

## TACKLING UNDECLARED WORK

Across the 27 member states of the EU, a great deal of effort is being invested in policy measures for tackling undeclared work. The European Foundation for the Improvement of Living and Working Conditions has commissioned a report on the effectiveness of the policy measures used in several countries (Williams et al. 2008). In the following we shall present some of the results of this report: a typology of potential policy approaches and a choice of particular measures.

### A typology of policy approaches

Most literature on tackling undeclared work distinguishes between two broad approaches: the dominant deterrence approach and an emergent approach focused on encouraging compliant behaviour. As the Table shows, the conventional deterrence approach seeks to engender compliance by detecting and punishing non-compliance. It is based on the understanding that those who are non-compliant are “rational economic actors” who will evade tax as long as

the pay-off from evasion is greater than the expected cost of being caught and punished. The goal is to deter engagement by changing the cost/benefit ratio confronting those who are engaged or thinking about participating in undeclared work. This is achieved by increasing the actual and perceived risks and costs associated with participation by raising the likelihood of detection and the penalties and sanctions for those caught.

The emergent approach aims to encourage compliance by either preventing businesses or people from engaging in undeclared work from the outset, enabling the transfer of undeclared work into the declared realm, or by facilitating a commitment to “tax morality”. Such an approach seeks to bring about a change in behaviour by encouraging “good” behaviour – that is, tax and benefit compliance – rather than taking it as given. It is grounded in a belief that punishing people for doing something wrong – in other words, negative reinforcement – is relatively ineffective compared with positive reinforcement of good behaviour. In the realm of undeclared work, a positive reinforcement approach can take three different forms. Prevention measures can be adopted to prevent non-compliance from the outset. Incentives can

be used to help those already participating in undeclared work to transfer into the declared work realm. And finally, commitment measures can be adopted that seek to encourage tax morality.

### Specific policy measures

In the following some specific policy approaches which are used to tackle undeclared work will be presented. These measures are quite diverse.

In several countries attempts are made to increase the likelihood of detection. One example is the so-called *Crossroads Bank in Belgium*. Measures to improve detection have been at the core of Belgium’s policy for tackling undeclared work since the 1990s. E-government is an integral part of the government’s strategy in this respect. An important step was

**Table**

**Policy approaches for tackling undeclared work**

Approach	Method	Measures
Deterrence	Improve detection	Data matching and sharing Joining up strategy Joining up operations
	Penalties	Increase penalties for evasion
Enabling compliance	Prevention	Simplification of compliance Direct and indirect tax incentives Smooth transition into self-employment Introducing new categories of work Micro-enterprise development
	Legitimising undeclared work	Employer incentives: <ul style="list-style-type: none"> <li>• service vouchers</li> <li>• targeted direct taxes</li> <li>• targeted indirect taxes</li> </ul> Worker incentives: <ul style="list-style-type: none"> <li>• society-wide amnesties</li> <li>• voluntary disclosure</li> <li>• business advisory and support services</li> </ul>
	Changing attitudes	Promoting benefits of declared work Education Peer-to-peer surveillance Tax fairness Procedural justice Redistributive justice
This table outlines the main types of approaches used for tackling undeclared work in the EU-27.		

Source: Williams et al. (2008).

the establishment of the Crossroads Bank for Social Security in 1991. This bank constitutes the central hub in an electronic network integrating the back offices of all social security institutions in Belgium and thus facilitates initiatives targeting undeclared work. Some of the main e-government initiatives targeting undeclared work include: the Social Identity Card (1991), which made undeclared work harder to perform; the Immediate Declaration system (2003), which requires employers to electronically inform social security services as soon as an employee joins or leaves the company; and the International Migration Information system (2006), which requires the electronic and immediate registration of any activity by foreign workers in Belgium.

One approach to encourage compliance by preventing people from engaging in undeclared work from the outset is the simplification of compliance. One such initiative is *CUORE in Naples*. The Operative Urban Centre for Economic Upgrading (CUORE) was established in 1999 based on an agreement between the municipality of Naples and the University Federico II to research the local business environment. This research revealed that the principal local labour market problem in Naples was not unemployment but rather the “hidden economy”. Today, CUORE consists of a network of neighbourhood service centres for entrepreneurs and aspiring entrepreneurs. Each local CUORE centre offers services to a low-income neighbourhood. Their target group is small and micro-sized “hidden” entrepreneurs. Once identified, CUORE centres offer information and advice to aid formalisation. Besides providing advice and support, attempts have also been made to offer incentives for businesses to do the same. As a result, business consortia have been established to provide promotional aid and training, arrange trade fairs, help protect the originality of their labels and offer assistance with the internationalisation of their markets. This creates further incentives for companies or individuals to legitimise their business.

