

TACKLING UNDECLARED WORK



Employment and Social Affairs Platform 2 #ESAP 2

Western Balkan Network tackling undeclared work

TACKLING UNDECLARED WORK: IMPROVING THE RANGE AND EFFECTIVENESS OF SANCTION TOOLS

Sarajevo, May 2021

By Colin C Williams

University of Sheffield

This document has been prepared for the Regional Cooperation Council (RCC) within the framework of its Employment and Social Affairs Platform 2 Project (ESAP 2), funded by the EU, and reflects only the views of the author. Responsibility for the contents lies solely with the author and RCC and/or EU cannot be held responsible for use which may be of any information contained herein.

Contents

Executive Summary	1
1. Introduction	4
2. Overview of the effectiveness of sanctions	4
3. Processes for executing sanctions	7
4. Sanctions to deter participation in undeclared work.....	11
5. Sanctions to transform undeclared work into declared work	11
6. Sanctions for buying goods and services from the undeclared economy	13
7. Non-compliance and compliance lists	15
8. Excluding sanctioned businesses from public procurement contracts and subsidies	17
9. “Naming and shaming” lists	18
10. Conclusions and recommendations	18
References	20

Executive Summary

The objective of this report is to enable Western Balkan enforcement authorities to share and deepen their understanding of:

- the effectiveness of using sanctions to tackle undeclared work, and
- the range of sanction tools available.

Most research finds that increasing the penalties does not decrease the likelihood of participation in undeclared work. Higher expected penalties only reduce the likelihood of engaging in undeclared work among those who do not accept the formal rules. When there is acceptance of the formal rules, higher penalties have the opposite impact to what is desired; they increase the likelihood of undeclared work because it breaks the social contract that exists between the state and its citizens. Therefore, caution should be exercised when using sanctions and they should be used in conjunction with:

- Improving the perceived and/or actual risk of detection;
- Making it easier and more beneficial to operate in the declared economy;
- Education and awareness raising about the benefits of declared work and disadvantages of undeclared work, and
- Modernisation of formal institutions to improve trust in government

When imposing sanctions, five key steps are involved:

- Information exchange on the offence and the offender;
- Deciding on a sanction and procedure for appeals;
- Ensuring that the information is recognised as evidence;
- Clear agreements on responsibilities, costs and recovered funds, and
- Enforcing sanctions.

For sanctions to be effectively implemented, the processes in each step need to be transparent, clear, coordinated and efficient.

Types of sanction

The most common sanction is to impose fines to deter participation in undeclared work. This type of sanction exists in nearly all economies. Fines for businesses found to be employing undeclared workers or for self-employed people identified as engaging in undeclared transactions are often set in legislation and may have upper and lower limits for different types of undeclared work. In some economies, this type of sanction to deter participation in undeclared work can involve: progressive fines for repeat offenders; reduced penalties for early payment of fines, and substituting fines with training for managers and staff.

Until now, less attention has been given to other types of sanction, including:

- Using sanctions to transform undeclared work into declared work
 - Greece has **reduced the fine depending on the length of the declared contract given to the previously undeclared worker**. This incentivises employers to transform undeclared work into declared work.

- **Reclassifying the employment relationship** when the employer is found to employ an undeclared worker so that the worker is employed as a declared employee. This again transforms undeclared work into declared work.
- Applying sanctions to citizens or businesses who buy goods and services from the undeclared economy
 - **Reverse supply chain responsibility** can be used to make businesses at the top of supply chains responsible for ensuring that those employed further down the supply chain operate on a fully declared basis.
 - **Sanctioning purchasers when they intentionally instigate undeclared transactions** (e.g., asking “how much for cash?”, “how much without a receipt?”) is hypothetically possible but the “burden of proof” limits its feasibility.
- Non-compliance and compliance lists
 - **Listing non-compliant businesses** who have recently violated tax, labour or social security law. These can be compiled either by enforcement authorities or social partners.
 - **Listing compliant businesses** with no tax, labour or social security law sanction against them in the recent past.
- Excluding sanctioned businesses from bidding for public procurement contracts and receiving subsidies
 - Those on “non-compliance” lists can be **excluded from bidding for public procurement contracts**.
 - There is also the sanction of **excluding non-compliant businesses from access to subsidies**, exemplified by the current call to exclude farm enterprises from Common Agricultural Policy (CAP) subsidies if they violate workers’ rights and engage in undeclared work practices.
- “Naming and shaming” lists
 - making public those business, workers and/or self-employed who have been sanctioned for operating in the undeclared economy. Both enforcement authorities and social partners can use such lists.
 - When shaming is followed by rehabilitation (e.g., training for managers and staff), it is more effective.

Recommendations for public authorities

The major challenges for public authorities in Western Balkan economies when seeking to diversify the range of sanctions are:

- There is a strong resistance to questioning the efficiency and effectiveness of higher fiscal penalties in tackling undeclared work.
- Fines are traditionally a source of revenue for inspectorates and the revenue from fines a long-standing strategic objective/key performance indicator. Shifting away from collecting fines to additional sanction systems (e.g., non-compliance and compliance lists, naming and shaming, excluding businesses from bidding for public procurement contracts and receiving subsidies) is therefore difficult.

To overcome these challenges, it would be useful for enforcement authorities to:

- Use the evidence that higher fiscal penalties do not decrease the prevalence of undeclared work to:
 - Warn against a heavy reliance on a strategic objective of increasing income from fiscal penalties;
 - Justify the diversification of sanctions, and
 - Justify the development of more effective detection (e.g., data mining and matching) and preventative measures alongside sanctions.
- Introduce strategic objectives/key performance indicators for inspectorates beyond the level of fines generated, such as the number of business and jobs moved into the declared economy.

Recommendations for the Western Balkan Network Tackling Undeclared Work

The Western Balkan Network Tackling Undeclared Work is organising seminars in each economy to bring together enforcement authorities and social partners to discuss how to tackle undeclared work. To improve sanction systems, these seminars could discuss the following three issues:

- How information exchange and cooperation might be improved between enforcement authorities when executing sanctions (e.g., inter-linking case management databases to allow faster checks of workers' and companies' status and real-time updates on the progress of a sanction; jointly advocate for legislative changes and procedural improvements);
- How information exchange and cooperation might be improved between enforcement authorities and social partners when executing sanctions. For example, social partners could:
 - support the process and follow-up activities by filing civil suits in cases of labour law violations;
 - act as witnesses in court;
 - offer support in respect to collective agreements, leading to better compliance;
 - provide alerts to authorities about (possible) undeclared work practices, and
 - provide support for workers during inspections and interviews of witnesses.
- The feasibility in their Western Balkan economy of adopting more innovative approaches to sanctioning undeclared work, such as:
 - Using sanctions systems that help transform undeclared work into declared work;
 - Applying sanctions to citizens or businesses who buy goods and services from the undeclared economy;
 - Non-compliance and compliance lists;
 - Excluding sanctioned businesses from bidding for public procurement contracts and receiving subsidies, and
 - “Naming and shaming” lists.

