2002).

⁸ Lith (2002).

⁹ Parliamentary State Auditors (2002).

¹⁰ Finland's National Action Plan (NAP) for Employment 2002.

through one notification. In the amendments to the Accounting Act, the criteria concerning turnover and balance sheet total for small companies legally required to keep accounting record have been almost doubled. These changes have made it easier for small companies to submit information on the profit and loss account, balance sheet and other information. Small limited-liability companies have been entirely exempted from having to draw up a separate annual report.

It was further decided that, to support the founding of new companies and to operations of existing companies, at least 50 regional business service points will be set up in 2002-7. The service points will combine the advisory and development services of central and local government and enterprise agencies.

In 2003, the government of Prime Minister Vanhanen launched its own Entrepreneurship Policy programme. The main objectives of this programme are to safeguard a stable and predictable operational environment for enterprises and to ensure that the resources available for promotion of entrepreneurship in various administrative branches will be utilised to the full. According to this programme, the aim of promoting entrepreneurship will be taken into consideration in preparing new legislation. The Ministry of Trade and Industry will systematically monitor preparation of new legislation from an entrepreneurial perspective.

According to this programme, the publicly-funded business advisory services will focus on improving business management skills of SMEs. The Employment and Economic Development Centres will start a programme for drawing up business plans. Furthermore, the system of start-up grants will be improved. In 2004, to reduce bureaucracy and to make it easier for occasional employers and small companies to deal with their employer obligations, an Internet payment system is being set up. In 2006, a "tax account system" will be introduced, which enables companies to combine their main tax payments and to minimise actual payments and notifications.

Over the next decade, several tens of thousands of entrepreneurs will be giving up their business operations due to ageing. In 2004, to support the generation change, the government has reduced the tax payable in generation change.

The government has also made changes to the value-added tax to promote growth of the smallest companies. As of the beginning of 2004, a gradual scale will be introduced to VAT liability, under which VAT reduction will decrease as turnover grows in scale, ranging from zero at a net turnover of 8,500 euro to full VAT at a net turnover of 25,000 euro.

Strengthening incentives to declare work

Finland's labour market can be characterised by a low number of labour-intensive jobs requiring only a low level of expertise and training. As a result of the progression of labour costs, low-skilled

jobs have been the first to become unprofitable. In 1996, the government initiated "incentive trap" reforms to improve the appeal of these jobs. As a result, the threshold salaries for those on minimum benefits and for unemployed persons living alone have dropped, making it economically more feasible to seek employment.

The government is determined to improve incentives for being both an employee and an employer, particularly in low-productivity sectors. Decisions on tax subsidies for low-pay fields will be prepared during 2004 for introduction in the budget for 2005. The tax wedge in low-pay fields will be decreased by cutting the income taxes of low-income earners and by cutting employer contributions.¹¹

To increase supply of labour for the low-income earners, the government will raise the maximum amount of work-related deduction and earned income deduction in municipal taxation. The earned income deduction and similar deductions in municipal taxation will also be increased. The tax relief that will be carried out will narrow the tax wedge for a low-income earner by about one percentage point to 50% in 2004. The tax wedge on labour has already narrowed by 5.5 percentage points since the mid-1990s.¹²

In 2003, the tax deduction allowed for household service work was increased to 1,100 euro per year (from 900 euro in 2002) as part of the comprehensive incomes policy settlement at the beginning of 2003. This deduction can be made for household work, care work, and repairs and renovations on a home or leisure dwelling. A household can deduct either the social security contributions on the household worker's pay or 40% of the wages paid if services are bought from a company.

The household work deduction was launched in 1997 as a temporary experiment. The system was made permanent in 2001. It has been estimated that the household work deduction has had a positive impact on employment and has reduced undeclared work. New small companies, co-operatives and associations providing household services have emerged to provide these services. Since the introduction of household work deduction, increasing numbers of households have started to claim it (Table 1). In 2002, the number of households claiming this deduction was increased almost fivefold compared to their number in 1998.

Strengthening surveillance

In Finland, both the government and social partners have been concerned about clandestine labour. In particular, social partners have been active in construction and hotels and restaurants in which undeclared labour has been used more extensively than in other sectors.

Government actions

The action to combat black economy and economic crime has been stepped up in Finland in recent years. The government has regularly

Table 1: The use of household work deduction 1997-2002

	1997, 3 months	1998	1999	2000	2001	2002
Number of households	4,600	19,300	24,000	31,500	73,800	89,500
Deduction, 1,000 euro	656	7,972	10,007	13,606	32,571	42,514

Source: The Finnish tax administration (2002).

¹¹ Finland's National Action Plan (NAP) for Employment 2003.

¹² Finland's National Action Plan (NAP) for Employment 2003.

approved programmes for this purpose. It continues to further measures to fight the black economy and economic crime, primarily by improving co-operation between authorities. One of the aims of the VIRKE project (on co-operation between public authorities against black economy) is to suggest how this work should be organised in Finland in future.

The government emphasises that to help in fighting black economy, the working conditions of foreign workers should be monitored more efficiently. It aims at using the following means to do this:

- Promoting co-operation between authorities;
- Rectifying shortcomings in the legislation that make monitoring difficult (Act on Equality, Penal Code, Act on Employment Contracts, Aliens Act and Act on the Supervision of Occupational Safety and Health and Appeal in Occupational Safety and Health Matters);
- Increasing information provision to foreign workers;
- Adding more efficient monitoring of the working conditions of foreign workers to the programme to combat the black economy.

According to VIRKE, the tax administration has a central role in combating black economy in Finland. However, the efforts of tax administration are by no means regarded enough. For the fight against undeclared economy to be successful, co-operation of several authorities (police, prosecutors, enforcement authorities, customs etc.) is required.¹³

The chosen line to rely on co-operation between different authorities has been deemed in Finland more efficient than the establishment of a separate organisation, the purpose of which is to tackle the informal economy (as has been done in some other Nordic countries). It is regarded that the complexity of undeclared work makes it difficult for one organisation to fully tackle it. However, there has been a growing need to put more resources on the surveillance of undeclared economy in Finland. At the beginning of 2004, a new body employing nine workers was set up at the National Bureau of Investigation (KRP) to control the use of illegal foreign labour. The new body is temporary but it is hoped that it will be made permanent in 2005. The Ministry of the Interior has noted that the resources for preventing economic crime have been cost effective in Finland. In 2002, each person-year of labour to prevent economic crimes has yielded 112,000 euro for the government and society.

Efforts by social partners

The prospective influx of foreign temporary agency workers has caused concern among Finnish trade unions. The Central Organisation of Finnish Trade Unions (SAK) and some of its affiliates have expressed their fears that employment agencies may, unlawfully, pay their workers wages that are below those agreed in Finnish collective agreements. They also worry that the enforcement of labour standards will be inadequate. The Service Union United (PAM) has pointed out that advertisements of a temporary employment agency offering underpaid labour have already been circulating among some service sector undertakings. According to the TNS Gallup survey, 27% of Estonians would agree to take up illicit work if they worked in Finland.¹⁴

Several steps have been taken in Finland in order to increase the control over illegal foreign labour. As mentioned above, a separate

unit has been established at KRP to this end. Among labour market organisations, SAK has demanded that foreign-based temporary employment agencies should be required to register with the Finnish tax administration and disclose any information about wages. SAK has also negotiated with two employers' organisations, the Employers' Confederation of Service Industries and its affiliate, the Private Employment Agencies Association (HPL) on how to curb illegal employment. The three of them agreed that contracts between HPL-affiliated temporary employment agencies and their customers will include collectively agreed terms and conditions of employment. Consequently, in cases of 'social dumping'¹⁵, an employment agency can be held responsible for a breach of contract and its payments can be frozen.

The Finnish Construction Trade Union on the employee side and the Confederation of Finnish Construction Industries on the employer side have been actively seeking to curb illicit activities in the construction industry. They have agreed bilaterally that:¹⁶

- Companies must demand proof of payment of tax and pension contributions from prospective contractors when they call for tenders. If these payments have not been met, it is justifiable to reject a bid;
- Information about contracts must be delivered quarterly to the tax administration;
- Electronic pass systems must be used for workers and contractors at building sites.

It appears that in assessing the state of the black economy, the electronic pass system has proved the most effective of the measures in the construction industry. It has made it possible to monitor all contractors and workers at building sites effectively. As a result, illicit activity is now easier to detect. The other two agreed measures have not been so successful. By setting up a new firm with a clean record, breaches of tax and pension contribution payments can be easily hidden. It is very easy to establish a new company and this is commonly done in the construction industry.

Furthermore, the Finnish Construction Trade Union has unilaterally conducted inspections of building sites in order to gather details of outsourced firms and their adherence to collective agreements. It has forwarded this information to the tax authorities.

In addition, social partners in construction have co-operated in informing construction firms about the proper use of foreign labour. In May 2004, they published a guidebook on the subject. This followed EU enlargement, which had prompted concerns about an influx of foreign temporary agency workers to Finland.

In 2000, the Finnish Hotel and Restaurant Association (SHR) launched a programme to curb the black economy in the hotels and restaurants sector. The programme includes lobbying for lower taxation as well as providing training and information to the member companies of SHR. As part of this programme, SHR also requested its member companies for letters of attorney, which allowed it to check that companies' payment of tax liabilities and pension contributions are in order.¹⁷

The social partners in their European-level multi-annual work programme have agreed to organise a seminar on undeclared work in 2005.

Despite the fact that social partners have been quite active in

¹³ Viranomaisyhteistyön kehittämisprojekti (2002).

¹⁴ Kuusisto (2004b).

¹⁵ An expression to describe the superior competitiveness of another country arising from lower labour costs, less job protection or less regulation.

¹⁶ See Kuusisto (2004a) for more details on this.

¹⁷ Lith (2002).

preventing undeclared economy, there is a common failing among all the measures introduced by the social partners. The problem is that only organised firms are effectively covered by them, leaving out undertakings which are either unorganised (by an employers' organisation) or categorised as being outside the sector. In construction, this problem is particularly marked in building one-family houses and in renovations that households have ordered. In hotels and restaurants, black economy is concentrated on small enterprises selling fast food or beer.

Conclusions

Despite the fact that the share of undeclared work in Finland is among the lowest in EU, there is a large consensus that more efforts need to be made in preventing black economy and economic crime in our country. The government has introduced programmes which aim to promote entrepreneurship and to increase incentives to declare work. It is also well recognised that more resources need to be directed to the surveillance of undeclared work. In this field, the social partners have also been active in their respective industries. The chosen policy line is to improve co-operation between different authorities in the prevention of undeclared work and economic crime. The evidence shows that these types of inputs have been quite efficient. Illegal foreign labour has become a new policy concern, and it is expected that tackling this problem will be the focus of policy-makers and social partners alike in the coming years.

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Sweden

Introduction

The term “undeclared work” is accepted throughout the EU as “any paid activities that are lawful as regards their nature but not declared to the public authorities”. In Sweden this is known colloquially as “svartarbete” (“black work”). Both the National Audit Office and the tax authorities (*Skatteverket*) see this as a concept distinct from tax avoidance of income from financial transactions and the avoidance of taxes from, for example, “moonshine” alcohol and smuggling. Thus there should be no confusion in using the Commission's concept in Sweden.

Given the high level of tax in Sweden, the issue of undeclared work is sometimes mentioned in the Swedish debate to argue for lower income taxation. It does not appear, however, that undeclared work and marginal income taxes are related in any obvious fashion (*Skattestatistiska Årsbok* 1999). In the last decade, the single most debated (and controversial) aspect of undeclared work in Sweden is

that related to domestic activities (*hushållsnärätjänster*) such as childcare, cleaning and repairs. In part the controversy is due to the gender issues involved. The government has recently proposed that house repairs are made tax deductible in a bid to incorporate this type of work into the legitimate economy. The issue of undeclared work has recently been high on the political agenda, particularly in the debate on transition rules for workers from the new Member States. Several recent court cases indicate that current legislation is not sufficient to prevent undeclared work by foreign nationals. Work permits have historically been issued only in very limited numbers and related almost exclusively to types of work which could not realistically be done by Swedes, such as foreign correspondents in the media and cooks in restaurants that serve foreign cuisine, although this situation has changed in recent years in the face of skills shortages in connection with the new economy. Under Swedish law, employers who use workers not possessing a work permit can be penalised as well as the workers themselves.

There would appear to be some agreement between various studies on the extent of undeclared work in Sweden. It is generally agreed that between 11% and 14% of the population undertake undeclared work; and those who do so are predominately young males; most often these people are students or the owners of small businesses. Some workers with declared jobs also take part in undeclared work, attracted by increase earnings and evasion of tax on this second income and social contributions. For employers, the attraction of undeclared work is a reduction in costs. Contrary to popular assumption, the National Audit Office found that the unemployed were not involved in undeclared work to any major extent.

Prevalence of undeclared work in the economy

In the late 1990s the National Audit Office (RRV) published four reports on undeclared work in Sweden. The tax authorities have also done some more recent work on this issue and this is reported below. However, the RRV studies are by far the best studies in Sweden and are cited extensively in this article. The RRV project used several methods in order to estimate the amount of undeclared work. When trying to ascertain hours of work or the category of people involved in undeclared work (as opposed to measuring the shadow economy's share of Gross National Product) the most direct and appropriate method is by interviews. RRV conducted two interview studies in 1997. The following was asked of a random sample of the population between 18 and 74 years of age:¹

There are clear indications that a sizable proportion of the population accept undeclared work and business without a receipt. The questions concern not only work when one receives cash payment but also the exchange of services between friends, acquaintances, neighbours or family members outside of one's own household. It also includes the sale of goods without a receipt such as at market places or other undeclared business. Have you, during the last 12 months, done such work or sold goods without giving a receipt? [Author's translation].

One can note that this is a rather wide-ranging but also a very specific definition of undeclared work. They found that about 700,000 people, 12% of the population and aged between 18 and 74 years, had performed some form of undeclared work that year. This corresponds to about 5% of all work performed and roughly 3% of Swedish GDP. (A year later the RRV put this figure higher, at 4.6%). Among the youngest members of the labour force (18-19 years of age) the corresponding figure was 25%. Those involved worked an average of five undeclared hours a week with average yearly income from undeclared work of SEK 25,000 (2,786 euro). The cost to the public budget was estimated to be a loss of between SEK 20 to 40 million per year (2.2 million euro to 4.4 million euro).

The National Tax Authority (*Riksskatteverket*) has also conducted similar interviews in order to ascertain the level of undeclared work in Sweden in 1998 and 2001. These were directed to employed persons (not self-employed). The question was simply "I have personally carried out undeclared work during the last year" (agree, do not agree, do not know). In 1998, 7% of the respondents answered that they agreed with this statement and in 2001 the corresponding figure was 6%. These are lower figures than found in the above-cited RRV survey from 1997. Possibly this is due to the respondents in the National Tax Authority's investigation not considering this to include "exchange of services between friends,

acquaintances, neighbours or family members outside of ones own household. It also includes the sale of goods without a receipt such as at market places or other black business" as in the RRV questionnaire. One can also note that the tax authorities addressed their questions to the employed while RRV asked a sample of the population.

The RRV survey also has information on the self-reported labour market status of those performing undeclared work.

