

Opinion of the European Economic and Social Committee on The role of civil society in helping to prevent undeclared work

(2005/C 255/12)

On 28 January 2004 the European Economic and Social Committee, acting under Rule 29(2) of its Rules of Procedure, decided to draw up an opinion on *The role of civil society in helping to prevent 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 15 March 2005. The rapporteur was **Mr Hahr**.

At its 416th plenary session, held on 6-7 April 2005 (meeting of 7 April), the European Economic and Social Committee adopted the following opinion by 112 votes to 1, with 2 abstentions.

1. Summary of the Council Resolution

1.1 On 20 October 2003, the Council (employment, social policy, health and consumer affairs) adopted a resolution on undeclared work⁽¹⁾. The Council's objective here is for the Member States to consider adopting a measured strategy to combat undeclared work in the Union. The strategy would be an integral part of the European Employment Strategy. The ninth guideline of the 2003 Employment Guidelines was directed exclusively at undeclared work⁽²⁾.

1.2 The Council calls on the Member States to consider the resolution as a frame of reference for framing and implementing policies as part of the European Employment Strategy, while respecting national circumstances and priorities. The resolution builds largely on the content of the Commission's 1998 communication on the subject⁽³⁾.

1.3 Moreover, the Member States are requested to take account of the actions outlined in the resolution when reporting on the principal measures taken to implement their employment policies in the light of the specific guideline on undeclared work in their future National Action Plans.

1.4 It recommends cooperation in order to examine the common features of undeclared work across the Member States. This might best be addressed by a common approach within the framework of the European Employment Strategy.

1.5 With regard to preventive actions and sanctions, the Council recommends developing a comprehensive approach in keeping with the European employment strategy based on preventive actions, encouraging all employers and employees to operate within the formal economy and in the context of regular employment; these measures should respect the sustainability of public finance and social protection systems, and may include:

- the creation of a legal and administrative environment which is favourable to the declaration of economic activity and employment, through simplifying procedures and by reducing the costs and constraints which limit the creation and development of businesses, in particular start-ups and small undertakings;
- strengthening incentives and removing disincentives to declare work on both the demand and the supply sides;
- reviewing and, where appropriate, reforming tax and benefit systems and their interaction to reduce high marginal effective tax rates and, where appropriate, the tax burden on low-paid workers;
- setting up suitable employment policies vis-à-vis beneficiaries of social-protection measures which will help them to participate in the regular labour market; and
- reducing the risk of unemployment and poverty traps by eliminating undesirable interactions between tax and benefits systems.

1.6 Surveillance of legislative implementation must be stepped up, where appropriate with the active support of the social partners, as should sanctions in the event of violations, in particular in respect of those who organise or benefit from clandestine labour. Social awareness of the negative implications of undeclared work for social security and the consequences of undeclared work for solidarity and justice must be raised. It is also necessary to improve knowledge of the negative consequences of undeclared work.

⁽¹⁾ Council document No. 13538/1/03.

⁽²⁾ Council decision of 22 July 2003 on guidelines for the employment policies of the Member States, ninth guideline: 'Member States should 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 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.'

⁽³⁾ Communication from the Commission on undeclared work, COM(98) 219.

1.7 To improve knowledge about the extent of undeclared work, it is necessary to estimate the scope of the informal economy and undeclared work at national level. This can be done on the basis of such data as is available to social security institutions, tax authorities, ministries or national statistical offices. It is also important that the Member States contribute to the development of the measurement of undeclared work at EU level in order to gauge progress in achieving the objective of transforming undeclared work into regular employment. Efforts should be made to seek cooperation between national statistical offices on methodology and foster the exchange of experience and know-how on this issue.

1.8 Finally, the Council calls upon the social partners to consistently address the issue of undeclared work in the context of their jointly agreed multi-annual programme and to further deal with undeclared work at sectoral level in the context of the social dialogue committees. At national level, the social partners should promote the declaration of economic activity and employment and combat the incidence of undeclared work through awareness-raising and other measures, such as collective bargaining undertaken in accordance with national traditions and practices, in ways which contribute to the simplification of the business environment, particularly as far as small and medium-sized enterprises are concerned.

