



International  
Labour  
Office  
Geneva

# The Regulatory Framework and the Informal Economy

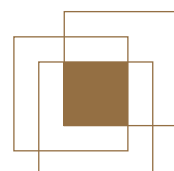


*Street artist, United Kingdom.*

## Specific Groups

### 4.b5 STRATEGIES FOR TRANSFORMING UNDECLARED WORK INTO REGULATED WORK

- This brief looks at how countries within the European Union have been addressing undeclared work – a type of informal work which is diverse in nature but explicitly hidden to avoid tax and social security responsibilities.



- Undeclared work and informality
- The diversity of undeclared work
- The European Union approach

■ **Undeclared work and informality.** Undeclared work<sup>1</sup> is a predominant form of informal work which is diverse in nature but explicitly hidden type. The resort to such work has been explained by the growing demand for domestic services, the trend towards more flexible working relationships, the growth of self-employment, disguised self-employment, sub-contracting, and the ease of setting-up group of enterprises that operate across borders.<sup>2</sup> It is furthermore made possible by inefficient labour inspection. The presence of undeclared work is problematic for all workers and society in general: not only is undeclared work generally associated with poor working conditions and little social protection, undeclared workers are often also vulnerable and lacking representation. It furthermore encourages inefficiency as businesses that hire undeclared workers will often avoid asking for credit, and will have more difficulty growing. Moreover, resorting to undeclared work is said to distort competition among firms.<sup>3</sup>

■ **The diversity of undeclared work.** The heterogeneity of undeclared work is certainly a challenge for policy makers. A combination of methods is clearly needed to curb undeclared work as effectiveness will depend on the type of work that measures are aimed at. For example, there is a huge difference between low paid exploitative employment that can be eradicated by preventative and deterrent measures, on the one hand, and self-employment that would need to be legitimised by enabling measures, on the other.

■ **The European Union approach.** The European Union has been tackling undeclared work directly since 2001, and in 2003, issued an Employment Guideline no. 9 entitled *Transform Undeclared Work into Regular Employment*, which has significantly shaped policy, in particular encouraging preventative and curative measures rather than simple deterrence. This Guideline states that “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.”<sup>4</sup> Although the guideline does not cover measures facilitating greater commitment to tax morality, there were later included in the European Commission’s second Communication on undeclared work: ‘*Stepping up the fight against undeclared work*’, 2007.<sup>5</sup>

1 Also referred to as the informal, hidden, cash, twilight, dual, subterranean, parallel, underground, second, unofficial, or shadow economy, as well as moonlighting (see Renooy et al., 2004, p.93). It is also referred to as “illegal work”.

2 Voss, 2009, p.38.

3 Ibid.

4 Williams and Piet, 2008, p.17.

5 2003/578/EC: Council Decision of 22 July 2003 on guidelines for the employment policies of the Member States, Official Journal of the European Union, L 197/13.

### What is undeclared work?

Undeclared work is generally understood as a legal remunerated activity that is hidden from the state for tax and social security purposes, although legal definitions, if they exist, vary from one country to the next. It is encompassed in the broader definition of the ILO’s definition of the informal economy, which is not limited to undeclared work but includes also work which falls outside the scope of the law - “all economic activities by workers and economic units that are – in law or in practice – not covered, or insufficiently covered, by formal arrangements.” Many initiatives have been adopted by the EU itself, and by EU countries.

“Undeclared work” applies to many situations, and can designate work done by a worker - whether national, migrant, or illegal migrant - who wants to avoid paying taxes, work offered by an employer who wants to avoid social expenses, and work done for reasons other than financial gain, amongst others. The worker may be self-employed or dependant, while the employer may be a firm or a private household (see the chapters on domestic work and MSEs). Undeclared work can thus be punctual employment or full-time employment, low-paid and exploitative, but also well-paid with harmonious relationship between the employer and the employee. There are also considerable differences between countries as to the number of hours worked and the nature of the work performed.<sup>6</sup>

6 See Williams, 2009, pp.148-152; Pfau-Effinger, 2009, p. 80-82.



*Migrant populations are amongst the groups affected by undeclared work in the European Union. A chef in a restaurant, London, UK.*





*Market garden, Poland.*

- **The need for a multi-pronged approach**
- **Measures to address the issue**
  - Improving labour inspection
  - Increasing penalties
  - Registration of transactions for tax purposes
  - Expanding the categories of workers
  - Coordinating activities at national level
  - Coordinating activities at EU level
  - Cross border inspections
  - Establishing incentives to declare irregular migrants

● A clear strategy, elaborated in consultation with social partners, concerning the planning and the evaluation of inspection activities is needed

■ **The need for a multi-pronged approach.** Addressing undeclared work clearly mixes social considerations with legal and economic ones, and also concerns tax and migration policy. Finding the right balance between these various considerations is not an easy task, however.