1. Introduction

Many economies tackle undeclared work by increasing the real or expected costs of participation in undeclared work. This can be achieved by increasing the perceived and/or actual sanctions imposed on those caught or by increasing the real and/or expected risk of detection.

This report focuses upon the range and effectiveness of the available sanction tools to facilitate learning among enforcement authorities. The objectives of this report are to share and deepen understanding of:

- the effectiveness of using sanctions to tackle undeclared work, and
- the range of sanction tools available.

The original intention was to hold face-to-face meetings of a Working Group to discuss these issues. However, the COVID-19 pandemic has prevented a face-to-face meeting and there is “zoom fatigue” amongst members of the Western Balkan Network Tackling Undeclared Work. Therefore, the decision was taken to circulate a draft report among members so that they can add their experiences on the use of sanction tools. Based on this feedback, a full report has been produced.

Until now, the focus of most enforcement authorities has been upon using sanctions to deter participation in undeclared work. Less attention has been perhaps given to the use of other types of sanction. That is, sanctions can involve:

- Using sanctions to deter participation in undeclared work;
- Using sanctions to transform undeclared work into declared work;
- Applying sanctions to citizens or businesses who buy goods and services from the undeclared economy;
- Non-compliance and compliance lists;
- Excluding sanctioned businesses from bidding for public procurement contracts and receiving subsidies, and
- “Naming and shaming” lists.

The next chapter provides an overview of the literature on the effectiveness of sanctions in tackling undeclared work whilst chapter 3 is a brief overview of the process for executing sanctions in authorities. Different sanction tools are then evaluated along with good practices where they are available. Chapter 4 evaluates the use of sanctions to deter participation in undeclared work, chapter 5 the use of sanctions to transform undeclared work into declared work, chapter 6 applying sanctions to citizens or businesses who buy goods and services from the undeclared economy, chapter 7 the use of non-compliance and compliance lists, chapter 8 the exclusion of sanctioned businesses from bidding for public procurement contracts and subsidies, and chapter 9 the use of naming and shaming lists. Chapter 10 then draws together the lessons learned and makes recommendations.

2. Overview of the effectiveness of sanctions

Imposing sanctions is widely believed to be the most important and effective way of tackling undeclared work. Indeed, a 2017 survey of the government representatives on the European Platform Tackling Undeclared Work found that they ranked penalties as the most important

and also most effective policy measure for tackling undeclared work (Williams and Puts, 2017; Williams, 2019). However, the evidence is less than clear-cut.

Table 1 reports the research conducted in Europe on whether increasing sanctions reduces the likelihood of participation in the undeclared economy. Starting with wholly undeclared work (e.g., unregistered employment, undeclared self-employment), the findings are mixed. Some find that increasing the expected sanctions reduces the likelihood of participating in undeclared work. However, most studies find no significant correlation between increasing the level of penalties and participation in undeclared work (see Horodnic and Williams, 2020). It is similarly the case with under-declared employment (envelope wages). Increasing the expected sanctions has no significant impact on the likelihood of engaging in under-declared employment.

Table 1. Impact of increasing sanctions on participation in undeclared and under-declared work: European studies

Finding	Study and coverage
<i>Undeclared work</i>	
Those perceiving the expected sanctions as high are less likely to engage in undeclared work compared with those perceiving the sanctions as low.	Feld and Frey, 2002 (Switzerland) Horodnic and Williams, 2019 (EU-27) Putniņš and Sauka, 2015 (Baltic countries) Williams and Horodnic, 2017 (EU-28)
Higher sanctions reduce undeclared work very little and have negative effects on declared employment.	Ciccarone et al., 2014 (12 EU countries)
No relationship between increasing sanctions and likelihood of participation in undeclared work.	Feld and Larsen, 2012 (Germany) Hartl et al., 2015 (Austria) Horodnic and Williams, 2018 (EU-28) Horodnic and Williams, 2020 (EU-28) Webley and Halstead, 1986 (UK) Williams and Bezeredi, 2018 (North Macedonia) Williams and Franić, 2015 (Croatia) Williams and Franić, 2016 (Bulgaria) Williams and Yang, 2018 (Bulgaria) Williams et al., 2017b (Croatia)
<i>Under-declared employment (envelope wages)</i>	
No relationship between increasing sanctions and likelihood of participation in under-declared employment.	Franić, 2017 (EU-27/EU-28) Franić, 2019 (EU-28) Williams and Bezeredi, 2017 (North Macedonia) Williams and Yang, 2017 (Bulgaria) Williams et al., 2017 (Croatia)

Although increasing the expected sanctions has no overall significant impact on participation in the undeclared economy, it does have a significant impact on the likelihood of some groups participating in undeclared work.

As Figure 1 displays, when employers, citizens and workers do not adopt the formal rules (i.e., when tax morale is low), increasing sanctions significantly reduces their likelihood of

participating in undeclared work. However, it is also important to recognise that in these environments where social norms do not align with the law, increasing the probability of detection has a greater impact on reducing undeclared work than increasing sanctions.