Table 1: Labour market status of those performing undeclared work

Labour market status of those performing undeclared work	Percentage
Self-employed	17.5
White collar	7.2
Skilled blue collar	15.8
Other blue collar	13.4
Unemployed	10.6
Pensioners	3.3
Students	23.5
Others	7.8
Total	11.1

Source: RRV (1998)

According to categories in Table 1, undeclared work is most prevalent among students (23.5% of student responses) and the self-employed (17.5%). It is not obvious how one should interpret these figures in relation to the official reporting of labour market status in the Swedish labour force surveys and thus in the European labour force surveys. Whilst the RRV investigation found that 5% of all work (hours) distributed among roughly 11% of the population was undeclared, it is difficult to interpret this figure in relation to impact on employment in the legitimate economy. To do so, one would first require an estimate of how much of this work would be performed at all if it were to be performed with the extra costs (taxes, social security contributions and maybe even wages), if this work were to be forced out of the black sector. Even if all the work could be transferred without loss to the legitimate economy, the impact on employment rates requires an estimate of how much would result in more hours by the already employed and how much would result in new jobs. Presumably the main impact on official labour market statistics is on the number of hours worked and not on labour market status. One can note from Table 1, for example, that the unemployed perform undeclared work to a lesser extent than the employed. However, the table also shows that there would appear to be some potential for undeclared work to be transferred to those groups with higher employment rates, particularly students.

Whilst there is some discrepancy in the total figures in the RRV studies and those conducted by the tax authorities, the breakdown by characteristics is rather similar. Men are twice as likely as women to have performed undeclared work and the young perform undeclared work appreciably more often than older persons. The market research company Observer found, in an investigation in

¹ Note, however, that this method cannot capture the extent of undeclared work performed by foreign nationals not registered in the country and thus not included in the sample frame. The issue of undeclared work by illegal foreign labour is currently very prominent in the public debate and is addressed below.

2000, that undeclared work was most prevalent among non-unionised, blue-collared male workers in the private sector. However, the RRV study provides some indication that the well educated are also over-represented among those performing undeclared work. This is primarily due to numerous fringe benefits that should be seen as constituting a component of the wage and thus should be liable to tax but remain undeclared, thus tax is (illegally) not paid.

RRV found that whilst undeclared work can be found in all sectors of the economy, it is most prevalent in the construction trade (including repairs) and in the hotel and restaurant sectors. It is also relatively highly prevalent in activities closely related to domestic life, such as household cleaning, childcare and the repair of cars and houses. The tax authorities have interviewed firms asking if competition from companies that perform undeclared work has a negative impact on their business. (*Skattestatistisk Årsbok 2001*). The highest affirmative response rate was found for hairdressers (54% of firms interviewed), trucking companies (43%), restaurants (37%), construction (37%) and taxi firms (31%). The average figure was 16%.

Data from a variety of sources (tax authorities, RRV and official government investigations), appears to indicate that, during the last 20 years, the amount of undeclared work has remained much the same and may even have declined slightly (Sjöberg, 2000).

Reasons for undeclared work in Sweden

There are numerous factors behind the extent of undeclared work in the economy such as the extent and form of social control, the level and structure of the tax system, conceptions of solidarity with society, social norms and values etc. It is difficult to speculate which of the many factors lie behind the extent of undeclared work in Sweden. However, the RRV investigations have simply asked why people did undeclared work. Table 2 provides the responses for both those who did and did not perform undeclared work. Tax avoidance is by far the most often cited reason for undeclared work.

The tax motive is particularly prevalent amongst men, the self-employed and the well educated. It is less often cited by the unemployed and students. Both these groups, to a higher degree than others, state that they “had no choice”, although the root cause of this response may well be the level of tax that this work would incur.

The risk of detection is, of course, an important factor. The RRV study showed that 90% of those doing undeclared work believed

there to be little or no risk of being caught. Women experienced a higher risk than men.

Given that taxes in Sweden constitute the highest share of GDP in all OECD countries (roughly 55% of GNP), it would appear obvious to attribute undeclared work to taxes. However, RRVs review of the academic literature concludes that there is no scientific evidence of such a relationship. Whilst a cursory comparison between Sweden and other countries may provide some indication that this may indeed be the case (very high Swedish taxes, very high employment rates and with lower undeclared work than in many countries), the responses in Table 2 indicate that taxation is surely of some importance. One can also note that 60% of the respondents in the RRV survey considered taxes in Sweden to be unreasonably high.

Undeclared work in Sweden appears to be strongly related to services used by households (for example building repairs and cleaning services). In this context the issue is not only taxes but also social security contributions that are paid on all declared work, regardless of working hours. This is a major topic of debate and some policy initiatives. Given that one can expect the relative prices of such services to increase over time, this is an issue that almost certainly will continue to be a matter of concern and policy debate for many years to come. One should, however, underline that the Swedish welfare state provides many services free of charge or with very low fees for activities that may otherwise be undeclared, such as childcare. There are no reliable estimates of the extent of undeclared work for household related services.

Measures taken to combat undeclared work

According to the Swedish NAP 2003, combating undeclared work is a “high priority”. The government sees undeclared work to be problematic as it distorts competition, undermines the legitimacy of the tax system and, in the long run, threatens welfare.

It has been pointed out above that the issue of services sold to the household may be of particular relevance to the extent of undeclared work in Sweden. This was the subject matter of a major governmental investigation published in the Service Sector Taxation Report from 1997 (*Tjänstebeskattningsutredningen SOU 1997:17*). The investigation made a number of recommendations. Most controversially it discussed the possibility of the exemption of social security contributions for domestic services. The various proposals led to practically no legislation. However, very recently the government has taken some limited action (Press Release Tax Authorities 2004-07-02). The “ROT” tax deduction proposal

Table 2: Reason for performing undeclared work

Reason	Performed undeclared work %	Did not perform undeclared work %
To avoid tax	76.5	76.7
To avoid bureaucracy	5.4	3.1
Had no choice	10.7	10.7
To avoid higher fees	0	1
To avoid lower benefits	2.1	2.4
To annoy the authorities	0.8	0.3
Other reason	4.5	2.0
No response	0	3.8

Source: RRV (1998)

addresses the issue of undeclared work related to the repair of dwellings. Whilst it has yet to become law it passed Parliament's Taxation Committee in July 2004 and is backed by a Parliamentary majority. The tax deduction applies to those who build or repair their dwelling between 15 April 2004 and 30 June 2005. 30% of the labour costs are tax deductible (maximum SEK 10,500 – 1,170 euro – for a house and SEK 5,000 – 557 euro – for an apartment and the minimum in both cases is SEK 2,000 – 223 euro). These rules are very similar to the previous ROT tax deduction system that was in operation between 1996 and 1999.

The design of the social security system may be of great importance in providing incentives to perform undeclared work. Practically all social security payments in Sweden are linked to previous (declared) income. The closer the relationship between contributions and entitlements, the more an individual will lose by working outside the system. The 1998 reform of the pension system reinforced the relationship between declared work and pension payments. In the new system all declared income throughout a person's working life impacts on the pension paid upon retirement. In the previous system this was only the case for the best 15 years of income. Thus the new system makes it more costly for an individual to operate "outside the system".

Concerted efforts to raise social awareness of undeclared work have been undertaken through a joint campaign by the tax authorities and the recently founded Economic Crime Authority (*Ekobrottsmyndigheten*). This started in 2000. The co-operation also involves branch organisations and trade unions in various sectors of the economy. Throughout 2000 they focused mostly on the construction sector. In 2004 the tax authorities declared particular focus would be placed on restaurants, taxis, cleaning firms, hairdressers and haulage companies. (*Aftonbladet* 2004-03-17).

The authorities identified clusters of firms involved in undeclared work that were largely based in Stockholm, Göteborg and Malmö. These clusters involved around 300 businesses. The initiatives resulted in several convictions. The first took place in Stockholm in August 2000 and the accused were sentenced to between two and four years in prison. More recently (March 2004), and also in Stockholm, the Court sentenced six people to up to five years in jail for performing undeclared cleaning services within the company Swede Serviceföretagen. These activities were related to bidding for tenders of outsourced cleaning services by the regional public health authorities.

As young people generally have more tolerant attitudes to undeclared work, the authorities have targeted them through both information campaigns and tax control. The campaigns have been broadly cast and included, for example, an Internet café at the country's largest rock festival (Hultsved). It also involves informing the young, (though cinema advertisements) on the useful social purposes for which tax income is utilised. In 2004 the tax authorities declared that young men are to be investigated more carefully in their examination of tax returns. Investigations of youth attitudes to undeclared work (conducted by the market research company GfK Sverige AB) show that the percentage of young people who think, "it is unacceptable to perform undeclared work" has increased from 42% in 2002 to 55% in 2004. This is a statistically significant increase and may well be influenced by the aforementioned campaigns. This was based on 2,000 telephone interviews with people between the ages of 16 and 20. The tax authorities see this as evidence of a clear break in the trend regarding young people's attitudes towards undeclared work (Director of Information, Sten Eriksson, National Tax Authorities).

The issue of undeclared work using labour from abroad has been

much debated with the accession of the new Member States in May 2004. Sweden was unique among the EU-15 in not introducing special transition rules for labour from the new Member States. However, during the transition rules debate in parliament, the government declared that it would subsequently present a Bill to Parliament with suggestions on how to monitor the implementation of collective agreements even at workplaces with unorganised labour. This was seen to be a means of identifying and preventing some undeclared work using labour from abroad.

There have been a number of court cases that have highlighted the legal problems involved in this issue. An important case was that of a Lithuanian women (without a work permit) who had performed cleaning services for four women in Gothenburg on several occasions. In a lower court the four women were found guilty of tax fraud. However, the higher court acquitted the four women on grounds that it could not be proved that they were the employer. The Public Prosecutor decided not to appeal. In July 2004 there was a similar "not guilty" ruling on a woman accused of using foreign labour for house repairs. The woman was cleared of the accusation of hiring foreign workers without a work permit. Again, the reason was that one could not prove that there was an employment relationship in place. In comments on the case the trade union representing construction workers appears resigned to the fact that the current law is not able to deal with these matters. Their strategy is to report these incidents to the police and to visit the sites and demand to negotiate a collective agreement. According to the union, when this occurs the foreign workers usually choose to leave the job. (*Dagens Nyheter* 8 July 2004).

As a result of the cleaning services case, the government set up a working group in March 2004 comprised of representatives of the Ministries of Finance, Justice and Foreign Affairs to examine its consequences for the exploitation of foreign workers and undeclared work. The group is to examine whether there are gaps in the current legislation.

While most of the public debate on foreign workers has focused on low wage and low-skilled work, there are also taxation issues pertaining to high-wage foreign workers. In January 2001 the government introduced tax exemptions for "foreign key personnel" (for example, executives, experts, and researchers). The main feature of the tax relief legislation, which was advocated by business and industry, is that it provides a 25% reduction of taxable income for "foreign key-persons". This means that a key foreign individual's income tax is now based on only 75% of his or her income. The reduced tax applies to all salaries and "perks", such as employers' contributions to housing and living costs. The tax reduction also applies to stock options and other special compensation, provided it is offered by the Swedish employer. The reduction applies to the first three years of employment in Sweden.

Conclusion

It would appear that 5% of all hours worked in Sweden are undeclared. Roughly 11% of the population perform some form of undeclared work every year. This appears to have remained stable during the last two decades. The major recent issues of public debate are undeclared work related to household services and (currently) undeclared work from foreign labour. These are particularly relevant issues in Sweden due to the high level of taxes and social contributions on wages and to the fact that Sweden did not introduce any transition rules on labour from the new Member States. There have been very few recent legislative initiatives explicitly introduced to prevent illegal work. The exception is the

soon-to-be-introduced ROT deduction for repair work on dwellings. However, this is merely the reintroduction of a measure in operation in the late 1990s. One could, however, also underline the potential impact of the major pension reform (1998) that strengthens the relationship between contributions and benefits, thus making undeclared work more costly for the individual in the long term. Since 2000 the tax authorities have tightened their control of tax returns and conducted campaigns to increase social awareness of the issue, particularly amongst the young. No transition rules on labour from the new Member States were introduced and a number of court cases have shown that the Public Prosecutor has not been able to obtain convictions concerning cases of undeclared foreign labour. This has led the government to investigate whether new legislation is required and it is likely that reform may be forthcoming.

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United Kingdom

This article gives a selective overview of literature and data on "undeclared work" in the UK. We begin by looking at how the concept of "undeclared work", as found in various European Commission communications, relates to concepts used in the UK, before turning to recent debates and policy developments.

Definitions of undeclared work in the UK

The UK literature contains a plethora of terms, used interchangeably with "undeclared work", including: "paid informal work"; "underground economy"; "hidden work"; "shadow economy"; "unobserved sector"; and "cash-in-hand work" (Williams and Windebank, 1998). Despite this variety, in practice these terms tend to be defined in similar ways to "undeclared work", as used by the Commission. The key feature in common to the various definitions is that they refer to:

".... the paid production and sale of goods and services that are unregistered by, or hidden from the State for tax, social security and/or labour law purposes, but which are legal in all other respects..... Such work covers only activities which are illegal because of their non-declaration to the State for tax, social security and/or labour law services. It excludes activities in which the goods and/or service itself are illegal (e.g. drug trafficking, prostitution). Hence this sphere covers only activity where the means do not comply with regulations, but the ends (goods and services) are legitimate" (Williams and Windebank, 2003, p.283)

Also consistent with the Commission's approach are the various categorisations of undeclared workers themselves found in UK

literature and policy debates. In particular, undeclared workers in the UK include:

- people who are officially "inactive" or "unemployed" but are working while claiming benefits;
- second and multiple job-holders;
- immigrants working illegally.

A further type of work mentioned in UK policy debates relates to individuals engaged in legal, declared activities, but who (in agreement with an employer or otherwise), misreport their employment status. An example is construction workers who report themselves as self-employed, but are consistently contracted by the same employer and should, arguably, be more accurately classified as dependent employees. This enables the employer to avoid tax and social insurance obligations, and may also offer the worker advantages with regard to income tax (and where relevant, VAT) obligations¹.

The policy debate on undeclared work in the UK

Political debate on undeclared work has gathered pace in more recent years, given impetus by a public inquiry in 2000 by Lord Grabiner². Grabiner's report focused on the scarcity of cross-governmental working, emphasising the need for a combined effort to tackle undeclared work by all affected government departments: the Inland Revenue (IR); Her Majesty's Customs and Excise (HMCE); and the Department for Work and Pensions (DWP).

Grabiner recommended new initiatives in addition to enhancements of existing measures. Subsequently, the UK Government has

¹ There have been a number of important measures introduced in the UK to reduce the amount of "false self-employment" of this kind. As, however, this area is not one given significant focus in the European debates on undeclared work, and given limited space in the current article, we do not cover these measures here.

² Full report available at: <http://www.hm-treasury.gov.uk/media/60F77/74.pdf>

intensified its efforts to tackle undeclared work, and nearly all Grabiner's recommendations have been implemented in some way, although it is too early to assess their impact.

Prevalence and nature of undeclared work in the UK

Wide range of macro-level estimates

There is no consensus on the size and economic value of undeclared work in the UK. The UK's National Action Plan for 2003³ used National Accounts⁴ to estimate undeclared income at £14 billion (20.3 billion euro), or 1.5% of GDP (for the year 1999). A recent Commission report (Renooy *et al.* 2004), puts the figure at 2%, lower than in most other EU Member States. However, as Table 1 shows, these figures are much lower than those in a range of economic studies over the years, many of which give an estimate of around 12-13% of GDP – though many criticisms have been made of such estimates on the grounds of methodological flaws, and lack of a theoretical basis (see Tanzi 1999, Thomas 1999, Dixon 1999 and Schneider & Enste 2002).

