



WORKSHOP REPORT

Introduction

This workshop was aimed at officials of the European Commission and was stimulated by presentations from two EEO experts (Giuseppe Ciccarone, EEO Thematic Expert, Sapienza University of Rome and Fondazione Giacomo Brodolini (FGB), Italy and Elvira Gonzalez, EEO SYSDem expert Spain, Centro de Estudios Economicos Tomillo SL (CEET), Spain).

The workshop sought to review preliminary evidence on the prevalence of undeclared work in the EU in the economic crisis. The presentations gave an overview of preliminary evidence of undeclared work (UDW) in times of economic crisis from a general perspective followed by a case study focussed on the situation in Spain.

The background

Undeclared work (UDW) is important in the EU, as elsewhere in the global economy, and has been on the policy agenda for several decades.

As stressed in the 2007 Commission Communication 'Stepping up the fight against undeclared work'¹, undeclared work has had negative implications for the European Employment Strategy. In particular, undeclared work:

- Undermines the financing of social and public services;
- Decreases individuals' social protection status;
- May influence competitive conditions between companies and individuals;
- Counteract European ideals on solidarity and social justice;
- May go together with tax and social security fraud; and
- May act as a pull factor for illegal immigration.

Undeclared work generally poses a threat to the functioning of the labour market and tends to distort growth-oriented economic, budgetary and social policies. For the development of adequate policy measures, it is important to have sufficient and comparable information not only about the extent, but also about the structure of undeclared work across the European Union. Thus, it is important to better understand and measure undeclared work, and in recent years the Commission has undertaken significant steps to do this.

A European Employment Observatory Review on undeclared work² in, 2007, highlighted difficulties in estimating and measuring undeclared work. Despite the fact that the majority of countries see links

¹ COM (2007) 628, <http://eur-lex.europa.eu/LexUriServ/LexUriServ.do?uri=COM:2007:0628:FIN:EN:PDF>

² European Employment Observatory Review: Spring 2007 <http://www.eu-employment-observatory.net/resources/reviews/EN-ReviewSpring07.pdf>

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between taxation and social security regimes, and undeclared work, there continues to be a lack of specific data or studies despite the high political profile of the problem.

In 2009, the Commission ran a study on Indirect Measurement Methods for Undeclared Work in the EU. This concluded that the Labour Input Method would be amongst the most suitable means of measuring undeclared work across the EU and noted that almost all EU Member States could be in a position to implement this approach within three years.

Workshop presentations

The workshop presentations can be found at:

<http://www.eu-employment-observatory.net/en/documents/Meetings-Workshops.aspx?year=2010>

1) Giuseppe Ciccarone - Preliminary evidence on undeclared work in the economic crisis: a general perspective

UDW is difficult to measure, especially over short periods, and even more difficult to predict. While the direct methods have not proved reliable, the indirect methods provide different estimates, however, mostly of the underground economy. Very few estimates exist which include the effects of the current economic crisis.

There are two scenarios for UDW in times of crisis. The first – an increase in UDW - is explained by the following aspects:

- firms (and households) may try to save on costs to support falling profit by shifting from regular to irregular employment;
- unemployed workers may be more willing to engage in UDW to support income, in which case UDW acts as a social shock absorber; and
- fired regular dependent workers may become irregular independent workers.

The opposite scenario – a decrease in UDW – could be expected, in an economic crisis, because of the following factors:

- lower demand and supply of labour in general (and of UDW);
- traditional UDW sectors (e.g. construction) may be hit harder in times of crisis, thereby reducing average UDW levels;
- UDW may be discouraged by more ‘flexible’ and cheaper labour contracts which increase regular dependent employment; and
- new arrangements may be more easily introduced to ‘regularise’ immigrant workers, again thereby reducing levels of UDW.

Recent data by Schneider (2010) indicates that with the economic crisis the underground economy (UNE) expanded in 2010, although not in the same way across all OECD countries. In 2010, all OECD countries faced an increase in the size of the UNE varying between 0.1 percentage points in

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Denmark and Ireland and 0.3 percentage points in Spain, reaching an average level of 14%. However, the UDE, or the shadow economy, must be differentiated from UDW. Schneider's figures are based on a mixture of monetary³ and MIMIC⁴ methods; the resulting figures, therefore, reflect much on the size of the UDE and have, therefore, been criticised for identifying unrealistically high levels of UDW.

Other countries, for example Italy, use other methods based on combining information on the supply and demand side of the labour market. According to the Italian experience, in the face of falling total employment during the period of the economic crisis (from 2008 to 2009), the number of irregular workers increased slightly and there was a decrease in the number of regular workers. Furthermore, the rate of regular employment remained stable, but the irregular rate increased slightly. This supports the view that UDW tends to increase in times of economic crisis. Given that this is the conclusion from the data for Italy, it is arguable that a similar trend is likely to occur in those countries which are as, or more, 'susceptible' to UDW.

Further analysis of the data from Italy shows that UDW varies across sectors. However, under-reporting is more likely in some sectors than in others and those working, on an undeclared basis, in sectors such as personal care, agriculture and tourism, may be more difficult to identify and more able to conceal their activity. The available evidence suggests, however: increasingly high rates of UDW in agriculture, until 2008-2009, when the rate became stable; much lower rates in manufacturing, although continuing to increase during the crisis; and a sharp increase in the construction sector. This pattern may reflect the variation, across sectors, in steps taken to tackle UDW; for example, increased inspections in the construction sector are likely to have uncovered the higher levels of UDW.

It is clear that there are both advantages and disadvantages of tackling UDW in a period of economic crisis. Governments with worse deficits are more intensively fighting both UDW and the UNE (e.g. Italy's extraordinary plan of surveillance against UDW in construction and agriculture, legislation in Greece to reduce tax evasion). In addition, there is evidence that productivity growth is higher when it is calculated excluding UDW.