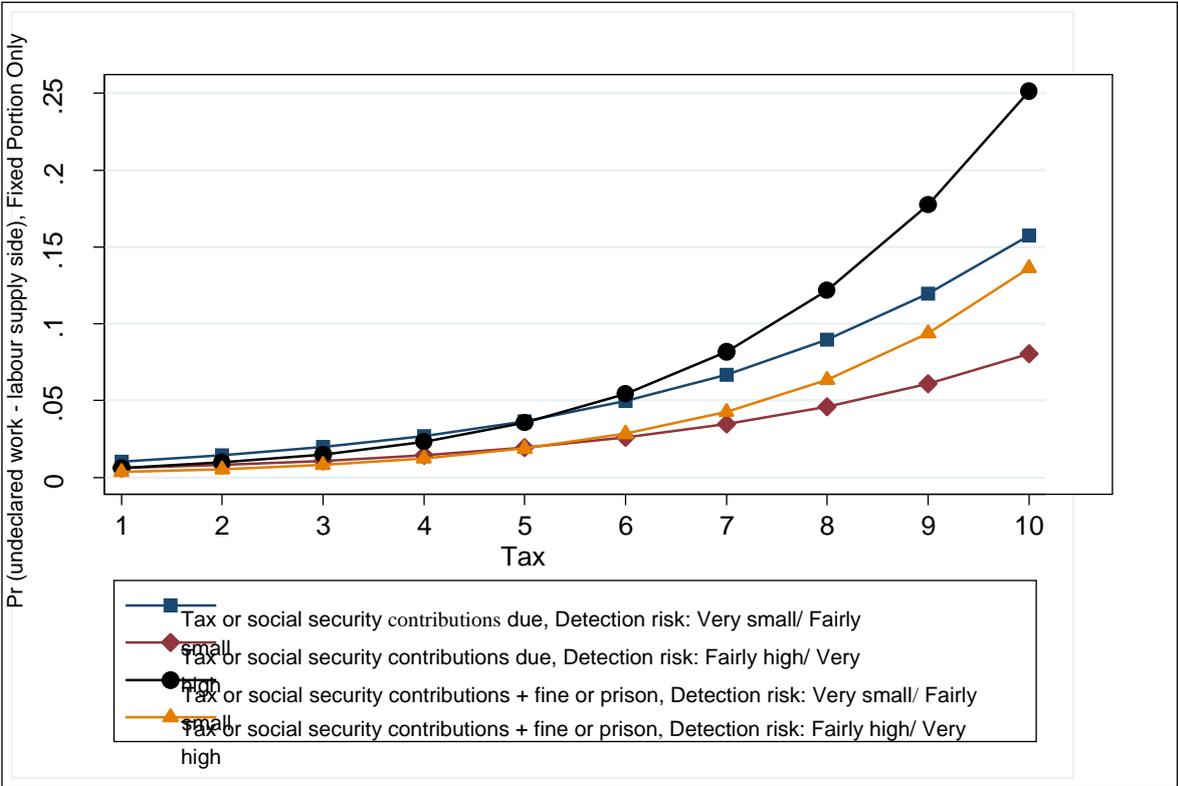


Figure 1. Predicted probability of participation in undeclared work of a “representative” EU citizen: by expected sanctions, detection risk, and tax morality

There is also evidence that increasing the severity of penalties in environments where social norms largely conform to the law increases undeclared work, rather than decreases it. This is because it destroys the view of employers, citizens and workers that the state trusts them (i.e., the social contract), which leads to greater non-compliance (Mohdalia et al., 2014; Murphy, 2005; Murphy and Harris, 2007; Wenzel, 2004).

This suggests that sanctions are useful only in environments where social norms are not aligned with the law and they should be used in conjunction with:

- Improving the perceived and/or actual risk of detection;
- Making undeclared work easier and more beneficial by providing incentives for both potential suppliers and purchasers of undeclared work to operate in the declared economy;
- Educating and raising awareness about the benefits of declared work and disadvantages of undeclared work, and
- Modernising formal institutions to improve trust in government¹.

¹ Williams, C.C. (2020) *Developing a holistic strategic integrated approach towards undeclared work: a toolkit*, Regional Cooperation Council, Sarajevo.

3. Processes for executing sanctions

Here, a summary is provided of the processes involved in implementing sanctions. The aim is to encourage reflection among Western Balkan enforcement authorities about their own current processes. In executing sanctions, five key steps are involved.

Step 1: Information exchange on the offence and the offender

The relevant authorities such as labour and tax inspectorates, social security/welfare agencies, police and prosecution, as well as social partners (where permitted and appropriate), share details about a case (within conditions set by the law, thus preserving the legal validity of evidence obtained). For example, a case can prompt administrative fines imposed by labour inspectorates, the recovery of taxes by tax authorities and the request of unpaid contributions by social security bodies. Each of the authorities involved needs to know the information that can be collected and shared and the type of information their collaborating partners need.

This sharing follows an inspection. Immediately after, a debriefing (held that day or shortly after) clarifies how to proceed. There can be unexpected findings or issues about which other public authorities, such as health and safety bodies, should be informed. An inspection report allows for the sharing of information on confirmed and suspected infringements, including recommendations for further action (issuing of a warning or sanctioning). Possible elements of an inspection report that could lead to sanctioning are presented in Table 2 below.

Table 2. Possible key elements of an inspection report

Inspection report	Analysis of the violation	Actions recommended
<ul style="list-style-type: none"> •General information on the enterprise (name, legal status, subsidiaries, address, CEO/manager, contact person, number of employees, etc.) •Working conditions (minimum wages and allowances paid, weekly rest periods and holidays, etc.) •Inspection details (nature of the inspection - routine, special, follow-up, investigation; uncovered violations) 	<ul style="list-style-type: none"> •Detailed information on the detected violation(s) - its seriousness and nature (labour law infringement; social security evasion/fraud; income tax evasion/fraud; bogus self-employment, etc.) •Information on the duty-holder's compliance record 	<ul style="list-style-type: none"> •Define responsible authority to execute the sanction •Recommendations for corrective action and/or sanctioning, based on enforcement priorities, the existing legal base, and the likelihood of achieving results. The penalties and recoveries could include: <ul style="list-style-type: none"> ○ Penalties (administrative, civil and/or criminal); ○ Tax/social contribution recoveries and back payments (administrative, civil and/or criminal); ○ Payment of outstanding remuneration; ○ Administrative advices, warnings or ordinances etc. issued to companies. •Informing other relevant authorities, e.g. tax and social security •Guarantee of the right of defence and a fair trial

Source: based on ILO (2006) and European Labour Authority (2020)

Step 2: Deciding on a sanction and procedure for appeals

The type of sanction depends on the legislation in an economy. Most economies use administrative or criminal procedures² to sanction undeclared work:

- Administrative sanctions most often refer to monetary fines. Often (but not always) they go hand-in-hand with increased/recovered tax and social security contributions and repayment of salaries. However, they can be complemented by secondary measures such as exclusion from public tendering and withdrawal of operation licences. In addition, sanctions can be made public to encourage future compliance ('naming and shaming');
- Criminal sanctions usually refer to prison sentences (sometimes suspended sentences or punishment with deferral) or to criminal monetary fines. These could also be applied in parallel with secondary measures such as freezing of assets, confiscation, deprivation of the right to be employed in a certain job or to hold a certain position, labour law-related sentences or business closure. They are usually connected to more severe cases (organised crime, higher numbers of workers involved, in conjunction with other crimes against basic human rights).

Table 3 presents the considerations for authorities when deciding on the type and severity of the sanction, applicable within the respective national legal base.

