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Informal Economy in the EU and Turkey

RAPPORTEURS

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1. Definition of "informal economy" and "undeclared work"

Non-declared work as part of the so-called informal economy is clearly manifest in all national economies. Although there are notable quantitative and qualitative differences between Member States in EU 15 as well as in the CEE countries, the broad existence of undeclared work presents national governments as well as the European institutions with a lot of legal, social and economic, but also ethical problems and challenges.

Any comparative view, global as well as within the EU, comes up against the challenge of dealing with a phenomenon which is not easily detected. Information on the size and structure of undeclared work collected through reliable methods is sparse. Research on this topic is carried out in very few countries and is often based on different definitions. And data reported by national agencies is often significantly below estimations by science or international organisations.

A wide array of colourful names has been used to describe the phenomenon which basically lies between employment in the informal sector (shadow economy) and illegal work (black economy): hidden, moonlight, parallel, underground, second, unofficial, and grey economy are a few examples. Similar names are found in different languages. Almost as many descriptions of the phenomenon can be found in documentation.

Many of them differ in the activities they describe (work, activities, paid labour etc.) or in the distinguishing criteria used, which sometimes emphasise legal aspects, sometimes stress statistical aspects and sometimes focus on fiscal matters.

- In general, employment in the informal economy covers employment outside formal economic activities subject to neither tax nor other legal provisions and/or regulatory requirements.**
- Wage employment which does not include either proper administrative registration, full legal payment of tax and social insurance contributions and/or necessary labour entitlements in line with national provisions is usually called 'black labour'.**

In this report, registration according to national requirements should be used as the criterion for what is to be understood as undeclared work: "... productive activities that are lawful as regards to their nature, but are not declared to the public authorities, taking into account the differences in the regulatory system between Member States ..."

This definition, used by the Commission in most studies and reports, is very similar to that of underground production and production of households for own final use in the OECD terminology for the Non Observed Economy.

Against this background the scope for and extent of undeclared work vary according to different institutional aspects of the economy of each Member State, such as:

- tax and social contribution levels,**
- burden of general costs and administrative procedures,**
- inappropriateness of legislation with regard to new forms of work,**
- local industrial structures based on a large number of small firms,**

- low competitiveness of firms in declining sectors which need a lot of low-qualified work,
- cultural acceptance of the informal economy,
- economic and political culture, including level of trust in the state apparatus
- level of unemployment,
- size of illegal immigrant/refugee communities
- existence of easy opportunities due to lack of control.

2. Status quo of informal economy in the EU and Turkey

2.1. Informal economy in the EU

In order to drive forward the debate on undeclared work and to help EU Member States to tackle the multiple problems and challenges concerned, in July 2004, the European Commission DG Employment and Social Affairs published a widely-disseminated report of an in-depth study on the extent of undeclared work around the EU, including the 10 new Member States that joined the Union in May 2004.

This report “Undeclared work in an enlarged Union”¹ not only revealed the extent of the phenomenon around EU 27 but also examined the reasons behind the existence and growth of undeclared work in various Member States. Major findings in this report show a picture which is different for EU 15 Member States on the one hand and most new Member States in Central and Eastern Europe (CEE) on the other:

EU 15 – Member States

Nevertheless, the nature of undeclared work makes it difficult to determine its extent; it was not possible to obtain fully comparable international data on the incidence of undeclared work. It can be concluded from the findings that the extent of undeclared work in most EU 15 Member States is relatively modest:

- on the basis of previous international studies the size of the undeclared economy is estimated all in all at between 7% and 16% of GDP of EU 15, or between 7% and 19% of total declared employment;
- many countries reported relatively low figures around or far below 5% of GDP (a level much lower than various academic studies suggest).
- exceptions to this low level of undeclared work are found in Southern European countries, in particular those such as Italy and Greece, whose figures far exceed 20% of GDP (national estimates which may ultimately prove to be very conservative ones, topped extensively by most international observations).