2. Introduction

2.1 Undeclared work means that tax and social contributions are not paid into the public purse. Revenue is not reported in economic activity and thus escapes taxation. VAT is neither reported nor paid. Work is paid for 'under the counter'. Employer contributions are not paid on undeclared wages. Neither do wage earners declare this income, so they pay no income tax.

2.2 Consequently, society is deprived of a considerable amount of the income, running into the billions every year, that goes towards funding, inter alia, welfare systems.

2.3 Efficient, honest businesses are either pushed out or find it hard to stay afloat and expand, whereas black economy businesses are able to stay in the market and even expand. This threatens to undermine the efficiency of the whole economy, and the productivity gains needed to continue to fund the welfare state also fail to materialise.

2.4 Undeclared work occurs throughout society, involving both employers and employees. It can basically be divided up into three groups.

2.5 The first group is made up of businesses that engage systematically in undeclared work — often in combination with regular employment. Employees often get their wages paid 'under the counter'.

2.6 The second is made up of people with two or more jobs, one of which might be undeclared. This group is made up of well-educated employees, for example, who want to top up the salary they get from their usual job in the regular labour market with some extra money on the side.

2.7 Finally, the third group is made up of unemployed workers who, for various reasons, are forced to work in the black economy because they are unable to secure employment in the regular labour market. This group is particularly vulnerable. They are often forced to work in poor conditions and for low pay. They are not generally covered by social security systems.

2.8 In addition to these three distinct main categories, undeclared work also takes place in other ways:

2.9 Unemployment or sickness benefits can be combined with undeclared income.

2.10 For small repairs, homeowners and tenants turn to workers who do not declare these jobs. They also do this for removals, for example. The reason behind this type of undeclared work is often that the relevant firms consider these jobs to be too small, so they suggest an employee who is prepared to do the job in his spare time as long as he is paid 'under the counter'.

2.11 The situation in the new Member States is similar to that in the EU15. However, the May 2004 Report on Undeclared Work in an Enlarged Union does highlight a specific phenomenon: the employer officially declares only part of the wage and the employee gets the remaining undeclared part as 'envelope wages' ⁽⁴⁾.

2.12 It is important to point out that all these types of undeclared work involve a not inconsiderable amount of tax evasion.

2.13 This dishonesty undermines society's moral code and that sense of responsibility that is essential in a society in which a not inconsiderable share of resources is used for redistribution and social benefits. Tax evasion also leads to tensions in society. A large proportion of the population pays tax while others take it upon themselves to decide how much to pay in tax and contributions.

⁽⁴⁾ 'Undeclared work in an enlarged Union', European Commission, Directorate-General for Employment and Social Affairs (2004), available in electronic format in English only: http://europa.eu.int/comm/employment_social/employment_analysis/work/undecl_work_final_en.pdf

2.14 Undeclared work does great damage to society as a whole. However, the damage cannot be measured in monetary terms alone. Trust is undermined at all levels. Many people accept or find excuses to do undeclared work; unemployment benefit is too low; regular — i.e. tax-declared — home services are too expensive, etc.

2.15 The rule of law and welfare systems are called into question when respect for the law and for rules and regulations cannot be maintained. It is therefore necessary to get to grips with these problems, using comprehensive, targeted measures. There is, however, a slowly growing recognition by the social partners, politicians and society at large of the negative consequences of undeclared work and the need to transform undeclared work into regular employment.

3. General comments

3.1 In 1999 the Committee issued an opinion on the Commission Communication on undeclared work⁽⁵⁾. The aim of the Commission communication was to stimulate a wide-ranging debate on this subject, both at EU level and in the Member States. The Communication was followed by a study carried out at the initiative of the Commission⁽⁶⁾.

3.2 The Committee welcomes the Council resolution aimed at taking this issue forward.

3.3 At the same time, the Committee notes that in 2003, the Commission embarked upon an extensive investigation into undeclared work in the enlarged EU. The Committee believes that the results of this enquiry, published in May this year⁽⁷⁾, make a valuable contribution to our understanding of undeclared work and how to combat it. The study thus provides Member State governments and authorities with an important basis for deciding the methods needed to tackle undeclared work.