In general, a clear strategy, elaborated in consultation with the social partners, concerning the planning and the evaluation of inspection activities is needed, as is the setting up of registries and systems of data collection at the national and international levels. Improved collaboration between national bodies, improved training of labour inspectors, targeted labour inspection visits to sectors where undeclared work is known or suspected are key. Furthermore, effective and dissuasive sanctions proportional to the infraction should be put in place; sanctions should be complemented by sensitisation training on undeclared work.<sup>7</sup>

■ **Measures to address the issue.** The range of measures available to States are described in the box below. In all cases, however, labour inspection plays a key role (see brief on labour inspection Guide), as do information campaigns on the benefits of paying taxes and social security contributions,<sup>8</sup> and reducing the paperwork for registration (see in this regard briefs on MSEs and on domestic work).

<sup>7</sup> For more details see Resources section to access: ILO, 2010, pp.32-35, Guidelines for improving the ability of labour inspectorates to address undeclared work in Europe.

<sup>8</sup> For more details see Resources section to access: Renooy, et al. 2004, Undeclared work in an enlarged Union. An analysis of undeclared work: An in-depth study of specific items, p.95.

## Approaches to 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	Preventative	Simplification of compliance Direct & indirect tax incentives Smooth transition into self-employment Introducing new categories of work Micro-enterprise development
	Curative	<i>Purchaser incentives</i> : service vouchers; targeted direct taxes; targeted indirect taxes <i>Supplier incentives</i> : society-wide amnesties; voluntary disclosure; business advisory and support services
	Fostering commitment	Promoting benefits of declared work Education Peer-to-peer surveillance Tax fairness Procedural justice Redistributive justice

Source: Williams, C. C. and R. Piet, 2008, Measures to tackle undeclared work in the European Union, European Foundation for the Improvement of Living and Working Conditions, Dublin p.14.

There are numerous examples of legislative measures that have been put in place throughout the EU to fight undeclared work, with different measures put in place in different regions to respond to different types of undeclared work. These measures<sup>9</sup> include:

- **Improving labour inspection.** Many EU countries provide specific training to inspectors regarding undeclared work. This includes training on how to carry out inspections in the field of undeclared work, how to detect persons without employment contracts, special behavioural training, etc.<sup>10</sup>

Labour inspection needs to be geared towards sectors where undeclared work is particularly prevalent. In Romania, inspections have therefore focused on the construction, clothing and textile industries, while in Latvia and Portugal, inspections have targeted the hotels and restaurants sector. In Sweden, it is the taxi, hairdressing and restaurant industries that have been most inspected, while in Slovenia, it is driving schools, and in Norway, the cleaning sector.<sup>11</sup>

In order to avoid situations where the employer would claim to the inspector that an unregistered worker has just started work, systems of identity cards and compulsory registration have also been put in place in some EU member state. There is an obligation to register new employees in Austria, Bulgaria,

● Labour inspection needs to be geared towards sectors where undeclared work is particularly prevalent

<sup>9</sup> Detailed, amongst others, in the 2008 European Foundation for the Improvement of Living and Working Conditions' report, Measures to Tackle Undeclared Work in the European Union and in ILO, 2010.

<sup>10</sup> For more details see Resources section to access: ILO, 2010, Labour Inspection in Europe: Undeclared Work, Migration, Trafficking, Labour Administration and Inspection Programme pp.16-17.

<sup>11</sup> For more details see Resources section to access: Williams and Piet, 2008, Measures to tackle undeclared work in the European Union, p.21.

Italy, and Slovakia, for example, and an obligation to hold identity cards in the Czech Republic, Finland, Italy, Norway, and Sweden.<sup>12</sup>

● A number of countries have put in penalties for employers failing to register employees

- **Increasing penalties.** Sanctions have been strengthened in several countries including Austria, the Czech Republic, Denmark, France, the Netherlands, Slovakia, and the UK. Fines for employers who fail to register their employees increased in Austria in 2007, for example, with an individual now facing a penalty of two years' imprisonment in case of organised recruitment, placement, and hiring out of workers without registering them.<sup>13</sup>

The obligation to impose sanctions on employers resorting to undeclared workers through the hiring of illegal migrants is promoted through a recent EU Directive.<sup>14</sup> These sanctions should include an obligation to pay any outstanding remuneration to workers as well as an amount equal to any taxes and social security contributions that the employer would have paid had the third-country national been legally employed. The employer may be excluded from public tenders, public aid or subsidies and from participation in public contracts for up to five years; the licence to conduct the business may be temporarily or permanently withdrawn. In addition, compliance should, in certain instances, be strengthened by the application of criminal penalties. This Directive must be transposed into national law by 20 July 2011.