Major qualitative findings in the Commission’s study “Undeclared work in an enlarged Union”:

- looking at the characteristics of undeclared work, participation in undeclared work is dominated by men, often holding regular jobs as well, who are generally skilled and are part of the dynamic age group between 25 and 45 years of age. This group has the better position in the

¹ Commission report entitled "An analysis of undeclared work in an enlarged Union: an in-depth study of specific items", May 2004, http://www.regioplan.nl/media/pdf/id/493/file_name/Undeclared+work+in+an+enlarged+union

‘informal labour market’. Others, like women, students and the unemployed take less favourable positions, earn less and work longer in less attractive jobs;

- undeclared work is particularly prevalent in traditional labour-intensive sectors such as agriculture, construction, the retail trade, catering and domestic services, but also in manufacturing and business services, where competitiveness depends mainly on costs, and in innovative sectors using electronic communications;
- the sector with the highest incidence of informal work in most EU 15 Member States is the construction sector. The sector is rivalled only in Germany by agricultural work, including gardening. After these two sectors, informal work is found mainly in the hotel and restaurant sector and in personal and domestic services.

New Member States

Compared with EU 15 countries (except some southern Member States) the extent of undeclared work is higher. Regarding the scale and dynamics of undeclared work in the CEE countries, three clear groups can be identified:

1. Countries where the share of undeclared work is relatively low (about 8-13 % of GDP) and decreasing. This group includes the Czech Republic, Estonia and Slovakia. In the latter, the share of undeclared work has stabilised and started to decline recently, while in the Czech Republic and Estonia it has been decreasing since the mid-1990s. These are countries where the social and economic basis for informal work has never been strong, and current governments have a higher chance of success in combating it (more trust in the state, higher civic conscience, better functioning legal systems).

1.2. Countries with a medium level of undeclared work (14-23 % of GDP), which in most cases has also been decreasing since the mid-1990’s. This group includes Poland, Slovenia, Hungary, Lithuania and Latvia. The first three countries are known for having a long and deep-rooted tradition of an informal economy. Latvia and Lithuania are post-Soviet countries.

1.3. Countries with a high and still-increasing share of undeclared work (about 25 % according to own statistic references, but estimated by national experts and international organisations to be 30-37 %). This group includes Bulgaria and Romania, where there is a long tradition of undeclared work and the state is still too weak (or unwilling) to combat it.

Major qualitative findings in the Commission’s study “Undeclared work in an enlarged Union”:

- Most of the undeclared work in the post-socialist countries is concentrated in the same sectors as in the EU in general. The difference is in the relative share of sectors and in the processes driving their development. In several countries we find a higher share accounted for by the retail and hotel/restaurant sectors, what is left of a subsistence economy with a focus on agriculture, more typical in developing countries, and a relatively high share accounted for by professional services.
- Factors contributing to undeclared work in the CEE countries may be subdivided into three major clusters: 1) socio-economic/market, 2) institutional and 3) social/cultural traditions and the relationship between individuals, society and state.
 - o Historical factors connected with cultural traditions are the most stable long-term factors.
 - o Work outside the formal economy is not a new phenomenon for the post-socialist countries. In most of them undeclared work became widespread and an integral part of the

economic culture under the centralised economy, although its proportion of the economy varied from country to country.

- To a large extent the size of this kind of informal economy in the socialist period depended upon population and governments' tolerance of undeclared work.
- Given the deficiency of services, it was justified as unavoidable and even useful. Penalties, for those caught, used to be not very stiff.
- In describing the forms of informal economy in CEE countries, special attention should also be paid to the widespread practice of “envelope wages”, where only the minimum wage is officially declared and an additional part is paid as cash ‘in an envelope’.
- This form of undeclared work exists in practically all of the CEE countries, but seems to be most common in countries with a lower level of economic development, which are in an earlier phase of transition.
- For instance, in the Czech Republic or Estonia, where the legal culture is developing rather quickly, envelope wages seem to remain only in certain economic sectors (hotel, restaurants, retail trade) and their use is declining.
- In countries with a lower GDP per capita and less-developed business culture envelope wages seem to be more popular, as they are one of the easiest ways to avoid taxes.
- Corruption and interconnection with legal business are also important characteristics.

