

Opinion of the European Economic and Social Committee on 'A strategy against the shadow economy and undeclared work' (own-initiative opinion)

(2014/C 177/02)

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On 14 February 2013, the European Economic and Social Committee, acting under Rule 29(2) of its Rules of Procedure, decided to draw up an own-initiative opinion on

A strategy against the shadow economy and undeclared work.

The Section for Employment, Social Affairs and Citizenship, which was responsible for preparing the Committee's work on the subject, adopted its opinion on 19 December 2013.

At its 495th plenary session, held on 21 and 22 January (meeting of 21 January), the European Economic and Social Committee adopted the following opinion by 129 votes to none with 4 abstentions.

1. Conclusions and recommendations

1.1 The European Economic and Social Committee (EESC) considers it necessary to reiterate the importance of combating the shadow economy and undeclared work, to accompany and complement the work being done by the European Commission, specialised institutions such as Eurofound and other international organisations, not least the World Bank.

1.2 In the face of the serious on-going economic crisis in Europe, the EESC would highlight the negative impact of such phenomena in terms of company growth trends and on opportunities for innovation and developing human resources. Bringing companies and workers out of the shadow economy could therefore be a factor in economic recovery and could lay the foundations for more lasting development.

1.3 Although these policies are the responsibility of the Member States, it is widely recognised that to be effective in this area it is necessary to arrange for the systematic exchange of information, data and studies at European Union (EU) level, so as to secure the involvement and cooperation of the competent authorities and the social partners concerned.

1.4 By its very nature, the EESC is therefore the ideal forum within which to nurture and encourage the sharing of tools, policies and best practice, in order to take action with regard to economic factors and also the cultural and social context, against the backdrop of the EU-defined strategy for combating irregular employment and tax evasion, which is based on an inclusive formal labour market.

1.5 First and foremost, the EESC believes it is critically important to conduct a quantitative and qualitative assessment of the situation, which differs enormously from one Member State to the next, and of its negative economic and social effects, which also vary in the Member States, as a result of differing structural and underlying conditions. Without coherent data and information for the various Member States the strategy loses impact, as there is a need for measures to gauge the extent of the problem and for the impact of policies in place to be assessed.

1.6 The EESC therefore recommends addressing the problem of the methodology for estimating the scale and development of the shadow economy and undeclared work, which is as yet incomplete and fragmented, by applying a method based on workforce surveys carried out in the same way in all the Member States. This method has been developed by the Italian National Institute of Statistics, and has therefore been tested in a country that is particularly vulnerable to these phenomena, and that also has great regional differences.

1.7 The main differences relate to the extent of the shadow economy, which in some Member States and regions is as high as 30% of total output, and is not so much a residual problem as an integral part of their productive systems. For this reason, the EESC would underscore the need to launch a policy mix, to be differentiated for various regional, productive sector and employment types, so as to address the specific factors that fuel the shadow economy and undeclared work effectively, be they economic, cultural or social.

1.8 Both sides of industry can help to bring the shadow economy into the open, particularly in areas where it is not just a ruse to save on production costs, but appears to be an integral part of the productive fabric. Policies to tackle the problem require the activation of networks between European, national and local players who are aware of the problem and able to take measures to ensure that operating in the shadow economy ceases to be more convenient. This can be done by penalising those responsible with effective deterrents and by coaxing activities into the open by means of preventive and remedial measures, which would probably be more useful during the current crisis.

1.9 At local level, the EESC is promoting the establishment of observatories to monitor the shadow economy, involving representatives of employers, unions and the relevant public authorities, with the aim of examining the problem and its development over time, identifying the prevalent features, choosing the most effective measures and monitoring them in practice.

1.10 The EESC calls for the fight against the shadow economy to look beyond EU borders and for corporate social responsibility to be applied where minimum decent working standards are lacking in third countries subcontracting for EU companies. Not only does this practice distort competition between companies, it is also open to the use of child labour and, when basic safety rules are ignored, puts these workers in mortal danger, as was the case recently with the collapse of a factory in Bangladesh.

