

Working document

Undeclared Work and the European Employment Strategy

The new European Employment Guidelines highlight the importance of **transforming undeclared work into regular employment** in line with the orientations given in the 2003 Synthesis report and in the conclusions of the Brussels European Council. The European Parliament¹ has supported the Commission policy line and requested action to improve the status of the millions of (mostly) women doing low paid undeclared household work. The European social partners have included undeclared work in their 2003-5 Joint Work Programme as a subject on which actions are planned by 2005.

The European Commission has launched two major studies on undeclared work since its 1998 Communication on this subject. The first one, published in 2002, reports on the effectiveness of the different policies. The second one, ongoing, focuses on the measurement of undeclared work, the situation in the accession countries, the gender dimension and good practice. Its interim results will serve as a contribution to a Presidency Conference of December 2003 on the segmentation of labour markets. The study will be completed in April 2004.

1. The concept of undeclared work

Undeclared work is understood in various ways in the Member States. The 1998 Commission Communication on undeclared work clarified that it is to be understood as *"any paid activities that are lawful as regards their nature but not declared to the public authorities, taking into account differences in the regulatory system between Member States"*.

Broadly speaking, **three main forms** of undeclared work can be distinguished:

- Undeclared work through "undeclared hours" as part of a regular job (e.g. Saturday work on own account using the firm's equipment, contacts or networks; firms declare only part of work and benefit is shared between firm and workers);
- A regular worker has one or several additional jobs which are not declared (secondary job holders);
- The main job held by a worker which is undeclared, including work of low number of hours per week/month.

¹ A-K Glase report, September 2000 and M. Smet report, November 2000; Opinion of 3rd June on the Commission proposal on Employment Guidelines

2. Undeclared work: a problem with many dimensions

It is very difficult to indicate the size of undeclared work. Various methods of estimation have been used by academics and Statistical Offices. The 1998 Commission Communication reports that studies estimate the size of the **informal economy** on average at **between 7% and 16% of the EU GDP**. This would correspond to anywhere between 10 and 28 million labour units in the 15 Member States.

In terms of the volume of work, **undeclared work would be 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 the number of people in unemployment, as most of the undeclared work is carried out by people who also work in the formal economy.

It is recognised that undeclared work has **strong** implications: for workers, for business, for consumers, for gender equality and for social protection systems.

1) **Workers**, including self-employed and family workers. Undeclared work is particularly problematic for those who perform it as their main professional activity. It is often characterised by low quality and pay, low or no security, no or low social protection, no or few training opportunities or career prospects.

In some instances, a spell of undeclared work may bring about benefits in terms of work experience and socialisation, but the transition towards better conditions at work and the acquisition of social rights are by no means ensured. It has also been argued that undeclared work facilitates integration at an early stage. This would hold in particular for immigrants joining ethnic minorities. However, these forms of integration entail a lack of contractual security and of civic recognition which increases precariousness.

2) **Business**: undeclared work is typically present in labour intensive sectors, with low productivity and profits, particularly when firms operate at the margin. Such enterprises have difficulties in hiring skilled people and have few prospects for business developments, in particular when they are totally operating in the informal economy. They may also distort competition. However, undeclared work provides an opportunity to very small suppliers of innovative goods and services at an early stage of their life cycle.

3) **Consumers**: Undeclared goods and services offer no guarantee to consumers. An apparent advantage in price may not compensate for defects or failures in delivery.

4) **Gender equality**: in certain sectors, undeclared work has a strong gender dimension. The labour market in these sectors is very segregated. Women are over-represented in certain undeclared jobs, e.g. jobs providing care, and they tend to be in a particularly fragile position.

5) **Sustainability of social protection systems**: undeclared work undermines the financing and delivery of social protection and public services. It threatens the sustainability of public finances and social solidarity. It is recognised that society as a whole will benefit from the transformation of undeclared work into regular employment.

3. The changing nature of undeclared work

Five factors influence the amount, type and trend of undeclared work:

1. The trend in undeclared work varies according to **institutional and regulatory conditions of the economy**, such as tax and social contribution levels (high tax burdens on labour being a disincentive to declare work), regulatory burdens (excessive overheads may discourage the declaration of work and of businesses) and inappropriate labour market regulations (limited recognition within legislation for new, flexible forms of work). At the same time, the estimated differences between Member States cannot be totally accounted for by the above factors. They must also have to do with what the citizens expect from the State (trust) and with their willingness to contribute financially to its functioning and to the provision of public services (solidarity).
2. Recent **technological and organisational** changes create scope for new types of undeclared activities, in particular when they result in vertical disintegration of firms and chains of subcontracting. The spread of light technology (personal computers) and the development of ICTs have been speeding up this process.
3. The **ways of life** increasingly adopted by households with relatively high income who consume a wide range of services provided by the informal economy.
4. **Globalisation** is speeding up the search of enterprises for economies of scale and scope. This entails cost increases to reach the viability threshold. The employers who are unable to meet these requirements tend to escape into the informal economy.
5. **Immigration** is sometimes induced by a growing offer of undeclared work. More immigrants who have entered the Union illegally or who have no more the right to stay in the Union constitute a potential supply of undeclared workers. Such situations are related to insufficient control of immigration and to failures of integration policies. In its Communication on Immigration, Integration and Employment of 3 June 2003², the Commission stressed the need to *"combat undeclared work and reduce the informal economy with a view to developing a broad policy mix of sanctions and preventive measures to transform undeclared work into regular employment"*.