A more recent consensus emerges in comparative studies (Renooy *et al.* 2004, and OECD 2004, Chapter 5) that the share of GDP accounted for by undeclared work is rather modest in most northern European countries (including the UK), and much lower than suggested by the various macro-economic proxy estimates summarised in Table 1.

Faced with a lack of robust data on the extent of undeclared work, it is notable that the Grabiner report (2000) avoided attempting to quantify the problem, and simply chose to assume that the “hidden

economy is a major problem, involving billions of pounds”.

Official focus on measuring “benefit fraud”

Grabiner did, however, note that more progress had been made in measuring undeclared work due to benefit fraud – the part given most prominence in UK Government statements. Thus, in 2000, the government estimated social security fraud at £2-4 billion (2.9 billion-5.8 billion euro)⁵ per annum. The methods used to calculate benefit fraud have been criticised (Sainsbury 2003), on the grounds that whilst official statements use the concepts “benefit fraud” and “undeclared work” interchangeably, official estimates include all types of fraud, not just failure to declare earnings. Other types of fraud (*e.g.* non-declaration of income from occupational pensions, claiming benefits as a single person whilst cohabiting, and not declaring savings) account for up to 70% of benefit fraud among working age people (Sainsbury, 2003). Yet fraud data can be misleading, since it often includes “claimant error” (Sainsbury 2003).

How much undeclared work?

Estimates of the numbers engaged in undeclared work are also subject to methodological difficulties. Whilst any estimates of the *absolute* extent of undeclared work should be treated with caution, recent surveys (Pederson 2003) in five countries (Denmark, Norway, Sweden, Germany and Great Britain), using a standardised methodology, offer the possibility of a *comparative* picture between Member States. Results confirm that reported participation in the undeclared economy in the UK is the lowest of the countries studied (affecting only 7.8% of the 18-74 year-old population in 2000). The research gives little indication of the reasons for the UK's low incidence, but it is likely to reflect a range of institutional, legal and

Table 1: Selected estimates of prevalence of undeclared work/shadow economy

Year	Estimate	as % of	GB/UK	Source/notes
1960	0.0%	GDP	UK	Feige 1981, cited in Thomas, 1999
1970	2.0%	GNP	GB	Schneider & Enste, 2002 (cash approach), Table 4.6
1975	14.0%	GDP	UK	Feige 1981, cited in Thomas, 1999
1980	8.4%	GNP	GB	Schneider & Enste, 2002 (cash approach), Table 4.6
1986-90	9.7%	GDP	UK	Tanzi, 1986, cited in Lysiotou <i>et al.</i> , 2004, Table 3 (currency demand method)
1986-90	13.2%	GDP	UK	Enste & Schneider (19978), cited in Lysiotou <i>et al.</i> , 2004, Table 3 (physical input — electricity, method)
1989-90	9.6%	GNP	GB	Schneider, cited in Schneider & Enste, 2002 (cash approach), Table 4.3
1989-90	13.6%	GNP	GB	Schneider, cited in Schneider & Enste, 2002 (electricity consumption method), Table 4.3
1990	10.2%	GNP	UK	Schneider, 1997a, cited in Dixon 1999 (currency demand method).
1990	12.4%	GDP	UK	Schneider, 1997, cited in Lysiotou <i>et al.</i> , 2004, Table 3 (currency demand method)
1990-93	11.2%	GNP	GB	Schneider, cited in Schneider & Enste, 2002 (cash approach), Table 4.3
1990-93	7.2%	GNP	GB	Johnson <i>et al.</i> , cited in Schneider & Enste, 2002 (cash approach), Table 4.3
1995	12.6%	GNP	GB	Schneider & Enste, 2002 (cash approach), Table 4.6
1999	1.5%	GDP	UK	National Action plan for Employment (derived from National Accounts data)
2000	2.0%	GDP	UK	Renooy <i>et al.</i> , 2004, (European Commission), Tables 1 and 4.1
2001-02	12.5%	GDP	GB	Schneider and Klinglmaier, 2004 (Currency Demand and DYMIMIC method), Table 3.5
2002-03	12.3%	GDP	GB	Schneider and Klinglmaier, 2004 (Currency Demand and DYMIMIC method), Table 3.5

³ The NAP is available at: http://europa.eu.int/comm/employment_social/employment_strategy/nap_2003/nap_uk_en.pdf

⁴ UK National Accounts: The Blue Book (2002). Available from http://www.statistics.gov.uk/downloads/theme_economy/BB_2002.pdf

⁵ Estimate used by Alistair Campbell in 2000, DWP Press Release <http://www.dwp.gov.uk/mediacentre/dss/pressreleases/2000/jul/17-07-00-1.asp>

policy factors: it is notable, for example, that compared with many Member States, the UK has relatively low rates of income tax, and a deregulated environment for the start-up and operation of small businesses, alongside (see below) a major recent policy impetus to reduce social security fraud.

The characteristics of undeclared workers

Research on the characteristics of undeclared workers is sparse in the UK. The Commission's Communication (1998) stated that undeclared work across the EU is generally present in sectors involving low-profit, labour-intensive work such as agriculture and construction, industries where costs are a major factor of competition (e.g. manufacturing), and in modern innovative sectors. The Communication stated that such work in the UK is dominated by men.

A recent study of two UK local labour markets suggests, however, that women play a major part in the undeclared economy (Williams & Windebank, 2003). Informal work in lower income areas was particularly concentrated in: hairdressing, childcare, window cleaning, car repair, appliance maintenance and plumbing. Whilst women tended to do traditionally female tasks (childcare, domestic affairs, etc.), men in the informal economy undertook jobs such as plumbing and car maintenance.

The five-country study of Pederson 2003 provided further comparative evidence of the characteristics of undeclared workers (see Renooy *et al.* 2004, Tables 4.3 and 4.4). It confirmed that, although in all countries undeclared work was more common among men than among women, the gender difference was less marked in Great Britain than the other four countries. In the UK, as in other countries, the incidence is higher among young people, but the UK stands out as having a particularly high incidence of undeclared work among students (at 30.2%, the highest of the five countries), which may reflect high levels of debt amongst students. Also interesting (in the light of the emphasis on benefit fraud, discussed below) is the low incidence of undeclared work amongst the unemployed and pensioners (at 9.2% and 1.1% respectively, the lowest of all five countries — although these results should be treated with caution as sample sizes are small).

Motivations for undeclared work

Macro-level studies say little of individual motivation for undeclared working. A common assumption in the policy debate is that motivations are largely cost-driven. Some UK evidence, however, suggests other reasons. Williams and Windebank (1998) note clear gender difference in the extent to which participation is financially-driven: whilst 72% of the tasks conducted by men were done for financial reasons, the equivalent figure for women was just 18%. Only 5% of women performed undeclared work for a formal business, with the vast majority undertaking tasks (childcare and similar) on behalf of friends and relatives, the stated motivations being less about money and more about helping others, or forging social networks.

Such rationales for undeclared work suggest that any deterrence methods will need to be coupled with the provision of alternative coping mechanisms, such as affordable alternative childcare, in order to limit negative effects on both employers and working parents (Williams, 2001).

Measures to combat undeclared work in the UK

Recent UK measures to tackle undeclared work have been largely a response to the recommendations of the Grabiner (2000) report, embodying two main approaches:

- a proactive approach to prevent people joining the undeclared economy (e.g. schemes to make it easier for businesses to declare themselves, and harder for people to cheat the benefits system).
- a reactive approach — detecting and taking sanctions against those involved in the undeclared economy.

Reducing legal and administrative burdens on businesses

Whilst much help was already available to new businesses (e.g. through the *Business Links* network), the government responded in 2001 to Grabiner's recommendations of reducing the tax compliance burden on business, with a "*Starting up in Business*" campaign. This included a streamlined procedure for registering with the IR, and improved guidance for new businesses on tax, National Insurance Contributions (NICs) and VAT, a guidance video, direct support from IR Business Support teams and a Helpline.

Grabiner also recommended encouraging businesses to register as soon as possible with the IR to avoid getting their finances confused and slipping into the informal economy. With effect from January 2001, anyone becoming self-employed/eligible to pay Class 2 National Insurance Contributions (NICs) was required to register with the IR within three months (reduced from six) in order to avoid a £100 fine (145 euro).

A 2002 evaluation of the *Starting Up in Business* campaign⁷ showed improvements. Prior to 2001, 33% of businesses delayed registration until more than three months after start-up. This fell to 20% by 2002. The evaluation also suggested increasing use of the new support provisions, and positive user responses.

However, a report by a parliamentary committee (the Public Accounts Committee) on the IR's performance in 2003-2004⁸ criticised the department for not further easing the business start-up process (e.g. by allowing payment of tax and social contributions in instalments). The compliance strategy was criticised as out-dated, and for not being revised to take account of changing business circumstances. The committee also presented evidence suggesting that fines for late registration had not been implemented effectively. Between May 2001 and August 2002, 92,600 notifications were received outside the three-month time limit, but in 60% of these, a penalty was not imposed or was waived due to low earnings.

Increasing incentives

Prior to the Grabiner Report, there were already a number of initiatives in place in the UK that aimed to make working in the formal economy more attractive. These included the National Minimum Wage (introduced in 1997), followed by the Working Families Tax Credit (effectively, an in-work benefit regime, recently combined with other tax credits as the Working Tax Credit). Grabiner noted that the success of such initiatives would depend on effective publicity. The government set up a comprehensive publicity campaign on tax credits which ran until September 2002. According to the UK NAP for 2003, by July 2003, some 5.75 million families had taken advantage of tax credits. The overall impact of tax credits

⁷ Full report available at: http://www.inlandrevenue.gov.uk/startup/startup_in_business_evaluation.pdf

⁸ HM Treasury Minutes on the report available at: <http://www.official-documents.co.uk/document/cm61/6130/6130.pdf>

has yet to be assessed, and although there were a number of administrative problems in their introduction, there is preliminary evidence that they have had a positive effect on the labour market participation of certain groups (e.g. lone parents). There is no clear evidence, however, on the extent to which tax credits have affected the proportion of work which is undeclared.

In his report, Grabiner criticised the current benefit system and rules for failing to adapt to new patterns of work, which are often flexible and temporary in nature (see also Sainsbury 2003). He noted that many claimants starting work prefer not to risk coming off benefits and having to reapply if the new job fails to last. (Rowlingson *et al.* 1997 also note the “economic rationality” of benefit claimants who fail to declare their income). Research shows that anxiety surrounding transition from benefits is cited by half of all job-seekers as a concern about starting work (Bottomley *et al.*, 1997). Steps have been taken, through the introduction (and extension) of “linking rules” (enabling claimants starting work to return to their same benefit rates and terms automatically if the job fails within a certain period), but there is no evidence on how far these steps have alleviated such anxieties.

Whilst some benefit “run-ons” (for lone parents and the long-term unemployed) were available prior to the Grabiner Report, these were not comprehensive. The UK NAP 2003 detailed new benefit run-ons, including the Job Grant (an automatic payment to jobseekers aged 25+, covering the transition period between leaving benefit and starting work), and an extension of housing benefit for those moving into work. However, there is no evidence of either the uptake or the effectiveness of these schemes in encouraging people into the formal economy.

Deterring benefit fraud

As well as removing disincentives to leave benefits, Grabiner argued strongly for effective deterrence measures against those working and claiming benefits. Whilst the IR, HMCE and DWP all had fraud teams in place, Grabiner raised concerns about their effectiveness, noting that in 1998/1999 the Department for Social Security (now DWP) prosecuted 6,000 individuals (and 362 collusive employers) for not declaring income when receiving their benefits, but only 7% were punished (other than by a reduction or termination of benefit payment). Grabiner recommended improved working methods (stronger partnership working, improved surveillance technology and new systems of penalties).

Key examples of such methods relate to *Jobseekers Allowance (JSA)*. Although JSA requires claimants to interact frequently with officials, the regular timetable of appointments made it easy for fraudsters to arrange working lives around them. In 2001, the More Frequent Attendance (MFA) regime was introduced, requiring those suspected of fraud to attend extra advisory meetings arranged at unpredictable times, to disrupt any routine undeclared working activity. However, an evaluation of MFA (Garland *et al.* 2002)⁹ showed that it had little impact. It is questionable whether MFA would act as an effective deterrent, given research (e.g. Williams and Windebank 2003) suggesting that much undeclared work is of a type that can be re-arranged even at short notice.

Some similar initiatives appear, however, to have had a disincentive effect on benefit fraud. For example, an evaluation of the New Deal Plus by Wilson (2002)¹⁰, which involves weekly meetings and case

conferences with Jobcentre staff, showed that one effect was the exposure of those in the informal economy.

Partnership working

Grabiner 2000 stressed the importance of joint investigation and action to combat “combined tax and benefit fraud”. In 2001, 20 *Joint Shadow Economy Teams* (JoSETs) were established with staff from several branches of government, including HMCE, the Inland Revenue, and Jobcentre and DWP officers, to tackle colluding employers involved in complex fraud and tax evasion cases. Similar teams were established to focus on fraud in the clothing sector and, more recently, *Operation Gangmaster* has been set up to work in agriculture.

Whilst no independent evaluation of the impact of these measures exists, DWP¹¹ reported that between April 2002 and January 2003, the teams found 535 instances of fraud, worth £610,413 (886,269 euro). In the year to January 2004, JoSETs made 667 prosecutions, collecting fines worth £4.2 million (6.09 million euro)¹².

Surveillance

Grabiner recommended that the government consider ways of sharing information held on clients, and using conflicting or inconsistent data from other sources, such as financial institutions, to check for fraud. Prior to Grabiner, data-sharing had been piecemeal, due partly to data protection legislation, and a lack of understanding across government departments of what the law allows.

The Social Security Fraud Act (2001)¹³, however, provided government officials with new powers to investigate and punish benefit fraud. Officials can use information from private organisations, including banks, insurance companies and utility companies, when they have “reasonable grounds” to do so. Between April 2003 and February 2004, 217,501 “inconsistencies” in data for further investigation were identified, amounting to total “savings” of £39 million (56.6 million euro) (DWP Departmental Report 2004). However, it is not clear whether all these “inconsistencies” refer to undeclared work.

In terms of tax evasion, the UK NAP 2003 described how the IR’s investigations had identified 22,959 people who had not declared their income and 10,332 people who had failed to declare their income from part of their activities. The additional liabilities resulting from these investigations totalled £23.1 million (33.5 million euro). Whether these outcomes can legitimately be described as “savings” is open to question since, as shown below, it is unlikely that these liabilities will have been recouped through fines. Any savings may, therefore, be longer-term in nature through a deterrent effect.

Fines/penalties

Whilst Grabiner argued for a “*strong environment of deterrence*”, he stressed that this should not involve *increasing* fines, since most people working in the hidden economy do not have the means to pay large penalties, and enforcement faces practical problems. In the case of benefit fraud, typical sanctions involve reducing benefit payments, or payment in small instalments over a long period.