Table 3. Considerations when deciding on sanctions

Consideration	Further details
Priorities of the government, judicial authorities and/or enforcement authority	The government, social partners, general prosecutors and enforcement authorities have action plans against undeclared work. These plans set priorities for sanctions, depending on the gravity of the fraud encountered. The plans usually also foresee a combination of 'random' inspections (which aim to prevent the feeling of impunity) with targeted inspections based on risk assessments.
Wider impact on society and public finance	Depending on the seriousness of the offence, inspectors are allowed to take more stringent action and opt for stricter penalties, within the sanctions' minimum and maximum threshold values set in the legal base.
Size and economic circumstances of the enterprise	Inspectors could apply discretion, if foreseen within the legal framework, towards small enterprises, in particular regarding deadlines for compliance with minor violations. Inspectors ideally consult with social partners. ³
Combination of sanctions	For risk sectors, repeated offenders or more severe cases, consideration can be given to combining administrative and/or criminal sanctions (if the legal base allows it) with: <ul style="list-style-type: none"> • Withdrawal of operating licences; • Introducing joint liability of contractors and subcontractors; • 'Naming and shaming' non-compliant companies;

² In general, administrative procedures are based on administrative law and criminal procedures on criminal law. However, there is also a formal (not necessarily legal) criterion to distinguish between the two: administrative procedures are applied by an administrative authority that imposes sanctions. In some cases, the general basic principles of ordinary criminal law are applied in this administrative procedure. In the case of criminal proceedings, a penalty is imposed by a judge competent in criminal cases, after prosecution by the public prosecutor.

³ ILO (2006). *A toolkit for labour inspectors*, ILO, Geneva.

	<ul style="list-style-type: none"> • Introducing progressive sanctioning or lectures for companies on the correct application of the employment act (e.g. instead of paying a fine); • Exempt the company from increased social contributions if they start declaring workers (e.g., in Belgium); • Making the use of IDs and photos at construction sites mandatory; and • Making procedural improvements for faster processing of registration of special groups of workers (e.g. migrants).⁴ <p>Each time a sanction is imposed, the offence needs to be clearly communicated, together with instructions for future compliance.</p>
--	--

Step 3: Ensuring that the information is recognised as evidence

It is crucial that the information collected in Steps 1 and 2 can be recognised as evidence, especially if the case is taken to court. Documentation needs to present the facts clearly and precisely, be sufficient and follow the right format. Some legal considerations related to the gathering of evidence are presented in Table 4.

Table 4. Legal considerations when gathering evidence

Considerations	Further details
What documents are needed?	<p>The most common documents checked by inspectors are work contracts, staff registries, internal company regulations, registries of working hours and overtime, payslips and timesheets, payments of social security contributions, permits and licences (e.g. of temporary work agencies). In addition, any other (paper or digital) information may also prove useful, such as emails, texts, personal notes (e.g. to prove cases of envelope wages).</p> <p>Fiscal documents and commercial contracts are also collected to compare, for example, the declared workforce with the size of deliveries to clients, or to identify the owner and subcontractors and any possible bogus self-employment.⁵</p>
What format?	The format of the documents relating to imposed sanctions must comply with the legislation in the economy.
What other forms of evidence are needed?	<p>Additional evidence should clarify the facts of the case: what, who, when, where, how, how long, since when, etc.</p> <p>Circumstances uncovered during on-site visits should also be verified (e.g. observations by inspectors, photos, video, audio, surveillance recordings, signatures of inspectors/witnesses/ employees/managers, physical objects seized, official documents in legally accepted formats). These could relate to:</p> <ul style="list-style-type: none"> • Existence/status of labour relationship (hierarchical elements, proven authority of the employer); • Proof of activity, established personally by the inspectors, and not only on paper; • Verified place where the infringement was committed and place where it was established; and • Time and period within which the infringement was committed.
Are witnesses required?	Witnesses could also be asked to provide statements/testimonials/ interviews - either by the enforcement authority (if it has such authority)

⁴ OECD, (2014). *Regulatory enforcement and inspections*. OECD best practice principles for regulatory policy, Paris.

⁵ ILO (2013a). *Labour inspection and undeclared work in the EU*, ILO, Geneva.

	<p>or through cooperation by relevant law enforcement bodies. Interviews on the spot with employers and employees confirm the inspector’s own findings and make a stronger case.</p> <p>The possibility to bring the employer and employees as witnesses needs to be clarified at an early stage.</p>
--	---

Step 4: Clear agreements on responsibilities, costs and recovered funds

Clarifying roles

Once the evidence and types of sanction are confirmed, a clear role distribution between all authorities involved helps to enforce the sanction efficiently.

Joint responsibilities can be also clarified in the ‘sanction report’. Depending on the case, it can be helpful to think about other relevant stakeholders. For example, social partners could:

- support the process and follow-up activities by filing civil suits in cases of labour law violations;⁶
- act as witnesses in court;
- offer support in respect to collective agreements, leading to better compliance;
- provide alerts to authorities about (possible) undeclared work practices;
- provide support for workers during inspections and interviews of witnesses;
- provide contacts, advice, and logistical support for cross-border collaboration (in particular for umbrella organisations and trade union federations).

Clarifying costs and recovered funds

When deciding on tasks and responsibilities, cooperation partners need to clarify how costs will be covered. These can include authentication of documents or staff time needed to gather certain types of information or evidence. Furthermore, partners need to decide on procedures for who will claim any fines for their authority.

Step 5: Enforcing sanctions

Administrative route

As a first step, enforcement authorities notify the offender to pay a fine. A quick direct notification can lead to instant compliance, saving resources for the authorities. The content and form of the notification letters can have a substantial effect on the efficiency of sanction procedures (see Box 1).

Box 1: Possible wording of notification letters

A notification letter can be sent by registered post or with electronic verification that the letter was delivered. Many enforcement authorities recommend the following as likely to result in the instant payment of fines:

- Legal reminders about the obligations of the employer with respect to paying taxes and social security for employees;
- Normative information about compliance and the risks of non-compliance;

⁶ Based on ILO (2013b). *Labour inspection sanctions: law and practice of national labour inspection systems*, ILO, Geneva.

- Tips to improve compliance (e.g., simple ways to declare workers);
- Offering options to pay the fine in instalments, and
- The possibility of a visit/audit in the foreseeable future or a follow-up visit shortly after the compliance deadline.⁷

It is good practice to inform other relevant enforcement authorities of the sanctions imposed, as they may also need to undertake parallel actions.

Criminal route

Criminal sanctions, such as criminal fines, prison sentences, freezing of assets, confiscation, or business closure, are less frequent in undeclared work cases. For example, in Belgium, 25% of the infringements are prosecuted by labour prosecutors (criminal proceedings) and 75% result in administrative sanctions. If the uncovered violations are criminal in nature, the labour or tax enforcement authorities transfer the case to the police, directly to the prosecutor (specialised or general), and/or the courts. These authorities then become responsible for notification and execution of the sanction.

4. Sanctions to deter participation in undeclared work

The first and most common type of sanction is to impose fines to deter participation in undeclared work. This type of sanction exists in nearly all economies. It involves fines for businesses found to be employing undeclared workers or for self-employed people identified as engaging in undeclared transactions. These fines are often set in legislation and may have upper and lower limits for different types of undeclared work. For example, there may be an upper and lower limit to the level of fine that can be imposed for employing an unregistered worker.