- **Registration of transactions for tax purposes.** According to legislation recently adopted in Sweden, anybody selling goods and services in return for cash payments must be able to provide a certified cash register from 1 January 2010.<sup>15</sup> This machine will register all transactions for tax purposes, and make it more difficult to withhold revenue in order to finance undeclared work, for example. The aim of this legislation is to protect businesses from unfair competition.
- **Expanding the categories of workers.** Faced by a steep increase in the number of small jobs exempted from social security, Germany decided, in 2002, to introduce three new job categories - 400 Euro jobs, mini jobs and midi jobs - that introduced varying levels of social security contributions.<sup>16</sup> This has led to an initial reduction in undeclared work.
- **Coordinating activities at the national level.** Several European countries, such as Bulgaria, France, Germany, Poland or Spain, have introduced data sharing and access to registries managed by tax authorities or social security institutions or have established new coordinating institutions. This has helped to detect undeclared work.<sup>17</sup>

Germany has put in place measures to vary levels of social security contributions

12 *ibid* p.21.

13 *ibid.*, p.24.

14 Directive 2009/52/EC of the European Parliament and of the Council of 18 June 2009 providing for minimum standards on sanctions and measures against employers of illegally staying third-country nationals

15 For more details see: <http://www.skatteverket.se/fordigsomar/foretagare/kassaregister/newcashregisterlegislationbecomeseffective1january2010.4.69ef368911e1304a6258000272.html> and Williams and Piet, 2008, p.28.

16 For more details see Resources section to access: Renooy, et al., 2004, Undeclared work in an enlarged Union. An analysis of undeclared work: An in-depth study of specific items p.35.

17 For more details see ILO, 2010, Labour Inspection in Europe: Undeclared Work, Migration, Trafficking, Labour Administration and Inspection Programme p.10.

In Belgium, a law passed on 3 May 2003 instituted a Federal Council for the prevention of illegal work and social fraud, which included setting up a Federal Coordinating Committee and district offices. The Council coordinates actions of the Departments concerned, raises awareness among all governmental institutions, provides guidance on prevention and submits proposals for amending the legislation. The district offices, set up in each judicial district, organise and coordinate checks on compliance with legislation. The law envisages the conclusion of partnership agreements between the responsible ministries and professional organisations, which ought to lead to information and awareness campaigns aimed at professionals and consumers, and the detection of clandestine work. One of these agreements was signed in 2003 with the Federation of Passenger Transport Employers (FEAA) in order to collaborate in combating unfair competition from “black” labour, all forms of unfair employment and non-compliance with regulations. To this end, the administration undertakes to increase checks, together with other information and preventive measures which will also be evaluated by the parties.<sup>18</sup>

- **Coordinating activities at the EU level.** There is a recognised need to develop effective information and communication systems in all EU States to enable the collection and exchange of data that will allow the verification of the legal situation of the workers and their affiliation to social security schemes. Efforts in this direction have been made. For example, an agreement between France and Germany was signed on 31 May 2001 to promote the exchange of information concerning illegal work; a similar agreement was signed on 9 May 2003 between France and Belgium.

Moreover, a European network on undeclared work was recently set up between the governments of Belgium, France, Germany, Italy and Romania, seeking to promote the exchange of expertise in the domain of undeclared work.<sup>19</sup>

- **Cross-border inspections.** In response to the increasing mobility of workers across EU borders, cross-border inspection has become a main topic for the EU. Ad hoc campaigns on joint inspection activities are carried out in a cross-border manner, particularly in border zones. For example, labour inspectorates of Luxembourg have been inviting German control bodies on a regular basis to perform joint cross-border inspections of construction sites. Such inspections campaigns are also being introduced in other EU countries.<sup>20</sup>

- **Establishing incentives to declare irregular migrants** A regularization campaign took place in Spain where employers were encouraged to declare their workers without risks of sanctions. As a result, more than half a million foreign workers were enrolled in the social security system in 2005.<sup>21</sup> Similar efforts have been made or are under way in Belgium, Ireland, Italy, the Netherlands and Portugal.<sup>22</sup>

Some countries such as Spain encourage regularization through campaigns for registration without sanction

18 For more details see Resources section to access Daza, 2005, p.49. See also <http://www.emploi.belgique.be/defaultTab.aspx?id=377>, available in French only.

19 For more details see Resources section to access ILO, 2010, Labour Inspection in Europe: Undeclared Work, Migration, Trafficking, Labour Administration and Inspection Programme, p.22.

20 *ibid* p. 28.

21 For more details see Resources section to access: Daza, 2005, Informal economy, undeclared work and labour administration p.21.