2. The European Union's commitment to combating the shadow economy and undeclared work

2.1 Against the backdrop of the EU's Europe 2020 strategy, designed to secure smart, sustainable and inclusive growth, employment policy guidelines have been built into the economic policy guidelines for Member States, including measures to combat the shadow economy and the associated undeclared, illegal and informal work; areas that remain their responsibility⁽¹⁾. The broad concept of the shadow economy encompasses a variety of activities, ranging from legal activities conducted in an illegal manner to illegal activities. Undeclared work is defined as 'any paid activities that are lawful as regards their nature but not declared to public authorities, taking into account differences in the regulatory system of Member States'. This definition encompasses disparate activities spanning informal services geared towards families and the undeclared work of people residing in the country illegally; it excludes criminal activities however⁽²⁾.

2.1.1 The shadow economy has an impact on the proper functioning of productive activities and on the quality of the workforce, obstructing growth-oriented economic, social and financial policies and undermining efforts to achieve the ambitious economic and employment-related objectives set out in the Europe 2020 strategy. The negative effects are worsening in the face of the social and employment impact of the financial crisis, which is reducing job opportunities and jeopardising companies' and workers' prospects for profit and income.

2.1.2 The attention paid to these phenomena has grown in recent years⁽³⁾ in the context of the European Employment Strategy (EES) and they have been addressed directly and as part of a more general debate on the need for labour market reform, as well as in relation to parallel related themes such as illegal immigration in the EU and decent work in third countries.

⁽¹⁾ Towards a job-rich recovery, COM(2012) 173 final, paragraph 1.1; Council Decision 2010/707/EU on guidelines for the employment policies of the Member States, Guideline 7.

⁽²⁾ COM(2007) 628. An equivalent definition is used by the OECD. The World Bank meanwhile proposes that the term 'informal' cover employees without contracts and non-professional self-employed workers with five or fewer employees.

⁽³⁾ — 2013 ILO Working Document 'Labour Inspection and Undeclared Work in the EU';
 — Eurofound 2013 database and report, Tackling undeclared work in 27 European Union Member States and Norway. Approaches and measures since 2008;
 — 2012 Employment Package, Commission Communication: Towards a job-rich recovery;
 — Commission Communications from 2012 and 2013 — Annual Growth Survey;
 — 2012 and 2013 country-specific recommendations;
 — 2012 PROGRESS Mutual Learning Programme, Peer Review on Combating undeclared work as a growing challenge in the context of high unemployment;
 — Commission Communication, 2010 — An Agenda for new skills and jobs: A European contribution towards full employment, COM(2010) 682 final;
 — Council Decision 2010/707/EU of 21 October 2010 on guidelines for the employment policies of the Member States;
 — Commission Communication of 2007 — Stepping up the fight against undeclared work, COM(2007) 628 final;
 — Special Eurobarometer of 2007 on Undeclared Work in the European Union;
 — Commission Communication — Outcome of the Public Consultation on the Commission's Green Paper Modernising labour law to meet the challenges of the 21st century, COM(2007) 627;
 — Green Paper — Modernising labour law to meet the challenges of the 21st century, COM(2006) 708;
 — 2010 Regioplan study: Feasibility of establishing a European platform for cooperation between labour inspectorates, and other relevant monitoring and enforcement bodies with the aim of preventing and fighting undeclared work.

2.1.3 The shadow economy and undeclared work are specifically addressed in the April 2012 Employment Package, the 2012 and 2013 Annual Growth Surveys and the recommendations to a number of Member States regarding the need to tackle irregular employment and tax evasion. Alongside legislative initiatives to be implemented by 2014, the Commission Work Programme⁽⁴⁾ includes the European platform to fight undeclared work, designed to improve cooperation between the relevant Member State authorities, disseminate best practice and pinpoint a number of common principles.

2.2 One crucial element is the involvement of employers' organisations and trade unions in the decision-making process: 'Social partners play an important role at the national level in (...) defining labour market rules'⁽⁵⁾. For this reason, the European Economic and Social Committee too has been discussing and promoting the development of European policy on combating the shadow economy and undeclared work, adopting two opinions on the subject in 1999 and 2005⁽⁶⁾.

