

## **Brief Comments on the European Union Strategies for Preventing and Combating Undeclared Work**

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**Abstract:** In social life, undeclared work has acquired economic and legal connotations that are more and more pronounced, with major influences on social security systems on the one hand and on budget revenues on the other. Therefore, knowing the causes of this phenomenon, the forms of manifestation in each EU Member State, may determine a more realistic assessment of the social-economic impact, and may also identify legal action ways of reducing illicit work. In a European Union which has set the objective to create more and safer jobs, the vulnerability of those under undeclared employment is an important problem, whose solution can be found not only at European level. Identification of the means of action against undeclared work is a concern of each Member State of the European Union, due to the fact that the underground economy undermines national social programs and funding has a negative effect on economic growth. In this respect, the Community institutions have proposed the Member States, for effectively combating undeclared work, reducing work-related taxes and bureaucracy, and a more active involvement of society in the fight against undeclared work. Also, undeclared work could be reduced by improving checks taken by authorities in all categories of employers. In the context of a labor market with normative dimensions in constant evolution, the employee status is quite difficult. In consistence with the principle of protecting employee rights, labor law has imposed new measures that counterbalance the employer's position of authority within the employment relationship, both at European and national levels. These include the obligation to inform the employee about the essential elements of his working relationship, obligation established at European level by Council Directive 91/533/EEC of 14 October 1991, and at national level by the Labor Code.

**Keywords:** vulnerability; social security; restriction; public restriction; the employee status

### **1. Introduction**

The EU Commission developed in 1998 a Communication (Doc. COM/1998/219) on undeclared work which indicated the need for an interdisciplinary analysis of this phenomenon, allowing the EU to develop a strategy to combat undeclared work, due to the fact that it affects all Member States. The Commission concluded at that time that the issue of undeclared work should be addressed first in terms of legal regulation of employment forms, as this phenomenon is a burden for funding

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public services and the social security system, also weakening the insurance system and harming competition.

Reducing the undeclared work phenomenon should aim primarily at the integration of undeclared workers in the formal economy and, secondly, at reducing the danger created for society as a whole, by undeclared employment.

In considering these issues, the analysis of the causes of undeclared work expansion and of its negative consequences on different areas of society is absolutely necessary, both at European and national level, in order to identify and shape means of action that would reduce the effects and improve the regulatory framework needed to perform under normal conditions of labour.

## **2. Brief History of the EU Institutions' Actions in Combating Undeclared Work**

In carrying out the provisions of Article 198 of the Treaty establishing the European Community, the Council consulted the European Economic and Social Committee on the Communication from the Commission, which developed on 27 January 1999 a **Report** on undeclared work.

The Commission also elaborated on June 3, 2003, a *Communication* (Doc. COM/2003/579) relating to immigration, integration and employment stating that undeclared work and illegal immigration are fueling each other and that there is a clear relationship between general policies to combat illegal immigration and to combat undeclared work.

Council Decision of 22 July 2003 (Published in „Jurnalul oficial al Uniunii Europene” L no. 197/13) established guidelines for the employment policies of the Member States. The 9th of these guidelines refers to illegal work and it states that " Member States should develop and implement comprehensive measures and actions to eradicate undeclared work, which combine simplification of companies environment, suppressing destructive factors and offering appropriate solutions for tax and insurance systems, better enforcement of laws and penalties. The necessary efforts should be made at national and EU levels to properly assess the problem and progress made at the national level."

On 20 October 2003 the Council adopted a *Resolution* on undeclared work (Council Resolution of 20.10.2003 „*Transformarea muncii nedeclarate în muncă în muncă formală*” Doc. COM/2003/336), by which Member States are invited to establish preventive measures and sanctions designed to eliminate undeclared work and to make the necessary efforts in order to assess the magnitude of the problem and advancement made in the programs to eliminate undeclared work; it also calls on the social partners to develop a program of work on this area and on the Commission to carry out assessments of progress achieved by the Member States.

The conduct of the Community institutions in this regard emphasizes the magnitude of the problem of informal economy, being, in the medium term, between 7% and 16 % of EU GDP and affecting all Member States. It was also stated that employment policies are against undeclared work, as illegal labour regulation will contribute to the emergence of legal employment, improving quality and productivity at work, strengthening social cohesion, the elimination of poverty and the avoidance of market distortions.

### **3. The Concept of Undeclared Work**

The 1998 Communication of the European Communities Commission defines illegal or undeclared work as "any paid activities that are lawful as regards their nature, but not declared to public authorities, given the differences in the regulatory system of Member States."

