

**NOTE TO THE INFORMAL COUNCIL OF MINISTERS OF EMPLOYMENT AND SOCIAL AFFAIRS ON
UNDECLARED WORK**

CONTRIBUTION BY THE EUROPEAN STATISTICAL OFFICE (EUROSTAT)

Introduction

On February 28, 2002, Commissioner Diamantopoulou stated that "... Member states must increase efforts to quantify undeclared work" because a proper, reliable evaluation is needed of policy measures to reduce undeclared work. Estimates of the underground economy vary significantly according to the assumptions and methods used. This shows how difficult it is to measure the underground economy or undeclared work.

Currently, there are no comparable official statistics on undeclared work. Statistics on employment and national income are designed to include undeclared activities, but not to measure these phenomena explicitly. This note clarifies the main tools for statistics about employment and GDP with respect to the inclusion of undeclared activities. It aims at explaining the main challenges for official statistics in producing explicit estimates of undeclared work. The note concludes with suggestions for methods to improve statistics on undeclared work in the Member States and Acceding and Candidate countries.

Definitions

To get a better understanding of what we try to measure, we first define the different terms involved such as underground economy, undeclared work, informal economy and informal employment. A useful starting point is the *System of National Accounts 1993* (SNA93). It notes in par. 6.34:

Certain activities may be both productive in an economic sense and also quite legal (provided certain standards or regulations are complied with) but deliberately concealed from public authorities for the following kinds of reasons:

- (a) To avoid the payment of income, value added or other taxes;
- (b) To avoid the payment of social security contributions;
- (c) To avoid having to meet certain legal standards such as minimum wages, maximum hours, safety or health standards, etc.;
- (d) To avoid complying with certain administrative procedures, such as completing statistical questionnaires or other administrative forms.

(..) Producers engaged in this type of production may be described as belonging to the "underground economy". The underground economy may account for a substantial proportion of the total output of certain industries - for example, construction or certain service industries where small enterprises predominate.

This definition of underground economy is rather wide, it includes for example also non-response in statistical surveys (point (d) above). Clearly, all productive activities have to be included in the national accounts, irrespective of whether they are declared or not declared to public authorities.

In its Communication on Undeclared Work, the European Commission adopted the following definition of undeclared work: "any paid activities that are lawful as regards their nature, but not declared to the public authorities, taking into account differences in the regulatory systems of Member States". When one compares this definition with the SNA93 definition of underground economy, one notes that both speak of activities not declared to "public authorities". In the SNA93 definition it is clear that this includes statistical authorities.

Both definitions refer only to legal activities. The SNA93 explicitly defines *illegal production* (par. 6.30 and further), that is also included in GDP and may have overlaps with the underground economy (par. 6.35).

In a statistical context, "undeclared labour" relates generally to employment data, while "underground economy" is used in the national accounts and relates to generated income. Undeclared work generates undeclared income¹. However, there are cases of undeclared income without undeclared labour, e.g. when enterprises underreport profits.

The international definition of the *informal economy*² was given by the 15th International Conference of Labour Statisticians in 1993. It states:

Art. 5 (1) The informal sector may be broadly characterised as consisting of units (... which) operate at a low level of organisation, with little or no division of labour and capital as factors of production and on a small scale. Labour relations – where they exist - are mostly based on casual employment, kinship or personal and social relations rather than contractual arrangements with formal guarantees.

Art. 5 (3) Activities performed by production units of the informal sector are not necessarily performed with the deliberate intention of evading the payment of taxes or social security contributions, or infringing labour or other legislations or administrative provisions. Accordingly, the concept of informal sector activities should be distinguished from the concept of activities of the hidden or underground economy.

To estimate undeclared work, the concept of informal economy is therefore not relevant. Informal employment is a broader concept. It includes not only employment in the informal sector but also informal jobs (in the formal sector) where there is no clear employer-employee relationship (e.g., some homework outside the premises of the employer's business or unpaid family workers assisting in the family business). Further discussion of conceptual frameworks and measurement methods can be found in the OECD (2002) handbook "Measuring the Non-Observed Economy".

Challenges in measuring undeclared activities

A distinction should be made between 1) *unobserved activities*: activities that escape observation by statistical surveys and 2) *undeclared activities*: activities that were not reported to public (non-statistical) authorities. The first concept relates to the statistical domain, the second to the fiscal/administrative domain.