A popular assumption is that the most basic way to eradicate undeclared work is by reducing overall tax rates. However, the problem with using general tax reforms to deal with undeclared work is that they have much broader impacts. For this reason, more targeted measures are often developed – as demonstrated by the *Rich Aunt Agatha scheme in the Netherlands*. It is well known that many people starting up in business secure their venture capital not from formal but from informal sources – such as family,

friends and acquaintances. A resulting problem is that these loans are often made on a relatively informal basis, which may contribute to an attitude from the outset that informal practices are part of the culture of the enterprise that is being established. In the Netherlands, it was formally recognised that this is how many entrepreneurs receive their venture capital. As a result, a scheme called the Rich Aunt Agatha Arrangement was introduced as an incentive to those giving loans, and in doing so to help those using personal loans obtained from family and friends (Aunt Agatha) to start off on the right footing. By exempting these private moneylenders from certain taxes, such loans are deliberately put on the radar of the tax authorities. At the same time, the initiative helps to encourage businesses to start off on a more formal basis rather than seeing themselves as being engaged in informal arrangements which might carry over to their everyday trading practices.

Another possible method for encouraging people and businesses to engage in legitimate activities is to introduce new categories of legitimate work, enabling those involved in undeclared work, often by necessity, to move into the declared realm. For many years, EU member states effectively shut their eyes to the fact that people undertake small jobs that they do not declare. Unlike other countries, the *German* government decided to address this situation, creating a new “*Mini Jobs*” category of employment, which encourages people to legitimise these small jobs. Until 1999, “minor employment” was allowed up to a certain income level of about 325 and with a weekly working time cap of 15 hours. This work was exempt from social security payments for both employers and employees. Employers had to pay a lump-sum tax rate of 23 percent, while employees were not obliged to pay any tax whatsoever. This minor employment could be combined with normal employment and still remained exempt from tax and social security contributions. In 1999, the government reformed the minor employment scheme, in an effort to limit its growth. This drove much of this work into the undeclared sphere. As a result, in 2002, the government introduced a new initiative providing for three new types of “mini jobs”:

- Jobs with a 400 earning threshold – the former 325 income limit was raised to 400. Within this income limit, mini jobs also became subject to reduced social security contributions of 23 percent (12 percent for pension insurance and 11 percent for health insurance contributions) and a lump-sum tax rate of 2 percent. Moreover, the 15 hours weekly working time cap was abolished.

- Mini jobs in the household sector – introduced to combat undeclared work in this sphere. Accordingly, the employer pays a levy of 12 percent and can deduct a certain amount from their tax payments.
- “Midi jobs” – in order to ease the transfer from minor to normal employment, a transition zone was introduced allowing for earnings ranging between Euro 400 and Euro 800, with social security contributions for the employee gradually rising from about 4 percent to the full 21 percent.

Besides using measures to prevent people from engaging in undeclared work in the first place, measures also exist to enable those already participating in undeclared work to legitimise their activities. These measures include, for example, voucher schemes such as the *Service Vouchers in Belgium*. Service vouchers are a means of paying for everyday personal services. Each voucher costs Euro 6.70 and this pays for an hour of work from certified companies that hire unemployed people. At first, the unemployed person can be hired by the company on a part-time, temporary basis. After six months, the company has to offer the worker a permanent employment contract for at least half-time employment if the person was registered as unemployed. An employee of a certified company can carry out the following activities: housecleaning, washing and ironing, sewing, running errands and preparing meals. The household pays using the vouchers, the cost price of which was Euro 21 in 2005; the difference is paid to the company by the government. The household can recover 30 percent of the price of the voucher in their tax returns. This effectively means the cost of one hour’s work to the customer is Euro 4.69.

In order to encourage household work to be carried out in the formal rather than the hidden sector, wage costs for official household work can be reduced directly by government as is done by the *Home Service Scheme in Denmark*. The Danish Home Service Scheme was launched in 1994 as a pilot project and made permanent in 1997. Its aims were to: firstly, compete with undeclared work; secondly, promote the development of formal enterprises that provide household services; and thirdly, offer job opportunities to low-skilled jobseekers. Under this scheme, businesses registered with the Danish Commerce and Companies Agency provide services to households, for which the government reimbursed a portion of the cost.

Another measure to legitimise undeclared work involves offering amnesties on an individual basis to

those who voluntarily disclose that they have been working on an undeclared basis, as the *Regularisation Campaign in Italy* shows. In October 2001, the Italian government implemented a law known as the Regularisation Campaign (Law 383/2001), which eventually ceased in February 2003. This allowed hidden workers and enterprises to regularise their situation with respect to issues such as tax, labour, safety, social security contributions and land use irregularities. In exchange, they paid reduced taxes and social contributions for three years, as well as reduced pension contributions for the previous years, to enable them to adapt. Hidden workers were given two options: to declare their irregularities and immediately pay all (reduced) taxes and contributions owing, or to engage in gradual “regularisation”. The latter entailed submitting a regularisation plan, which included deadlines for solving irregularities, to an ad hoc committee. If the plan was not followed and the deadlines not met, the workers would be penalised by having to pay 100 percent of the tax and contributions owing, rather than the reduced amount.

W.O.

## Reference

Williams, C. C., E. Horlings and P. Renooy (2008), *Tackling Undeclared Work in the European Union*, European Foundation for the Improvement of Living and Working Conditions, Dublin.