Undeclared work is an activity that is performed without being declared to the public authorities and, therefore, is an activity for which taxes are not paid, and there is no contribution to social security budgets. Unreported income escapes taxation, contributions are not paid to the social insurance system and employees fail to declare income received for these activities illegally, because they avoid income tax accordingly. Therefore, society as a whole is deprived of significant revenue that could serve, among other things, to the financing of social protection systems.

Companies with undeclared activities cause, in addition, serious harm to those businesses that declare their activities and often have economic difficulties or are forced to cease trading, while the lower costs of companies with undeclared work help them remain on the market and even develop, which causes degradation of the whole economy.

Undeclared work is a phenomenon that occurs in any society, according to the Report " Undeclared work in an enlarged Europe " of the European Commission (published in May 2004).

Undeclared work is produced with the involvement of employers and employees and can be divided into three groups:

- businesses resorting systematically and in an organized manner to undeclared work, often combining it with legal work: businesses that pay wages wholly or partly undeclared;
- employees with two or more jobs, some of which are not declared;
- unemployed people who are obliged to work illegally because they cannot get a job in the legal job market, combining or not undeclared work with receiving unemployment benefits or health insurance.

In the three cases reported, the undeclared work involves tax fraud, in addition to unfair practices that reduce collective morality and sense of responsibility necessary in a society where a significant part of the resources are transferred to social insurance. However, the damage that undeclared work brings cannot be measured solely in economic terms, as living and working conditions of employees who must necessarily resort to illegal labour in order to subsist are under acceptable thresholds of society which they belong to.

Finally, it should be noted that state law and the collective welfare system require compliance with the law and, therefore, it is necessary to solve the problem of undeclared work by certain global and specific measures. Therefore, this issue will be part of the European Employment Strategy, which aims to create a higher quality of work.

#### **4. Features of Undeclared Work**

The main element of undeclared work is of economic origin and its causes are:

- hindering of social and tax burden;
- administrative burden;
- inability to adapt to labour law;
- attracting illegal immigrants.

One of the fundamental characteristics of the illegal work that is carried primarily in sectors in which operate mostly small craft, trade or services businesses for which the fiscal, social, legal and administrative environment impose a disproportionate burden, as concluded over 15 years ago in the White Paper of former European Commission President Jacques Delors " *Growth, Competitiveness, Employment - Challenges and tracks into the 21<sup>st</sup> Century*", launched by the Commission in 1993. Traditional sectors characterized by production that use more labour and local economic circuits are some of the activity groups most affected by undeclared work.

Great attention must be paid to the systematic occurrence of undeclared work in certain sectors such as construction, both of buildings and public works, where Member States face regularly and on a large scale undeclared work and where there are providers of illegal activity even at transnational level. Another sector that uses undeclared labor is that of services provided to individuals such as child care, elder care, cleanliness in private homes, the main cause of this situation being the lack of structuring of the sector in terms of offers.

In other words, special attention must be paid to the development of electronic activities which, through their fulfillment conditions, can facilitate nondeclaring the activities and subcontracting which, in practice, if used incorrectly, could lead

to the emergence of a phenomenon of tax and social evasion and independent and structured undeclared work.

There are other factors that can facilitate the development of undeclared work such as cultural acceptance, low competition, the lack of attractiveness of the requested service.

As far as the undeclared workers are concerned, they can be separated in four groups:

- people who accumulate various services;
- people economically inactive;
- unemployed people;
- third country nationals.

Given the above, the need for a strategy occurs for tackling undeclared work, differences in hiring unemployed people on a long term, with difficulties of access to the formal labour market and illegal immigration. The illegal immigrants have no access to the legal labour market or social security systems and are obliged to seek income in another way, in most cases on the illegal market. Therefore, they are often caught in a dependency relationship that is profitable for irresponsible employers, and any policy to eradicate undeclared work must consider immigrant integration and political measures to combat illegal immigration.

## **5. Effects of Undeclared Work**

Undeclared work effects are felt in all the areas of economic and social life, being interdependence. Thus, there have been found effects on social security systems and on the public funds as well as on the competitive economy, but also on the social status of the individuals performing illegal activities.

### **5.1. Effects on social security systems and public finances**

The Commission Communication of 1998 highlights the negative implications that undeclared work has on public finances both for tax and social reasons, that have an impact on the social security system and therefore on the insurance itself that the state receives if necessary.

In this regard, it should be noted that it is the responsibility of enterprises and employees declaring work done to sustain public social security systems and the public services financed by revenue from direct taxes (individual income tax and corporation tax).

The situation worsens when, in addition, those conducting or receiving undeclared work have access to public services or public provision of which it is very difficult for them to be excluded. Regarding controlling access to public benefits of the

social security system, it can be achieved by the Labour Inspectorate or by social security institutions by controlling the access requirements for charging fees and by controlling incoming documents in the social security system and the contribution to it when the working relationship starts; however, access to certain public services is impossible to be eliminated in the case of persons performing undeclared work, especially when there was a sum paid in advance by the state to obtain these goods, such as access to health and education products.

