Tackling undeclared work in the European Union: Policy report

Colin C Williams
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Policy Report

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August, 2019
Undeclared work represents a persistent feature of contemporary economies and results in lost public revenue, lack of worker protection and unfair competition for legitimate businesses. Conventionally, undeclared work has been viewed as an individual criminal act, which is solved by governments increasing the penalties and risks of detection in order to discourage participation. This, however, only deals with the outcome (i.e., participation in undeclared work) and does not address the drivers of this behaviour.

This report explores the formal institutional failures which make undeclared work an acceptable behaviour in the eyes of citizens and, consequently, result in high participation in undeclared work. Addressing these institutional failures is important in order to tackle the determinants of undeclared work. This report investigates what policy measures are effective by exploring in turn the views of citizens, businesses and policy makers.

The finding is that, despite the increasing importance attributed by the governments to deterrent measures, both citizens and businesses are influenced by other factors when deciding whether to participate in undeclared work. Thus, to tackle undeclared work in a more effective manner, preventative measures and measures aimed at fostering trust need to complement deterrent measures.
What is UNDECLARED WORK?

Undeclared work is defined by the European Commission as ‘any paid activities that are lawful as regards their nature but not declared to public authorities, taking into account differences in the regulatory systems of the Member States’. This implies that the provision of illegal goods or services (i.e. drugs) belongs to the wider criminal economy and not to the undeclared economy.

4%  
1 in 25 EU citizens are engaged in undeclared work

32%  
1 in 3 EU citizens know persons engaged in undeclared work

Source: Eurobarometer 79.2 (2013)
The dominant policy approach adopted by governments when tackling undeclared work has been a repressive one grounded in a rational economic actor approach. However, the evidence that increasing deterrents reduces participation in undeclared work is less conclusive. While some studies are supportive of this approach [9-12], others identify no effect [13-15], only a short duration effect of increasing the level of deterrents, or even an increase in non-compliant behaviour due to deterrents breaking the trust between the state and its citizens [16-20].

The result has been a call to complement repressive measures with measures which enable the transformation of undeclared work into declared work [21, 22]. There are three categories of such policy [23], namely: i) preventative measures which aim to prevent the emergence of undeclared work, ii) curative measures which aim to help those already performing undeclared work to move to declared economy and iii) fostering commitment measures which aim to increase citizens’ tax morality in order to encourage voluntary compliance (by fostering trust, both at the horizontal and vertical level). Indeed, lately, the scholarship on participation in undeclared work has increasingly advocated the social actor approach drawing inspiration from a variant of institutional theory [24-26]. This focuses on improving the social contract between the state and its citizens in order to encourage voluntary compliance instead of aiming to force citizens to comply using repressive measures and threats (i.e. the focus of the rational economic actor approach).

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 (i.e., state morale), as well as informal institutions which are the citizens’ norms, values and beliefs reflecting their view on what is right and acceptable (i.e., civic morale). Viewed through this institutionalist lens, undeclared work occurs within the formal institutional prescriptions set out in the laws and regulations, whilst, in contrast, undeclared work occurs outside of formal institutional prescriptions but within the norms, values and beliefs of informal institutions [26, 27].

As such, participation in undeclared work is attributed to the asymmetry between the codified laws and regulations of a society’s formal institutions (state morale) and the socially shared norms, values and beliefs of its informal institutions (civic morale). To measure the acceptability of undeclared work, and thus the asymmetry between formal and informal institutions in relation to undeclared work, previous studies frequently used tax morale [27-29]. It is argued that if the formal institutional failures generate the asymmetry between the formal and informal institutions (i.e., low tax morale) and therefore determine whether citizens find it acceptable to participate in undeclared work [26]. This is graphically summarized in Figure 1. The major types of formal institutional failure identified in previous studies for explaining participation in undeclared work are summarized in Table 1. These will be explored in turn in the results section.