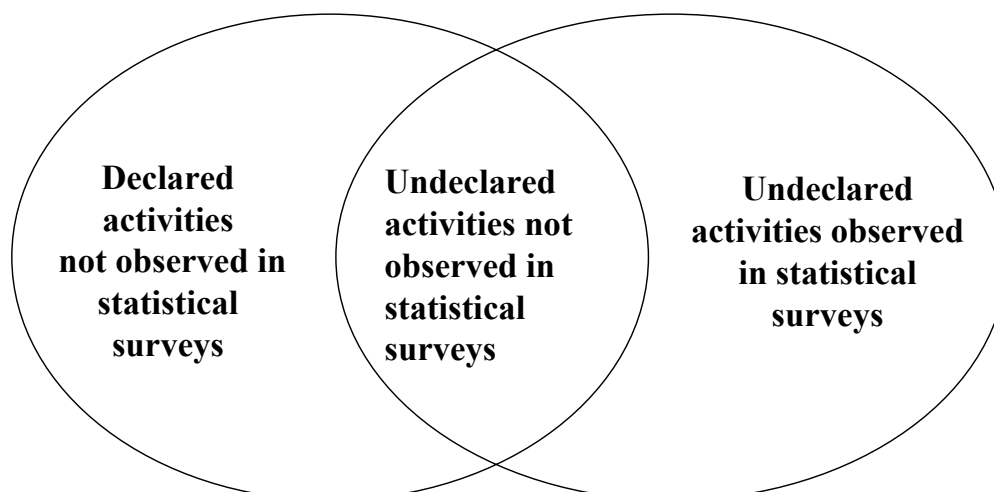
In the following diagram, unobserved activities are depicted in the left oval. There can be many reasons why activities are not observed by statistical surveys. These reasons could be statistical: it is impossible for a statistical office to continuously survey all enterprises and all households of an economy, simply for budgetary and practical reasons. Large pressure on statistical offices to reduce the reporting burden on enterprises makes that sample sizes of surveys and numbers of questions asked are continuously being reduced. In some countries, there is also a lack of surveys in particular branches of the economy, such as in certain services areas. Statistical offices make adjustments and corrections to the outcomes of surveys to compensate for unobserved activities.

¹ It should be reminded that this is only underground economy when the income exceeds a threshold and is thus subject to taxes.

² ILO has published results on employment in the informal sector for some acceding countries: Latvia (14.5%), Poland (7.5%) and Slovakia (23%), it may comprise unregistered own-account workers, employees without labour contract and not covered by social insurance, employees of unregistered employers and producers of goods for own final use. This employment is identified through questions on the size of the business, on the registration of the business and the type of ownership [<http://www.ilo.org/public/english/bureau/stat/papers/comp.htm>]

Unobserved

Undeclared



In the right oval the undeclared activities are illustrated. They concern activities that are deliberately concealed from public authorities, for example for tax reasons, or activities that fall under administrative thresholds. Some may also be concealed from statistical authorities: these are found in the overlapping section. Others may be picked up by statistical surveys; they are found in the most right section. (The size of the ovals and their overlapping part is no indication for the size of these parts in reality.)

Statisticians focus on the left oval, to provide exhaustive and accurate statistics. However, they usually do not try to provide explicit estimates for the unobserved economy, since it does not have a sound economic interpretation. Some countries publish some of the adjustments in their national accounts made to increase the coverage of GDP. Policy makers aiming at combating undeclared work will be mostly interested in the right oval. One of the problems for statisticians in providing a measure of undeclared activities is to know to what extent they are already observed in statistical surveys.

Measurement of the labour force

The labour force survey is a household sample survey and is designed to capture in principle all employment. It will generally capture more employment than business surveys. First, households may report their labour input in a household survey whereas businesses may conceal those same inputs in order to evade taxes or administrative regulations. Secondly, businesses may not be registered in the sampling frame because they are too small (in terms of size or turnover) to be included but this employment is captured by the labour force survey because there is no threshold. The labour force survey covers undeclared labour on the condition that it has a good survey design.

Three methodological conditions for a good survey design need to be satisfied in relationship with coverage, a high response rate and a correct measurement. The legal basis for the labour force survey³ specifies these conditions:

- coverage, art. 2 (2): "the principal scope of the survey consists of persons residing in private households [...] If possible, this main population is supplemented by persons living in collective households."
- correction for non-response, art. 3 (5): "the weighting factors are calculated taking into account the probability of selection and external data relating to the distribution of the surveyed population by sex, five-year age groups and region ..."

³ Council Regulation (EC) n° 577/98, OJ L 77 of 14.3.1998 and Commission Regulation (EC) n° 1897/2000, OJ L 228 of 8.9.2000

- correct measurement, art. 4 (3): "a list of principles for the formulation of the questions concerning the labour status [is] drawn up."