2.2. Informal economy in Turkey

The problem of the size of the informal economy is even greater in Turkey, where undeclared work is as high as 43.8%² and the size of the shadow economy itself is estimated to be as high as 50% of gross domestic product. As of 2009, of the 21.3 million people in the active working force, almost 9.3 million rank among those who are not subscribed to any social security scheme. Undeclared work can take two forms - those who work in undeclared and unregistered workplaces and those who work in registered workplaces but whose employment is not declared, at least not fully.

There is a significant gender gap in undeclared work in Turkey, as in other European countries, with the number of women whose employment is undeclared as high as 58% of all employed women, as against 38% for men. Women, who are overwhelmingly employed in the service sector, including informal domestic care services, are prone to a lack of social security coverage.

Additional issues are the age gap, as younger and older age groups are more prone to be within the undeclared work category, and the education gap, with undeclared work prevalently higher among those with lower levels of schooling.

An interesting point in the Turkish case is the fact that the vast majority (68%) of self-employed choose to remain within the grey economy, while the rate of undeclared work among employers themselves stands at 27% and among waged employees at 28%. The greatest share of undeclared work is observed among unpaid family workers, typically working in the sectors of agriculture and trades. Of all unpaid family workers, 91% have no social security, while the figure stands at

² All figures in this section are provided by the Turkish Statistics Institute, unless stated otherwise.

86% in the agriculture sector. Of all undeclared work, almost 50% is in the agriculture sector, while the share of agricultural employment within the total economy stands at 25%.

The factors contributing to the size of the shadow economy in Turkey are manifold, and many are the same as the factors cited for other European countries. One of the most significant factors in the Turkish case, however, is the sheer scale of unemployment and poverty, which takes away any bargaining power workers might have vis-à-vis employers. The weakness of organised labour, labour movements and solidarity is another factor that reduces the power of employees to resist the imposed obligation to work without social security coverage.

A major part of the problem is the shortage of educated and skilled labour, making it a major disincentive for employers to pay higher sums for social security coverage given the low productivity. The low levels of productivity and high levels of unemployment combined imply that a significant part of the population are forced to work at wages below the legal minimum, and hence without legal registration. In addition, lack of awareness among employers and employees alike concerning the need to register and be registered contributes to the problem, as well as diminishing the appeal of social security services,

Informal groupings and networks based on patronage relations, which help in both finding employment and accessing informal social services, are another factor in the high levels of unregistered work. These may take the form of traditional land-based communities living and working under the patronage of the landlord in a semi-feudal scheme. , An interesting issue in the Turkish case is the existence of a highly-developed entrepreneurial culture, with numerous economic, cultural and structural obstacles to formalising employment and production practices and processes in full. This helps to explain the prevalence of lack of social security coverage among the self-employed. This, combined with rapid and irregular urbanisation and the need for internal immigrants to stay and keep their families afloat, implies that many people will resort to unregistered and often irregular (*ad hoc*) economic activity to make a living.

Low levels of wages in general, owing to a high unemployment rate and a young and underskilled workforce, prompting employees to approach employers with the suggestion that the latter forego social security and pay higher wages instead, in order for workers to meet their subsistence needs.

Nevertheless, a very considerable factor here is the lack of incentives for people to register and get registered employment and work, given the low expectations of what they can receive in return.

A part of the equation here is the low level of trust in the state and the perception of widespread corruption, which compels employers and employees alike to question who gets to benefit from the taxes and the social security premiums that they have been and will be paying. Corruption scandals within social security systems feature frequently in the media, making it almost seem naïve to pay lawful liabilities.

Furthermore, it creates a feeling among employers that they can easily get away with misconduct even if they get caught by striking a deal with the social security inspectors, adding further to the disincentive. Likewise, frequent state pardons for social security and taxation misconduct also reinforce the tendency towards evasion.