⁹ Summary report available at : <http://www.dwp.gov.uk/jad/2002/esr105su.pdf>

¹⁰ Full report available at: <http://www.dwp.gov.uk/jad/2002/wae111rep.pdf>

¹¹ Full Report available at: <http://www.dwp.gov.uk/publications/dwp/2003/dwpreport/index.asp>

¹² Full report available at: <http://www.dwp.gov.uk/publications/dwp/2004/dr04/home.asp>

¹³ Details of the Act available at: <http://www.legislation.hmsso.gov.uk/acts/acts2001/20010011.htm>

Sanctions for tax evasion

Grabiner reported that the process of sanctioning tax offenders worked well, but that too few prosecutions were made and only for serious cases, through the slow and expensive Crown Court process. In accordance with his recommendations, a statutory offence of knowingly failing to meet basic tax obligations was introduced under Section 144 of the Finance Act 2000. Any such case can be tried in a magistrate's court.

In 2004 the PAC Report on the IR's performance criticised the service for its limited use of the new offence, with only 60 prosecutions a year, even though financial returns (estimated at 12:1) suggest it would be worthwhile to bring more.

Sanctions for benefit fraud

Grabiner argued that there was no reason why persistent benefit fraudsters should not lose their right to benefit for a fixed period, so long as the vulnerable remained protected. The Social Security Fraud Act (2001) introduced a new "*Two strikes*" scheme. With effect from April 2002, benefits can be removed for 13 weeks from those caught fraudulently claiming benefits twice within a three-year period. The Act also introduced discretionary powers to fine employers between £1,000 and £5,000 (1,452 – 7,258 euro), as an alternative to prosecution.

There is little evidence of use of the new sanctions, although aggregate statistics show that between April 2003 and February 2004, the DWP sanctioned 23,002 people for benefit fraud, of whom 8,212 were successfully prosecuted (DWP Departmental Report 2004). The UK NAP 2003 stated that, in total, DWP involvement in teams working across government aimed at tackling the informal economy led to the application of sanctions in 654 cases and to 2,371 adjustments to benefit (combined, these were worth £5 million, or 7.3 million euro).

Amnesties

Grabiner warned against the use of amnesties to encourage people to join the formal economy, on several grounds. Firstly, amnesties for VAT evasion are problematic because most businesses have already collected the tax from their customers. Secondly, amnesties can create bad feeling amongst honest workers. Finally, they can create the expectation of future amnesties, and further reduce the incentive for undeclared workers to come forward.

Nonetheless, in April 2003, the government announced a six-month amnesty for VAT registrations. Businesses were able to register without the normal late penalties (of 15%) until September, after which the government planned a strong crackdown. It was the first time the UK Government had offered such an amnesty. Unfortunately, no data is available on the impact of this.

Raising social awareness

A key recommendation of Grabiner was to improve publicity about initiatives to tackle undeclared work. In particular, the public should:

- be aware of the sanctions they may face by working in the undeclared economy;
- be aware of what steps they can take to join the formal economy;

- be educated about the effects of undeclared work on the unprotected worker, and on society as a whole.

In practice, most effort has been focused on the first of these objectives. Substantial funds have been put into the *Targeting Benefit Fraud* campaign¹⁴, encouraging people to "stop or shop". Prominent advertisements are accompanied by a benefit fraud hotline, and a dedicated website. Between April 2003 and February 2004, some 190,827 responses to the hotline and website were made, resulting in 161,916 fraud referrals (DWP Departmental Report 2004).

The government outlined a long-term strategy to change public attitudes towards benefit cheats, and some evaluation evidence shows a lower climate of public tolerance of fraud (UK NAP 2003)¹⁵. However, in the same NAP, the government admitted that there has been little attempt to raise awareness of the benefits of working in the legitimate economy.

The IR was criticised by PAC in 2004 for not undertaking similar national campaigns against tax fraud. Arguably, even more publicity is needed here, since research (Adams & Webley 2001) into attitudes to VAT compliance shows that many perceive the VAT collection process to be inequitable, and regard VAT monies as a legitimate part of their business turnover.

Conclusion

There is little robust data on the scale of undeclared work in the UK, although what evidence exists suggests that it is likely to be lower than in many Member States. The bulk of the measures taken to date to tackle undeclared work are focused on combating benefit fraud, although we have found little evidence either that benefit fraud is the most important part of undeclared work in the UK (rather than for example, the activities of multiple job holders or working students), or that the UK has a particularly large problem of benefit fraud.

Furthermore, the political rhetoric concentrates on the "problem" of benefit fraud being rooted in individual claimants' aberrant behaviour, rather than being a product also of a hugely complex and relatively ungenerous social security system (Sainsbury 2003); and the worry remains that increasing focus on benefit fraud will stigmatise legitimate claimants and lead to continuing non-claiming of benefits (Sainsbury, 2001¹⁶). A further danger relates to the possibility of "mixed messages" undermining other strategies to reintegrate economically inactive groups. Thus, for example, the government has made much of the new Permitted Work Rules for Incapacity Benefit claimants¹⁷, now allowed to undertake limited amounts of work without jeopardising their benefits, the objective being to encourage them to "try out" labour market activity. There is clearly considerable scope for confusion among this vulnerable group if, at the same time as being encouraged by DWP to undertake "permitted work" while receiving benefit, they are also aware of wider campaigns in society encouraging citizens to report people suspected of both working and claiming benefit.

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¹⁴ Please refer to the Targeting Fraud Website: www.christchurch.gov.uk/resources/benefits/fraud.htm

¹⁵ But see also the evidence from surveys of social attitudes, showing that the proportion of the population who think that benefit recipients are claiming fraudulently was already at an all time high by 2000 (Hills, 2001)

¹⁶ "Getting the measure of fraud" available at: <http://www.cpag.org.uk/info/Povertyarticles/Poverty108/fraud.htm>

¹⁷ See, for example, <http://www.dwp.gov.uk/lifeevent/benefits/pwr.asp>

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Norway

Introduction

Undeclared work is defined in this article as paid activities that are not declared to the public authorities in order to evade taxes and social security contributions, or to obtain or keep public income support. In this definition, which accords with the approach adopted in the most important Norwegian surveys in this field, the activities themselves are not illegal. The only illegal element is that the work is not declared to the tax authorities. The Norwegian equivalent of undeclared work can be directly translated as 'black labour'.

The Norwegian definition of undeclared work is very similar to that given in the 1998 European Commission Communication on undeclared work, where it is defined as any paid activities that are lawful in nature but not declared to the public authorities. Both definitions exclude criminal activities and all types of unpaid activities. The Norwegian definition, however, is slightly stricter in requiring that paid activities should be declared and that not doing so is a criminal act.

In the European Commission report *Undeclared Work in an Enlarged Union*, the term "paid activities" is substituted with "productive activities". Thus, unpaid productive activities such as building your own house are included in the concept of undeclared work. This coincides with the concept of the "non-observed economy" as defined by the Organisation for Economic Co-operation and Development (OECD, 2002). However, this is a much broader concept than is used in this article.

Nevertheless, it is difficult to draw a clear line between the types of activities that should be included in the undeclared economy and those which should not. In Norway, productive activities that are paid for in kind, for example through barter of services and goods, should be declared to the tax authorities except for some cases of help between friends and neighbours. Deciding which activities should be excluded is obviously difficult.

Combating economic crime has a high priority in Norway, and combating undeclared work is one aspect of this. Although the term 'black labour' was not mentioned in the national budget for 2004 or in the White Paper on tax reform (March 2004), the government's action-plan to tackle economic crime (presented in June 2004) sees combating undeclared work as one aspect of combating tax evasion.

Undeclared work has attracted increased attention since European Union enlargement on 1 May 2004. Although Norway is not a member of the EU, it is included in the free labour market through its membership of the European Economic Area. Citizens of the new Member States can now travel to Norway to seek employment, and may remain there if they get a job. There is anecdotal evidence of a possible increase in undeclared work carried out by migrant labour from some of the new Member States.

Prevalence of undeclared work in the economy

The prevalence of undeclared work in Norway was surveyed in 1980, 1989 and 2001, using an almost identical questionnaire each time. The results of these surveys were published by Sporstøyl (1982), Isachsen and Strøm (1989), Goldstein (1990) and Goldstein et al (2002). For each of the three surveys, the data comprised

responses to a questionnaire mailed out to a random sample of the Norwegian population aged 15 and over.

The proportion of people who had participated in undeclared work was measured by their response to the following question:

Have you during the last 12 months performed work where the income from this work has not or will not be declared to the tax authorities?

Those answering 'yes' to this question were either self-employed and had not declared all or some of their work, or were employed by an employer who had not declared all or part of their wages, salaries and assets from employment, either with or without their knowledge.

Table 1 outlines the main results regarding participation in undeclared work. The overall proportion of people performing undeclared work was 20% in 1980, rising slightly to 22% in 1989, but falling markedly to 13% in 2001. The same trends were evident for both men and women. Looking at the figures for 1980 and 2001, Table 1 shows a decreasing proportion of people working undeclared for almost all groups.

The results of the surveys suggest that men take part in the 'black economy' roughly twice as often as women, and that the participation rate decreases with age. The participation rate is lower for those with university education than for those with secondary school education, and highest in the construction sector (see Table 1).

Following the survey question on participation in undeclared work, two further questions aimed to provide data for estimating the total income received from undeclared work:

Approximately how many hours have you performed in such work?

What average wage per hour did you get from this work?

The estimated income from undeclared work is shown in Table 2. Undeclared income increased from 1980 to 1989 and decreased from 1989 to 2001. However, the decrease shown in the figures between 1980 and 2001 is not statistically significant (Goldstein et al, 2002).

The estimated level of total income originating from undeclared work in 2001 equalled 6.8 billion Norwegian Kroner (NOK) (0.8 billion euro), or 0.6% of gross domestic product (GDP) for mainland Norway (excluding petroleum and shipping). Goldstein et al (2002) also estimated the total income from undeclared work, interest, dividends and other kinds of income. Their estimate for 2001 came to NOK 11 billion (1.4 billion euro), or 0.9% of mainland Norway's GDP. About 60% of the 'black economy' income measured by the questionnaires was related to undeclared work.

The surveys found that the prevalence of undeclared work depended on the following factors:

- **How much could be gained**

The main motivating factor behind undeclared work was the profit made from not paying taxes or from avoiding the loss of public income support. Goldstein et al (2002) found that the

Table 1: Percentage of people aged 15 and over performing undeclared work during the previous 12 months

	1980	1989	2001
Females	11	16	8
15-29	12		11
30-49	13		9
50+	7		6
Males	28	32	18
15-29	47		33
30-49	24		28
50+	15		7
Total	20	22	13
15-29	32		21
30-49	19		17
50+	12		6
Primary school (1-6)	14		6
Lower secondary school (7-9)	26		12
Upper secondary school (10-12)	27		20
University level (13+)	15		10
Primary	20		18
Construction	65		48
Manufacturing	26		23
Trade	18		10
Transport	36		13
Health and social services	7		9
Education	15		11
Financial mediation, legal activities, police/defence and public administration	13		4
Other services	22		21

Source: Goldstein et al (2002)

Table 2: Total income from undeclared work, 2001 prices in billions of NOK; Euro equivalent added in brackets

	1980	1989	2001
Females	2.8 (0.3)	4.6 (0.6)	1.7 (0.2)
Males	5.1 (0.6)	8.6 (1.1)	5.1 (0.6)
Total	7.9 (1)	13.2 (1.6)	6.8 (0.8)

Source: Goldstein et al (2002)

probability of undeclared working increased with the level of the perceived marginal tax rate.

- **The risk of being caught and punished**

Goldstein et al found that the probability of working undeclared was higher where the perceived risk of being caught was smaller. In 2001, about half of the survey respondents indicated that they would probably not have been caught if they had had the opportunity to receive undeclared income and had chosen not to notify the tax authorities.

- **Social morals**

In the 2001 survey, about 63% of respondents said that they would have worked undeclared if they had had the opportunity.

- **Restrictions on the opportunities not to declare work**

Goldstein et al found that about a quarter of those who would do undeclared work if they had the opportunity perceived that they actually had the opportunity.

The falling rate of participation in undeclared work between 1980 and 2001 can be explained by several factors:

- The marginal tax rate on income from work was reduced during this period.
- The tax authorities have increased the emphasis on combating undeclared work.
- The proportion of people perceiving that they had the opportunity to work undeclared fell from 27% in 1980 to 23% in 2001.
- A smaller proportion of people in 2001 (63%) stated that they would have worked undeclared if they could, as compared with 1980 (78%).

An important contributory factor behind the falling percentage of women participating in undeclared work is the considerable increase in the female participation rate in the overall labour force. This has reduced the supply of services associated with the 'black economy', such as childcare and housework. At the same time, the demand for such services has also been reduced because of longer paid maternity leave, increased capacity in kindergartens, earlier mandatory school starting and simplified, more attractive tax rules for private childcare services.

Table 2 also indicates a decrease between 1980 and 2001 in total income from undeclared work by women. On average, women gained less income from the 'black economy' in 2001 than in 1980 (2001 prices). A contributory factor was that they had fewer available hours to use in 'black economy' activities, as a result of higher occupational participation.

The participation rates in undeclared work and incomes from such work were higher in 1989 than in both the earlier and later surveys (1980 and 2001). Goldstein et al argued that the high figures for this year were because of special circumstances in 1989 and several of the preceding years. Undertaking undeclared work probably became a more attractive option because of a strong increase in unemployment from 1988 to 1989, a debt crisis in the latter half of the 1980s, and a wage freeze in 1988 and 1989.

Undeclared work by citizens of the new Member States has possibly increased since EU enlargement on 1 May 2004. This supposition is based on reports, rumours in newspapers and assertions by trade union representatives, drawn from local observations. It has not yet been measured in a systematic way.

Schneider and Enste (2000) have provided estimates of the size of what they call the 'shadow economy' relative to GDP for selected countries, including Norway. Using the currency demand approach, they found that the shadow economy in Norway was 18.2% of GDP in 1994-5, increasing to 19.4% in 1996-7.

The shadow economy includes all forms of tax evasion and criminal activities, not just undeclared income from work. Schneider and Enste's estimated figure relative to GDP should therefore be higher than that of Goldstein et al (2002). However, the difference is extremely large – 19.4% of GDP compared with 0.9%. Goldstein et al (2002) made several critical comments on the methods used by Schneider and Enste and the assumptions made in their

calculations. The estimates of Schneider and Enste are therefore not considered as realistic and are not used in the Norwegian debate on undeclared work.

Measures taken to combat undeclared work

Taxes, social security contributions and public income support are to a large extent based on self-declaration of the economic circumstances of people and enterprises. This trust-based system includes a risk of misuse. Controls and sanctions are therefore an integral part of administering the system.

In January 2000, the government presented an annual action plan to tackle economic crime. A new plan was presented in June 2004. Combating undeclared work is one aspect of combating tax evasion.

