Shadows: tackling undeclared work in the European Union

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SHADOWS: Tackling undeclared work in the European Union

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Across the member states of the European Union and beyond, paid transactions are occurring that are not declared to the state for tax, social security or labour law purposes. The practice is not a minority one. As a result, tackling undeclared work has become a core issue on the policy agendas of both governments and the European Commission, reflected in the establishment of the European Platform Tackling Undeclared Work.

How, therefore, can undeclared work be tackled? A review of the literature indicates two major distinct approaches. First, a rational economic actor approach that tackles undeclared work by ensuring that the costs of engaging in undeclared work is greater than the benefits, i.e. by increasing the actual or perceived penalties and risks of detection. Second, a social actor approach grounded in a view that undeclared work arises when tax morality is low, and seeks to foster both greater horizontal trust between citizens and greater vertical trust between citizens and government. There is also an emergent debate about whether these are complementary or competing approaches. As Figure 1 displays, the project seeks to evaluate these two approaches and the most effective overall approach by analysing the interaction effects between the two approaches in various contexts.

All the countries in the European Union and one EU candidate country have been analysed using multiple sources of data, more precisely, the 2007 and 2013 Eurobarometer surveys on undeclared work in the EU27/EU28 and the 2015 GREY surveys in Bulgaria, Croatia and Republic of North Macedonia. Some 40 in-depth interviews with citizens in two countries with contrasting levels of undeclared work, that is, Romania and the United Kingdom, have also been conducted to provide a more nuanced and deeper understanding of horizontal and vertical trust and the determinants of their tax morality. Who do they trust, not trust, and why? Under what circumstances is undeclared work deemed acceptable by citizens? Also, what are the main reasons given for participating in undeclared work?

To answer these questions and explain citizens’ participation in undeclared work, the project adopts the lens of institutional theory (Helmke and Levitsky, 2004; North, 1990). Institutions represent the rules of the game existent in a society (Denzau and North, 1994; Mathias et al., 2014) and, according to this institutional theory, all societies have both formal institutions (i.e. codified laws and regulations) that set out the legal rules of the game (prescribing what is state morality), as well as informal institutions which are the “socially shared rules, usually unwritten, that are created, communicated and enforced outside of officially sanctioned channels” (Helmke and Levitsky, 2004, p. 727), and are citizens’ norms, values and beliefs reflecting their individual morality about
what is right and acceptable (prescribing what is civic morality). Viewed through this institutional lens, declared work occurs within the formal institutional prescriptions set out in the codified laws and regulations. In contrast, undeclared work occurs outside of formal institutional prescriptions but within the norms, values and beliefs of informal institutions (Horodnic, 2018; Williams, 2017; Williams and Horodnic, 2015). Therefore, undeclared work is expected to be more prevalent where an asymmetry between formal and informal institutions exists, in other words, where is low tax morality, meaning a lack of trust in government and the rule of law.

The results of both the survey data and interviews suggest that the rational economic actor approach needs to be complemented by measures related to the social actor approach. Moreover, Figure 2 reveals, the interaction between the perceived level of penalty and perceived risk of being detected (rational economic actor approach), and vertical trust (social actor approach). As tax morality worsens, the probability of the representative citizen engaging in undeclared work is smaller when the risk of being detected is perceived as fairly high or very high.

However, when there is high vertical trust and tax morality is relatively high, an increased level of detection has only a minor impact on the probability of participating in undeclared work.

Does horizontal trust in fellow citizens also influence participation in undeclared work? Reporting the results of the GREY data on Bulgaria, Croatia and Republic of North Macedonia, Figure 3 again displays that as vertical trust improves, the predicted odds of the ‘representative’ citizen engaging in undeclared work are smaller. However, those who have lower levels of societal-level horizontal trust are more likely to engage in undeclared work at all levels of vertical trust. Indeed, the highest probability of engaging in undeclared work is when undeclared work becomes the norm, in other words, when citizens consider that 50% or more of the population in their community is working undeclared. Nevertheless, when there is a very high level of vertical trust the influence of societal-level horizontal trust on the probability of engaging in undeclared work is smaller. The salient influence of vertical trust on the likelihood of engaging in undeclared work is also underlined by the in-depth interviews. The main narratives on accepting or participating in undeclared work support the hypothesis that formal institutional failures reduce tax morality and therefore stimulate participation in undeclared work (Williams, 2017). Indeed, respondents highlighted all the major types of formal institutional failure and imperfect policy voiced in previous studies to explain citizens’ engagement in undeclared work (summarised by Williams, 2017), namely: formal institutional resource misallocations and inefficiencies (e.g. lack of government modernisation); formal institutional voids and weaknesses (e.g. lack of worker protection); formal institutional powerlessness (e.g. lack of capacity to enforce the formal rules or of the ability to provide incentives to encourage adherence to the formal rules); and formal institutional instability and uncertainty (e.g. continuous changes in laws and regulations).

The project suggests that if participation in undeclared work is to be reduced, there should be a greater focus upon improving citizens’ tax morality. Thus, both formal and informal institutions need to be altered. Government authorities should focus on altering those institutional failures causing a low tax morality among citizens. Therefore, not only policies aimed at improving the economic environment and the social protection of vulnerable groups (Dau and Cuervo-Cazurra, 2014) are necessary, but also modernising the quality of government by improving procedural and distributive justice and fairness (Kangl et al., 2015; Murphy, 2005).

Improving tax morality is essential considering that a perceived lack of fairness and effectiveness of the formal institutions (e.g. Parliament, the legal system) informs citizens on the norms of other citizens and encourages dishonest behavior (Sanderson and Thisted Dinesen, 2015). Respondents also revealed that education about the benefits of declared work is necessary, aiming to alter their views on the acceptability of undeclared work (i.e. civic morality).

In sum, this research has revealed that it is insufficient simply to detect and punish those engaged in undeclared work. If it is to be tackled, then there is also a need for greater emphasis on improving both vertical and horizontal trust.

REFERENCES:


