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**ON UNDECLARED WORK**

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## **Executive Summary**

Undeclared work is one of the issues of common concern in the employment field. 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.

The main motivation for employers, employees and self-employed for participating in the undeclared economy is economic. Working in the undeclared economy offers the opportunity to increase earnings and to avoid taxation and social contributions or to reduce costs. There are three contributing factors: a growing demand for “personalised services”; the re-organisation of industry into long lines of vertical disintegration and chains of sub-contracting; and the spread of light technology which opens up new working opportunities and new areas of service activities. Undeclared work is generally present in sectors which are labour intensive and with low profits such as agriculture, construction, retail trade, catering or domestic services; manufacturing and business services where costs are the major factor of competition; and modern innovative sectors.

Four main groups of participants in the undeclared can be identified: second and multiple job holders; the “economically inactive” population; the unemployed; and third country nationals illegally resident in the EU. The age and gender of undeclared workers depend to a large extent on the sectors affected.

Undeclared work risks undermining the financing and delivery of social protection and public services. The curtailment of receipts means a reduction in the level of services the State can offer, and this creates a vicious circle, as the government raises taxes to continue to provide the services, thus creating more incentives to undeclared work. In countries where social protection coverage is universal or where individuals have rights derived from their partners, undeclared work may not affect health or pension rights. The same is true for second job holders. However, undeclared workers who are normally inactive forego all the benefits derived from working with a formal contract, such as training, a specific career profile, pay rises, a sense of belonging to the enterprise. These people will also have difficulty in moving into other jobs. The impact on enterprises is felt through the distortion of competition, especially at the micro-level.

There are two dimensions to the problem of undeclared work: it can be viewed as an issue of individuals taking advantage of the system and undermining solidarity in the process, or as the outcome of greater flexibility in the labour market and slower adaptation of existing legislation. In the first case, intervention should be oriented towards sanctions and awareness campaigns; in the second case, policy should concentrate on prevention through adapting inappropriate legislation to reflect new labour market realities and reducing burdens and obstacles.

The establishment of a comprehensive targeted strategy is essential if combating undeclared work is to be effective. A strategy which is to have any effect on reducing undeclared work should involve a mix of elements. This policy mix will inevitably vary from one Member State to another. Effective implementation and enforcement remain an important part of the overall strategy whatever the measures chosen.

This paper aims to launch a debate on the causes of undeclared work and the policy options for combating it. It suggests that there is, firstly, a need to identify correctly the causes and extent of the problem, and, secondly, to regard combating undeclared work as part of the overall employment strategy.

The Commission hopes and expects that the Member States, Community institutions and social partners will participate vigorously in this debate. An increased awareness of the causes and extent of undeclared work, the identification of best practices in combating it and the possibility of coordinated EU action should be considered in this context. Implementation of several of the 1998 employment guidelines, such as those on developing entrepreneurship and encouraging adaptability, will help to discourage undeclared work. If the outcome of this debate indicates that further action at EU level would be appropriate, it could be considered in the context of the 1998 Joint Report and the Employment Guidelines for 1999.

## **1. INTRODUCTION**

Undeclared work affects all Member States and is therefore one of the issues of common concern in the employment field. Undeclared work risks undermining the financing of social services, already under pressure, decreases individuals' social protection status and labour market prospects and may affect competitive conditions. It also runs counter to European ideals on solidarity and social justice.

The White Paper on Growth, Competitiveness and Employment launched by the European Commission in late 1993 called, *inter alia*, for a widening of the concept of work, and encouraged the Member States to facilitate "the re-entry into the formal labour market of many citizens who have to work at the margins". Subsequently, in the Medium Term Social Action Programme 1995-97, the Commission announced its intention to launch a debate on illegal work.

As part of the follow-up to the White Paper, several studies and reports dealing with the characteristics and typologies of undeclared work have been undertaken. This Communication builds on the information gathered in these reports and reviews measures to combat undeclared work. The objective of this paper is to launch a debate on how Member States can tackle this problem more effectively on the basis of exchange of good practices or, where appropriate, co-ordinated action at EU level. If the outcome of this debate indicates that action at EU level would be appropriate, it could be considered in the context of the 1998 Joint Report and the Employment Guidelines for 1999.

## **2. ANALYSIS OF THE UNDECLARED LABOUR MARKET**

### **2.1. Defining undeclared work and the size of the problem**

The very nature of undeclared work makes it a difficult problem to deal with. From a European perspective it is hard to find a common definition of undeclared work owing to its differing characteristics in the different parts of the Union. Moreover, it is difficult to make a definite statement on the size of the problem since it can only be estimated.

In a major study carried out for the European Commission from 1988-1992 the concept of the underground economy and irregular forms of employment was found to be defined by the regulatory system. Illegal work does not exist in a totally non-regulated and permissive context. Thus some economic activities might be illegal in some countries but legal in others, and this makes it difficult to achieve a common EU definition.

"Undeclared work" is therefore defined here 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 to the public authorities, such as activities undertaken within the household economy.

It is difficult to identify what proportion of the Gross Domestic Product is undeclared and various methods have been used to estimate it. On average, the size of the undeclared economy in the EU can be estimated at between 7% and 16% of EU GDP, which would correspond to anywhere between 10 and 28 million labour units, or between 7% and 19%

of the volume of total declared employment, according to the assumptions made about the sectors where this activity takes place and hence the average productivity. This must not be confused with people in unemployment, as most undeclared work is carried out by people who also work in the formal economy and they are of course already counted as part of total employment. If all undeclared work were to pass to the formal economy, it is therefore not clear by how much GDP would increase.

Estimates of the underground economy vary significantly according to the method used; nevertheless groups of countries can be identified<sup>1</sup>. On the one hand there is a group of countries where the undeclared economy is estimated at around 5% of GDP (the Scandinavian countries, Ireland, Austria and the Netherlands); on the other hand, in Italy and Greece it is estimated at more than 20%. There are two intermediate groups: the UK, Germany and France, form a group roughly halfway between the two extremes, while Belgium and Spain are somewhat higher..

## **2.2. Why does undeclared work exist?**

The main motivation for employers, employees and self-employed for participating in the undeclared economy is economic. Working in the informal economy offers the opportunity to increase earnings and to evade taxation on income and social contributions. For employers, the incentive is to reduce costs. From an historical perspective there are three factors which contribute jointly, but in varying degrees, to the existence of undeclared work:

- a) the emergence of a highly disparate demand for ‘personalised services’ to families and individuals (such as care, cleaning...); these services have a high labour content and low productivity growth;
- b) the reorganisation of industry and firms into long lines of vertical disintegration and chains of subcontracting, in order to make production more flexible and to increase the capacity for innovation and adaptation to specific situations and market fluctuations. This kind of flexibilisation leads to an increase in self-employment and of worker-entrepreneurs, some of whom may be operating within the undeclared economy.
- c) the impact of the spread of light technology, such as personal computers, which provides new working opportunities and opens up new areas to service activities.

The scope for and extent of undeclared work vary according to different institutional aspects of the economy in each Member State, such as:

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<sup>1</sup> These estimates have been obtained by consulting national experts on labour markets of the EC Networks SYSDÉM (Système d'évaluation et de monitoring) and MISEP (Mutual Information System on Employment Policy). The following comparative studies have also been consulted: “Underground economy and irregular forms of employment (travail au noir)” by Philippe Barthelemy, Fausto Miguelez, Enzo Mingione, Raymond Pahl and Alois Wenig, commissioned by DGV, 1990; “Measurement of the Shadow Economy - Study on five European countries (Germany, Belgium; France, Great Britain, Italy)” by Jean-Luc Bizeur, supervised by Jean-Pierre Yonnet, ORSEU, 1995; Deloitte & Touch, “The Black Economy and Taxes and Social Contributions”, commissioned by the Task Force “Statutory Contributions and Charges”, DG XXI, 1997. “Empirical Results of the Size of the Shadow Economy of 17 OECD countries over time” Friedrich Schneider, dep. of Economics, Johannes Kepler University of Linz, Austria, 1997. Several studies have suggested that the undeclared economy has been growing in recent decades, but estimates of its magnitude vary widely

- Tax and social contribution levels: The level of tax and social contributions clearly influences the level of undeclared work. A higher tax burden is an incentive to enter the underground economy both for the worker and the employer. Apart from the level of tax and social security contributions, the structure of these contributions will also shape the black economy. In countries where income taxation is high, the push will come from labour supply, and the undeclared worker will characteristically be self employed; in countries where social security contributions are high, the push will be from the demand side and undeclared labour will tend to be structured in (completely or partially) undeclared firms.
- Regulatory and administrative burdens: The weight of excessive overheads and administrative procedures, for example for registering as a service provider or for formalising an employment relationship, may discourage the declaration of work where both sides can see the advantages of not declaring it. The existence of craft corporations may also be conducive to undeclared work since in some countries membership of a craft association is required in order to exercise certain professions. While these exist to guarantee the quality of the product or service, they can also act as barriers to entry with the result that non-members could be tempted to exercise their profession clandestinely.
- Inappropriate labour market legislation: Limited recognition within current legislation for new kinds of work (for example non-standard working hours, part-time work or temporary contracts) may also force people into undeclared work.
- Industrial structure: In localities dominated by a few large companies the underground labour market is relatively insignificant but, at the other extreme, in local economies composed of a plethora of small firms, not only is undeclared labour more likely, but it is also more likely to be organised rather than on an individual basis. However, where workers are aware of their rights, undeclared work tends to be less prevalent.
- Low competitiveness: Recourse to undeclared labour may be a cost-cutting survival attempt by firms in declining sectors which would otherwise not be able to survive in a competitive market. In the long run, however, it is difficult for an undeclared sector to compete internationally, because it is more disorganised and requires a high degree of mutual trust between the operators which makes it difficult for it to reach beyond a closed circuit.
- Cultural acceptance: There is a certain cultural understanding or acceptance of the informal economy. Participating in the informal economy at local level will often be perceived as an exchange of services or mutual assistance which does not need to be declared (cleaning, agricultural seasonal work etc.).
- The existence of easy opportunity: Each individual chooses whether to engage in undeclared work, doing a personal cost-benefit analysis in which he or she will weigh the advantages, such as higher (immediate) income against the disadvantages, such as sanctions if caught, the risk of being caught or moral considerations. The more an individual has the opportunity to exercise an undeclared activity at low risk (for example, because of laxity of controls; because he or she is already covered by the insurance of the main employer or of a spouse), the easier it will be to take advantage of it.

### **2.3. Who are the undeclared workers?**

Effective access to undeclared work is a major factor determining who becomes an undeclared worker.

Undeclared workers comprise:

- The second and multiple job holders. The majority of undeclared work is carried out by people who also have a regular activity. Being able to participate in the undeclared economy often means that the individual is responding to a demand, which requires certain skills or special qualifications.
- “Economically Inactive” persons (students, housewives, and early retired persons). They have fewer time constraints on taking part in the undeclared economy and the opportunity will be greater for those who have had a previous contact with the world of work.
- The unemployed. On the one hand, the risks of participating in undeclared work may be higher for them, as they might lose their unemployment benefit, especially if it depends on active job search or participation in training. On the other hand, they may be offered a job on condition that it remains undeclared, and their ability to resist is very low, particularly where the unemployment benefit is low. However, the longer unemployment lasts, the more the opportunities to do undeclared work decline.
- Third country nationals (see para 2.5 below).

The age and gender of undeclared workers depend to a large extent on the sectors affected. Women do not form the majority of undeclared workers but they tend to be in a more fragile position. While most of the second or multiple job holders would be men, women working illegally would typically be officially inactive (housewives). This has negative consequences where their pension rights depend exclusively on their partner, rather than on their own work.

### **2.4. In which Sectors is undeclared work prevalent in the Member States?**

Three groups of sectors with fairly homogeneous behaviour patterns can be identified as present in nearly all Member States:

- the traditional sectors such as agriculture, construction, retail trade, catering or domestic services (characterised by labour-intensive production and local economic circuits). The construction sector often uses a high level of sub-contracting, with limited public control; in the hotel/restaurants/catering sector many small businesses are also difficult to control as regards turn-over and employees; private services are highly dependent on cultural traditions and acceptance, indeed, for some personalised services formal jobs do not exist.
- manufacturing and business services where costs are the major factor of competition. In Southern Europe the textile sector, with its opportunities for home-working, is considered to be especially affected by undeclared work.

- modern innovative sectors (primarily self-employed) where the use of electronic communications and computers facilitate contracting for, and carrying out, services in different locations, and this allows non declaration of these activities.

The first and the second groups can still be considered as those where the majority of undeclared work is carried out and where undeclared work can lead to exploitation, while the third group includes high skilled professionals choosing to do so. This latter phenomenon may be a consequence of inappropriate or unenforced regulation. Once these activities become mainstream, there are incentives to become part of the formal economy. Many new businesses start in the undeclared economy, only to be formalised once the business has become established.

National information on the situation in the Member States indicates, however, that there is no common European picture of undeclared work and that there are in fact many differences between countries.

- In the Scandinavian countries, the Netherlands, Belgium, France and the UK there is a tendency for the undeclared worker to be a younger skilled man.
- In Southern Europe the undeclared workers tend to be younger people, women working from the home and illegal immigrants.
- In Germany and Austria, the number of illegal immigrants taking up undeclared work is significant, although they are not the dominant group.

## **2.5. Third Country Nationals and undeclared work**

The extent to which third country nationals illegally resident in Europe (called illegal immigrants in this paper) participate in the informal economy is even more difficult to estimate than the size of the underground economy. The involvement of illegal immigrants in undeclared work is considered by all Member States as a serious problem to be addressed as part of their global strategy of combating illegal immigration.

For many illegal immigrants undeclared work is a survival strategy. Compared to other categories, illegal immigrants are particularly vulnerable, because in breaching the rule of residence they are likely to be removed when apprehended. This allows employers to employ illegal immigrants on conditions which would not be accepted by other individuals. In addition, third country nationals are often smuggled into the territory of the Member States and subsequently become engaged in undeclared work. On the other hand, there is also evidence that good possibilities for undeclared work act as a 'pull' factor for illegal immigration.

Although undeclared work performed by illegal immigrants previously tended to be concentrated in the construction industry, the trend now seems to be towards undeclared service jobs.

### **3. IMPACT OF UNDECLARED WORK**

#### **3.1. Social security and the impact on public finances**

In terms of social security, undeclared work has implications for health insurance and pension rights, and insurance against accidents at work. For the latter, undeclared workers are usually not covered.

Undeclared work can have a significant impact on the public finances especially in countries where rights are universal. For the undeclared worker in these countries there is no difference in coverage apart from what they would gain from voluntary supplementary pension schemes. As many declared workers are not affiliated to voluntary pension schemes, there is no difference between the undeclared worker and the declared worker in such cases. Generally, in all Member States, public finances suffer from the non-declaration of work and the resulting tax and social contributions revenue losses. This has consequences for the tax-financed public services of each Member State as the curtailment of receipts means a reduction in the level of services the State can offer. This creates a vicious circle, as the government raises taxes to continue to provide the services, thus creating more incentives to be undeclared<sup>2</sup>.

#### **3.2. The impact on individuals**

In the different Member States, health insurance and pension rights depend on residence (universal), or on contributions made (or derived from a spouse), or a mixture. Second-job holders in all Member States will normally always be covered by social security. In countries where coverage is universal for health and/or pension rights, all undeclared workers would be covered. In countries where coverage depends on contributions, either for old age pension, health, or both, undeclared workers who derive their rights from the spouse are also covered. Officially inactive undeclared workers (mainly women) are more dependent on their partner than if they were declaring their work. In these countries, other undeclared workers, and, of course, illegal immigrants, are not covered.

In all Member States, in cases of undeclared work, the workers concerned will not be covered by voluntary supplementary schemes, which leaves them with the basic pension. And of course, nowhere are undeclared workers covered by unemployment insurance or insurance against professional accidents.

Undeclared workers who are not second or multiple-job holders also suffer other consequences by not declaring their work. As their work is not formally recognised, they forego all the benefits of working with a formal contract, such as training, a specific career profile, pay rises, a sense of belonging to the enterprise. These people will be locked in their undeclared activity and will have difficulty in moving into other jobs. Indeed, those engaged in activities identified as the ultimate form of flexible labour end up with more difficulty in changing occupation.

Consumers also lose out because they do not have the same guarantees of protection for any goods and services provided, while at the same time they are responsible for tolerating, or even encouraging undeclared work.

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<sup>2</sup>Since 1996 the issue of the link between taxation and employment has been investigated at EC level in the High Level Group and its successor the Taxation Policy Group, both chaired by Commissioner Monti.

### **3.3. Effects on competition**

As undeclared work lowers the costs of a firm, it can be argued that it affects competitive conditions, both within Member States (between enterprises using undeclared work and those who comply with the rules) and between Member States (lower costs of production in some Member States could be due to use of undeclared work).

But it is important to distinguish between the two cases. At the international level trade is clearly affected by a whole range of factors; as undeclared work is a fraction of all work in the traded sectors, and since 'cost of labour' is only one of the factors that come into play, we can assume that the role of undeclared labour in distorting fair trade is minimal (the low-cost advantage of sweat-shops in textiles is principally exercised through proximity of location to the market, which is lost if these goods are to be exported too far.)

However most undeclared labour is carried out in non-traded sectors, specifically proximity services. It has been noted that formal and informal enterprises cut out their separate market niches; at the micro-level, however, competitive conditions will be more affected by informal enterprises. Normally an enterprise would not be working completely in the undeclared economy, so the cost-saving margin is reduced to the proportion of activities carried out in the black. The main impact would be on the receipts of public finances.

## **4. POLICY ISSUES**

### **4.1. Policy options**

From the discussion above it can be seen that undeclared work is part of the problem affecting the functioning of the European labour market. Given the right incentives, people active in the undeclared sector could be encouraged to declare themselves; also customers would buy more services in the formal economy if a structured offer existed.

The problem can be seen in two ways. If it is mainly an issue of individuals or firms taking advantage of the system and damaging everybody's welfare in the process, then intervention should be oriented towards sanctions and concentrate on:

- ensuring greater enforcement of the rules. If re-distribution of income and provision of welfare services is valued in society, it is up to the State to ensure that the number of free riders is limited.
- favouring systems where the rights to social protection benefits are linked to contributions effectively made.
- awareness raising campaigns highlighting unsociable behaviour and that defrauding the system damages everyone.

If it is mainly the outcome of new forms of work or working patterns and slower adaptation of inappropriate legislation to these changes, then policy should concentrate on prevention through:

- liberalisation of product and service markets and simplification of procedures for setting up small businesses;

- favouring the structuring of the supply for some sectors (care, cleaning...) and the recognition of new occupations and competencies
- greater involvement of the social partners in information, enforcement and control, at the sectoral, local and European level
- adaptation of inappropriate labour legislation in line with the evolution of new types of work
- reform of the social protection system to cover short spells of work, irregular work, people in and out of employment, care etc.
- decreasing taxation on labour both as a cost for the employer (social security payments) and on the disposable income of the individual
- reducing rates of VAT on labour intensive services.

It is important to decrease the economic incentives not to declare work and to increase the appeal of participating in the formal economy in order to change the overall risk/advantage balance. In order to be effective in combating undeclared work the establishment of a comprehensive targeted strategy is necessary. A mix of measures drawing on the two approaches outlined above must be implemented ensuring that different measures interact and that other policy initiatives do not contradict the measures taken to combat undeclared work.

#### **4.2. Review of policy measures introduced in the Member States**

In response to the various short- and long-term impacts of undeclared work, Member States have implemented a number of measures tailored to match the differing forms of the phenomenon and their prevalence (tables 1-3). In some Member States initiatives have concentrated on undeclared work in the form of second jobs, whereas in others, they have been targeted towards the more “industrialised” form of undeclared work. It is important to note, however, that some initiatives have been taken with other objectives in mind, but have had some positive side effects as regards undeclared work. However, when it comes to measuring the impact of these policies it is in many cases premature to draw any firm conclusions.