FIGURE 1
An institutionalist perspective on participation in undeclared work

What’s the RATIONAL ECONOMIC ACTOR APPROACH?

According to this view people engage in undeclared work when the benefits of doing so are perceived as higher than the costs related to this activity. Therefore, according to this view for reducing the participation in undeclared work it is necessary to increase the costs associated with this behaviour.

Policy measures related with this view focus on repressive measures (i.e., deterrents) and seek to:

- Increase the actual and/or perceived level of detection
- Increase the actual and/or perceived penalties

What’s the SOCIAL ACTOR APPROACH?

According to this view people engage in undeclared work when there is low trust at both the horizontal and vertical level. Therefore, according to this view for reducing the participation in undeclared work, measures focused to foster trust are necessary.

- Horizontal trust refers to trust between citizens in terms of the degree to which citizens trust other citizens to be compliant. It is more likely that people will engage in undeclared work if they perceive that a large share of the population undertake undeclared work (e.g., they know other persons engaged in undeclared work). This displays the asymmetry between the formal and informal institutions. It is more likely that people who engage in undeclared work when a high asymmetry exists between the formal and informal institutions (i.e., a low tax morale, meaning there is a lack of trust in government and the rule of law).

- Vertical trust refers to the degree to which citizens trust the government. This displays the asymmetry between the formal and informal institutions. It is more likely that people who engage in undeclared work when a high asymmetry exists between the formal and informal institutions (i.e., a low tax morale, meaning there is a lack of trust in government and the rule of law).

Policy measures related with this view focus on fostering commitment measures aiming to foster trust and seek to:

- Alter the formal institutions by modernising the governance through improving procedural justice, procedural fairness and redistributive justice.
- Alter the informal institutions regarding the acceptability of engaging in undeclared work through tax education and awareness raising campaigns (e.g., information about what public goods and services are paid from taxes, information about the benefits of undeclared work or normative appeals (e.g., by linking the taxes with the public goods and services such as schools, hospital).

BOX 2
Rational economic actor and social actor approaches

Source [1,4,8]

TABLE 1
Formal failures and imperfections

<table>
<thead>
<tr>
<th>Source</th>
<th>[38], abridged and adapted from [26]</th>
</tr>
</thead>
<tbody>
<tr>
<td><strong>CODED LAWS AND REGULATIONS</strong></td>
<td><strong>EXPLANATION / LINK TO UNDECLARED WORK PARTICIPATION</strong></td>
</tr>
<tr>
<td><strong>Lack of redistributive justice</strong></td>
<td>Citizens do not feel that they receive the goods and services they deserve given the taxes they pay.</td>
</tr>
<tr>
<td><strong>Lack of procedural justice</strong></td>
<td>Citizens believe that authorities adopt a cops and robbers approach and do not treat them in a respectful, impartial and reasonable manner.</td>
</tr>
<tr>
<td><strong>Lack of procedural fairness</strong></td>
<td>Citizens do not believe that they pay a fair share compared with other citizens.</td>
</tr>
<tr>
<td><strong>Lack of capacity to enforce the formal rules</strong></td>
<td>Weak deterrence measures</td>
</tr>
<tr>
<td><strong>Lack of ability to provide incentives to encourage adherence to the formal rules</strong></td>
<td>Low benefits of operating in undeclared sector</td>
</tr>
<tr>
<td><strong>Lack of ability to provide penalties to enforce the formal rules</strong></td>
<td>For reducing participation in undeclared work, the government can use incentives and rewards to increase the benefits of operating in the declared sector and to encourage citizens to participate in compliant behaviour (e.g., information about the benefits of undeclared work or normative appeals (e.g., by linking the taxes with the public goods and services such as schools, hospital).</td>
</tr>
<tr>
<td><strong>Instability and uncertainty of the formal rules</strong></td>
<td>Continuous changes in laws and regulations</td>
</tr>
</tbody>
</table>

| **Inefficiency and imperfections** | **Source:** [26] |
| **Lack of capacity to enforce the formal rules** | **Formal institutional failures determines an asymmetry between the formal and informal institutions, asymmetry that in turn generates larger participation in undeclared work. The asymmetry is frequently measured using tax morale.** |

Tackling Undeclared Work in the European Union
The project explores not only the effectiveness of using a rational economic actor approach and a social actor approach but also analyses whether these are complementary or competing approaches in various contexts. To investigate these issues and explain citizens’ participation in undeclared work, the project adopts the lens of institutional theory.