The causes of undeclared work in **accessing and candidate countries** are perceived to be even more complex. In these countries, the **economic and institutional determinants** of undeclared work include an unstable institutional environment, low administrative capacity, a remaining distrust in the state, the need to make up for unreliable payment of salaries in many branches, the length of legal procedures and a high demand for cheap services and products, with acceptance of low quality, by some groups of the population. Undeclared work in the Baltic States e.g. reflects the low productivity of rural and small-scale farming³ and unreported wage supplements "envelopes"⁴.

² COM(2003) 336 of 3 June 2003

³ In Lithuania e.g., indicators for it are the number of small agricultural plots (300 000 farms plots under 3ha and 60 000 of 10 ha in average) and consumption patterns (32% of consumption and more than 50% of food consumption of rural households earned by in-kinds).

4. The policy line - Transforming undeclared work into regular employment - a new specific employment guideline

Pursuing the three overarching and interrelated objectives of the European Employment Strategy requires an integrated policy mix to tackle undeclared work which in turn will contribute to their achievement in a mutual supporting way: transforming undeclared work into regular employment will contribute to achieving full employment; it will improve quality and productivity at work as most of undeclared work does not meet basic standards; it will strengthen social cohesion and inclusion as it will provide civic integration for those who were excluded from the regular labour market.

In the **new Employment Guidelines**, transforming undeclared work into regular employment has become a specific guideline. Member States are committed *"to develop and implement broad actions and measures to eliminate undeclared work, which combine simplification of the business environment, removing disincentives and providing appropriate incentives in the tax and benefits system, improved law enforcement capacity and the application of sanctions. They should undertake the necessary efforts at national and EU level to measure the extent of the problem and progress achieved at national level."*

This will have the following policy implications:

- **Simplification of the business environment:** The removal of excessive bureaucracy, e.g. when starting an enterprise, reducing extensive reporting obligations when hiring employees, and the revision of complex legislation are important. Services for start-ups and small enterprises can play a useful complementary role.
- **Strengthening incentives to declare work:** To remove disincentives to declare work, the taxation of labour should be reduced and poverty traps eliminated as far as possible. Incentives can be provided through active labour market policy and easy access to the labour market and social protection. Earnings related unemployment benefits e.g. provide no incentive to declare work. Providing support (e.g. by the tax system) to small enterprises for staff training can have a similar effect.
- **Sanctions:** require improved communication and co-operation between authorities (tax offices, labour inspection, police) and strengthened surveillance. In this way, sanctions also have a preventive effect.
- **Awareness raising:** The efficacy of this mix of measures would be enhanced through information to the public about the implications of undeclared work on social security and on the consequences of undeclared work for solidarity and fairness, the basis of the European social model.
- **Measurement:** The note from the European Statistical Office reproduced as Annex makes clear that most of the ground work will need to be carried out at national level, on the basis of data that may be available in Social Security Institutions, Tax Authorities or National Statistical Offices. The Commission could co-ordinate and facilitate research in the Member States.

⁴ In Lithuania e.g., the gap between the wages declared to social insurance and those reported to Statistical Offices is around 10% and tends to increase. Estimates are that around 20% of private-sector employees earn more than what is reported even to the Statistical Offices.

Member States are expected to take into account the guideline on undeclared work in drawing up their National Action Plan to be submitted in October 2003. Monitoring the issue will be ensured in the context of the European Employment Strategy. They should also work out measurement methods in line with the guideline.

As part of their contribution to the implementation of the Employment Guidelines, the European **Social Partners** have announced a joint opinion on undeclared work in 2005. Undeclared work should also be further dealt with in sectoral social dialogue committees.

The **Commission** is expected to highlight developments in the draft joint report and to draw lessons based on experience in Member States. It will prepare recommendations when appropriate. It will promote the exchange of good practice between Member States, if possible through the organisation of one or several peer reviews. It will draw conclusions from the study to be completed in April 2004, assess methodological improvements in the description of the problem and broadly describe progress.

The **Presidency** intends to take stock of progress in research and policy development at the conference on the segmentation of the labour market due to take place in December 2003.

5. Questions

1. How do you assess the extent of undeclared work in your country?
2. What policy mix do you consider appropriate to transform undeclared work into regular employment in your country ?
3. Are there examples of good practice which you would like to highlight? Please indicate at least one good example of good practice.
4. What steps are you envisaging to take in the direction of improving measurement of undeclared work and assessing progress ?