3.4 Part of the Employment Strategy

3.4.1 According to the Council, combating undeclared work must be an integral part of the European Employment Strategy, which aims to provide more and better job opportunities. The Commission was already focusing on this objective and the EU Employment and Social Affairs ministers expressed their views at their informal meeting in Varese in July 2003. They recalled that transforming undeclared work into regular employment would contribute to achieving full employment, improving quality and productivity at work, strengthening social cohesion and inclusion, eliminating poverty traps and avoiding market distortions.

⁽⁵⁾ COM(1998) 219 final; EESC opinion in OJ C of 12.4.1999, pp. 30-37 (rapporteur: Mr Giron).

⁽⁶⁾ Regioplan Research Advice and Information (Mateman, Sander & Renooy, Piet): 'Undeclared labour in Europe - Towards an integrated approach of combating undeclared labour' (in English with summary in French and German), Amsterdam, 2001.

⁽⁷⁾ See footnote 4

3.4.2 In its 1999 opinion on the Commission communication, the Committee endorsed the employment-based approach to undeclared work. The Committee continues to adhere to this view.

3.4.3 A whole range of measures is needed to achieve the objective of transforming undeclared work into declared work, or bringing black economy work into the legal 'white' economy.

3.4.4 First of all, we need to make a distinction between those who ought to be employed in the regular labour market and those who have chosen not to declare their activity.

3.4.5 It is also essential to understand which activities in the informal black economy can be transferred to the formal, 'white' sector.

3.4.6 There is unlikely to be any demand for some types of black economy activities or services in the legal economy. The Committee therefore believes that this area requires special attention. Support measures could perhaps be used to bring these activities into the legal 'white' sector too.

3.4.7 The implementation of the Lisbon Strategy requires, *inter alia*, new dynamic, competitive companies to be created and developed in the European Union, in order to provide more jobs.

3.4.8 Translating an idea into a functioning productive company with its own payroll is a very long, complicated process.

3.4.9 Consequently, it is important to create the right climate for start-ups, i.e. one that is conducive to growth and development.

3.4.10 Employees must be able to expect the companies they work for to be aware of and to comply with existing labour market and tax legislation.

3.4.11 A balance needs to be struck between these two requirements or there is a risk that a large number of companies will never see the light of day and that many good ideas will never be translated into reality.

3.4.12 The visionary nature of the Employment and Social Affairs Ministers' comments in Varese in July 2003 could easily give the impression that bringing undeclared work into the declared sector is merely an employment issue. Undeclared work — particularly when it is organised systematically — is often linked to other forms of economic crime. This crime calls for specific societal initiatives and must be combated through the usual channels.

3.5 Definition of undeclared work

3.5.1 In order to separate undeclared work from other types of economic activity, the Council uses the definition used by the Commission in its 1998 communication: The Committee took the view that the definition of undeclared work as 'any paid activities that are lawful as regards their nature but not declared to the public authorities' was acceptable in view of the need to establish a common definition for all Member States. The Committee endorses this approach.

3.6 Illegal immigration and undeclared work

3.6.1 The Committee has, on a number of occasions, commented on the incidence and causes of illegal immigration, and also addressed the relationship between illegal immigration and undeclared work. Illegal immigrants do not have access to the regular labour market nor to social security. They are therefore obliged to make a living somewhere else, and, more often than not, they turn to the moonlighting sector. Moonlighting is rife in industries such as the building trade and the agricultural and gardening sectors. This often means illegal immigrants become heavily dependent on the irresponsible employers who exploit them.

3.6.2 The EU Member States therefore need to take action under the common immigration policy to combat illegal immigration⁽⁸⁾. This must be done using different strategies, which could vary from Member State to Member State. One obvious strategy is to make sure that illegal immigrants return to their country of origin. Another is to step up border controls significantly.

3.6.3 However, someone who is ready to give up everything in his homeland in order to start a new life somewhere else is possessed of an energy that is hard to counter.

3.6.4 There are also people whose papers are stolen or confiscated in order to force them to pay back the costs of their clandestine journey. Reduced to slavery, victims are compelled by networks of people smugglers to repay their 'debts'. Not only employees working for individuals (such as servants) but also those working e.g. on building sites, in shipyards, on farms or in the catering industry are affected. It is extremely disturbing to note that criminal activities are being organised with the involvement of several social levels, before our very eyes. In order to deal with the problem and to protect victims by giving them rights and ensuring respect for such rights, we must be aware of the situation and acknowledge that it exists.