Measures to combat undeclared work fall mainly into four categories:

- *Implementing procedures and rules that are more favourable to the declaration of paid work.* The action plan supports simplification of the tax system in order to clarify the duties of each person and each enterprise. The costs of complying with the regulations will be studied in order to identify possible improvements.
- *Strengthening incentives to declare paid work.* Paid work in private houses and holiday homes is exempted from the employer's element of social security contributions when a household's total wage payment is less than a certain amount. The income limit has increased significantly since 2003, from NOK 30,000 (nearly 3,700 euro) to 50,000 (6,150 euro). This equals about 15% of the annual income of a manufacturing worker. A tax reform presented by the government in March 2004 aims to reduce marginal tax rates on labour incomes. The reform was passed in parliament in June. One of the motivating factors for this measure is to provide incentives for working more and postponing retirement. At the same time, reduced marginal tax rates will decrease the profitability of not declaring extra work.
- *Strengthening surveillance and sanctions.* The action plan states that the tax authorities will increase the actual and perceived risk of detection if people are committing economic crime, including doing undeclared work. Measures will include random visits to employers to check the information given, co-operation in linking the information provided by different sources, and a concentrated effort in selected sectors such as taxi driving, restaurants and construction. A new team will be set up at the Norwegian National Authority for Investigation and Prosecution of Economic and Environmental Crime to work on cases concerning the misuse of public support schemes.
- *Raising social awareness.* A co-operation forum to combat undeclared work was established in 1992, involving the Confederation of Trade Unions, the Confederation of Business

and Industry, the Association of Local and Regional Authorities and the tax administration. An important aim is to strengthen attitudes against undeclared work through information and campaigns locally and in specific branches.

Conclusions

The proportion of people aged 15 and over who have participated in undeclared work has fallen from 22% in 1989 to 13% in 2001. The total income from undeclared work in 2001 equalled 0.6% of GDP for mainland Norway. Undeclared work by citizens from some of the new EU Member States has possibly increased since 1 May 2004, but this supposition has not yet been measured systematically.

Combating economic crime is a high priority in Norway. Combating undeclared work is one aspect of tackling tax evasion and the misuse of public income support schemes. The campaign to combat undeclared work has gradually been intensified through simplifications in procedures and rules, better incentives to declare work, more efficient surveillance, and improved information about the consequences of undeclared work, both for the individual and for society.

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Bulgaria

Introduction

The Commission Communication on the “concept of undeclared work” (1998)¹ corresponds to the second and third parts of the nationally accepted definition, where the accent falls on labour.

In the first half of the 1990s, research conducted in Bulgaria mainly included studies related to the clarification of the concept, conditions, awareness and methodological approaches for measuring the scale of the hidden economy. Since the second half of the decade, the studies include measurements of the scale and effects of the hidden economy and employment.

When considering the informal economy (whatever the differences in its scope or the accepted labelling concept), the purposes are to: present partially evaluated and included in GDP components and/or unaccounted components of the production system; cover the economic activities in a comprehensive manner; provide an overview of the scope, place and functions of atypical behaviour of the economic units.

Many authors accept the creation and allocation of incomes out of public control, performed within activities and relations in illegal and/or hidden forms, as the main features of the informal sector.² It is underlined that the “informal economy is closely connected with the formal economy”. The shadow sector “entrepreneurs” do utilise the State services, capital and labour without entering into formal relations as economic units³.

The main reasons behind the existence of undeclared work are the concealing of income and the reduction of the volume of the taxes due. Under high rates of unemployment and low flexibility of the labour market, the concealment of income is a profitable prospect, both for the employer and the employee. Because of the heavy tax burden for companies with medium/low incomes/profits and the low reciprocity from the State (what it pays the citizens and the businesses back in exchange for the taxes paid), this logic can easily guide the behaviour of both the corporate managers⁴ and the population. Other reasons include the political environment and the level of links with illegal and criminal structures; the status of the national economy and the adopted “philosophy” of privatisation; social reasons originating from the levels of living standards, unemployment, poverty, insurance culture and behaviour; quality of the social services and access to them; legal framework; capacity of the institutions in the public sphere and the judicial system; scope of crime-generating conditions; various forms of crime – including organised economic crime.

As the results from undeclared work include not just the “leakage” (loss) of GDP value, but also contribute to the illegal enrichment of particular groups of people, the issue has become a subject of permanent political debate. In Bulgaria, among the most popular topics are the control over the customs offices, illegal import/export,

the drugs trade; prostitution, corruption, the protection and compensation of labour, etc. It is still not possible to claim the complete eradication of the tendencies created in the initial years of the transformation period for the subjection of State economic policy to the interests of criminal or para-criminal structures.

The publicity of the political debates on undeclared work is not as high as it is for the criminal activities. Despite its unfavourable consequences, throughout the years of the transformation and under high unemployment, undeclared work provided large parts of the population with income (including “in kind”). Without these, the scale of poverty would have become considerably bigger. At the same time, in the beginning of the 1990s, the informal sector provided employment and chances for the development of entrepreneurial skills.

It should be underlined that employees in the informal economy in Bulgaria belong to the culture of independence and of private initiative. Research shows that they are rather satisfied with their current status and plan to improve it by climbing several levels higher when registering their own businesses and themselves as owners.⁵ At the same time, there is always a risk. Since informal economy employees could enter criminal activities in order to increase profits, the creation of favourable conditions for legalising such businesses has become another popular issue in the political debate.

During the last couple of years, the issues connected with undeclared work have been discussed in connection with the general goals of acceding in the European Union with higher employment rates. Other considerations are the evaluation of the real incomes levels of the population and the scope of poverty, changes in labour legislation, tax reforms and the improvement of their rates of collection, determining the scope and nature of employment in agriculture and the necessary subsidies, etc.

Prevalence of undeclared work in the economy

During 1998-1999, the rate of undeclared work in Bulgaria was estimated at 30.4%, which is the second highest level among the Central and Eastern European countries after Macedonia, which was 35.1%. For comparison, the rates are lowest in the Czech Republic (12.6%) with Hungary (20.9%).⁶

According to a publication of the Centre for the Study of Democracy (2004), the size of the informal economy is decreasing, since the study estimates that the share of undeclared work was 16% of GDP in 2002.

Objective information on undeclared employment

The comparison between the number of employed in 2000 and in

¹ http://europa.eu.int/comm/employment_social/employment_analysis/work_en.htm

² Christoskov, G., Shopov, I., Beleva (1996),

³ The Hidden Economy in Bulgaria, (to be published) Centre for the Study of Democracy, Sofia, 2004

⁴ The problems at managerial level are connected not just with the social insurance of the employees, but also with the payment of high amounts in case staff are dismissed.

⁵ The Grey Economy in Bulgaria – Reasons, Consequences, Policies, E. Dajnov (ed.), Sofia 2002, p. 24-25

⁶ Schneider, F. (2003), The Development of the Shadow Economies and Shadow Labour Force of 21 OECD and 22 Transition Countries. Dice Report, Journal for International Comparison, Vol. 1, No 1, p. 19: the hidden unemployment indicator is calculated as the ratio between the relative share of the unregistered labour force within the total number of the population of working age (16-65 years) in 1998-1999.

Table 1. Number of employees in 2000 and 2003*

Period /Year	Number of Employees (in thousands) according to:		Difference (in thousands)
	Survey of Enterprises **	Labour Force Survey	
Q3 2000	1,903.4	2,371.1	467.7
Q3 2003	2,068.9	2,453.1	384.2

* The data in the table compares the number of the employees in the same period of the year – Q3.

**The Survey is carried out every 3 months. It presents data about those employed with labour contracts at the end of the month. For comparability, in this table the average monthly employment is calculated for Q3 in 2000 and 2003.

2003 coming from the supply and demand side of the labour market (labour accounts method), shows that, from the demand side, the scope of undeclared work is diminishing. Under limited economic growth and the stabilisation of the economy, this is not surprising.

According to the Labour Force Survey (LFS), carried out by the National Statistical Institute (NSI), the number of employed without a labour contract decreases, while the number of the hired employees is increasing (Table 2). The change is due to the reduction of undeclared employment in the private sector, which is the main employer within the grey economy. With the improvement of the business climate and the recent increase in the activity of the private

sector, the share of employees without labour contracts is decreasing.

Men have always been dominant in the gender structure of undeclared work. Nevertheless, in 2003, the number of men employed without a labour contract decreased. Women tend to prefer stable employment (with labour contract) in the public sector.

The share of services (44.4%), followed by industry (31.7%), agriculture and forestry (24%) dominates the structure of undeclared work by sector. However, in agriculture and forestry the share of the employed without a contract in the overall number of the hired is the highest (19%)⁷, which proves that undeclared work is most popular in these two sectors. The proportions are stable and

Table 2: Employees by type of contract with type of enterprise and gender

Type of contract	Number – thousands			Structure –%		
	Total	Male	Female	Total	Male	Female
Third Quarter 2000						
Total	2344.9	1202.3	1142.6	100.0	100.0	100.0
With labour, civil or other contract	2231.4	1134.3	1097.1	95.2	94.3	96.0
Without contract	113.6	68.0	45.5	4.8	5.7	4.0
In private enterprises	1005.6	541.5	464.2	100.0	100.0	100.0
With labour contract	898.9	476.8	422.1	89.4	88.0	90.9
Without contract	106.8	64.7	42.1	10.6	12.0	9.1
Third Quarter 2003						
Total	2453.1	1253.7	1199.4	100.0	100.0	100.0
With labour contract	2355.0	1192.4	1162.6	96.0	95.1	96.9
Without contract	97.7	61.0	36.7	4.0	4.9	3.1
Unknown	0.4	0.2	0.2	0.0	0.0	0.0
In private enterprises	1477.8	780.9	696.9	100.0	100.0	100.0
With labour contract	1384.7	722.2	662.5	93.7	92.5	95.1
Without contract	92.9	58.7	34.2	6.3	7.5	4.9
Unknown	0.2	-	0.2	0.0	-	0.0
2003/2000						
Total (%)	104.6	104.3	105.0			
With labour contract	105.5	105.1	106.0			
Without contract	86.1	89.7	80.6			
In private enterprises	241.1	242.2	238.3			
With labour contract	154.1	151.5	157.0			
Without contract	87.0	90.7	81.3			

Source: NSI.

⁷ According to LFS Q3/ 2003.

have remained at the same levels in previous years, although the share of undeclared work has been higher.

The LFS (Q3, 2003) reads that *15.5% of the economically inactive persons (515,000 people) are willing to start work*. The biggest shares belong to the discouraged and to the people attending schools or training. For the last three years, the number of the discouraged has increased by about 30,000 people. This is the group that is the most seriously threatened by the risk of “starting a job without a contract”. It is even stronger for young people who have not yet completed their education⁸.

The administrative statistics of the EA provides data on the number unemployed who have resigned from registration at the LO. It is considered that in most cases, the unemployed allow themselves to terminate their registration only if they are engaged in undeclared work. In 2003, the number of people with terminated registrations was 2.5% lower than in 2002⁹, which could be considered an indication for the decreasing share of undeclared work. On the other hand, in 2003, the number of people with renewed registration within the inflow of the unemployed increased 1.5 times. Evidently, those who are looking for jobs do prefer the legal way, namely, through labour contacts.

Certain activities that remain unaccounted for by national statistics take place in households. The share of unpaid family workers was about 1.5% to 2.3% during 2002-2003. Two-thirds of them were women

Information from Sociological Surveys

Data from national representative surveys in 1996 and 2002-2003 is cited to trace the changes in undeclared work.

The study of the team led by J. Christoskov¹⁰ included a representative survey and in-depth interviews with more than 30 employers. The study concludes the following:

- Almost one-third of the employed labour force in the country is hired in the “black” (entirely hidden) or “grey” (partially hidden) economy; every tenth person receives additional hidden remuneration;
- Incomes from additional economic activities remain almost entirely undeclared – 73% of the people practising additional economic activity do not declare the incomes received from it, and another 6% declare the incomes partially.
- The private sector has the largest share of non-institutionalised employment – 60% of the self-employed in this sector do not declare their incomes; 87% work without contracts;
- The main sectors where non-institutionalised employment prevails are agriculture (80% of the self-employed), trade and construction.
- Men prevail among the individuals engaged in non-institutionalised employment while women prefer legal economic behaviour (they represent two-thirds of the individuals who entirely or partially declare their incomes from additional activity). However, women are more often hired without a contract.

Research from the Centre for the Study of Democracy and the “Vitosha Research” Agency (2002-2004) show a tendency for the

shrinking of the informal economy¹¹ and the employment in it. Representative questionnaire surveys on undeclared incomes are carried out on the population and on representatives of businesses.

According to the average estimations of the entrepreneurs, the share of employees who work without a contract was 25% in December 2002 and 16.7% in March 2003. The highest shares were in construction (29.1%) and in services (25.3%), while in industry it was just 19%.

The data from the survey of the population reveals somewhat more stable results. In November 2002 and January 2003, the share of persons (excluding the self-employed, owners and freelancers) working without a contract was about 6.0%-6.5%. The differences with the estimations of the entrepreneurs could be due to the unwillingness for declaring the real current employment status.

Not declaring the full extent of the remuneration proved to be far more popular than hiring without a contract. The survey among the entrepreneurs shows that about one fourth to one third (33.3% in December 2002 and 22.6% in March 2003) of the employees with labour contracts have been receiving higher salaries than officially declared.

Moreover, according to the March 2003 survey on entrepreneurs, the share of salaries paid from the “black cashier” is about 18%. In small companies, with a single employee (the interviewed person who is also the owner), this share is 29%.

The comparison of data from the cited surveys shows that although the scope of undeclared work is decreasing, its structural characteristics remain the same. Different sources confirm that usually undeclared work is practised in the private sector, more frequently by men, being highest in agriculture, trade, services and construction. Most often, incomes remain undeclared in small and the one-person businesses.

Measures taken to combat undeclared work

Creation of a legal and administrative environment which is favourable to the declaration of economic activity and employment

The Law on the Reduction of the Administrative Influence and Control over the economic activity has been in force since December 2003. The goals of the Law are to: improve the conditions for starting and carrying out economic activities and to improve the business climate. The number of licences and the necessary administrative procedures for starting business are reduced and simplified.

The conditions for foreigners who are willing to start their businesses in Bulgaria are also improved. The Law on the Amendments of the Law on Foreign Investment (2003) postulates unified conditions for investing in the country and lifts the protection for local investors. The co-ordination and co-operation between all competent central and local authorities is also improved. All these measures stimulate job creation and the legalisation of undeclared work.

The Ministry of Economy itself has also proposed a programme of

⁸ According to data from the Inspectorate on Labour.

⁹ The Labour Market in 2003 – Yearly Review 2003, Employment Agency, p. 29

¹⁰ J. Christoskov, G., Shopov, I., Beleva (1996)

¹¹ Source: The Hidden Economy in Bulgaria, (forthcoming) Centre for the Study of Democracy, Sofia, 2004. The information utilised for the analysis is a result of the efforts of experts from the National Statistical Institute, National Insurance Institute, Bulgarian National Bank, Ministry of Finance, Agency for Economic Analyses and Forecasts, Centre for the Study of Democracy and Agency “Vitosha Research”.

measures for fighting the grey economy. This includes creating a department for fiscal investigations, fighting the illegal sales of excise goods, creating a National Tax and Insurance Collecting Agency (NTICA), increasing the customs and tax control, reducing fraud connected with the payment of VAT, and fighting the distribution of illegal software.

The pilot stage for the collection of taxes and social insurance by one institution, the NTICA¹², is supposed to begin within the next four years. The plans include the elaboration of a unified information system that will allow the payment of taxes via the Internet. All things being equal, this is expected to increase the rates of their collection.