22 For more details see Resources section to access ILO, 2010, Labour Inspection in Europe: Undeclared Work, Migration, Trafficking, Labour Administration and Inspection Programme, p.8





*The construction sector is one of the industries affected by undeclared work in the European Union.*

This section provides a list of resources which can enable the reader to delve deeper into the issue. Details of the good practices cited above can be accessed here. The section comprises international instruments, International Labour Conference conclusions, relevant publications and training tools. A bibliography of references in the text is further below. There may be some overlap between the two.

### Relevant Publications

Daza, J.L., 2005, Informal economy, undeclared work and labour administration, Geneva: ILO.  
[http://www.ilo.org/wcmsp5/groups/public/---ed\\_dialogue/---lab\\_admin/documents/publication/wcms\\_113918.pdf](http://www.ilo.org/wcmsp5/groups/public/---ed_dialogue/---lab_admin/documents/publication/wcms_113918.pdf)

ILO, 2010, Labour Inspection in Europe: Undeclared Work, Migration, Trafficking, Labour Administration and Inspection Programme, Working Document Number 7, Geneva: ILO.  
[http://www.ilo.org/wcmsp5/groups/public/---ed\\_dialogue/---lab\\_admin/documents/publication/wcms\\_120319.pdf](http://www.ilo.org/wcmsp5/groups/public/---ed_dialogue/---lab_admin/documents/publication/wcms_120319.pdf)

Renooy, P., S. Ivarsson, O. Gritsai, R. Meijer, 2004, Undeclared work in an enlarged Union. An analysis of undeclared work: An in-depth study of specific items, Brussels: European Commission, Directorate-General for Employment and Social Affairs.

Williams, C. C. and R. Piet, 2008, Measures to tackle undeclared work in the European Union, European Foundation for the Improvement of Living and Working Conditions, Dublin: European Foundation for the Improvement of Living and Working Conditions.  
<http://www.eurofound.europa.eu/pubdocs/2009/25/en/1/EF0925EN.pdf>

### Tools

Council Decision of 22 July 2003 on guidelines for the employment policies of the Member States, 2003/578/EC, Official Journal of the European Union, L 197/13.

Directive 2009/52/EC of the European Parliament and of the Council of 18 June 2009  
<http://eur-lex.europa.eu/LexUriServ/LexUriServ.do?uri=OJ:L:2009:168:0024:0032:EN:PDF>

Voss, E., 2009, Cooperation between SMEs and trade unions in Europe on common economic and social concerns, joint ETUC-UEAPME project, Brussels: ETUC.  
[http://www.etuc.org/IMG/pdf\\_ETUC\\_UEAPME\\_SME\\_Expert\\_Report\\_2009040609a.pdf](http://www.etuc.org/IMG/pdf_ETUC_UEAPME_SME_Expert_Report_2009040609a.pdf)

**For further information see the ILO's Labour Administration Department website**  
<http://www.ilo.org/labadmin/lang--en/index.htm>

## References

- Council Decision of 22 July 2003 on guidelines for the employment policies of the Member States, 2003/578/EC, Official Journal of the European Union, L 197/13.
- Daza, J.L., 2005, *Informal economy, undeclared work and labour administration*, Geneva: ILO.
- Directive 2009/52/EC of the European Parliament and of the Council of 18 June 2009
- European Commission, 2007, *European Employment Observatory Review: Spring 2007*, Luxembourg: European Commission.  
<http://www.eu-employment-observatory.net/resources/reviews/EN-ReviewSpring07.pdf>
- ILO, 2010, *Labour Inspection in Europe: Undeclared Work, Migration, Trafficking, Labour Administration and Inspection Programme*, Working Document Number 7, Geneva: ILO.
- Pfau-Effinger, 2009, "Varieties of undeclared work in European societies", *British Journal of Industrial Relations*, Vol.47, No.1, pp.79-99.
- Williams, C. C. and R. Piet, 2008, *Measures to tackle undeclared work in the European Union*, European Foundation for the Improvement of Living and Working Conditions, Dublin: European Foundation for the Improvement of Living and Working Conditions.
- Williams, C. C., 2009, "Tackling undeclared work in Europe: lessons from a 27-nation survey", *Policy Studies*, vol. 30, no. 2, pp.143-162.
- Renooy, P., S. Ivarsson, O. Gritsai, R. Meijer, 2004, *Undeclared work in an enlarged Union. An analysis of undeclared work: An in-depth study of specific items*, Brussels: European Commission, Directorate-General for Employment and Social Affairs.
- Voss, E., 2009, *Cooperation between SMEs and trade unions in Europe on common economic and social concerns*, joint ETUC-UEAPME project, Brussels: ETUC.

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