### **5.2. Effects on competitive economy**

In the case of firms undeclaring work wholly or only partly, they compete directly with recorded companies, which could mean a serious distortion and falsification of competition to the detriment of declared businesses losing market access, as work undeclared operates and they are endangered.

### **5.3. Effects on individuals who work in irregular modes of employment**

Recourse to undeclared work puts people involved in a situation of social insecurity regarding employees, as often undeclared work is done for a vital subsistence necessity, when these employees no longer have access or have difficulty accessing the legal labour market. This insecurity is manifested through lower wages given to employees and inferior working conditions such as the schedule, safety and health conditions and so on, as well as the lack of social protection in case of financial necessity (unemployment, sickness, death, disability, maternity).

However, as commented when discussing the different groups of undeclared employees, not all employees have difficulty accessing the labour market, but there are groups of employees who perform various work activities declaring only some of them. Therefore, they are neither deprived of access to social security, nor do they perform undeclared work done precariously; in some cases, even highly skilled employees voluntarily perform undeclared work in favourable working conditions.

Therefore, undeclared work can be a real financial opportunity for businesses and certain employees, while for others it is a vital necessity precarious to declared employees.

Regarding consumers, they do not enjoy the same guarantees on the quality of the services when resorting to declared or undeclared labour. It is clear that the use of undeclared work is the result of calculations made by employers in respect of the cost of products or services and, therefore, its purpose is to reduce costs for a greater number of consumers to have access to those products or services, which will permit multiple benefits.

## **6. Types of interventions against illegal work proposed by the European Commission and the Economic and Social Committee**

The EU Commission established in its 1998 Communication on undeclared work two types of interventions against illegal work, preventive and coercive measures.

### **6.1. Preventive Interventions**

Prevention means to adapt existing legislation to new forms of work. In this context, the Commission proposes the following measures to combat undeclared work:

- Liberalization of markets for goods and services and simplifying procedures to create small businesses; the European and Social Committee considers it necessary, in addition to simplifying the procedures for the creation of small businesses, to improve the overall legal and administrative environment for small businesses that generate jobs and the development of specific training programs designed to help small, medium and micro-businesses to better understand and adapt more easily to Community Directives concerning them;
- Support for the restructuring of services in certain sectors and the recognition of new employment and competition; it is provided as necessary to structure certain sectors creating jobs, such as the personal care, help for children and the elderly, cleaning, home care and cultural activities generated in the illegal sector and remaining in it if not ordered and not structured. It is also important to regulate and to pay attention to new jobs, as already mentioned, such as electronic activities.
- Greater involvement of social partners in information provision, implementation and control; on this measure, the European Economic and Social Committee considers it necessary to strengthen representative participation of all social partners to the information and prevention of undeclared work. In this sense, the social partners can contribute to unmasking forms of undeclared work and to helping, in cooperation with the competent authorities, the compliance with legal and collective bargaining, also being able to assume their responsibilities by, for example, the creation of arbitration bodies and internal disciplinary procedures or developing new preventive or control mechanisms in collaboration with public authorities.
- Adapting improper labour law developments under new types of activities; The Commission considers that labour regulation occurs after the emergence of new types of work that, in the absence of proper regulation, are in the illegal sector. The Economic and Social Committee focuses particularly on the need to adapt to the reality of the legal, fiscal,

- and administrative environment and to regulate small businesses generating jobs whether using new forms of work or traditional activities;
- Reform of the social protection system to cover periods of limited work, irregular work, people working intermittently in the form of assistance, and so on; regarding this measure, there should be a " restructuring of national income supplement so that work can complement revenues from social security income, developing integrated tax and supplementary income (White Paper of the former European Commission President Jacques Delors, the European Commission presented in 1993);
  - Reduction of labour taxes on both the employer and the employee; adoption of such measures must not go hand in hand with the substitution of stable jobs with precarious jobs, should not weaken the rights of recipients to social security;
  - Reduced VAT types of services that use much labour; the Economic and Social Committee ruled repeatedly in favor of reducing VAT on products, activities and services that use more labour and can provide insights in terms of job creation, because the objective of this measure is to create jobs and transform undeclared work into something less attractive.