One of the major administrative regulations that brought about the reduction of hidden employment is the requirement for the registration of all labour contracts upon their termination or modification at the National Insurance Institute (NII). As a result, the number of insured people increased in 2003 by more than 300,000.

Furthermore, the Law on Obligatory Social Insurance and the Law on the State Budget (including the NII budget) introduced rates for minimal insurance income for the different industries and for nine separate personnel categories. This measure facilitates the reduction in the number of the people who are insured for the minimum salary and the legalisation of the real wages.

The progress of the **health reform** and the introduction of limitations for the access to health services for people who have not been paying their insurance contributions, are expected to further enhance the registration of the activity of the self-insured.

Strengthening incentives and removing disincentives to declare work on both the demand and the supply sides

Reviewing and reforming tax and benefit systems

In Bulgaria, personal incomes taxation is progressive and the tax-free amounts for 2003 are up to BGN 1440 (approximately 720 euro). The current policies are for the further increase of the tax-free rate and for the decrease of the taxation rates for the lowest income categories (in 2001 this rate was 20%, in 2002 – 18%, in 2003 – 15% and in 2004 – 12%). Hopefully, this will also be an incentive for the registration of undeclared incomes.

The insurance contributions paid by the population are rather high. For example, in 2004, the contributions for the third category of labour, the most popular one, were 42.7% of the gross salary. Recently, proposals have been made for the reduction of the insurance burden and for the introduction of a flat tax rate of 10%. However, calculations show that this would deteriorate the stability of the pension system and of the remaining insurance funds. For the time being, this proposal is seen as unacceptable and is considered populist. Control over the behaviour of the insuring and the insured persons; the cited obligatory registration of the labour contracts and the minimal insurance rates will remain of prime importance for the regular and correct payment of State social insurance.

The amount of corporate tax rate was reduced from 25% to 23.5% for 2003 and to 19.5% for 2004¹³. In 2003 several changes in the corporate taxation system were made. A unified tax rate was

adopted. The profit tax and the municipal tax were transformed into one corporate tax.

Companies investing in high unemployment areas are entitled to a tax exemption. This measure will stimulate higher investors' interest in these areas. In 2003, jobs in the sewing and textile industries, as well as in industry, the production of furniture and food processing¹⁴ were created in just half of the municipalities entitled to the cited exemptions. Evidently, these are important for the reduction of undeclared work in regions with critical unemployment.

Setting up suitable policies for employers and the unemployed

Since 2002, the principles for the intervention on the labour market have been radically changed. The main goal is the creation of employment. Labour market policies are being activated, while the unemployment benefits are administered by the National Insurance Institute.

Of prime importance for the successful realisation of this policy is the "From Social Benefits to Employment" programme. Starting in 2003 and for a period of three years, it provides employment to 117,000 people of working age who have previously been receiving benefits. The programme provides funds that cover the minimal remuneration and insurance, thus removing the incentives for undeclared work without labour contracts.

The encouragement of entrepreneurship among the unemployed is regulated by the Law on the Employment Promotion (2002). For the implementation of the programmes and the measures decided, employers are provided with funds for payment of salaries and social insurance (the share to be paid by the employer) for the hired unemployed. Further, the provision of professional qualification, motivation and training and the territorial mobility of the registered unemployed are also subsidised. Other measures include favourable leasing plans and low interest rates on loans taken by people with reduced capacities to work.

The package of services offered by the LOs to people who are willing to start their own businesses is considerably extended. Free advice, market research data, facilitation of the access to grants, training and consultations on Phare projects are now regularly offered. The mediating role of business incubators is also intensified.

All these stimuli for starting own businesses looks far more attractive than the employment in the informal economy.

Subsidies for the employers for hiring the unemployed are of both preventive and of direct importance for combating undeclared work. The benefits are distributed in the cases of part-time hiring of the unemployed; the employment of people in disadvantaged positions on the labour market; of unemployed who have been receiving benefits for more than five months and of long-term unemployed. The employers of micro companies are compensated for the insurance payment for the first five new job positions. The salaries and insurance for internships and apprenticeships are covered for a period of six months.

Employers applying for these subsidies should not be indebted to the State (i.e. to have due payments of taxes, insurance, etc.). The subsidies cover newly-created job positions and require the

¹² The project is financed through a loan from the World Bank – 31.8 million euro, as well as with funds from the budget – about 11 million euro. It is planned that the NTICA will start operating in January 2005.

¹³ According to the broadcasted plans of the Government for 2005 the corporate tax will be reduced to 15%.

¹⁴ The Labour Market in 2003 – Yearly Review 003, EA, p. 31.

conclusion of a labour contract with the hired unemployed. Each of the above conditions are in line with the requirements for the legitimacy of the employer.

The interest of the employers for utilisation of the above subsidies correlates with their expectations for the near future. Unfortunately, these are not optimistic enough and most of the unemployed are hired only for the duration of the benefit.

Strengthening surveillance

The overall control over the observance of the labour legislation in all sectors is done by the Executive Agency of the CLI¹⁵. Administrative measures and responsibility¹⁶ are enforced/sought in the case of disclosure of violations. In 2003, 28.8% of the violations were related to the hiring, utilisation and dismissal of staff.¹⁷

The opinions of labour unions and employers' organisations regarding the dangers from undeclared work and labour market irregularities that it causes are coinciding. For the legal employers it is a kind of unfair competition; for the labour unions – a disincentive for the increase in the price of labour and a social dumping factor. Both the labour unions and the employers' organisations support the initiatives and measures of the Government and, at the same time, insist on the further reduction of the tax and insurance burdens, which will contribute to the further reduction of the shadow sector.

Strengthening transitional co-operation to combat undeclared work

Bulgaria has signed agreements for official employment with the governments of Germany, the Czech Republic, Portugal and Spain. All of these agreements aim to reduce undeclared work of Bulgarians abroad.

Several initiatives for the regulation of employment conditions and for the limitation of social dumping are being negotiated between labour unions from Bulgaria, Greece and Turkey.

Raising social awareness of the costs of undeclared work

There are several areas of interest related to the limitation of undeclared work that are common for the State and for the population. These include the poor or non-existent working conditions/safety and the absence of social insurance. These spheres should become the focus of control from the administrative bodies, NGOs and the media (with national PR campaigns). The provision of information on the risks from carrying out undeclared work could play an important preventive role.

Conclusions

The results of all the research on undeclared work are favourable. It is shrinking, but its structural characteristics remain unchanged.

The limitation of undeclared work is carried out under the overall revival of the local economy, increasing employment rates and alongside the widening of the administrative and legal measures against undeclared work, with positive results so far.

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¹⁵ The following institutions are all engaged in combating the undeclared work: ministries, the Chief Labour Inspectorate (CLI), regional and municipal administrations, the EA, nationally represented labour unions and employers' organisations, NGOs.

¹⁶ The employers who have not met all their obligations regarding the registration of the labour contracts are fined BGN 1000 (500 euro) for each separate violation. The employers who violate the regulations regarding the payment of social insurance contributions on the minimum insurance income are fined between BGN 50 (25 euro) and BGN 1000 (500 euro) depending on the nature of the violation.

¹⁷ Annual Report of CLI for 2003, Labour Bulletin, 6/2004.

Romania

Introduction

This article examines the issue of undeclared work in Romania. While undeclared work is not just found in developing countries or those in transition, for Central and Eastern European countries which have recently undergone the transition to a market economy, it has some distinctive characteristics.

The article explores the multiple dimensions of undeclared work, and argues that a definition of undeclared work appropriate for a more developed economy may be too rigid for an emergent, transitional economy such as Romania's. It is also worth noting that the mix of policies employed in Romania during its transition have played their part in allowing the phenomenon of undeclared work to thrive – even in an economic environment characterised by sustained growth and enhanced macro-stability. Finally, the paper explores the link between globalisation and undeclared work, looking at the issue of employment migration abroad, undertaken through 'informal channels'.

The article draws on the findings of the first comprehensive study of this issue in Romania: the National Labour Research Institute's (NLRI) *Best Practices for the Combating and Prevention of Undeclared Work* (Ghinaruru et al, 2004). It also draws on the *Joint Assessment Paper on Employment Policies* (JAP), developed by the Romanian Ministry of Labour, Social, Solidarity and Family and the European Commission's (EC) Directorate General for Employment and Social Affairs at the end of 2002. This latter document included a first assessment of the scale of employment in the non-observed/non-registered economy in Romania ('the informal sector').

Although undeclared work takes place in the context of the non-observed/non-registered economy, not all work undertaken in this particular sector of the national economy falls under this label.

Prevalence of undeclared work in the economy

The 'stop-go' type of transition that persisted in Romania throughout the 1990s has generated a high prevalence of undeclared work. The lack of sufficient numbers of consecutive years of economic growth and a second transition recession in the mid-late 1990s, which was associated with achieving the critical mass of the transition process, have induced a propensity towards engaging in undeclared work. This propensity is part of a survival strategy as well as a result of the economic strategy pursued in the transition process.

Overall, the government was forced to focus first and foremost on macro-economic stability and tightening monetary and fiscal anchors rather than on growth, which risked feeding into persistently high inflationary pressures. The necessary but harsh reform measures pushed large segments of the population into income poverty. It is estimated that the poverty rate (calculated at 50% of the median income) surged, albeit briefly, to 50% in 1997. The measures also pushed income inequality higher than before.

As a result of these developments, undeclared work increased in scale. Evaluations of the contribution of undeclared work and the

non-registered economy in terms of gross domestic product (GDP) suggest that undeclared work probably reached a peak during the late 1990s, after which some decline occurred. However, this decline is thought to have been only in the 'informal agricultural' sector (small family farming). Undeclared work associated with non-agricultural activities has probably remained at the same levels or even increased marginally. There is uncertainty because the evaluations carried out have varied in the methodology employed and the results yielded.

The most comprehensive evaluation was carried out by the National Labour Research Institute¹ in March-May 2004. This study employed a mixture of direct observation and econometric modelling, using the share of wages in total household disposable income as an explanatory variable. The findings suggest that undeclared work equates to around 30% of Romania's GDP. Some of this can be accounted for by subsistence-type agriculture, which could be considered as an element of 'visible' GDP, despite being defined as undeclared work in the EC report *Undeclared Work in an Enlarged Union* (2004). However, around half of the above estimated share of GDP might be accounted for by activities in the non-agricultural/non-subsistence part of the economy.

The share of Romania's GDP which can be accounted for by the non-registered/non-observed economy has declined from approximately 35% in 2000-1. These values are broadly convergent with the estimates of Professor Schneider (2002), who identified a decline from 40% of total employment in 2000 to an estimated 30% in 2003, with a figure of 34% in 2004. This decline can partly be explained by an increase in the wage economy and a marked decrease in agricultural employment, which has traditionally been based on subsistence agriculture.

Undeclared work in the non-observed/non-registered economy was estimated in the NLRI study² to involve around 2.2 million people. This includes around 1 million (roughly equivalent to 11% of total employment) thought to be involved in 'underground' non-agricultural non-declared activities (i.e. legal in nature but not declared) as well as around 1.2 million (roughly equivalent to 14% of total employment) involved in informal non-agricultural activities (see Table 1).

There is some confusion as to whether subsistence agriculture should be included as undeclared work (informal sector). If it is included, the above estimates would have to be increased to include the work undertaken in the very large agricultural sector, which currently employs around 3.15 million people – equivalent to approximately 35% of total employment in 2003. These individuals are mostly employed in family farms, which fall almost entirely into the category of 'household production for own consumption/own use'. Adding this figure to that for informal non-agricultural employment would yield a total of around 4.4 million people, or the equivalent of 49% of total employment. Adding the 1 million individuals involved in non-agricultural activities in the 'underground' sector would result in a total of approximately 5.4 million individuals or the equivalent of almost 60% of total employment in Romania.

¹ Dr Catalin Ghinararu, Ana Maria Zamfir, Cristina Mocanu and Miriam Munteanu, under the auspices of the NLRI (2004) *Best Practices for the Combating and Prevention of Undeclared Work*, Bucharest, Romania: RO MEDIA.

² At the time of writing (August 2004), the National Institute for Statistics had not been able to publish any data on this phenomenon. Therefore the only estimates available are those from the NLRI. The author of this thematic article and the Institute are also the source of the JAP (2002) data on this issue.

Table 1: Estimates of undeclared work and employment in the non-observed/non-registered economy in Romania

	Employment in agricultural non-observed/non-registered economy			Employment in non-agricultural non-observed/non-registered economy			Total employment in the non-observed/non-registered economy		
	People (000s)	% in total agricultural employment	As % of total employment in Romania	People (000s)	% of total non-agricultural employment	As % of total employment in Romania	People (000s)	% in total employment in the non-observed/non-registered economy in Romania	As % of total employment in Romania
Employment in the informal sector	3,150	71.4 (100)	35	1,260	28.5 (50.5)	14	4,410	100 (78.1)	49
Employment in the 'underground' (legal but undeclared) sector	-	-	-	1,000	100 (40)	11*	1,000	100 (17.7)	11*
Employment in the illegal sector	-	-	-	235	100 (9.4)	2.6**	235	100 (4.2)	2.6**
Total employment in the non-observed/non-registered economy	3,150	55.8 (100)	35	2,495	44.1 (100)	27.7	5,645	100 (100)	63

* 'Real undeclared employment'; % = equivalent percentage of total employment, since individuals engaged in undeclared work can be employed, unemployed or inactive above or in some cases below the minimum working age.

** Employment in the 'illegal sector' of the non-observed economy, which is disregarded for the purposes of this article.

Source: Dr Catalin Ghinara et al (2004) *Best Practices for the Combating and Prevention of Undeclared Work*

However, a number of experts argue that small farming is in practice 'informal but declared work'. Those involved in such work declare their activities to the public authorities, and are considered as employed according to the definitions of the Labour Force Survey (EUROSTAT methodology). This means that they are not covered under the definition of undeclared work in the 1998 Commission Communication. In addition, individuals' involvement in agriculture, even at a small, subsistence scale, is based on legal tenure of the land. An additional 1.2 million individuals involved in 'informal non-agricultural activities' should perhaps also not be included in estimates of undeclared work, as in most cases these marginal, small-scale activities do not have to be declared to the public authorities.

Applying the above restrictions, the number of people involved in undeclared work can be estimated at around 1.1-1.3 million, which comprises roughly 13-14% of total employment in Romania.

Romanian agriculture has mainly been subsistence farming since the most comprehensive agricultural reform in Central and Eastern Europe in 1921, which ensured that small peasant farms were the main form of agricultural producer. Communism saw a break in this tradition with the creation of collective farms, which were later re-privatised. Agricultural employment increased during the transition, as urban unemployment and income poverty supported a large-scale shift from urban to rural areas. Agricultural employment, as a form of 'buffer employment', reached its peak at around 42-45% in 1999-2000.

During the last four to five years, economic growth has been more sustainable and is likely to continue for the foreseeable future. Subsistence agriculture continues to dominate. However, with this economic growth, agricultural employment is decreasing by roughly one percentage point per year. It is estimated that by maintaining the current rhythm of growth, agriculture's share of total employment

will fall to around 28-29% in 2014, with predictions of 23% or even 20% by 2014 should growth accelerate at an even faster rate.