For the state, other issues are high taxes on employment and social security premiums, the complexity of legal provisions and bureaucratic processes of registering and declaring work, the lack of effective inspection and monitoring, the lack of coordination and cooperation among

public bodies and the failure of the legislative provisions to keep pace with changing work schemes (flexible, part-time, free-lance, home-based work).

Turkey has made considerable progress in reducing the complexity of bureaucratic processes and financial burdens on employment and in improving the business environment.

The government launched an incentive program that includes social security premium deductions on new employment. Businesspeople are exempt from part of the social security employment premiums they normally pay for newly employed young and women employees

Moreover, the number of tax brackets was reduced from 5 to 4 and the lowest and highest tax rates were scaled-back to 15 and 35% respectively (previously 20% and 40% respectively).

Another key step was taken in the social security area, covering both administrative issues and pension parameters. The administrative reform unified the three social security institutions under one umbrella. This step enabled some savings through enhanced efficiency. The administrative reform was complemented by a parametric reform which unified the pension standards and norms for all employees, introduced a universal health insurance scheme and gradually increased the retirement age. Thanks to these initiatives, the social security deficit is projected to decline in the medium term.

Social security systems in Turkey have also been functioning relatively more effectively following recent changes to the healthcare system that combined healthcare services under one umbrella and provided linkages with private healthcare facilities, which have improved the incentives to receive state-funded healthcare. Nevertheless, pensions remain quite low. Hence, as long as they have some form of access to health services, often through informal means such as an acquaintance, people may tend to forego their retirement plans and hence remain outside the social security schemes.

3. Negative impact of the informal economy, both in TR and the EU

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

Undeclared work occurs throughout society, involving both employers and employees. The main attraction of the undeclared economy is financial. This type of activity allows employers, paid employees and the self-employed to increase their earnings or reduce their costs by evading taxation and social contributions. Undeclared work does great damage to society as a whole:

- undeclared work can have a significant impact on public finances, owing to the resulting losses in tax and social contributions revenue. Consequently, society is deprived of a considerable amount of the income, running into the billions every year, which goes towards funding, *inter alia*, welfare systems;
- efficient, honest businesses are either pushed out or find it hard to stay afloat and grow, whereas black economy businesses are able to stay in the market and even expand. This threatens to undermine the efficiency of the whole economy, and the productivity gains needed to continue to fund the welfare state also fail to materialise.

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

The impact on individuals is also significant:

- **as regards social security cover, the implications vary depending on the Member State and the individual situation. In any event, undeclared workers are not covered by unemployment insurance or insurance against workplace accidents;**
- **undeclared workers who are officially inactive forgo all the benefits of working with a formal contract, such as labour law entitlements, training, a specific career profile, pay rises and a sense of belonging to the firm. They will also have difficulty in moving into other jobs.**

In Turkey, as elsewhere, the informal economy and unregistered work are an indication of complicity between employers, employees and the state alike, which thrives on the current economic and legal infrastructure. Employers seek to avoid higher costs and hence boost competitiveness, while employees tend to consent to the deal in the name of finding and keeping a job. Job creation and national competitiveness concerns take priority for the state, which seeks to avoid the serious social consequences of massive-scale unemployment in a country where the number of unemployed, underemployed and discouraged employment seekers combined is estimated to be as high as 40 to 50% despite the low levels of labour force participation, especially among women, and the high numbers of younger members of the population still in education.

The most significant problem with the shadow economy is that it creates a two-tier economic structure, whereby the formal economy, which constitutes the modern component of the economic system, exists side by side with an informal economy, the traditional segment. While the former operates with higher labour productivity, conforms to basic economic notions like economies of scale and enjoys easier access to capital and export markets, the latter has very low productivity levels, operates with low technological infrastructure and offers minimal standardisation and lower-quality production. This not only leads to unfair competition within the domestic market as well as in terms of access to global markets, but also halts the mechanism of self-sustained growth, slowing down and complicating the process.