This report summarizes the main results of the SHADOWS project and aims to provide a more nuanced and variegated deeper understanding of tax morale and its association with participation in undeclared work, and the policy measures perceived as effective for reducing this practice.

The next part of the report provides a description of the methods and data used within the project. This will be followed by the results, which summarises the main findings of the project.

The fourth section reports a brief summary of some previous studies with policy makers across EU27/28 and focuses on the policy measures used and considered effective by the enforcement bodies. The project focuses on the policy measures related to the rational economic actor approach (i.e., repressive measures) and social actor approach (i.e., fostering commitment measures aiming to increase citizens’ and employers’ tax morale by fostering trust, both at the horizontal and vertical level). However, when the data is available for providing a more inclusive picture, two other measures which transform undeclared work to declared work are analysed, namely: preventative measures which focus on preventing the occurrence of undeclared practices and curative measures which focus on helping the non-compliant citizens to move to declared economy.

The report concludes by summarizing the views of citizens, employers and policy makers and discusses the policy implications of the findings.

METHODS

The main methods and sources of data used within the project are displayed below. In addition, secondary data extracted from previous studies with citizens, employers and policy makers are reported. This report summarises the main findings.

**Systematic literature review**
- Systematic search conducted using a library catalogue which provides access to more than 400 databases storing journal articles, working papers, conference papers, books, official reports and thesis dissertations.
- Inclusion criteria based on two keywords, namely tax morale or tax morality.
- Screening the first 300 results generated by each key word plus papers available on the personal pages of the most relevant authors in the field.
- Less than 200 papers were relevant and retained based on screening the titles and abstracts.
- A detailed review of these papers narrowed the analysis to 82 studies where tax morale has been used as the dependent variable and revealed the factors associated to tax morale.

**Quantitative analysis**
- 4 databases used, namely: the Eurobarometer 67.3 (2007) and Eurobarometer 79.2 (2013) surveys on undeclared work which involved 26,659 and 27,563 face-to-face interviews respectively at EU27/EU28 level, and the 2015 GREY representative surveys conducted in Bulgaria, North Macedonia and Croatia which involved 6,019 face-to-face household interviews and 1,430 face-to-face interviews with businesses.
- Uni- and multivariate analyses.

**Qualitative analysis**
- 40 in-depth interviews conducted at the end of 2018 in two different contexts, namely in Romania and the UK.
- Snowball sampling method.
- Three categories of interviewees were included in respect to nationality and the country they work in, namely: British citizens working in the UK, Romanian citizens working in Romania and Romanian citizens working in the UK (we were unable to reach British citizens working in Romania due to their low prevalence). The Romanians working in the UK provided a comparative group for exploring how (if) tax morale is influenced by the formal institutional failures considering that they have experienced two different formal institutional settings (e.g., home country and host country).
- Respondents of both genders, ranging from 23 years old to 69 years old, residents from urban and rural areas, in different occupations and education levels.
**SECTION I**

Factors associated with tax morale

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**FIGURE 2**
Factors associated with tax morale

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<table>
<thead>
<tr>
<th>Structural conditions</th>
<th>Centralisation</th>
<th>Corruption</th>
<th>Government fairness</th>
<th>Tax rate</th>
<th>Trust in public authorities/ Vertical trust</th>
</tr>
</thead>
<tbody>
<tr>
<td>4 studies</td>
<td>7 studies</td>
<td>7 studies</td>
<td>10 studies</td>
<td>13 studies</td>
<td>7 studies</td>
</tr>
</tbody>
</table>