The intention is that these fines will act as a deterrent to those considering engagement in the undeclared economy. The level of these sanctions needs to be proportionate in relation to other criminal acts.

In some economies, this type of sanction to deter participation in undeclared work can involve:

- progressive fines for repeat offenders;
- reduced penalties for early payment of fines, and
- substituting fines with training for managers and staff.

5. Sanctions to transform undeclared work into declared work

Most economies use sanctions to deter participation in undeclared work. However, very few design sanction systems to help transform undeclared work into declared work. To show how this can be done, Box 2 reports how Greece has designed a sanctions system that facilitates the transformation of undeclared work into declared work.

⁷ European Platform tackling undeclared work, (2018). *Practitioner toolkit: information tools and approaches to reach out to workers and companies in the fight against undeclared work*. Available at: <https://op.europa.eu/en/publication-detail/-/publication/97fa5fc6-4c55-11e9-a8ed-01aa75ed71a1>

Box 2: Designing sanction systems to transform undeclared work into declared work, Greece

Background

Before the new sanctions system was introduced in 2018, when a labour inspector identified an employer using undeclared workers, they could impose an administrative penalty (fine). For employees over 25 years old, the fine was €10,549.44 (i.e., 18 times the minimum wage) whilst for employees under 25 years old, the fine was €9,1979.10 (i.e., 18 times the minimum wage for under 25 year olds). In the case of recurrence of the above infringement by the company/employer, temporary or permanent closure of a specific production process or a section or sections or the whole of the undertaking or operation in which the infringement was committed, could be imposed, in addition to the above fines. The problem was that if such penalties were imposed on small offending businesses, this could result in the end of their business activity.

This is not necessarily a desired outcome if transforming undeclared work into the declared economy is the goal. The result was a rethinking of the sanctions system.

New sanctions system

To transform undeclared work into declared work, Greece has redesigned its sanctions system. The fine for employers is set at €10,500 for each undeclared employee. However, the employer can hire within 10 days the undeclared employee as a registered declared employee to decrease the fine by the following amounts:

- €7,000 if they hire the employee for 3 months;
- €5,000 if they hire the employee for 6 months, and
- €3,000 if they hire the employee for 12 months.

Outcomes

In 2017, before the new sanctions system, only 32% of detected undeclared workers were subsequently hired on a declared basis by the employer. Of these, two-thirds were hired on a part-time basis and only one-third full-time.

For the period August 2018 - February 2019, after the new sanctions system was introduced, 45% of detected undeclared employees were hired by the employer, all of them on a full-time basis. Of those hired formally:

- 91% were hired for 12 months;
- 3% for 6 months, and
- 6% for 3 months.

The innovative aspect of this sanctions system, therefore, is that it is designed to encourage the transformation of undeclared work into declared work, rather than simply to punish employers who employ undeclared workers.

Source: <https://ec.europa.eu/social/BlobServlet?docId=22206&langId=en>

Another similar sanction that helps to transform undeclared work into declared work is to request that when an employer is found to employ an undeclared worker or somebody as bogus self-employed, they are requested to **reclassify the employment relationship** and employ the worker as a declared employee. This is increasingly occurring so far as “bogus self-employment” is concerned (see Box 3). The courts are requesting that these “bogus self-

employed” are employed as declared employees. This again is a type of sanction (i.e., reclassification of the employment) to transform undeclared work into declared work.

Box 3: Reclassifying the employment relationship to transform undeclared work into declared work: the case of bogus self-employment

Bogus self-employment is an employment relationship where a worker is formally registered as self-employed but works under the same working conditions as those of direct employees and/or they depend on a single employer for a main part of their income. Workers are falsely classified as self-employed to circumvent collective agreements, labour laws (e.g., minimum wages, working time legislation, protection in case of redundancy), employment tax and other employer liabilities implied in the standard contract of employment.

In many economies, the usual sanction is a reclassification of the employment relationship. Labour courts do not declare the employment relationship void, but change it to a dependent employment relationship, often applied from the original start-date of the employment. Further, all rights (e.g., minimum wage, pension contributions) associated with the real contractual relationship are also applied and the costs must be paid by the employer, as if the relationship had been correctly classified since the beginning of the employment. This is the case in Czechia, Finland, France, Germany, Ireland, Luxembourg, Portugal, Sweden, the UK and the Netherlands (Eurofound, 2016). Many economies also apply fines (e.g., Spain, the Netherlands, UK) in addition to the above costs associated with reclassifying the employment relationship. In the Netherlands, for example, the fine can be up to 100% of the amount of money recovered due to the misclassification of worker (Heyes and Hastings, 2017).

In other economies, the reclassification of the employment relationship is limited to certain aspects. In Romanian law, the reclassification of self-employment as waged employment is relevant only for fiscal matters (Eurofound, 2016). The fiscal authority (National Agency for Fiscal Administration – ANAF) recalculates the taxes due as for a dependent activity and can apply additional penalties (Heyes and Hastings, 2017).

In Norway, reclassification of the employment relationship is seen as an alternative to economic compensation and the worker is given a choice between which of the two they wish to receive. It is an either/or choice rather than the worker receiving both the reclassification of their employment relationship as well as compensation. In Ireland, Poland and the UK, only judges, not control bodies, can reclassify the employment relationship, meaning that the employee must sue the employer. However, the length and costs of trials, and fear of being viewed as a ‘difficult worker’ by prospective future employers, often discourages workers from taking such action. Sweden has addressed this problem by allowing trade unions to sue the employer on behalf of the worker. The sanctions are usually applied to the employer rather than to the worker because of the difference of power between the two in deciding the type of contract (Eurofound, 2016).

6. Sanctions for buying goods and services from the undeclared economy

Few economies have so far applied penalties to citizens or businesses who buy goods and services from the undeclared economy. This is largely because the assumption is that it is difficult for a customer to know if the goods and services are being sold on an undeclared basis. On the whole, therefore, economies have been reluctant to impose sanctions on citizens or businesses who purchase goods and services from the undeclared economy.

One exception is where **reverse supply chain responsibility** is imposed, such as in the construction industry. Here, businesses at the top of the supply chain are made responsible for ensuring that those employed further down the supply chain are operating on a fully declared basis (see Box 4).

Box 4: VAT reverse charge in the construction industry

Aims

VAT reverse charge is a measure intended to shift liability onto the businesses purchasing services, instead of those supplying services. It is deemed particularly effective in sectors, such as construction, where VAT evasion is high.

Description

VAT reverse charge in the construction industry shifts responsibility for paying VAT from small businesses and self-employed professionals (service providers) to bigger businesses (main contractors/purchasers). In the reverse charge system, the vendor (business) transfers liability to the purchaser (business) who is responsible for reporting and paying VAT to the state.