Undeclared employment puts the social security system under immense pressure, while at the same time the size of the shadow economy deprives the state of a considerable share of revenue needed to pay for a young and growing population, reducing both the availability and the quality of services provided by the state to the people (education, health, infrastructure, among others). This clearly not only takes its toll on the contemporary levels of economic development and social welfare, but also hijacks the future of the Turkish society. It should be added that leakages from the social security system due to corruption on the part of the administration, the companies that do business with the state and the individuals themselves also impose an extra burden on the economic system.

4. Possible solutions

The problem of undeclared work can be interpreted in two ways:

- as a situation in which individuals or firms take advantage of the system, damaging solidarity. In this case political intervention should be oriented towards penalties and awareness-raising;
- as the result of the inappropriateness of legislation for new forms of work, in which case action should concentrate on prevention (simplification of procedures, recognition of new jobs and skills, reduction of taxation on labour, etc.).

In addition to economic factors like tax burdens or specific labour-market conditions, trust in and quality of government play an important role. Furthermore, the role of culture in shaping an informal economy should not be overlooked. Therefore, actions to combat undeclared work have to include transforming it into regular employment and a policy mix combining both preventive actions and penalties.

It is therefore important to reduce the economic incentives for not declaring work and change the risk/benefit balance. In order to be effective in combating undeclared work, a comprehensive, targeted strategy must be established. A mix of measures drawing on the two approaches outlined above must be implemented, ensuring that the various measures interact and that other policy initiatives do not contradict them.

One of the most important success factors in combating undeclared work is the general success and stability of economic development and political stability.

4.1. Possible solutions – EU initiatives and policies

Undeclared work affects all Member States. In all quantitative and qualitative differences between Member States it has come to constitute a structural feature of all European societies. It is in danger of undermining the financing of social services, already under pressure, decreases individuals' social protection status and labour market prospects and may affect competitive conditions. It also runs counter to European ideals on solidarity and social justice.

Therefore, undeclared work has been an issue of common concern in the area of employment for more than a decade now in European policy.

- In order to combat undeclared work and social security benefit and contribution fraud, in 1999 the Member States decided on a programme of cooperation and reciprocal provision of administrative assistance.³ This cooperation was characterised by:
 - direct communication between competent bodies;
 - designation of national liaison offices in the Member States in order to facilitate cooperation, and notification thereof to the other Member States and to the Commission;
 - forwarding of any request for cooperation to the competent body of a Member State;
 - reciprocal provision of administrative assistance between the competent bodies (supply of information and transmission of documents).
- At the end of the 1990's, the European Commission launched a debate on the causes and consequences of undeclared work in the Member States and possible policies to counter the phenomenon. A Communication on Undeclared Work was issued, followed by respective studies

³ Resolution of the Council and the representatives of the Governments of the Member States in 1999 on a code of conduct for improved cooperation between authorities of the Member States concerning the combating of transnational social security benefit and contribution fraud and undeclared work, and concerning the transnational hiring-out of workers. (Official Journal C 125 of 06.05.1999)

that sum up its results in a report published in February 2002.⁴ This report stresses the importance of a policy mix to combat undeclared work: a good mix consists of both preventive actions and penalties.

- Following the Communication and the study report, the initiatives on the subject became part of a comprehensive, targeted European strategy. The Commission intended to boost the debate on the causes of undeclared work and the options for combating it as part of the European employment strategy. In the future, Member States' policy to combat undeclared work should be monitored in the context of the European Employment Strategy (EES). The issue of 'undeclared work' has been receiving remarkable and increasing attention since the EU employment guidelines included a specific guideline entitled 'transform undeclared work into regular employment' in 2003.

- This provides 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 penalties. They should undertake the necessary efforts at national and EU level to measure the extent of the problem and progress achieved at national level.” It is furthermore important that Member States improve data collection and monitor progress, including through impact assessments of policy initiatives.