⁽⁸⁾ See also Green Paper on An EU approach to managing economic migration, COM(2004) 811 final.

3.6.5 In a large number of cases of illegal immigration, however, the person concerned cannot be sent back to his homeland for humanitarian, legal or practical reasons. Naturally, in these cases the immigrant needs to be integrated into society through various measures.

3.6.6 Future evaluation of transitional measures on the 'free movement of workers' or rather, the lack of such freedom for nationals of Member States which joined the EU on 1 May 2004, should discuss the unnecessary difficulties faced by employers and workers, taking into account changing qualifications, demographic changes, cultural changes and changing needs for mobility.

3.6.7 Otherwise there is a risk that these groups will become part of a moonlighting pool, with all the negative repercussions this has for the regular labour market.

3.6.8 As the Committee pointed out in its own-initiative opinion on Immigration, integration and the role of civil society organisations, an important complement to other measures to combat undeclared work is the use of various integration measures and eventually citizenship to admit the immigrant into civil society⁽⁹⁾.

3.6.9 The authorities have a duty to clearly inform immigrants of their rights and duties, and ensure they have access to the regular labour market and full access to training. Healthcare and other services must be available to immigrants on the same terms as the rest of the population. Housing segregation must be avoided.

3.7 Preventive measures

3.7.1 In its resolution, the Council calls on the Member States to create a legal and administrative environment that is favourable to the declaration of economic activity and employment. More generally, the aim is to make undeclared work a less attractive proposition.

3.7.2 In this connection, the Committee would highlight some potential solutions that, either individually or used together, can help to achieve the objective:

3.7.3 Comparative studies should be carried out in order to ascertain which tax bases are particularly vulnerable to undeclared work and what potential exists to eliminate the problem.

3.7.4 The Member States must have properly functioning legal systems in order to identify, prosecute and punish those who engage in undeclared work. This is particularly important where it takes place systematically and workers are exploited.

⁽⁹⁾ OJ C 125 of 27.5.2002, pp.112-122 (rapporteur: Mr Pariza Castaños, co-rapporteur: Mr Melicias).

3.7.5 Comprehensive information and education initiatives must be implemented in order to show the damaging effect that undeclared work has on society and on individual citizens.

3.8 *Tax issues*

3.8.1 Investigations into the black economy generally assume that undeclared work is a problem because it leads to lower tax receipts.

3.8.2 Research carried out in various countries into the extent of the black economy provides no support for the hypothesis that there is a statistical link between the size of the sector and the overall tax burden.

3.8.3 The link between undeclared work and the tax burden is complex. The Committee does not believe that low taxes automatically lead to less tax evasion. The black economy also exists in countries where tax and contribution rates are low.

3.8.4 The Committee would welcome a comprehensive study to shed light on the link between taxes and contributions and the extent of undeclared work.

3.8.5 Since experience shows that undeclared work often takes place in very small firms with limited administrative resources, one might ask whether the reason for this is unawareness of the rules in force, if the rules are too complicated or if undeclared work is carried out deliberately in order to gain competitive advantages.

3.8.6 We place much store by fairness. This is why our systems of regulation are so detailed. The tax system is an example of this. High expectations of fairness mean that large resources have to be committed, not least for the authorities tasked with ensuring that decisions are complied with.

3.8.7 If a not insignificant proportion of businesses and employees in a certain sector chooses to withhold profits and wages from taxation, the tax system can be perceived as unfair by honest businesses, which can even be forced out by unfair competition.

3.8.8 There is therefore a case for exploring whether greater use can be made of flat-rate schemes in order to provide a simpler system that makes life easier for both individuals and the authorities. This would reduce the scope to manipulate systems and free up resources to pursue more serious lawbreakers.

3.9 *Monitoring and control*

3.9.1 One of the Council resolution's key arguments with regard to transforming undeclared work into regular economic activity is that monitoring and sanctions must be stepped up.