This has been implemented in:

- Finland: 1 April 2011 - ongoing
- Italy: 1 January 2007 (art. 1.44 L. 296/2006) - ongoing
- Sweden: 1 July 2007- ongoing

Source:

<https://www.eurofound.europa.eu/observatories/emcc/case-studies/tackling-undeclared-work-in-europe/reverse-vat-in-construction-finland> (FI)

<https://www.money.it/IVA-reverse-charge-edilizia-2017> (IT)

<http://www.finanze.it/export/sites/finanze/it/.content/Documenti/Varie/Corte-dei-conti-2015-14-settembre-ore-19.38-3.pdf> (IT)

<https://www.eurofound.europa.eu/observatories/emcc/case-studies/tackling-undeclared-work-in-europe/reverse-charge-vat-in-the-construction-industry-sweden> (SE)

<https://www.skatteverket.se/download/18.7be5268414bea0646946f-3e/1428566850726/552B14.pdf> (SE)

<https://www.sage.com/en-gb/blog/vat-reverse-charge-construction/>

Another scheme for sanctioning purchasers of undeclared goods and services is found in the construction sector in Finland (see Box 5).

Box 5: Making purchasers responsible for information reporting in construction industry, Finland

To ensure that the tax administration and labour inspectorate have a complete overview of all workers present at the construction site at all times, the overall responsibility lies with the buyer and main contractor to report contract and employee details of all parties in the supply chain - buyer, developer, main contractor as well as sub-contractors. They file a monthly report to the Tax Administration.

Every month, each 'buyer' must give the names of all companies or people from whom they have ordered construction services directly to the Tax Administration. This includes details of the contracts (including contracting parties, total amount, and duration) and

transaction data related to the contract (including the amount invoiced during the reporting period).

The project supervisor (main contractor) of the construction project is responsible for collecting information from its sub-contractors on the people who work at the construction site. Each company operating at the site must submit details of their employees to the project supervisor. In case of a shared construction site, it is also the project supervisor who is obliged to file reports on all the people who work there - including their own employees, the employees of other contractors, and any independent, self-employed individual contractors and leased employees (temporary agency workers) working on the building site.

In case a buyer or contractor fails to fulfil the obligation report, a negligence fee is issued. The maximum fine is 15,000 euros.

Besides making businesses responsible using reverse supply chain responsibility, consideration could be also given to sanctioning citizens who intentionally purchase undeclared goods and services. Some goods and services may be unintentionally and unknowingly purchased from the undeclared economy, since the purchaser does not know that the supplier is not declaring these transactions. However, there are also transactions where citizens are the intentional instigator of undeclared transactions, such as when they ask, “how much for cash?”. In these cases, they knowingly and intentionally instigate undeclared transactions. There are also cases when it is sometimes obvious to a customer whether a transaction is going to be declared or not, such as when a supplier asks, “with or without a receipt?”. How this can be sanctioned has not been considered so far as is known. Hypothetical ways forward might be (i) to make it an offence for a customer to request “without receipt” or “how much for cash?” (although the burden of proof would be difficult) or (ii) to organise an education and awareness raising campaign of the benefits of purchasing goods and services on a declared basis for customers and the disadvantages of purchasing goods and services on an undeclared basis, with a focus upon goods and services commonly purchased on an undeclared basis that have potentially significant harmful effects for purchasers.

7. Non-compliance and compliance lists

Using non-compliance lists is also another means of sanctioning those who supply undeclared work, and these may or not be made public. These non-compliance lists have been previously called “blacklists”, but this term is no longer acceptable due to its racist connotations. They can be compiled by enforcement authorities, such as by listing businesses who have violated tax, labour or social security law in the recent past. These non-compliance lists can be used by enforcement authorities to sanction businesses named on them, such as by making the list public so that purchasers can decide not to purchase from them, or by not allowing firms named on them to bid for public procurement contracts (see below).

Social partners and other stakeholders can also compile non-compliance lists. In **Czechia**, for example, the Czech-Moravian Confederation of Trade Unions (CMKOS), together with the Czech Metalworkers’ Federation (OS KOVO), has tackled the issue of illegal temporary work agencies (TWAs) by introducing a non-compliance list (“blacklist”) of “pseudo” TWAs. Those named on this list are then not used by employers who seek to employ temporary workers.

Such non-compliance lists act as a sanction either by preventing access to a major source of funding for businesses (i.e., public procurement contracts) or by encouraging employers not to use these non-compliant businesses to purchase their services or goods.

An alternative to a non-compliance list is a “compliance list” (what was previously termed a “whitelist”) composed of businesses with no tax, labour or social security law sanction against them in the recent past. One option is to introduce business certification schemes and payment certification of tax and social contributions to create a list of compliant businesses, which a business needs to be listed on to tender for public procurement contracts. An exemplar of such an approach is to be found in the agriculture sector in Italy (see Box 6).

Box 6: Quality Agricultural Work Network (*rete del lavoro agricolo di qualità*), Italy

Aims: To tackle undeclared work in agriculture, its objectives are to:

- Create a “compliance list” of farm enterprises based on their compliance to the rules (fiscal law, labour law, social security provisions, among others);
- Improve firms’ compliance with labour law, collective agreements, social security and income rules; and
- Better target inspections in the sector.

Description: The Quality Agricultural Work Network puts companies operating in the agriculture and fishing sector that fulfil their statutory obligations on a compliance list. The initiative was started in June 2016 (Law 199/2016). According to the law, firms which “have not been convicted for violations of labour law and social legislation, for crimes against public administration, crimes against public safety, crimes against the public economy, industry and commerce, crimes against sentiment for animals, with regard to income tax and value added tax [...]” may join the network (<https://www.inps.it/nuovoportaleinps/default.aspx?itemdir=46316>). Inspections are carried out mostly on firms not included in the network.

It is managed by the Steering Board “Cabina di Regia”, chaired by the Social Security Institute (INPS) and includes representatives of the Ministry of Labour, Ministry of Agricultural and Forestry Policy, Ministry of Economy, Labour Inspectorate, National Tax Agency, Committee of Autonomous Regions and Provinces, Confederation of Agriculture, trade unions and other agricultural workers’ organisations.

Evaluation: Just 3,500 of the 1.5 million agricultural companies in Italy have registered (<https://www.inps.it/nuovoportaleinps/default.aspx?itemdir=50213>). In part, this has been argued to be because even minor administrative sanctions (perhaps paid because it was less expensive than contesting them) exclude companies from joining.