- A 2003 Council resolution concerning transformation of undeclared work into regular employment⁵ aimed to strengthen this priority, which was included in Employment Guideline 20 (2005-2008). These policies are based on:

- preventive actions: the aim is to simplify procedures and reduce the costs and constraints which limit the creation and development of businesses, in particular start-ups and small undertakings; to remove disincentives to declare work on both the demand and the supply sides;

- penalties: the aim is to strengthen surveillance and to apply appropriate penalties in respect of those who benefit from illegal labour and also to protect the victims, notably through better coordination between the relevant authorities (tax offices, labour inspectorates, police);

- cooperation between Member States: with a view to combating social security fraud and undeclared work in the framework of transnational economic activities;

- a campaign to raise social awareness as regards the negative implications of undeclared work for social security and the consequences of undeclared work for solidarity and fairness.

Most Member States set out policies regarding undeclared work, in response to Employment Guidelines No. 9 (2003) and No. 20 (2005 and 2008). As there are no general, universal causes for the existence and development of an informal economy and it is brought about by complex interplay between a number of variables that differ between countries, the measures to be implemented vary of necessity among the Member States.

Against the background that scope and the extent of undeclared work vary according to different institutional aspects of the economy of each country, actions to combat undeclared

⁴ Communication from the Commission of 7 April 1998 on undeclared work, COM(98) 219 final

⁵ Official Journal C 260, 29.10.2003

work and to transform it into regular employment have to be a suitable policy mix combining both preventive actions and penalties.

4.2. Possible solutions – Turkish view

Despite the implicit consensus that the informal economic system should continue, the twin problems of informal economy and unregistered work need to be tackled for reasons that would benefit all parties involved. For employers, this would abolish the dichotomy in the economy, prevent unfair competition, increase productivity, and ensure institutionalisation and better access to funding. For employees, it would ensure social security coverage with access to the health services and retirement benefits that it entails, pave the way for better chances for unionisation and union rights, and allow for more productivity and hence more income. Finally, for the public administration, formalising the economy means a broader tax base, bringing the capacity to offer more and better services, benefit from the multiplier effect of higher and more secure income for a broader social base, and ensure more sustainable growth and better social justice at the same time.

There is no single one-size-fits-all remedy for the struggle against the shadow economy, and any effective strategy must take into account socio-economic parameters, the legal and corporate infrastructure and cultural variables. That said, both theory and practice indicate that the most effective way of tackling the informal economy is to combine and coordinate carrots and sticks, by minimizing the burden of taxation and regulation on employment, on the one hand, while ensuring better and more efficient supervision and inspection on the other. The target here should be particularly the firms that (ab)use informality to gain a competitive edge, with the goal being an increase in productivity-generating skills to prevent skill atrophy, as well as the institutionalisation of SMEs.

To this end, better information exchange and coordination should be ensured across public bodies, mainly by relying on estate practices. Awareness-raising activities targeting employers and employees alike should go hand in hand with more attractive social security services for both parties. Fewer, less complex bureaucratic procedures and reduced financial burdens on employment are an essential component of any strategy to cope with informality. At the other end of the spectrum, effective monitoring measures should be taken, with better cooperation and information-sharing among state institutions and heavier penalties put in place to discourage informality.

Considering the social and cultural variables, particularly the gap of trust in the state, a strategy to tackle the shadow economy must be combined with a parallel strategy to tackle corruption. The latter also includes the notion of effective use of taxes by the public administration and an emphasis on the link between taxes and more and better public services.

The strategy to tackle the shadow economy must be linked to a broader labour market scheme that eliminates the rigidity of the labour market and allows for a more flexible mechanism that protects the worker rather than the work. Considering the fact that unemployment and poverty are significant pieces in the puzzle that compel individuals to take work in whatever form it may come, any attempt at eradicating informality in the economy will fail without a combined attempt to reduce unemployment and underemployment. This requires effective education and training facilities for skills formation, skills renovation and productivity increase, and an incentive system that prioritises job creation and skills formation, including, for instance, tax exemption for on-the-job-training expenditure filed by enterprises.

An example of good practice in this connection is the SME incentive schemes for women in Turkey, which require the beneficiary to legally employ a certain number of workers in order to benefit from repayment advantages. To this end, financial burdens on new employment and the employment of individuals who have lost their jobs owing to, e.g., state privatisation initiatives, or employment of the long-unemployed, should be delayed and/or partially removed in order to promote more employment. Likewise, making job creation a priority criterion in access to public financing for enterprises appears to be a sound incentive.