The disadvantages of tackling UDW in the crisis are two-fold: there is likely to be an increased burden on the social security system if unemployment continues to increase; and, linked to this, there will be reductions in incomes if the reduced UDW is not matched by increased regular work (an especially high cost if UDW indeed acts as a social shock absorber).

2) Elvira Gonzalez - Preliminary evidence on undeclared work in the economic crisis: a Spanish perspective

Evidence shows that in Spain the informal economy (IE) increased in the period 2008-2009 – from 18.9% to 19.5% of GDP, according to Schneider. As mentioned above, however, IE should be differentiated from UDW. Using an adapted version of the Labour Input method, it seems that undeclared work has decreased during the economic crisis. This method adjusts employment figures, as shown by the Labour Force Survey (LFS), by deducting numbers of social security registrations. A conclusion is that the (downward) adjustment in employment during the economic crisis has relied upon a reduction in levels of UDW.

³ In short, the monetary method measures the demand for cash in by the underground economy and uses this to calculate the proportion of GDP that is accounted for by the underground economy.

⁴ In short, the MIMIC method asserts that the undeclared economy cannot be observed but its size can be understood by studying its determinants.

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The estimated reduction, from 2008 to 2009, in the number of undeclared workers is 416,033. Further analysis of the data suggests that 230,333 of these undeclared workers would have been immigrants, with the majority of those being male (70%, or 160,000). This pattern fits with the distribution of UDW across sectors – UDW decreased most in the construction sector, thereby affecting mostly men.

In summary:

- According to the LFS, in one year employment has decreased by 1.21 million jobs, of which 340,000 were immigrants, of which 250,000 were men;
- UDW has fallen by 416,033 of which 230,333 are immigrants, and of which 160 000 are men;
- A greater proportion of men have been affected by the fall in UDW. This relates to their prevalence in the construction sector, the sector most affected by the fall in UDW;

Spain has developed a Plan for prevention and correction of tax, labour and social security fraud (March 2010). The Plan is based on a former plan in 2005 and was updated in 2008 to have a stronger focus on prevention and on labour and social security fraud. In particular, Spain needs to cut public deficit to 3% of GDP in 2013, from 11.4% in 2009; the Plan aims to increase public revenues by 0.1% of GDP. With regard to UDW, the Plan focuses on: transport, clandestine workshops, agrarian seasonal campaigns, private education and health services, and practices such as fraud in employers' social security contributions, non-payment of additional hours worked, false sick leave claims, subsidised sheltered jobs in the regions, and fraud in claims for unemployment benefits.

For Spain, this analysis of the available evidence concerning UDW and the economic crisis, leads to the question of whether UDW may (again) increase as the economy recovers; if it does so, it is arguable that even stronger steps are needed to tackle it.

Workshop discussions

This section provides a brief summary of the discussion which followed the keynote presentations.

The likely impact, on productivity, of tackling UDW

This relates to the overall effect on demand and GDP of lower levels of UDW. There is insufficient evidence to draw firm conclusions on this point. However, data for Italy suggest that there could be a positive impact on productivity; there are likely to be sufficient increases in revenue, to outweigh increases in state expenditure. However, this depends very much on the structures in place and the relationship between revenues and expenditure. If there is a one-to-one transfer from irregular to regular work, then of course the impact on productivity will be positive. The greater the proportion of irregular work that cannot be transferred into regular work, the greater the likelihood that the impact will be less positive.

Methodological issues – the LFS and the measurement of UDW

The measurement of UDW using an indirect method compares information on the supply side of the labour market with that on the demand side. Sources for the supply side information will include the Population Census and Labour Force Survey and they can reveal part of the UDW: (i) individuals are less motivated than enterprises to conceal the nature of their work, especially when this is recorded via anonymous questionnaire completed by workers or households; and (ii) household surveys

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identify labour inputs that are not included in business surveys, for example because enterprises are too small to be registered or to be included in the survey. For the demand side, information will be taken from, e.g., Industry, Services and Institutions Census, the Agriculture Census, and Ministry of Finance VAT data. UDW is then computed as the difference between the overall (recorded and unrecorded) number of workers identified by supply side sources and the number of (recorded) workers emerging from demand-side surveys. It may make use of several additional statistical and administrative sources.

The difference between UDW and the underground economy

The underground economy includes both legal and illegal activities. In contrast, undeclared work concerns only legal economic activity which is not declared, either in part or as a whole, to state authorities. Thus, undeclared work can include, for example: legal workers who are not fully regular; greater number of hours worked than officially recorded ones; higher levels of qualification than those officially recorded (therefore part of the salary is unregistered).

The difference between UDW and the underground economy has important methodological implications. The monetary method and the MIMIC method produce overall estimates of the whole of the underground economy and the resulting figures are often taken as representative of undeclared work. However, given that they are based on the underground economy – both legal and illegal activities – their estimations tend to produce unrealistically high rates of UDW. For example, the UNE in Italy in 2006 was 23.2% of GDP, whereas according to ISTAT official data, the incidence of added value produced by productive units employing irregular labour was 6.4% of GDP.

The relationship between subsistence activities and UDW

It is important to draw this distinction and to exclude, from UDW, agricultural self-production – subsistence activities on 'household' land. It is likely that different countries would require a different definition of what constitutes self-production, as opposed to UDW.

References

Schneider, F. & Feld, L.P. (2010) Survey on the shadow economy and undeclared earnings in OECD countries. Johannes Kepler University Linz.
<http://www.econ.jku.at/members/Schneider/files/publications/LatestResearch2010/SurveyShadEconTaxEvasion.pdf>

More information about other EEO activities can be found at:
<http://www.eu-employment-observatory.net>