A similar “compliance list” is a social label initiative in **Belgium**. The mushroom growing sector was experiencing difficulties due to low prices. Together with social partners, a plan for the sector’s future was put in place. Employers who sign up (i.e., they must sign a declaration each year) to respect Belgium’s social legislation and not to resort to systems involving posting abuses and bogus self-employment, and who agreed to keep the number of permanent workers at 2011 levels, could use seasonal workers for up to 100 days per seasonal worker per year instead of 65 days. The social partners have been responsible for drawing up the list of companies eligible to make use of this expanded regime. The Minister for Social

Affairs approves the list and the list is then sent to the administration. The social label system has increased the number of companies in the mushroom growing sector.

In the **Netherlands**, again in the mushroom sector, the foundation **Fair Produce** established since 2011 by the social partner, LTO Nederland, certifies companies pursuing fair working conditions that meet the legal and extra requirements established by social partners in the Dutch mushroom supply chain. Fair Produce therefore stimulates good employment practices in the mushroom supply chain. Companies are certified if they pay wages according to the Dutch law and regulations, the maximum amounts withheld for accommodation, and - if temporary employment agencies are involved - the obligation that only NEN 4400 certified agencies are considered qualified. During the audit, employees are extensively interviewed, and if necessary with the help of an interpreter. If the audits meet the required standards of Fair Produce the company receives the Fair Produce label for a certain period. With the help of the Fair Produce label, the working conditions in the Dutch mushroom supply chain have very much improved.

8. Excluding sanctioned businesses from public procurement contracts and subsidies

Those on “non-compliance” lists can be further sanctioned by excluding them from bidding for public procurement contracts. This provides businesses with an incentive to be compliant. If they are not compliant, then they are excluded from a major source of funding in many economies.

If non-compliance lists are used to exclude businesses from bidding for public procurement contracts then these non-compliance lists need to be kept up-to-date and decisions need to be taken on how long a business will remain on a non-compliance lists after a violation has occurred. So too is a decision required on which violations mean that a business will be put on a non-compliance list and which violations will not result in them being put on this list.

There is also the option of sanctioning businesses from access to subsidies. One present-day example is the argument that far enterprises should be excluded from Common Agricultural Policy (CAP) subsidies if they violate workers’ rights and engage in undeclared work practices (see Box 7).

Box 7: Making agricultural subsidies conditional on non-violation of labour rights, European Union

Common Agricultural Policy (CAP) subsidies for farmers are currently conditional on respect for basic environmental standards, public health and animal welfare. However, compliance with human and labour rights plays absolutely no role in the allocation of these direct subsidy payments to farmers. A popular movement of 300+ organisations and respected individuals is currently calling for European Union CAP subsidies to be conditional on respect for labour rights in agriculture.

The argument is that they should be conditional on respect for the applicable working and employment conditions under relevant collective agreements, national and EU law as well as ILO conventions. The conditionality would cover various areas such as declared employment, equal treatment of workers, remuneration, working time, health and safety, housing, gender equality, social security and fair conditions for all workers employed in agriculture, including mobile and migrant labourers.

Farm enterprises not meeting these conditions would be excluded from receiving CAP subsidies. This initiative is potentially transferable to those Western Balkan economies where similar subsidy payments are made to farmers but without such a condition needing to be met. For example, farm enterprises who have been sanctioned for violating labour, tax or social security laws, could be excluded from receiving farm subsidies.

Sources: <https://www.etuc.org/en/document/joint-letter-new-cap-needs-social-conditionality>
<https://effat.org/in-the-spotlight/press-release-open-letter-the-new-cap-needs-social-conditionality/>

9. “Naming and shaming” lists

Finally, “naming and shaming” lists can be used as a sanction. By making public those business, workers and/or self-employed who have been sanctioned for working undeclared, the intention is to shame them as a sanction.

Shaming can either simply shame the offender, or it can shame them and then offer reintegration. Coricelli *et al.* (2014) show that when cheating is made public and the perpetrator is not successfully reintegrated, the amount of cheating significantly increases compared with when cheating is made public but is followed by reintegration.

Until now however, the former has tended to be used in most countries (e.g., Greece), such as when “non-compliance” lists are made public, but without re-integration or rehabilitation measures.

Again, this sanction is not limited to public authorities. Both trade unions and employer federations could hypothetically use “naming and shaming” lists, such as on a sectoral level. So too can civil society groups use “naming and shaming”. One such civil society “naming and shaming” initiative is in the city of Bologna in Italy where a [2017 government report](#) identified that 72.6% of jobs in the city’s food and hotel sector were in the undeclared economy. In response, a civil society organisation, [Padrone di Merda](#) (“crappy bosses”) has taken direct action staging protests outside the premises of 37 businesses. This has been an effective form of direct action that has received widespread publicity and stopped customers using these restaurants, cafes and hotels.

10. Conclusions and recommendations

This report has shown that sanctions are particularly effective when those whose values, beliefs and attitudes do not align with the law perceive the expected penalties of engaging in undeclared work as high.

In recent years, it has been recognised that not only is cooperation between authorities is necessary when imposing sanctions but also that consideration needs to be given to the many innovative new types of sanction beyond simply fining offenders.

The major challenge for public authorities in Western Balkan economies in diversifying the range of sanctions are:

- There is a strong resistance to questioning the efficiency and effectiveness of higher fiscal penalties in tackling undeclared work.

- Fines are traditionally a source of revenue for inspectorates and the level of fines sometimes a long-standing strategic objective/key performance indicator. Shifting away from using solely fines to some of the above alternative sanction systems (e.g., non-compliance and compliance lists, naming and shaming, excluding businesses from bidding for public procurement contracts and receiving subsidies) is therefore difficult.

To overcome these challenges, it would be useful for enforcement authorities to:

- Use the evidence that higher fiscal penalties do not decrease the prevalence of undeclared work to:
 - Warn against a heavy reliance on a strategic objective of increasing income from fiscal penalties.
 - Justify the diversification of sanctions, and
 - Justify the development of more effective detection (e.g., data mining and matching) and preventative measures alongside sanctions.
- Introduce strategic objectives/key performance indicators beyond the level of fines generated for inspectorates, such as the number of business and jobs moved into the declared economy.