Certain sectors of the economy display a greater propensity for undeclared work. On the basis of NLRI estimates, construction may account for around 14% of undeclared work in non-agricultural sectors, followed by commerce (especially small retailers) at around 12%. The lower-value manufacturing sectors of textiles, clothing, shoe and leather industries, which dominate Romania's economy, comprise about 11% of non-agricultural undeclared work.

A large proportion of non-agricultural undeclared work is concentrated in small and micro-enterprises with low productivity. Undeclared labour, including child labour, flourishes in these firms and the distinction between capital and labour is frequently blurred. The NLRI study estimates that this particular sector of the economy accounts for around 19% of the non-agricultural undeclared work in Romania.

In all, the sectors mentioned above account for 57% of the non-agricultural undeclared work. The rest is thinly spread across other sectors of the economy. The energy and telecommunications sectors have the lowest concentration of undeclared work because of the prevalence of large companies, including multinationals.

Undeclared work in the small and micro-enterprises sector often goes hand in hand with attempts to evade legal obligations. A strong correlation has been identified between the prevalence of undeclared work and recourse to tax evasion, bribes, corruption and other phenomena associated with the 'shadow economy' – The NLRI study identified that the higher the prevalence of undeclared work, the greater the recourse to tax evasion and bribes in order to escape paying taxes or avoid inspections and controls. The correlation is a two-way process, with recourse to tax evasion,

bribery and corruption explaining to a large extent the propensity for engaging in undeclared work.

Undeclared work is particularly concentrated in low-productivity sectors of the economy which are only able to maintain their market niche by evading legal obligations and lowering to the minimum the cost of labour. This can partly be explained by the state of the overall economy during the transition. A long period of high inflation and perceptions of unpredictability encouraged small to medium-sized enterprises (SMEs) to engage in the shadow economy, at least partially, as a mean of ensuring their economic survival. The current economic growth should begin to generate more job opportunities in the formal, visible economy – as long as this growth remains sustainable over a number of years.

Some argue that the tax burden on labour should be reduced. The aim would be to make it affordable for companies with low profitability to declare work, and to encourage companies that are viable and have real job-generation potential to renounce practices such as ‘cash-in-hand’ payments. The combination of declared low-income work and undeclared cash-in-hand payments is particularly pervasive in Romania. It deprives employees of a significant part of their social security benefits, particularly with regard to pensions.³

In parallel, it is argued that the minimum wage – which about 20% of Romania’s employees receive – should be increased in order to provide these workers with sufficient motivation to become formally employed. At 35% of average gross salary, Romania now has one of the highest ratios of minimum wage to average salary in Europe. This is a positive factor, except that Romania’s average gross salary (at the equivalent of 200 euro) is one of the lowest in Europe. Around 40% of the country’s exports depend on sectors of the economy where the minimum wage is prevalent and where labour productivity is reduced because of the large subsistence farming sector. Policies have been adopted with the aim of increasing the level of the minimum wage and raising living standards for around a fifth of the total number of workers. But these moves have been tempered by efforts to keep jobs in low-productivity sectors in the ‘visible’ economy and prevent companies from moving to ‘cheaper’ countries such as Moldova or Ukraine.

It is important to pursue an adequate mix of salary and labour taxation policy in the years to come, to encourage formal employment in the low added-value sectors of the economy. These sectors will receive the bulk of the workforce gradually released from subsistence agriculture. Increases in the minimum wage will need to be made with restraint in order to maintain competitiveness and encourage investments in both capital and labour, to support greater productivity and a shift towards higher added-value sectors of the economy. In the meantime, some sort of fiscal relaxation may be necessary to maintain as much employment as possible within the formal economy.

To conclude this section:

- Informal work in the subsistence agricultural sector cannot easily be classified as undeclared work as it is known to the public authorities and is based on private land tenure.
- Outside this sector, undeclared employment thrives in low-value retail, manufacturing, construction and even service establishments.
- The existence and subsequent development of undeclared work is one of the most pernicious legacies of the ‘stop-go’ transition economy of the 1990s.

- It is expected that as the economy moves more towards a ‘functional market economy’ and economic growth with a background of ever lowering inflation gains pace, the scale of the phenomenon should diminish.
- However, one should not underestimate the effects of salary and labour taxation policy, which will be important for ensuring that growth is reflected in formal rather than informal forms of employment.
- Finally, it is important to note that levels of undeclared work in Romania would possibly be higher if people were not able to go abroad for employment. This phenomenon may be partially responsible for Romania’s low unemployment rate but rather high inactivity rate for the working-age population.

Measures taken to combat undeclared work

Although there is no national definition of undeclared work in Romania, the government and the public authorities consider the extent of the phenomenon to pose a significant risk to Romanian society. Undeclared work is recognised as having an important impact on the functioning and growth of the economy, as well as on the social security of the workforce and on social cohesion.

Measures have already been enacted to combat ‘real undeclared work’ in non-agricultural sectors. The business community has repeatedly mentioned high labour taxation as a factor encouraging firms to resort to undeclared work. As a result, the government has reduced employers’ social security contributions by three percentage points in 2004 as against 2003 levels. This comprises a 2.5 percentage point reduction in contribution rates to the state social security fund (pensions) and a 0.5 percentage point reduction in contribution rates to the unemployment insurance fund. Taking into account that a further reduction of the contribution rates occurred in 2003, the tax burden on labour is now eight percentage points lower than its 2002 level.

Part of this reduction has been offset by a nominal increase in the contributions as a result of increasing the minimum wage. However, in relative terms the aggregate tax burden on labour has decreased from 48.2%, as calculated for the average gross salary in 2002, to 45.5% in 2003. Therefore, for an employee earning the gross average salary, with two dependent children, the tax burden on labour has been reduced from 42.8% to 40.2%. For an employee earning 67% of the average gross salary, with no dependants, the tax burden on labour has been reduced from 45.5% in 2002 to 42.7% in 2003.

A new fiscal code has recently enhanced the coherence of the fiscal regulatory framework, thereby providing for more stability. However, in spite of these measures, the government has not succeeded in promoting an anticipated amendment enforcing a flat rate income tax of 19%. Some changes are envisaged in relation to tax brackets, which currently penalise middle and middle-to-high income earners, potentially opening another channel for undeclared work in high added-value activities.

A new labour code was introduced at the beginning of 2003, including important changes to labour contracts. Fixed-term and part-time contracts have been properly recognised and regulated, and the concept of temporary work has also been recognised. Subsequently, as of June 2004, this has resulted in the adoption of a law regarding temporary work agencies. In the meantime, the scope of so-called ‘civil conventions’ has been reduced to its original function, with usage limited to the provisions of the civil code. These civil conventions are a type of common-law agreement widely

³ Old-age pensions in the public system (the only form of pension currently operational in Romania) are calculated on the basis of contributions made throughout entire working life and also on the amount of contribution paid into the system. Therefore, a low-income employee can expect a low pension in old age.

seen as a form of 'informal' labour contract and therefore an important element of undeclared work.

It is debatable whether these measures have yet had a tangible impact in reducing undeclared work. The business community, especially SMEs, complain that the newly enacted regulations – including the labour code – add new rigidity instead of promoting much-needed flexibility. While new labour regulations, especially the labour code, actually enhance labour-market flexibility, the successive increases in the minimum wage have potentially had a negative impact on competitiveness. This in turn is reflected in low generation of jobs and the virtual standstill of the share of wages as a percentage of GDP (currently around 40% for formal salaries, increasing to around 65-67% when cash-in-hand payments are taken into account).

Measures have been taken to support some of the costs associated with the creation of new jobs, especially via employment-generation policies financed through the Unemployment Fund. Fiscal incentives are granted to employers hiring unemployed people, provided that such workers remain in employment for at least six months after hiring. In addition, unemployed people who find a job prior to expiry of the period of unemployment benefit continue to receive 30% of their benefit on entering employment until the statutory end of the paid unemployment period. This is to discourage people from seeking to supplement their income through undeclared work. It is estimated that more than 100,000 people have benefited from this measure, which is expected to yield significant results in combating undeclared work. This measure is complemented by the flat-rate unemployment benefit (75% of minimum wage, or 50% for young graduates with no prior employment record), which acts as an incentive for active job-seeking.

Control has also been strengthened through the Labour Inspectorate, which acts under the auspices of the Ministry of Labour. It has engaged in a national campaign against undeclared work, acting jointly with the police, tax authorities, local authorities and the fraud squad. Its actions have had a limited effect, however, as evasion techniques are growing ever more sophisticated.

It is important to note that while the potential for undeclared labour in Romania remains considerable, because of the reservoir of cheap labour provided by subsistence agricultural employment, actual undeclared work only involves around 1 million people. On the other hand, it is clear that the current economic and policy context in Romania is encouraging the existence and spread of a 'disguised' form of undeclared work. 'Disguised' undeclared work formally observes minimal legal requirements while using 'undeclared payments' to evade legal obligations.

To combat irregular channels for migration for employment abroad, the government has strengthened the powers of the National Office for Labour Force Migration and issued new regulations to increase the protection of migrant workers against the malpractices of private employment agencies. The Labour Inspectorate has been entrusted with full responsibility for ensuring compliance with current legislation, and has been given the authority to take action against those in breach of the law.

As stated in the introduction, evaluation in the area of informal and undeclared work in Romania has mainly been restricted to the two reports on which this article is based (*Best Practices for the Combating and Prevention of Undeclared Work* and the *Joint Assessment Paper on Employment Policies*). The National Institute for Statistics does not yet conduct such evaluations, but does provide (albeit not on a regular basis) estimates of the scale of the

non-observed/non-registered economy as a percentage share of GDP. Other more partial evaluations have been carried out by research institutes belonging to the Romanian Academy. Some evaluations have also appeared in various economic journals.

Conclusions

Undeclared work in Romania is in part a product of the nature of the transition to a market economy, and to a certain extent derives from historical developments which took place before and during the communist period.

Apart from subsistence-type agricultural employment (which can only to a limited extent be considered as undeclared work) the phenomenon is most persistent in sectors such as construction, small retail, commerce and manufacturing.

The level of undeclared work in Romania does not currently surpass 10-12% as a share of total employment. However, calculations by the National Labour Research Institute have shown that a one percentage point increase in the average rate of economic growth could deliver a 2.8 percentage point reduction in subsistence agricultural employment. This would produce a pool of labour both for undeclared work in the domestic labour market and for migration for employment abroad through irregular channels.

In the meantime, the same calculations have pointed out that a one percentage point reduction of the tax burden on labour results in a 0.04 percentage point increase in economic growth. This proves that fiscal relaxation can really contribute to the acceleration of growth, which in itself is the most important determinant of net job generation in the formal economy. A reduction of the tax burden on labour will also provide a competitive advantage in the bid to attract more foreign direct investment (FDI). It is estimated that the productivity growth generated by increasing FDI as a share of GDP will contribute to a reduction in low-income jobs (which largely serve as a means of concealing undeclared work) as a share of the total number of jobs by 0.03 percentage points.

To combat undeclared work, a stronger partnership is needed between the central authorities, local authorities and social partners, through better control procedures, more focused inspections and improved tax collection. A mix of policies also needs to be put in place to harness the benefits of economic growth and macro-stability for more vigorous generation of jobs in the 'formal economy'. This would also create a disincentive for both labour supply and demand to engage in undeclared work practices.

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Turkey

Introduction

The European Union (EU) concept of ‘undeclared work’¹ is very close to the Turkish concept of ‘kaçak işçilik’ (literally, clandestine/illicit workmanship) or ‘kaçak çalışma’ (clandestine/ illicit labour/work). The extensive national debate on this topic distinguishes between undeclared work and ‘informal (unregistered) employment’. The latter term is used to describe those workers who are not known to the authorities. All informal employment is therefore undeclared work, but the full scope of undeclared work is wider than just unregistered employment. Criminal activities are, however, excluded from the concept of undeclared work.

Undeclared work is sometimes discussed as an issue in academic reports or news items. However, it is more common to find it analysed in detailed reports on the ‘unregistered economy’, or sometimes more specifically in reports on unregistered employment. The official documents setting out information on these issues are the *Special Expertise Commission Reports* of the State Planning Organisation (SPO). These are prepared every five years for the corresponding periods of development plans. The latest plan covers the period 2000-2004. The SPO report (2001) on the unregistered economy has four parts: national accounts, taxation, employment and criminal activities. Fully or partially undeclared work is covered in the employment section of the report. The definitions closely follow those used by the EU and the Organisation for Economic Co-operation and Development (OECD).

Scope of the phenomenon

As a result of frequent economic crises in recent years and still being under austerity measures sanctioned by the International Monetary Fund (IMF), the employment performance of the Turkish economy has not been satisfactory. The recent macro-economic recovery has not brought about an increase in jobs. The phasing out of agricultural subsidies and large regional disparities in income are likely to bring about another wave of rural-to-urban migration. As a result, unemployment is steadily rising.

Given the lack of marketable skills (in particular low levels of education) of most Turkish workers, the work environment is conducive to unregistered work. Non-compliance with the rules allows for flexibility (minimal hiring and firing costs) for unskilled workers in low added-value, low-productivity activities such as working from home in the garment industry, and clothing industry production of brand names in small firms. The smaller the firm, the more likely there is to be non-compliance with labour and tax regulations. Larger firms may register themselves but not all of their workers. Many registered employees receive ‘envelope wages’ in cash over and above the legally registered minimum wage. This arrangement is commonly found in Central and Eastern European (CEE) states. This type of fully or partially undeclared work probably comprises the bulk of the phenomenon in Turkey.

A second undeclared work arrangement is driven by the ‘extra income effect’. This is the dominant type of undeclared work in EU countries such as Austria or Belgium where the share of unrecorded activities is

below 5% of gross domestic product (GDP) (European Commission (EC), 2004). Such ‘moonlighting’ (second jobs) by workers in the formal employment sector (e.g. public employees and teachers driving cabs or selling from market stalls) exists in Turkey. However, the level of such activity is almost negligible, and the market for such services can only exist in a few big cities.

The final significant component of the phenomenon of undeclared work in Turkey is work carried out by illegal immigrants, who can be found in the construction industry and in textile workshops in the northwest of the country. The majority of these illegal workers originate from Romania. However, in the construction sector, which has traditionally been a focus for unskilled young men, informal employment and undeclared work have been steadily declining in Turkey. Over the past two decades and until recent years, this sector constituted 8% of urban employment on average (Ercan, forthcoming). The current figure is 4%.

Enforcement against undeclared work is weak in Turkey. Work by illegal immigrants is largely viewed as a police matter, as such workers are deported. However, this problem is not generally a police priority. In 2002, the Ministry of Labour estimated the number of illegal foreign workers to be 1 million (4% of the total workforce).

Undeclared work in the political debate

Officials from the Turkish Ministry of Finance and Ministry of Labour routinely speak out against the unregistered economy and undeclared work. Avoiding taxation and social security contributions creates unfair competition for law-abiding companies, from low-productivity firms to large, formal, unionised businesses in the highly competitive food and textiles and clothing sectors. Ministers therefore pay some heed to the problem in meetings with employers’ organisations. Recently, for example, the Ministry of Finance declared its support for a research grant competition jointly organised by the private Sabanci University and the Turkish Council of Shopping Centres. The theme is ‘The registered and regulated economy and retailing’. Defining and measuring the unregistered economy and its impact on the formal economy and comparisons with the EU are the research topics.