2.2.1 In its first opinion, the EESC welcomed the strategy, based on inclusion in the formal labour market and a policy mix that could be adapted to the Member States' various legislative and productive contexts. It also highlighted a number of ambiguities and under-estimates in relation to the definition of undeclared work, the distinction between workers who are obliged to remain in the shadow economy and those who make a deliberate choice to do so, the weight of the administrative and tax burden on small and medium-sized and craft enterprises, the management of illegal immigrants, the regulation of new forms of work, the variety of types of undeclared work, and the potential inefficacy of some of the planned measures.

2.2.2 The second opinion was an own-initiative opinion adopted by the EESC in 2005⁽⁷⁾, reiterating the criticisms already highlighted in the previous opinion and adding further elements. These included the need to enhance incentives to declare employment, to cut the red tape surrounding business start-ups, to pay special attention to workers on low salaries, to promote information and education campaigns for companies and workers, to introduce an effective system for controls and penalties as a disincentive, to look at working conditions in third countries, and to examine the link with unemployment.

3. General comments: the need to act

3.1 The shadow economy is not just a reaction to the perception that costs (especially for labour) are excessive, and so is not geared solely towards reducing production costs illicitly by means of tax and social insurance fraud. It is also the result of a desire to side-step working regulations and standards (minimum wage, maximum working hours, safety and certification). This is not about criminal activities or legal activities conducted by unauthorised operators; it does, however, relate to occasional informal workers working with family or neighbours, although there is greater social acceptance of this category.

3.1.1 The complexity of the phenomenon is such that the workforce concerned is very diverse⁽⁸⁾: self-employed workers who choose not to apply the rules, employees not covered by social security or without a contract or paid partly in cash, family helpers, workers who do not declare their second or third job, illegal immigrants and workers in third countries who do not enjoy minimum standards for decent work, subcontracting for EU companies.

3.2 The need to address the shadow economy and undeclared work properly arises from their numerous effects on both companies and workers, not to mention on the public purse:

— competition is unfair and distorted between those that abide by the rules and those that do not, keeping companies in business that would probably be absent from the market; it also creates a dynamic of inefficiency, with companies stunting their own growth so as to remain in the shadow economy and not having adequate access to credit;

⁽⁴⁾ COM(2012) 629 final.

⁽⁵⁾ COM(2012) 173 final, paragraph 3(2).

⁽⁶⁾ OJ C 101, 12.4.1999, p. 30-37, following on from COM(98) 219; OJ C 255, 14.10.2005, p. 61-66. The subject has also been addressed however in other opinions about the labour market more generally or parallel phenomena related to the shadow economy: these include OJ C 175, 27.7.2007, p. 65-73 and the OJ C 204, 9.8.2008, p. 70-76.

⁽⁷⁾ On the basis of the Council Resolution No 13538/1/03 on undeclared work and the Council Decision of 22 July 2003 on employment policy guidelines.

⁽⁸⁾ ILO, Labour Inspection and Undeclared Work in the EU, Working Document Number 29, Geneva, 2013, Chapter 1.

- the workers concerned suffer poor conditions in terms of safety, income and social security, with consequences not only from an ethical standpoint regarding their dignity, but also in terms of production, as they are denied the opportunity for life-long learning, retraining and for keeping skills, production processes and products up to date;
- resources are lost to the public purse, as tax and social security income falls (the tax gap), meaning that the cost of public services and the welfare state is unevenly spread (free-riding).

3.3 The process of economic globalisation and socio-demographic change also provides potentially fertile ground for the shadow economy and undeclared work, and for this reason, policies to counter them need to evolve constantly, adapting to changes in conditions and addressing new phenomena. Examples include the increased demand for domestic help and care services, the reduction in standard forms of work, the growing flexibility of contractual relationships, the increase in self-employed work and outsourcing, and the growth in multinational companies. All of this calls for greater attention to be paid to the framing of legislation, to monitoring and control instruments, and to international coordination.

3.4 From a statistical viewpoint, shadow economic activities are an integral part of GDP, and appropriate methodologies are needed to measure them. Reliable and comparable information in the EU regarding their scale and structure is difficult to obtain, however, for at least three reasons: i) their nature is such that by definition they cannot be observed directly; ii) the Member States take many different approaches, resulting in varying national rules; iii) the calculation techniques used also vary. Obviously, different approaches generate different results that can vary significantly even within an individual country (Table 1). Generally, the figures published by official national sources are lower than those contained in the studies of experts and international organisations.

3.4.1 There are three ways of measuring the scale of the hidden economy, and they can also be applied to various subjects of analysis (value added or employment):

- direct surveys at microeconomic level (e.g. Eurobarometer and the European Social Survey), which involve occasional or regular sample surveys in which interviewees are asked certain questions about their employment relationship⁽⁹⁾;
- indirect estimates at macroeconomic level, based on other quantities that are known and that correlate well with the shadow economy, such as the national accounts, labour market trends, consumption and currency demand;
- econometric models treating the shadow economy as a non-observable variable, on the basis of the main factors that encourage it and indicators for unlawful business activities.

3.5 One European-level study has recommended that a useful basis for generating homogeneous and comparable estimates for the Member States might be the indirect methodology developed by the Italian national institute of statistics, based on easily accessible and reliable data from labour input⁽¹⁰⁾. In the medium-term, this could supply the EU with a common, shared basis for analysis, comparison and evaluation, independent of the reports of external research bodies or organisations.

3.6 Currently, comparable data for all the Member States comes either from econometric models for the shadow economy or from direct sample surveys on the proportion of the workforce (employed and self-employed) that is employed informally; the results obtained are partly conflicting as they analyse varying aspects (see Table 2). Furthermore, only a few Member States conduct regular national surveys of this phenomenon.

⁽⁹⁾ Although this runs the risk that the shadow economy will be under-represented owing to untruthful answers, the advantage is the high level of socio-economic detail.

⁽¹⁰⁾ Ciccarone, G. et al., Study on indirect measurement methods for undeclared work in the EU, GHK & Fondazione G. Brodolini, Final Report to the European Commission, DG Employment, Social Affairs and Equal Opportunities, December 2009.

3.6.1 The econometric method shows the highest values in certain central and eastern European Member States (reaching over 30% in Bulgaria), levels are high for the south, middling in the rest of central and eastern Europe and the Nordic countries, and low for western Europe and the UK and Ireland⁽¹¹⁾.

3.6.2 The direct method however records provides a more nuanced picture, with the highest values in the south (especially in Cyprus and Greece), but also in Ireland and Poland, and minimal values in certain central and eastern, Nordic and western Member States⁽¹²⁾.

4. Specific comments: the impact on the crisis and policy pointers

4.1 The impact of the crisis and the austerity measures is not immediately clear. On the supply side, the recession ought to lead companies to reduce production costs, whether lawfully or not, to compensate for reduced profits and income, while there are more unemployed people available to accept undeclared work. On the demand side, meanwhile, employment opportunities for people with low qualifications dwindle as we consume and invest less in sectors such as construction, commerce, hotels and restaurants and domestic services.

4.1.1 The empirical evidence is inconclusive however⁽¹³⁾. Recent trends show a uniform decline according to the econometric models, apart from a slight increase in 2009 when the economic crisis was at its height, but with a rapid recovery subsequently between 2010 and 2012 (Table 3). The direct surveys however show a more varied picture, with certain Member States showing a reduction in informal employment for employees and others in contrast showing an increase in tax evasion among the self-employed.

4.2 It is not just the scale but also the structure of the shadow economy and of undeclared work that varies from one Member State to another; this is owing to differences in the productive structure and also in welfare state systems⁽¹⁴⁾. The categories of worker most concerned by these phenomena, already worse off than average, are also affected by the recession and are seeing their income potential reduced⁽¹⁵⁾.

4.3 The dynamics of the shadow economy and undeclared work, therefore, especially following the crisis, impact on the workforce in differing ways, in the various Member States and also within individual economies. This diversity of impact must be taken properly into consideration in the shaping of policies to combat the shadow economy and when launching counter-cyclical social policies.

4.4 Given the complexity and multidimensional nature of the shadow economy and of undeclared work, the consensus is that a mix of instruments is needed to tackle the problem, taking in deterrents, including controls and penalties, and incentives to abide by the rules. The EESC welcomes the growing importance over the last few years of preventive and remedial measures to pre-empt the factors underpinning or fostering the shadow economy, and considers that these are probably more useful in terms of finding a way out of the economic crisis⁽¹⁶⁾ (see Table 4).

⁽¹¹⁾ Schneider, F., *The Shadow Economy and Work in the Shadow: What Do We (Not) Know?*, IZA Discussion Paper, No 6423, March 2012; Schneider, F., *Size and Development of the Shadow Economy of 31 European and 5 other OECD Countries from 2003 to 2012: Some New Facts*, Working Paper, 2012.

⁽¹²⁾ Hazans, M., *Informal Workers across Europe. Evidence from 30 European Countries*, Policy Research Working Paper, No 5912, World Bank, December 2011; In *From the Shadow — Integrating Europe's Informal Labor*, Packard, T., Koettl, J., Montenegro, C.E., World Bank, 2012, Chapter 1.

⁽¹³⁾ Schneider, F., cit.; Hazans, M., cit., Packard, T., Koettl, J., Montenegro, C.E., cit.

⁽¹⁴⁾ In the Nordic countries where spending on labour market, social protection and redistribution policies is higher and where, as a result, there is greater equality in income, records show a lower incidence of undeclared work, which relates predominantly to people having second jobs to supplement their income. In southern Europe, on the other hand, the shadow economy plays a substitutive role owing to the limitations of active labour and welfare policies, and it is therefore particularly prevalent among the unemployed and people who are on the margins of the formal labour market. See Eurofound, *Tackling undeclared work in 27 European Union Member States and Norway. Approaches and measures since 2008*, June 2013, Chapters 1 and 4.

⁽¹⁵⁾ Hazans M., pp. 22-39.

⁽¹⁶⁾ Eurofound, Chapters 2 and 3.

4.5 Generally, the measures proposed vary and apply to different aspects of the problem:

- making it cheaper and easier for companies to abide by the rules, reforming and simplifying administrative and tax procedures;
- increasing the risk of being found out, tightening controls (not least by means of tripartite inspections involving representatives of the relevant public authorities⁽¹⁷⁾, employers and unions) and making existing penalties more efficient and effective;
- encouraging the growth of small and medium-sized businesses and applying industrial policies to encourage productive sectors with a high intensity of qualified labour;
- making undeclared work less attractive for workers, for instance by providing income support and making the connection between contributions and social benefits clearer;
- regulating new forms of work, so that they are not misused but provide a way for companies and workers to reconcile their needs;
- monitoring compliance with social security requirements by means of appropriateness indicators for labour costs⁽¹⁸⁾ (which vary by sector, category of company and region), agreed on by both sides of industry;
- reducing the social acceptability of the shadow economy and defending the tax ethic, raising public awareness, seeking greater fairness in the tax burden and increasing confidence in government and politics;
- drawing up regular monitoring reports, assessing current trends and the effectiveness of the measures taken;
- bolstering cooperation among Member States regarding multinationals, not least by means of dedicated agencies or institutional structures⁽¹⁹⁾.

4.6 All of these measures have a shared objective however: for companies, to make the cost in terms of fines and loss of reputation greater than any potential benefits to be derived from fraud or unlawful practices, and thus less worth the risk; and for workers, to ensure that declared employment pays better than undeclared work in terms of monthly income and future prospects. This will necessarily involve forms of support to enable undeclared work to be converted into lawful employment.

Brussels, 21 January 2014.

The President
of the European Economic and Social Committee
Henri MALOSSE

⁽¹⁷⁾ ILO, cit., Chapter 3.

⁽¹⁸⁾ These provide a means of uncovering possible irregular employment, as audits will show labour costs (salary plus social security contributions) lower than minimum estimates. They are referred to as good practice in COM(2007) 628 final.

⁽¹⁹⁾ Dekker, H. et al., *Joining up the fight against undeclared work in Europe*, Regioplan, Final Report to the European Commission, DG Employment, Social Affairs and Equal Opportunities, December 2010, Chapter 5.