In order to make the labour market more flexible, labour law needs to be amended in a way that takes into account flexible work schemes, including home-based, part-time, free-lance and domestic work. Effective measures should be taken to eliminate child labour, ensuring more effective supervision and more incentives to promote longer schooling. Efforts should also be made to balance employment promotion with unionisation rights by, *inter alia* giving enterprises with a unionised labour force priority as regards receiving incentives.

A fair and effective strategy safeguarding the interests of all parties involved, i.e. preserving and promoting the competitiveness of the enterprise, protecting the employers, their jobs and welfare, and ensuring a sustainable public finance system for the public administration is a challenge, and should strive to balance the burden equitably among the parties. Likewise, any strategy will fail to deliver without addressing the multiple and multi-faceted economic, social and cultural factors that trigger informality.

5. Best practice in fighting undeclared work/the informal economy

5.1. Best practice – EU 15 initiatives and policies

In recent years, many EU Member States have implemented policies to combat and/or transform undeclared work. The incidence of undeclared work has different root causes in the various countries of the enlarged EU. The causes even differ within countries. Consequently, different approaches are used in different Member States.

EU Member States have implemented a number of measures tailored to the differing forms of the phenomenon and their prevalence:

- in several countries new measures have been implemented, introducing institutional innovations and modernising legal and or fiscal arrangements;
- in some Member States initiatives have concentrated on undeclared work in the form of second jobs, whereas in others they have been aimed at the more ‘industrialised’ form of undeclared work;
- great attention has been given to measures that simplify rules and regulations and that reduce the administrative burden for employers. Labour market innovations have been implemented in several countries to combat informal economy;
- in a few countries, like Belgium and Germany, completely new institutional arrangements (various forms of service cheques) have been developed to undermine the existence of informal labour in certain sectors of the economy, in particular personal and domestic services. Similar initiatives were taken in France and Denmark in the early 1990’s;
- In addition, tighter controls are being introduced in most countries, and new or upgraded supervisory bodies are being set up or existing bodies are being strengthened in their work.

5.2. Best practice – CEE Member States' initiatives and policies

Most of the CEE countries have targeted policies to combat undeclared work. Among them are:

- **countries where such a policy was initiated in the 1990s and has already shown some positive results, facilitated by a steadily improving economic situation (Estonia, the Czech Republic and Slovakia);**
- **countries with some record of such a policy, which, however, is not very effective yet (Latvia, Lithuania);**
- **countries which started introducing this policy only very recently (since 2000) and have so far achieved few results (Bulgaria, Romania).**

Everywhere, the emphasis is put on institutional measures like tax regulation, reduction of social security contributions, labour market regulation, better control over the market, improvement of the legal environment, making the process of business registration and obtaining licenses etc. easier. One of the most important success factors in combating undeclared work, however, is the general success and stability of economic development, political stability, integration in Western markets (including the presence of foreign capital).

For this group of countries (with targeted policies), “stimulating” measures aimed at the transformation of undeclared work into formal work (creating better conditions for legal jobs, improving the business environment) seem to be more effective than preventive or repressive ones (control and punishment). Repressive (controlling) measures seem to work better in countries with a greater civic and business culture.

However, there is also a group of countries (Poland, Hungary and Slovenia) with a long history of an informal economy, which now follow the laissez-faire approach. Here, the present level of undeclared work is tolerated by politics and politicians, who see it as a measure to prevent mass unemployment and socio-economic tensions, and no serious action is launched against it.

A crucial element in regulating and controlling undeclared work is the strength of the state.

Strength, in this context, should not be understood in the sense of heavy-handedness, but as the capability to induce and regulate social change effectively and efficiently. Strong political leadership and credibility of politicians are seen as important factors in successful economic policy.

6. Recommendations

To be drafted following the discussion in the JCC meeting in Istanbul on 19-20 April.