To improve sanction systems, therefore, a recommendation is that the forthcoming seminars in individual economies of the Western Balkan Network Tackling Undeclared Work, that will bring together the enforcement authorities and social partners in each economy, discuss the following three issues:

- How information exchange and cooperation might be improved between enforcement authorities when executing sanctions (e.g., inter-linking case management databases to allow faster checks of workers' and companies' status and real-time updates on the progress of a sanction; jointly advocate for legislative changes and procedural improvements)
- How information exchange and cooperation might be improved between enforcement authorities and social partners when executing sanctions. For example, social partners could:
 - support the process and follow-up activities by filing civil suits in cases of labour law violations;
 - act as witnesses in court;
 - offer support in respect to collective agreements, leading to better compliance;
 - provide alerts to authorities about (possible) undeclared work practices, and
 - provide support for workers during inspections and interviews of witnesses.
- The feasibility of adopting in Western Balkan economies more innovative approaches to sanctioning undeclared work, such as:
 - Using sanctions systems that help transform undeclared work into declared work;
 - Applying sanctions to citizens or businesses who buy goods and services from the undeclared economy;
 - Non-compliance and compliance lists;

- Excluding sanctioned businesses from bidding for public procurement contracts and receiving subsidies, and
- “Naming and shaming” lists:

References

- Ciccarone, G., Giuli, F. and Marchetti, E. (2014). Tackling undeclared work. Suggestions from a business cycle model with search frictions. *Economia politica, Società editrice il Mulino*, 2, 125–148.
- Coricelli, G., Rusconi, E. and Villeval, M-C. (2014). Tax evasion and emotions: An empirical test of re-integrative shaming theory. *Journal of Economic Psychology*, 40(1), pp. 49–61.
- Eurofound (2016). *Exploring the Fraudulent Contracting of Work in the European Union*. Publications Office of the European Union, Luxembourg.
- European Labour Authority (2020). *Report by the Working Group on Inspections*. European Labour Authority, Bratislava.
- European Platform Tackling Undeclared Work, (2018). *Practitioner toolkit: information tools and approaches to reach out to workers and companies in the fight against undeclared work*. Available at: <https://op.europa.eu/en/publication-detail/-/publication/97fa5fc6-4c55-11e9-a8ed-01aa75ed71a1>
- Feld, L.P. and Frey, B.S. (2002). Trust breeds trust: How taxpayers are treated. *Economics of Governance*, 3, 87–99.
- Feld, L.P. and Larsen, C. (2012). Self-perceptions, government policies and tax compliance in Germany. *International Tax and Public Finance*, 19, 78–103.
- Franić, J. (2017). *Envelope wage practices: Underlying motivations from the perspective of workers* (PhD thesis). Sheffield: The University of Sheffield.
- Franić, J. (2019). Explaining workers’ role in illegitimate wage underreporting practice: Evidence from the European Union. *The Economic and Labour Relations Review*, 30 (3), 366–381.
- Hartl, B., Hofmann, E., Gangl, K., Hartner-Tiefenthaler, M. and Kirchler, E. (2015). Does the sole description of a tax authority affect tax evasion? - The impact of described coercive and legitimate power. *PLoS One*, 10 (4), e0123355.
- Heyes, J. and Hastings, T. (2017). *The Practices of Enforcement Bodies in Detecting and Preventing Bogus Self-Employment*, European Platform Undeclared Work, Brussels.
- Horodnic, I.A. and Williams, C.C. (2018). *Do Deterrents Prevent Undeclared Work? A Policy Brief. An Evaluation of the Rational Economic Actor Approach*. Policy Brief no. 1, SHADOWS: Tackling Undeclared Work in the European Union. Sheffield: Sheffield University.
- Horodnic, I. and Williams, C.C. (2020). Tackling undeclared work in the European Union: beyond the rational economic actor approach. *Policy Studies*, <https://doi.org/10.1080/01442872.2019.1649384>
- ILO (2006). *A toolkit for labour inspectors*. ILO, Geneva.
- ILO (2013a). *Labour inspection and undeclared work in the EU*. ILO, Geneva

- ILO (2013b) *Labour inspection sanctions: law and practice of national labour inspection systems*. ILO, Geneva.
- Mohdali, R., Isa, K. and Yusoff, S.H. (2014). The impact of threat of punishment on tax compliance and noncompliance attitudes in Malaysia, *Procedia: Social and Behavioral Sciences*, 164: 291–297.
- Murphy, K. (2005). Regulating more effectively: the relationship between procedural justice, legitimacy, and tax non-compliance, *Journal of Law and Society*, 32(4): 562–89.
- Murphy, K. and Harris, N. (2007). Shaming, shame and recidivism: A test of re-integrative shaming theory in the white-collar crime context. *British Journal of Criminology*, 47, 900–917.
- OECD (2014). *Regulatory enforcement and inspections*. OECD best practice principles for regulatory policy, OECD, Paris.
- Putniņš, T.J. and Sauka, A. (2015). Measuring the shadow economy using company managers. *Journal of Comparative Economics*, 43 (2), 471–490.
- Webley, P. and Halstead, S. (1986). Tax evasion on the micro: Significant simulations or expedient experiments? *The Journal of Interdisciplinary Economics*, 1, 87–100.
- Wenzel, M. (2004b). The social side of sanction: Personal and social norms as moderators of deterrence. *Law and Human Behaviour*, 28, 547–567.
- Williams, C.C. (2019). Tackling undeclared work in the European Union: an evaluation of government policy approaches. *UTMS Journal of Economics* 10(2): 135-147.
- Williams, C.C. (2020). *Developing a holistic strategic integrated approach towards undeclared work: a toolkit*, Regional Cooperation Council, Sarajevo
- Williams, C.C. and Bezeredi, S. (2017). Tackling the illegal practice of under-reporting employees' wages: Lessons from the Republic of Macedonia. *UTMS Journal of Economics*, 8 (3), 243–258.
- Williams, C.C. and Bezeredi, S. (2018). Evaluating policy approaches towards undeclared work: Some lessons from FYR of Macedonia. *South-Eastern Europe Journal of Economics*, 2, 171–187.
- Williams, C.C. and Franic, J. (2015). Tackling the propensity towards undeclared work: Some policy lessons from Croatia. *South East European Journal of Economics and Business*, 10 (1), 18–31.
- Williams, C.C. and Franic, J. (2016). Beyond a deterrence approach towards the undeclared economy: Some lessons from Bulgaria. *Journal of Balkan and Near Eastern Studies*, 18 (1), 90–106.
- Williams, C.C. and Horodnic, I.A. (2017). Evaluating the policy approaches for tackling undeclared work in the European Union. *Environment and Planning C: Politics and Space*, 35 (5), 916–636.
- Williams, C.C. and Puts, E. (2017). *Platform Survey Report: organisational characteristics of enforcement bodies, measures adopted to tackle undeclared work, and the use of databases and digital tools*. Brussels: European Commission.
- Williams, C.C. and Yang, J. (2017). Tackling falsely-declared salaries in Bulgaria: evidence from a 2015 survey. *Economic Alternatives*, 3, 333–351.

Williams, C.C. and Yang, J. (2018). Evaluating competing perspectives towards undeclared work: Some lessons from Bulgaria. *Journal of Contemporary Central and Eastern Europe*, 26 (2-3), 247–265.

Williams, C.C., Radvansky, M. and Stefanik, M. (2017). *The extent and nature of undeclared work in Croatia*. Twinning Project - Strengthening Policy and Capacities to Reduce Undeclared Work (CRO MOONLIGHTING).