- **Wider corruption is associated with lower tax morale**
- **The higher the perceived fairness of the government, the higher the tax morale**
- **Direct democracy leads to higher tax morale**
- **Trust in public authorities/ Vertical trust**
- **Government quality/ spending effectiveness**
- **Tax rate**

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**TAX MORALE**

- **Culture**
  - Culture has impact on tax morale. There are cultural differences within and between countries influencing tax morale
  - Religiosity
  - Higher pride in national origin is associated with higher tax morale

- **Culture**
  - Culture is associated with tax morale

- **Religion**
  - A high trust in public authorities is associated with high tax morale
  - Higher religious values (high attendance to church) are associated with higher tax morale

- **Horizontal trust**
  - Higher trust in other taxpayers is associated with high tax morale
  - A high trust in other taxpayers is associated with high tax morale

- **Vertical trust**
  - A high trust in other taxpayers is associated with high tax morale
  - A high trust in other taxpayers is associated with high tax morale

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**Formal institutions and vertical trust**

- **Corruption**
  - Centralisation induces lower tax morale. Local autonomy has a significantly positive effect on tax morale and the size of the shadow economy
  - Higher perceived quality/ effectiveness of spending is associated with higher tax morale

- **Government fairness**
  - The higher the tax rate, the lower the tax morale. Progressive tax systems improve tax morale
  - The higher the tax rate, the lower the tax morale. Progressive tax systems improve tax morale

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**Informal institutions and horizontal trust**

- **Religion**
  - Higher religious values (high attendance to church) are associated with higher tax morale
  - Higher religious values (high attendance to church) are associated with higher tax morale

- **Horizontal trust**
  - Higher trust in other taxpayers is associated with high tax morale
  - Higher trust in other taxpayers is associated with high tax morale

- **Vertical trust**
  - A high trust in other taxpayers is associated with high tax morale
  - A high trust in other taxpayers is associated with high tax morale

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Analysing the tax morale literature, the finding is that tax morale is shaped by a large number of variables describing both, formal and informal institutions. However, as Figure 2 displays, the most salient factor identified was trust. On the one hand, vertical trust or the trust in public institutions (e.g. government, parliament, legal systems and rule of law, police, tax authority and public servants) has been identified as associated with tax morale in a vast number of studies (for a full review see [31]). In addition, other variables related to vertical trust such as the perceived fairness of the government, the quality and the effectiveness of government spending as well as corruption were identified in a large number of studies as being associated with the level of tax morale. Due to this substantial influence of vertical trust on tax morale, various studies (including this one) use tax morale as a proxy for capturing the vertical trust. On the other hand, horizontal trust or trust in other citizens and the perceived level of undeclared work in the society or community has also emerged from a high number of studies. Indeed, leaving apart the culture and the religiousness (i.e., persistent norms in society), the perceived behaviour of the other citizens (i.e., the norm towards undeclared work) was identified as most frequently associated with the tax morale. Thus, the finding is that a low level of trust in public institutions, the formal institutional failures as well as a low level of trust regarding the compliant behaviour of other fellow citizens is associated with a low tax morale. Is low level of tax morale associated with a high participation in undeclared work? Previous studies, regardless of the type of measures of tax morale or regional area covered, found that indeed, a low tax morale is associated with a high participation in various non-compliant practices such as the shadow economy [32-34], tax evasion [35-37], participation in undeclared work [29,38] or participation in under-reporting salaries [27,28,39].
SECTION II

What do Citizens Say about Tackling Undeclared Work?

RATIONAL ECONOMIC ACTOR APPROACH:

How are the repressive measures perceived by European Union citizens?