## **6.2. Coercive Interventions**

Coercive actions address companies or individuals who benefit from the system. The measures proposed by the Commission are:

- Ensuring the strictest legal standards; it is necessary to establish a system of sanctions in cases of non-compliance, which would be more expensive than the profit obtained by the lack of respect for the rule. In this respect, the European Economic and Social Committee considers penalties may be excluded for companies that do not meet social obligations relating to public offers of employment and coercive measures could be adopted regarding social responsibility throughout the production chain. Public authorities should devote more control measures to unreported businesses, because companies normally companies surveyed are companies declared. The theme of control in the labour aspect will be treated in the next paragraph. However, control measures must not only be work but also tax related, also connected to custom services;
- Developing systems in which the rights to social security are linked to contributions brought effectively; but the adoption of this measure, although it favours the control of illegal employment, would bring a return to the absolute link between contributions and insurance in countries that have a universal coverage and taking out of public systems inactive workers excluded from society.

Council Resolution on October 20 (JO, 2003) on undeclared work aimed at determining the Member States to take actions that are indicated in its contents



regarding employment policy. These measures, designed to reduce undeclared work were:

- Creating a legal and administrative framework favourable for declaring economic activity and employment, simplifying procedures and reducing costs and restrictions limiting the creation and expansion of businesses, particularly small businesses or recently firms constituted.
- Stimulate growth and eliminate labour dissuasive factors for declaration of work regarding both the supply and demand;
- Reviewing and reforming tax and insurance, and their interaction, in order to reduce high marginal tax types and tax burden weighing on employees with lower wages, establishing appropriate employment policies regarding beneficiaries of protective social measures in order to help them participate in the labour market;
- Reducing the risk of unemployment and poverty debts by eliminating unwanted interactions between the tax and insurance benefits;
- Strengthening oversight, with the active support of the social partners, and with appropriate sanctions, especially against those who perform illegal work or benefit from it, while ensuring adequate protection of those prejudiced by undeclared work, by collaboration of authorities and in accordance with national practice;
- Strengthening transnational cooperation between competent bodies designated by various Member States in so far transnational economic activities are affected, in order to help combat social security fraud and undeclared work;
- Improvement of social consciousness in order to enhance the efficiency of this set of measures, bringing to the public the negative repercussions of undeclared work in the social security system and undeclared work consequences in terms of solidarity and justice.

The measures proposed by the Council have both preventive and coercive features. Along with these measures, the Council called on Member States to make the necessary efforts to assess the magnitude of the problem of undeclared work and progress, by calculating the magnitude of undeclared work and illegal economy nationwide, contributing to the assessment of undeclared work in the European Union in order to determine the progress made in achieving the objective of transforming undeclared work into regular employment and obtain an interchange of knowledge and experience between different countries in this field.

The Council also requested the social partners, both at European level and at national level to encourage economic activity and employment declaration and combat undeclared work, raising awareness and increasing recourse to collective bargaining, conducted in accordance with national practices, in order to help

simplify the enterprise environment, especially for small and medium businesses and to develop an agreed work programme.

Actions of EU institutions have been strengthened in recent years, their concerns for combating undeclared work being particularly intense.

The European Parliament, in its resolution of 14 January 2014, called on Member States of the European Union to intensify cooperation and to strengthen labour inspectorates to combat undeclared work. In this regard, on April 9, 2014, the European Parliament submitted a proposal for a decision (COM (2014) 221 final) establishing a European platform to strengthen cooperation to prevent and discourage undeclared work. According to it, the prevention of undeclared work and discouraging it will contribute to a better implementation of EU legislation and national laws, particularly in the areas of employment, labour law, health and safety of workers and coordination of national social security systems.

The European Parliament and European Council take into account the fact that the challenges are common to the Member States and that undeclared work is often a cross-border dimension. It is therefore imperative to action at EU level to enhance cooperation between law enforcement authorities in the field of employment in order to prevent and discourage undeclared work.

## **7. Conclusions**

Undeclared work continues to be an issue with major implications for the economy of the European Union Member States, the situation is worrisome. Along with Italy and Bulgaria, Romania occupies, according to European Union statistics, a top position in terms of upturn in economy, a fact revealed by the latest reports and Labour Inspection.

Most undeclared work performers are students, the unemployed and freelancers and areas that use the most this practice are constructions and home services. Among traditional causes of the existence of undeclared work are high levels of taxes and social contributions and complicated administrative procedures to be followed in legal employment.

In consideration of the subject it should be noted that the European Union member states do not want Europeanization of labour legislation, but regulating this area nationwide. In their arguments they state that it is preferable to find solutions to common problems at Member State level, where one can easily consider practical and local traditions. However, Member States agree that at the EU level there should be an ongoing dialogue and a good practice. Feedback received from the Commission for all those interested in this issue, suggests that the national reform process, started under the Lisbon Strategy for growth and development and integrated approach to implementing flexicurity principles, are

the best solutions for the regeneration of the European labour market, and the involvement of the European Union can play an important role in enhancing cooperation between law enforcement authorities of the Member States and between Member States to prevent and discourage undeclared work.

## 8. References

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