The Committee would add, here, that undeclared work must, of course, be combated by means of more regulation and public scrutiny. Failure to disclose paid employment should not be seen as a minor offence. As stated in the current employment guidelines, law enforcement capacity should be enhanced and linked to effective sanctions, as a disincentive to illegal work. Measures to curb undeclared work should always rest on the twin pillars of sanctions and prevention. These two aspects are mutually complementary, but neither can stand alone. A dual strategy combining control measures and incentives is also set out in the Council resolution and the current employment policy guidelines. The EESC endorses this approach.

3.9.2 Individual business people often feel that regulation and controls are patronising. Merely increasing the amount of regulations issued by the authorities is unlikely to produce an improved moral climate. Several sectors are currently cleaning up their act and ethical considerations are gaining ground in various organisations. Such voluntary action to combat illegal work is to be welcomed, but it cannot take the place of monitoring by the relevant authorities.

3.10 *The need for information and education*

3.10.1 For a worker, a job in the black economy generally involves a looser, more short-term type of employment, with no chance of career progression. Black economy firms cannot grow to any appreciable extent for fear that their fraud will be discovered. Workers who go in for undeclared work will therefore be denied any career development opportunities. Wages will not rise in line with the legitimate labour market, nor will sickness and pension contributions be paid.

3.10.2 People who engage in or organise undeclared work usually do so for a reason: to avoid paying taxes and social contributions. It is extremely important to increase awareness of the link between the payment of social contributions and future social benefits.

3.10.3 The Committee believes that both these examples show the need for comprehensive information and education initiatives. This means illustrating the negative impact undeclared work has on the individual and society in the short- and long-term.

3.10.4 The social partners and industry organisations can play a crucial role here. Undeclared work will be a less attractive proposition if the social partners see to it that wage agreements are properly respected and if they ensure, together with those representing business interests, that no-one is employed to do undeclared work. Employer and industry organisations could require their members to adhere to codes of conduct or risk various forms of sanctions.

3.10.5 However, the price of honesty must not be too high, otherwise the black economy could spread like wildfire. The black economy is more widespread in certain sectors. At the same time, there is, of course, a risk that some sectors could be singled out as a matter of routine because the black economy is easier to detect there than in others.

3.10.6 In the final analysis, it is always the individual that must decide in matters of morality, ethics and justice.

4. Summary and conclusions

4.1 Undeclared work takes place at all levels of society. However, it is very difficult to establish its overall extent. According to some studies, the informal sector accounts for an average 7 % to 16 % of EU GDP. There is therefore much to be gained by eliminating undeclared work and its underlying causes.

4.2 The Committee would like to draw attention here to a number of areas which need to be examined more closely and taken into account in order to find appropriate ways to resolve the problem:

- Incentives to declare work should be improved.
- Women are often in a vulnerable position when it comes to low-paid, undeclared work. Therefore their situation needs to be studied in greater depth so that appropriate measures can be taken.
- Business rules and regulations should be changed so as to cut red tape, especially with regard to start-ups. However, start-up owners must also have basic business administra-

tion skills. It is important that they should be aware of the demands of society regarding the running of a business, including in the area of labour law and social security for employees.

- There is a need for an extensive public information campaign to make producers and consumers aware of the negative impact of undeclared work on government revenue and social security and protection schemes and its negative consequences for solidarity and justice.
- Effective monitoring by the relevant authorities must be stepped up, for example through enhancement of law enforcement capacity, and cooperation between the relevant authorities both at national and cross-border level.
- Illegal work should not be seen as a minor offence. Effective sanctions must therefore be applied, in particular to act as a disincentive for businesses to indulge in the practice.
- Lastly, the Committee points out that some third countries do not adhere to generally accepted social standards and recommends that EU companies operating in such countries take this into account.

4.3 Finally, the Committee would stress the importance of getting the high unemployment rate down to a minimum in the Member States, as this is largely responsible for the existence of undeclared workers and undeclared work. Consequently, it is important to ensure that the European Employment Strategy is actually implemented, with the help of the national action plans. A smoothly operating labour market with full employment and quality jobs is the best antidote to undeclared work.

Brussels, 7 April 2005

The President
of the European Economic and Social Committee
Anne-Marie SIGMUND