##### Legislative measures and enforcement

Most Member States have reinforced and strengthened legislation as regards criteria and sanctions for violation of regulations on tax and social contributions and benefit fraud in order to combat undeclared work. Changes in labour market regulations to promote access to the formal labour market have been introduced in some Member States, such as Spain, where there have been certain changes regarding non-standard work arrangements, and in Italy, where a new type of work contract enabling people to enter the formal labour market has been introduced. Although it was not its main aim, the transposition of Directive n° 91/533<sup>3</sup> has been used in some Member States as a means of fighting undeclared work.

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<sup>3</sup> Directive on an employers obligation to inform employees of the conditions applicable to the contract or employment relationship. Directive n° 91/533 EEC OJ. N° L 288/32 of 18.10.91

As legal measures as such cannot be said to have a substantial impact in themselves, follow-up in the form of enhanced control of implementation has been provided for in some Member States. Inspection at various levels has also been reinforced. The instruments for this vary from one Member State to the other: in countries where the workforce is highly unionised, the unions have an active role in control, while in other countries the role of labour inspectorates is more important.

Furthermore, control-campaigns with the participation of both tax authorities and labour market authorities have been introduced, both directly and indirectly as preventive measures, often with positive effects. Greater co-ordination between different parts of the public administration helps enforcement. Co-operation at the European level has also increased, notably through the sharing of information<sup>4</sup>.

Most countries have strengthened sanctions relating to either the non-declaration of work or benefit fraud. In some countries measures have been targeted at all levels in sub-contracting chains. Increased control measures have also been introduced for the service sector (hotel, restaurants and catering) in some countries and the labour market authorities have collaborated with the tax-authorities with some positive results both directly and by dissuasion of other cases of “organised” undeclared work.

#### Information and awareness

Another area where some Member States have initiated action is that of campaigns against undeclared work. The campaigns focus on enhancing the feeling of belonging to a common society from which everybody receives and to which everybody should contribute. The German example “illegal ist unsozial” can be considered as a general encouragement to the population to declare any work carried out. Some Member States have introduced information campaigns about the risks of using undeclared labour such as in the construction sector where the use of undeclared labour means there is no recourse against any defects in the work carried out or when using unauthorised moving firms where there is no cover against the risk of burglary or damage.

#### Subsidies or reductions in overheads as encouragement measures:

The issue of second jobs and undeclared work in the private service sector (households) has been addressed specifically in Belgium, Denmark, Finland, Germany, Sweden and France. Examples of measures to help reduce bureaucratic burdens include service vouchers and *one-stop-shops* for SMEs. In Belgium, Germany and France a service voucher scheme has been introduced, whereby households can buy household services at a lower price, but still ensure that social security contributions and taxes are paid through the voucher.

The approach in the North of Europe has focused on both tax-deductions and subsidies for certain services and has aimed at encouraging households to use formal labour and not undeclared labour. Tax-deductions and subsidies for re-furbishing and improvements of houses have been particularly successful in encouraging more people to use the opportunity to repair their houses legally, and had the effect of moving work which might have been done informally to the formal and registered sector.

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<sup>4</sup> See article 4 of the Directive concerning the posting of workers in the framework of the provision of services. Directive 96/71/EC OJ N° L 18/1 21.1.97.

Subsidies for domestic services have also been introduced in Denmark, Finland and Germany in order to encourage household work (cleaning and gardening) to be carried out in the formal economy instead of in the informal economy, as is often the case. The subsidies are given by the state as a part of the wage which has to be paid to the worker and, in that way, they reduce expenses for users of the service. The State, for its part, ensures that this activity is declared (and thereby also taxed) since there is a clear incentive for the user to apply for the subsidy.

#### Tax measures:

Most countries have made changes in tax legislation concerning levels of personal taxation and tax-deduction possibilities. The changes have in some cases had certain positive side effects for the combat against undeclared work.

The implicit tax rate on labour (taxes and social contributions) in the EU has risen from 35% in 1981 to more than 42% in 1995. This is the result of taxation progressively moving away from mobile tax bases, such as capital. Since 1996 the need to reverse this structural trend and more in general the link between taxation and employment have been investigated at EC level in the High Level Group and its successor, the Taxation Policy Group, both chaired by Commissioner Monti. This process has led to the adoption of the Resolution of the Council and the Representatives of the Governments of the Member States, on a code of conduct for business taxation - Taxation of saving, O.J. N° C 002 , 06/01/1998 (98/C 2/01).

The Employment Guidelines for 1998 also provide for Member States to examine the advisability of reducing the rates of VAT on labour intensive services.

#### Interventions from the supply side

Another kind of intervention is to favour the restructuring and professionalisation of the supply side in certain sectors. For example widespread public childcare facilities in some countries have eliminated this sector from the undeclared economy. The liberalisation of product and service markets also acts as a structural intervention favouring the declaration of certain activities.

The fact that administrative and regulatory requirements are among the most serious constraints faced by businesses has been recognised by the Commission in its *Recommendation on simplifying and improving the business environment for business start ups*<sup>5</sup>. Based on best practices in member States it sets out measures to reduce the administrative burden imposed on newly created enterprises, including the burden resulting from tax and social security payments.