However, employment according to the labour force survey may be incomplete due to practical survey problems. Adjustments are needed, for example with respect to the coverage (the institutional population, for example, worker hostels), non-response (for example, non-nationals) and measurement (to identify all persons at work or with a job according to the principles for the formulation of the questions on the labour status).

Because of these methodological problems, a comparison of the labour force survey results with administrative sources or register data on an aggregate level does not yield an estimate of undeclared labour. The difference is a net effect. The labour force survey does capture non-registered employment, but some registered employment is missing in the labour force survey due to non-response and measurement error. These effects would need to be controlled for to obtain an estimate of undeclared employment.

The Italian statistical office ISTAT publishes regular estimates of undeclared labour (*occupazione irregolare*). The estimates are based on a comparison of the number of jobs in business surveys, labour force survey⁴ and according to administrative data. Although ISTAT's practice of publishing explicit data on undeclared labour is recommendable, unfortunately their method can not be generalised to other countries because of the particular design of the labour force survey in Italy.

Measurement of GDP

The main method used in national accounts to ensure exhaustiveness of GDP is the integration of all available, preferably independent, data sources into one consistent framework. Different data sources⁵ may have a different coverage of units and variables, partly overlapping, partly complementing each other. By using as many data sources as possible, the greatest coverage is achieved. What is not observed in one source may be picked up by another.

The integration of different data sources is an essential element of the process, but it may not be sufficient. Explicit further adjustments may be necessary, for example to include activities escaping all statistical observation. This is where national accountants have to rely on academic research or expert estimates e. g. to find indications of the adjustments should be. These adjustments are made at the detailed level, i.e. by industry or on specific components, such as wages. They can relate to unobserved and to undeclared activities. Countries try at this stage to distinguish between different types of adjustments, so some indication of the size of explicit adjustments made for undeclared income is available. This does not mean however that these adjustments themselves are an exhaustive measure of undeclared income⁶. Wherever countries make well-based adjustments to value added of particular industries, in relation to undeclared activities, it is conceivable that such adjustments could be converted to approximate estimates of undeclared labour on the basis of assumptions about productivity ratios.

The European Commission (Eurostat) has since the introduction of the fourth own resource worked with the Member States to improve the coverage of GDP. The centrepiece of this work is a Commission Decision⁷ that specifies the work to be done by Member States to improve and evidence the exhaustiveness of their accounts. One of the most important parts of the exhaustiveness work was to make a systematic comparison on employment as given by household surveys and business surveys and the value added included in national accounts.

⁴ According to the Labour Force Survey, Italy has the lowest share of second jobs (1,2%) among the Member States apart from Luxembourg, see table in annex

⁵ business surveys, household surveys, government records, administrative sources, etc.

⁶ The OECD handbook "Measuring the non-observed economy" gives more detail on statistical methods to include non-observed activities.

⁷ OJ L 77 of 19.3.1994, Decision n° 168

The exhaustiveness work led to significant increases in GDP of several Member States. Eurostat considers that currently a satisfactory level of comparability, reliability and exhaustiveness has been achieved, so that the data can safely be used for budgetary purposes. The exhaustiveness issue has been important for the Acceding Countries in order to prepare their accession.

Suggestions for possible further work

Because the labour force survey and the national accounts do not distinguish undeclared work or the underground economy from declared activities, Eurostat does not have the means to provide explicit measures of the size of undeclared labour in EU countries.

Such measures will have to originate in the Member States, on the basis of data that may be available in social security institutions, tax authorities, ministries or national statistical offices. Research could focus on comparisons of aggregate data on employment and income, but this will be hampered by some of the issues mentioned in this note. Another possibility could be to compare micro data which needs to be further explored.

Undeclared work and activities are likely to be concentrated in a few economic activities (construction, some manufacturing, retail trade, cafés and restaurants, some business services, household services). Research could therefore also focus on investigating these activities in more detail. This would provide more structural information on undeclared work. Some of the basic material underlying explicit exhaustiveness adjustments made in national accounts could be used for this purpose as well.

Annex to EUROSTAT Note

Second jobs (%), labour force survey Spring 2002

EU15	3,3	ACC	5,3
B	3,4	CY	4,9
DK	10,5	CZ	2,4
D	2,2	EE	4,3
GR	3,1	HU	1,7
E	1,7	LT	6,5
F	3,4	LV	6,9
IRL	1,9	PL	8,0
I	1,2	SI	2,2
L	1,1	SK	0,8
NL	5,8		
A	3,7		
P	6,4		
FIN	3,9		
S	9,4		
UK	4,1		