However, real inroads into the problem of tax evasion and undeclared activities are hampered by the practice of offering tax or social security amnesties following a number of years of non-payment. Political parties generally offer such amnesties ahead of elections. This and other practices such as under-declaration of income (see Apak, 2004) have undermined public trust in the state authorities’ powers to address the problem of undeclared work.

Prevalence of undeclared work in the economy

Size of the informal economy

The SPO report of 2001 discusses direct and indirect methods of measuring the informal economy along the same lines, for example, as *Undeclared Work in an Enlarged Union* (EC, 2004). It also reports

¹ The concept is defined in the 1998 Commission Communication on undeclared work and is often quoted in later related EU documents: “The concept of ‘undeclared work’ is taken to mean any *paid activities* that are lawful as regards their nature but not declared to the public authorities, bearing in mind that differences in the regulatory system of Member States must be taken into account. Applying this definition, criminal activities would be excluded, as would work which does not have to be declared.”

estimates of the size of the informal economy in relation to national income. Since the SPO report was written before the OECD's *Handbook for Measurement of the Non-observed Economy* (2002), a number of estimates based on unreliable sources are also included. Us (2004) has conducted a more recent study which analyses existing estimates as well as providing its own analyses using various methods.

This article places less emphasis on estimates derived from approaches relating to tax collection. These estimates are published by the Revenues Directorate of the Ministry of Finance (www.gelirler.gov.tr). They derive from information regarding the number of tax inspections conducted and the pre- and post-inspection amounts declared. In 2002, for example, 113,000 tax forms were inspected, which cumulatively declared an income tax base of 13,863 trillion Turkish lire (TL) (7.7 billion euro). It was concluded that there was an under-declaration of income of TL 7,971 trillion (4.4 billion euro), which was 57% of the figure for declared income. This is the starting point for the Revenues Directorate's estimate of the size of the unregistered economy. However, it ignores the fact that only tax forms already seen as 'problematic' are assessed.

If monetary approaches (such as wage payments, fixed ratio) are not used, estimates of the unregistered economy decline significantly. Using an employment methodology, Bulutay (1998) reported that in 1992 the informal sector's share of the economy was 16% (26% in non-agricultural activities). Using econometric modelling, Çetintas and Vergil (2003) estimated the size of the unregistered economy between 1971 and 2000 as 18-30% of gross national product (GNP), depending on the models used. Using a similar methodology, Us (2004) has estimated the size of the unregistered economy for 1978 to 2000 at about 10%. She also reports the results of two older studies yielding similar results: 8% and 12%. Çetintas and Vergil's (2003) results are high for econometric estimations, which generally yield more conservative estimates. Us (2004) also reports the results of a method that uses electricity consumption as a measure for estimating the size of the unregistered economy. This method yields an estimate of 20-22% of GNP in the period 1978 to 2000.

Close reading of existing studies and their methodologies indicates an estimate of 20% as a realistic minimum for the unregistered economy, which puts Turkey in the same league as Greece and Italy. The real figures are more likely to be around 30+%, which moves Turkey closer to Bulgarian and Romanian figures. The 'true' figure may be even higher; employers and trade unions often quote the size of the unregistered economy as being half or two-thirds of the registered one. However, their methodologies are not well documented.

In terms of unregistered employment, Bulutay (1998) reported a figure of 30% of total employment in 1992. Us (2004) reports the results of an exercise that uses the quarterly Labour Force Survey data of the State Institute of Statistics (SIS). Based on a number of assumptions, Us (2004) estimates that 3% of the total population (2.1-2.2 million people) were employed as unregistered workers between 2000 and 2003. This figure is about 10% of the total workforce of 22.5 million and 17% of the non-agricultural workforce. There are no studies to assess the incidence of undeclared work (as opposed to unregistered employment) or surveys specifically designed for this purpose (such as Pedersen's, quoted extensively in EC (2004)).

Sectoral distribution

The sectoral distribution of informal employment in Turkey reflects the usual sectors in a developing economy, such as textile production in households and small and medium-sized enterprises, and personal services. However, undeclared work occurs across the board as a result of the Turkish legal code, which exempts small-scale farmers, small-scale vendors and artisans from taxes; all street vendors are also

exempt. Vendors and artisans in one or two-person operations are not covered by employment legislation. The same applies for agriculture. As a result, agriculture should not be included in meaningful comparisons with the rest of the EU.

The output of one-third of the total labour force's work – i.e. in agriculture – is typically non-observable. Almost all self-employment in Turkey is likely to be either unregistered or partially or fully undeclared. This probably also applies to the majority of professionals such as doctors and lawyers; these groups often only declare incomes at the minimum level. In addition, more than half of urban employment is in services. All told, the work environment in Turkey is highly conducive to undeclared work.

The importance of the retail and restaurant sectors in undeclared work is similar to CEE countries. One may also stretch definitions a bit and talk about subsistence agriculture. The difference would be that Turkish farmers do not generally sustain themselves with the food they grow. The produce sold in markets or bought by public companies does not provide a comfortable living. Undeclared 'second jobs' carried out by professionals is not a widespread phenomenon in Turkey, unlike in CEE countries. Also unlike CEE economies, the incidence of the informal economy is high in the manufacturing sector. This is because most of it is on a small or micro scale in Turkey, and textiles are very important in industrial revenue and exports.

Table 1 provides information on the sectoral distribution of the economic activities carried out by individuals found guilty of illegal activity. The data come from the Istanbul office of the Ministry of Finance and are likely to reflect the broader picture in sectors outside agriculture.

The SIS (2000) conducted an informal sector survey of small urban enterprises. It reported the following distribution of employment in the informal sector: 20.3% in industry, 58.4% in trade, and 21.3% in services. Table 1 roughly matches this distribution in the totals for industry (small manufacturing), trade and services. The SIS survey revealed that the largest age group involved in such activity was the 31-40 group (30%). The majority of these workers only had primary education (62%, which is higher than the workforce average of 50%).

The SIS currently reports (first quarter of 2004) employment in the informal sector as 1.34 million (12.5% of urban non-agricultural employment). This low figure is the result of the severely restricted definition applied to the concept of the informal sector by the SIS. The informal sector is defined as those non-agricultural economic entities that are unincorporated (personal ownership or simple partnership) and that pay either no taxes or are nominally taxed by occupation, not by income. This definition categorically rejects the existence of informality or undeclared work in formal establishments and does not attempt to measure it. It also ignores social security status. SIS Labour Force Survey results for the first quarter of 2004 reveal that 4.5 million non-agricultural workers have no social security coverage whatsoever. This is 30% of the non-agricultural workforce of 15 million.

Perceived causes and effects

As noted above, one-third of total employment in Turkey is in agriculture. Workers in this sector tend to be uneducated and unskilled. When they migrate to urban areas (as agricultural price supports have mostly been phased out), women are not likely to participate in the labour force at first. Younger women go to school or find employment in textiles until they get married; this is almost the norm in the sector. Young uneducated men work in construction if they can. This means that low-skilled agricultural employment and urbanisation will continue to provide fertile grounds for informal

Table 1: Unregistered workers and their economic activities (January-July 2002)

Sector	Number	%
1 Textiles and clothing	725	12.8
2 Barbers and hair stylists	500	8.8
3 Restaurants	271	4.8
4 Markets	271	4.8
5 Transportation	254	4.5
6 Associations	224	4.0
7 Open market vendors	195	3.4
8 Auto repair	157	2.8
9 Real estate agents	132	2.3
10 Concession stands	121	2.1
RT Other retail trade (jewellery, clothing etc)	1,232	21.7
PS Other personal services and repairs (electricians, tailors etc)	572	10.1
SM Other small manufacturing and repairs (shoes, furniture etc)	354	6.3
Total retail trade = 3 + 4 + 7 + 10 + RT	2,090	36.9
Total personal services = 2 + 5 + 6 + 8 + 9 + PS	1,839	32.5
Total small manufacturing = 1 + SM	1,079	19.2
Other	413	7.3

Source: Raw data (of 70 activities) are reported at www.ist-def.gov.tr/birim/vdbb/kayitdisi.htm and have been classified and totalled by the author.

employment and undeclared work for at least another decade – and possibly longer – in Turkey. This may be an important reason for the authorities not to crack down on undeclared work. Formal employment-growth performance in Turkey has been very poor relative to the growth in unskilled working-age population. The strategy may be one of “look away and maybe the problem will go away”. Frankly, this may be an expedient strategy for the time being, until Turkey mandates more schooling (from eight to 12 years) and educates its younger population.²

The second important possible cause is the dominance of small and micro enterprises in Turkey (SPO, 2001). Low levels of human and physical capital imply low productivity. Exemptions in the tax code and employment legislation for self-employment and micro firms provide an environment for informality in the non-agricultural sector. Surveillance is in any case difficult in small-scale services and manufacturing. The exemptions can therefore be seen as an admission by the state authorities that resources are lacking for effective policing of the system.

The SPO report (2001) states that lenient official attitudes towards the unregistered economy go back several decades. In the process of capital accumulation and providing incentives for entrepreneurs, many tax exemptions were granted and the Turkish private sector mostly grew up automatically requiring such preferential treatment. These attitudes are now ingrained, reinforced by frequent amnesties on tax and social security payments. The tax collection system has

become distorted and is continually revised and re-revised. The perception of fairness has become a casualty along the way as governments have routinely collected ‘supplementary’ taxes for one reason or another. Matters may only improve when trust is re-established between the citizen and the government. This will be a function of stable macro-economic conditions.

Finally, employers’ organisations complain about red tape and non-wage labour costs.³ These are both high in Turkey relative to OECD averages. The Turkish Employers’ Unions Confederation (TISK) makes a strong case for simplifying the rules and regulations to reduce the administrative burden on employers. TISK claims that these pecuniary and administrative costs encourage informal employment and discourage entrepreneurship. Law-abiding establishments suffer unfair competition as a result. Trade unions counter with the ‘levels’ argument. Hourly pay in Turkey is a fraction of that in other industrialised countries. However, this does not take into account differences in productivity.

An important effect of the above picture relates to productivity. Informal employment and most undeclared work in Turkey are associated with low levels of human capital. Even if capital investment per capita goes up (and it has been rising since the end of 2003), workers on the shop floor or at the computer terminal will not be able to make the most use of such an increase because of their low skills base. The achievement of higher levels of education and training correlate positively with growth and further development of human resources. This would assist in combating undeclared work and the informal economy, which are concentrated in low-skilled sectors. In turn, this would lead to improvements in social security and increase tax revenues.

Measures taken to combat undeclared work

Political attitudes regarding undeclared work have been discussed above. The general attitude has historically been lenient, and this situation continues today because it is expedient. At the same time, finance and labour ministers are obliged to agree with employers and trade unions that the authorities should crack down on unregistered employment. Some important steps have been taken to tackle the informal economy and are described below. However, the list remains a short one at present.

Given time, measures which are not necessarily aimed at combating undeclared work will eventually contribute to its reduction. To quote from the EC report on undeclared work (2004): “Therefore, in the less advanced of the new Member States and candidate countries, efforts should be targeted at state formation, development of democratic institutions and stabilisation of the general socio-economic situation. Policy targeted towards undeclared work is of later concern.” If ‘state formation’ is replaced with ‘institution building’, and ‘development of democratic institutions’ with ‘strengthening democratic institutions’, the same conclusion would be reached for Turkey.

Legal and administrative environment

The main measure to combat unregistered employment has been the Social Security Reform law in 1999. Among other regulations regarding basic retirement and social security administration, unemployment insurance was instituted for the first time in Turkey. Contributions to the unemployment insurance fund began in 2000,

² This is the author’s personal opinion, which usually meets with resistance from other scholars. Opponents are correct in the sense that everyone deserves decent social security coverage and related benefits.

³ The website of the Turkish Employers’ Unions Confederation (TISK) (www.tisk.org.tr) is full of bulletins and reports making this case. TISK declared the size of the unregistered economy to be 66% of the registered one in 2003, compared with 40% in 2001. The computational methodology and what accounts for the jump are not discussed in TISK sources.

and payments started in 2002. This move was intended to encourage formal employment contracts so that workers would qualify for unemployment benefits. No mass formalisations of employment have so far resulted, but it is nonetheless a significant step.

Employers have long complained about the rigidity of Turkish labour legislation. Regulations were characteristically only applied by public employers and large, unionised private-sector companies, which make up the minority of employers. Small manufacturing and retail trade typically responded to this rigidity by remaining informal, and hence flexible. The new labour law of 2003 acknowledged for the first time the existence of flexible employment arrangements such as part-time work and working from home. This is the second major measure to tackle informal employment.

Surveillance

From 2003, any payment for goods and services in excess of TL 10 billion (5,500 euro) should be made through a bank. All people and firms have tax ID numbers, and transactions may therefore be traced. This can also be seen as a step in the right direction in combating the informal economy.

Conclusions

Socio-economic factors fuelling the existence of undeclared work and unregistered employment in Turkey are as follows:

- There is macro-economic instability and volatile growth. A series of anti-inflationary, demand-contracting IMF programmes have finally reduced inflation and achieved growth, but the recovery has so far been unable to generate jobs.
- A related factor is that the economic environment is unsuitable for foreign direct investment, as foreign capital complies with the rules and avoids undeclared work (EC, 2004).
- Unemployment has risen steadily, and people are more willing to accept informal work contracts.
- Agricultural subsidies have largely been phased out. Rural-to-urban migration of unskilled agricultural workers may well accelerate.
- Privatisation has de-formalised some former public-sector employment.
- Turkey's excessively lenient regulations on retirement age have recently been tightened up. However, there is still a young retiree population in their late forties and fifties. They are more likely to engage in undeclared work to supplement their pensions.
- Income distribution is highly skewed. The top 20% of households receive half the income. The bottom 20% receive 6%. Poverty is a powerful motivator behind undeclared work.

Institutional factors also contribute to the high level of undeclared work:

- There is a high tax burden and high social security contributions. The state does not contribute for individuals, but ends up paying the deficit lump sum from the budget. The social security gap already comprises 4.5% of GNP, despite favourable demographics.
- Tax controls are inadequate. The government has traditionally been unwilling to crack down on small enterprises, which account for the bulk of employment.
- There is excessive red tape. The Turkish Employers' Unions Confederation states that 172 signatures are needed to open up a business and the process takes 2.5 months. Nor does it end there. This level of bureaucracy tends to impede entrepreneurial activity.

Cultural factors must also be cited:

- People have come to mistrust tax collection authorities (and the government). 'Supplementary' taxes are the norm, and 'temporary' taxes have stayed in place.
- Transgressors have received too many amnesties on tax and social security payments. This has led to a deep-rooted feeling of unfairness in law-abiding citizens and enterprises. The state does not just let the market eliminate inefficient operations, and governments routinely cave in to popular demands. This is detrimental to the business environment in the longer term.
- Small businesses are routinely and conveniently ignorant of tax revenues coming back to them in the form of benefits (e.g. roads, water and electricity). The problem is not only undeclared work – theft of electricity and transmission losses make up 20% of total consumption.
- Former agricultural workers are not accustomed to asking for their rights.

Unsurprisingly, Turkey has so far achieved few results in tackling undeclared work. Cultural attitudes towards it are not sufficiently discussed. Employers' organisations emphasise the importance of tax cuts and reductions in social security contributions, while trade unions call for mandatory unionisation. However, greater economic development and political stability are needed as first steps in the fight against undeclared work – as advocated in the EC report on undeclared work (2004).

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