#### Social Dialogue

The social partners can have an important role to play in combating undeclared work. This may for example take the form of vigilance at individual work places to ensure that regulations and working contracts are respected. In some countries collaboration with the industrial and trade union bodies from the sectors concerned has also been initiated. In France, for example, the government and certain industries have collaborated on

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<sup>5</sup> OJ N° L 145 of 5.6.1997

information campaigns in order to encourage people to use declared labour for construction and for house-moving. Moreover, wherever there are wide ranging tripartite agreements any strategy to favour the reintegration of undeclared work is negotiated and monitored through the social partners.

#### Measures relating to third-country nationals

With regard to the problem of third-country nationals involved in undeclared work, France in particular has introduced special measures which are mostly related to control, but also include monitoring of current developments. In the UK, legislation obliging employers to ensure that their employees have residence and work permits was introduced in 1996. The same kind of regulation was introduced in the Netherlands in the early 1990s. In Portugal and Greece legislation concerning immigrants has been changed.

At European level, combating undeclared work by third country nationals on the territory of the Member States is considered a matter of common interest and falls under Title VI of the Treaty. Against this legal background and because of the substantive common interest in tackling this issue the Council has adopted two recommendations on fighting illegal employment<sup>6</sup>. The Amsterdam Treaty will include a specific chapter on Freedom, Security and Justice with a specific Community competence for immigration.

### **4.3. Three Country Examples of an Integrated Strategy**

An integrated approach has been taken in some countries where a co-ordinated effort has been made involving different services of the public administration. Efficiency depends to a large extent on broad political initiatives covering different areas from labour law to fiscal measures targeted according to the features of the problem in the individual Member States.

#### **Denmark**

Several initiatives have been taken to combat undeclared work. Some initiatives targeted at other areas have had some positive side-effects and have worked in harmony with the policy measures introduced against illegal work.

First of all enhanced control was initiated in the fields of tax and labour inspection to detect benefit fraud. This has been carried out in co-operation between the tax and labour market authorities. Secondly, various schemes to encourage work to be carried out within the formal economy were established, in response to the fact that in certain sectors undeclared work had appeared to be the rule rather than the exception (primarily in the field of domestic services):

- Home service schemes: A subsidy scheme for consumer services was introduced in 1994.
- Subsidies for house repair

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<sup>6</sup> Council Recommendation of 22 December 1995 on harmonising means of combating illegal immigration and illegal employment and improving the relevant means of control, Official journal NO. C 005 , 10/01/1996; Council Recommendation of 27 September 1996 on combating the illegal employment of third-country nationals, Official journal NO. C 304 , 14/10/1996

Finally, the implementation of a tax-reform in 1994 lowering marginal income taxes had the side effect of reducing the incentives to activities in the underground economy.

### **The Netherlands**

Initiatives have been focused on benefit fraud and legislation on this issue was passed recently. The law is intended to ensure that recipients of social benefits fulfil certain criteria and do not take up second/illegal occupations contrary to the conditions of receipt of a benefit. It is considered that the best way to combat undeclared work is through tax-legislation and reduction in VAT levels. For this reason there have not been any initiatives taken to step up sanctions and controls to combat undeclared work.

Moreover, non-wage labour costs have been reduced in the Netherlands. These reductions relate specifically to low wage earners. The measures were introduced with the aim of promoting employment, but has also had some positive side effects in reducing undeclared work.

### **France**

A special agency was established to combat undeclared work (Mission de liaison Interministérielle pour la lutte contre le travail clandestin, l'emploi non déclaré et le trafic de main-d'oeuvre, MILUTMO) and all actions are co-ordinated at the national level through MILUTMO. At the regional and the local level control measures have been reinforced.

The approach chosen has been primarily based on legal initiatives and focused on repression and sanctions for violating existing legislation. This includes action against the "donneur-d'ordre" who is considered to be the beneficiary of the undeclared work carried out, and not just against the undeclared worker.

A service-voucher scheme has also been established to encourage the declaration of domestic work and tax-credits for repairs to housing and employment of domestic personnel were also increased.

Finally, information campaigns have been launched in collaboration between the government and the social partners of certain sectors in order to raise awareness of some of the risks taken when undeclared labour is used. Moreover, Social dialogue was also initiated and an agreement between social partners and the Ministry of Labour has been concluded.

## **5. CONCLUSION**

Undeclared work is an important element in the dysfunctioning of product, service and labour markets and it risks undermining the foundations of financing and delivery of social protection and public services as the curtailment of receipts entails a reduction in the level of services the State can offer.

We could say there are two kinds of undeclared work: one which is mainly evasion of taxes and social contributions by people in employment with a second activity; and the sort of 'organised' undeclared work which does not respect labour legislation. At present, undeclared work is mainly of the first kind, while labour market policy makers tend to concentrate on the second kind.

A strategy which is to have any impact on reducing undeclared work should involve a mix of the elements set out in paragraph 4.1. This policy mix will inevitably vary from one Member State to another. Effective implementation and enforcement remain an important part of the overall strategy whatever the measures chosen.

This paper aims to launch a debate on the causes of undeclared work and the policy options open to combat it. It suggests that there is, firstly, a need to identify correctly the causes and extent of the problem, and, secondly, to regard combating undeclared work as part of the overall employment strategy.

The Commission hopes and expects that the Member States, Community institutions and social partners will participate vigorously in this debate. An increased awareness of the causes and extent of undeclared work, the identification of best practices in combating it and the possibility of co-ordinated EU action should be considered in this context. Implementation of several of the 1998 Employment Guidelines, such as those on developing entrepreneurship and encouraging adaptability will help to discourage undeclared work. If the outcome of this debate indicates that further action at EU level would be appropriate, it could be considered in the context of the 1998 Joint Report and the Employment Guidelines for 1999.

**6. TABLE 1: LEGAL OR CONTROL RELATED MEASURES:**

	Increased control by tax authorities	Increased control by labour market authorities.	strengthening of sanctions	change in labour legislation or other
Austria		yes	yes	simplification of Commercial and Industrial Activities Regulation and more flexible working time arrangements.
Belgium	Yes	yes	raise of fines	
Denmark	Yes	yes		
Finland	Re-enforced fiscal action an control	increased control on unemployed.	yes	changes concerning atypical work
France	Increased control	- increased inspection and control - establishment of MILUTMO	yes	
Germany	Yes	yes, more staff of employment services for outside control.	yes, raise of fines	more restrictive towards black work
Greece	Re-enforced fiscal control		yes, raise of fines	registration of illegal immigrants legalising their situation for 9-12 months.
Ireland	Re-enforced application of tax-laws.		yes	
Italy	Yes			
Lux.				
NL	Yes	yes	yes	liberalisation of private manpower agencies
Portugal			yes, for child labour	deregulation on illegal immigrants
Spain				changes in atypical work arrangements.
Sweden	More fiscal control			
UK	Increased control			

**7. TABLE 2: MEASURES RELATING TO SUBSIDIES OR COST REDUCTIONS.**

	Service vouchers	subsidies house-repairs or domestic services	Change in tax-legislation	tax-deductions (services)	reduction of non wage labour costs.
Austria		pilot projects for the unemployed			yes
Belgium	Introduction of cheque-service				
Denmark		yes, home service scheme.	yes (lower marginal taxes)		
Finland		yes			
France	Introduction of cheque-service				yes (loi Robien)
Germany	Introduction of cheque-service			yes (domestic services)	
Greece			tax-reform reducing possibilities of tax-evasion	yes	yes
Ireland			yes, reduction of personal taxation		yes, reduction of social security contributions for certain categories of workers.
Italy		tax reduction for house repairs		yes (professional services)	yes
Lux.		subsidies for house-repairs, tax-deductions			
NL		subsidies to suppliers of some services	Yes		
Portugal			Yes		
Spain			Fiscal reform lower taxation on labour		
Sweden			Tax reform lowering marginal taxes	yes (house refurbishing)	yes
UK			yes		

8. TABLE 3: OTHER MEASURES

Country	simplification of employer related bureaucracy.	information campaigns	other campaigns	co-operation with sectors
Austria	Simplification of administrative procedures			
Belgium				
Denmark		yes		
Finland	yes	yes (1996)		collaboration with industry and commerce
France	yes for agricultural seasonal workers			contribution from social partners
Germany		Yes (illegal ist unsozial)		
Greece		Information on stricter controls and sanctions		
Ireland				
Italy	yes		yes (+ special phone line to report tax-fraud )	new contractual agreements (contratti di riallineamento)
Luxembourg				
Netherlands	yes, PMA stimulate labour in accordance with the law.	yes		increasing
Portugal	Simplification of administrative procedures			
Spain				
Sweden				
UK			yes (encourage to report suspected tax-fraud)	

## 9. ANNEX 2: COUNTRY FICHES<sup>7</sup>

### Austria

**Characteristics of the undeclared worker:** 1/10 of all people in working age have a sideline activity. The focus has been on illegal employment of foreign labour

**Undeclared work distributed by sector:** 40% in building and craft, 16% in other trade and industrial enterprise (auto repair, machinery, etc.), 16% in service sector, 13% in entertainment business and 15% in other trades and services (remedial training, hairdressing, baby-sitting)

**Measures/ Policies:** Increased control by labour inspectors; simplification of Commercial and Industrial Activities regulation; more flexible working time arrangements; simplification of administrative procedures. Pilot projects for the unemployed in domestic services have also been introduced. Non wage labour costs are reduced for apprentices and when hiring older unemployed

### Belgium

**Characteristics of the undeclared worker:** semi- or low skilled workers, men, young people

**Undeclared work distributed by sector:** catering industry, retail trade, construction industry, textile sector, traffic/transport, household services (private cleaning etc.), agriculture (fruit-picking)

**Measures/ Policies:** Legal measures. Extension of inspection services. More control of certain industries. Raise of fines. Attempts to decrease labour costs through several initiatives (textile plan, Maribel). Service vouchers systems.

### Denmark

**Characteristics of the undeclared worker:** skilled and unskilled workers, students, men (twice as frequent as women). There is a geographical divide (cultural); (young skilled man living outside Copenhagen)

**Undeclared work distributed by sector:** 33% in construction sector, 50% in private service sector (baby-sitting, cleaning, car-repairs gardening etc.)

**Measures/ Policies:** Strengthening of sanctions in tax laws. Lowering of marginal taxes, subsidies for house repairs, subsidies for consumer services, increased control by fiscal and labour market authorities.

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<sup>7</sup> Source: National experts on labour markets of the EC Networks SYSDM (Système d'évaluation et de monitoring) and MISEP (Mutual Information System on Employment Policy).

## **Finland**

**Characteristics of the undeclared worker:** younger skilled men

**Undeclared work distributed by sector:** construction, hotel/restaurants, retail trade (include car repairs), real estate services

**Measures/ Policies:** Preparation of subsistence benefits/ Subsidies for special services in households. Increased control measures also with regard to unemployed. Re-enforcement of fiscal action and control. Changes in the legislation concerning atypical work. Collaboration with industry and commerce. Simplification of employer related bureaucracy. Extensive information campaign.

## **France**

**Characteristics of the undeclared worker:** nationals, legal immigrants, illegal immigrants

**Undeclared work distributed by sector:** 60% in the service sector (primarily hotels, cafes, restaurants), 27% in construction business, 13% other sectors

**Measures/ Policies:** Re-enforcement of legislation. Establishment of MILUTMO. Introduction of service-vouchers system. Increase of control by labour inspectors. Extension of public authorities competence toward illegal work. Enhanced co-operation between labour market authorities and other parts of the administration. Strengthening of sanctions. Social partners contribution. Simplification of procedures for agricultural seasonal workers.

## **Germany**

**Characteristics of the undeclared worker:** illegal immigrants, double workers and also those only working in the black

**Undeclared work distributed by sector:** construction, hotel/restaurants, transport (persons or goods), cleaning sector, entertainment/art/culture

**Measures/ Policies:** Increase of control measures, strengthening of legal instruments, raise of fines. Information campaign ('illegal ist unsozial')

## **Greece**

**Characteristics of the undeclared worker:** illegal/legal immigrants; pensioners, women/homeworking; young people - mostly seasonal jobs

**Undeclared work distributed by sector:** sectors with homeworking possibilities (textile), hotels/restaurants/tourism, services, household services, transport

**Measures/ Policies** Legal action: Strengthening of sanctions /fines. Step up in enforcement of tax laws. Tax reform reducing the possibilities of tax evasion. Reduction of taxes on presentation of receipts for purchases and services. De-regulation concerning immigrants possibilities to stay in the country.

## **Ireland**

**Characteristics of the undeclared worker:** students, double workers. No illegal immigrants

**Undeclared work distributed by sector:** building, construction, distribution

**Measures/ Policies** Enforced application of existing legislation as regards tax-evasion etc. Reduction of personal taxation. Reduction of social insurance contribution for some categories of workers.

## **Italy**

**Characteristics of the undeclared worker:** moonlighters, young people, women, pensioners

**Undeclared work distributed by sector:** agriculture, construction, private service sector, textile (homeworking)

**Measures/ Policies** Increased control of tax authorities. Tax-deductions for professional services. Reduction of non-wage labour costs. simplification of administrative procedures. new contractual agreements (contratti di riallineamento)

## **Luxembourg**

Some undeclared work in the construction sector if any. No measures introduced.

## **The Netherlands**

**Characteristics of the undeclared worker:** men, skilled with a formal job

**Undeclared work distributed by sector:** hotel and catering, taxi-business, couriers services, bus enterprises, metal industry, ready made clothes sector

**Measures/ Policies** Increased control by tax authorities and labour inspectors, strengthening of sanctions. Liberalisation in the area on private man power agencies. Changes in tax legislation. Changes in labour legislation. Increasing co-operation with sectors. Information campaigns. subsidies to suppliers of some services.

## **Portugal**

**Characteristics of the undeclared worker:** illegal immigrants, women, unregistered workers

**Undeclared work distributed by sector:** construction, textile sector, retail trade

**Measures/ Policies** Legal initiatives concerning illegal immigrants and child labour. Tax reform. Simplification of some administrative procedures.

## **Spain**

**Characteristics of the undeclared worker:** under 25 years old. women, skilled, in SMEs

**Undeclared work distributed by sector:** agriculture, Service sector (hotels and restaurants ), private service sector

**Measures/ Policies** Certain changes regarding atypical work arrangements.

## **Sweden**

**Characteristics of the undeclared worker:** no characteristic, mostly self-employed, or skilled males

**Undeclared work distributed by sector:** private service sector, restaurants, cleaning firms

**Measures/ Policies** More fiscal control. Tax reform lowering marginal rates. Tax deduction for house refurbishing. Reduction of non-wage labour costs.

## **UK**

**Characteristics of the undeclared worker:** men, (25-55 years old) skilled/working class

**Undeclared work distributed by sector:** construction sector, Streets markets, hotels and catering

**Measures/ Policies** Increase in control and staff to tackle benefit fraud. Tax legislation measures.