Using the latest data available (2013), the finding is that 36% of EU citizens perceive the risk of being detected if undertaking undeclared work as fairly or very high. There are cross-country variations, with the perceived risk of being detected higher in the UK, Ireland and Portugal (i.e., about 50% of citizens perceive the risk of being detected as fairly or very high) and lower in Slovenia, Malta, Sweden, the Czech Republic, the Netherlands and Bulgaria (i.e., a quarter or less of citizens perceive a fairly high or very high risk of being detected if undertaking undeclared work) [8].

Regarding the perceived level of penalties, the finding is that 21% of citizens in the European Union consider that the normal tax or social contribution is applied if detected doing undeclared work, 56% consider that a fine would be applied in addition to the normal contributions due, 6% expect prison and 17% expect other penalties or refused to answer. Again, cross-country variations are identified, with a higher percent of people perceiving that no additional fine will be applied if one is detected engaging in undeclared work in Poland, Lithuania, Latvia, Croatia and Estonia (i.e., more than one third of citizens) and, in contrast, a higher percent of people expecting a fine in addition to normal contributions due in Denmark, Sweden, Germany and Austria (i.e., more than two third of citizens) [8].

SOCIAL ACTOR APPROACH:

How acceptable is undeclared work and how do European Union citizens perceive the (non)compliant behaviour of other citizens?

The same Eurobarometer survey (2013) reveals that the social acceptability of undeclared work varies in respect to the type of undeclared work analysed. From a list of six types of non-compliant behaviours, EU citizens rated as the most unacceptable behaviour to claim benefits (i.e., welfare payments) without entitlement (87% find this behaviour highly unacceptable). This is followed by undeclared work conducted by/for firms, namely: undeclared work conducted by a firm for another firm (84% highly unacceptable), a firm hiring workers on undeclared basis (80% highly unacceptable) and undeclared work performed by a firm for a private household (79% highly unacceptable).

The most acceptable forms of undeclared work in the view of EU citizens are those undertaken by individuals, namely: someone partially or totally conceals their income (78% highly unacceptable) and undeclared work conducted by an individual for a private household (60% highly unacceptable). Therefore, the overall finding is that the EU citizens find it more acceptable for individuals rather than businesses to operate in undeclared economy (with the exception of claiming welfare payments without entitlement). This can be explained by the fact that the individuals claiming benefits without entitlement may be perceived as ‘taking our money’ rather than seeking to ‘keep their own money’ [4].

36% of EU citizens perceive the risk of being detected if undertaking undeclared work as fairly or very high.

56% of EU citizens consider that a fine would be applied in addition to the normal contributions due if detected doing undeclared work.
The results of the interviews conducted in Romania and the UK at the end of 2018, reveal rather similar findings. The spontaneous responses of the interviewees when asked under what circumstances is undeclared work acceptable and when it is not, are displayed below (listed from the most frequent narrative to the least frequent narrative)

- **ACCEPTABLE**: when undeclared work is conducted occasionally by the individual and a low income is generated; when people are struggling to make a living; when individuals have a main job where they pay taxes and they have a secondary undeclared activity; when it is difficult to declare.

- **NOT ACCEPTABLE**: when a high amount of money is earned and not declared; when it has a harmful effect on the client or competitors; when claiming benefits without contributing; when forced by employer; when the full work of an individual is undeclared.

Turning to horizontal trust and using the data from the Eurobarometer survey (2013), the finding is that one in three citizens (32%) of the European Union asserts that they personally know people engaged in undeclared work. Indeed, the results of the interviews conducted in 2018 in Romania and the United Kingdom reveal also a high perceived spread of undeclared work. The British respondents perceive the share of people engaging in undeclared work in their country as ranging from about 10% of the population to about 50% while the Romanian citizens perceive that in Romania the share of people engaged in undeclared work is higher, ranging from 50% to the whole population. Therefore, the overall finding is that citizens in the European Union display rather low trust in the compliant behaviour of their fellow citizens.

Indeed, similar findings are revealed when analysing data collected in 2015 from two member states of the European Union and one EU candidate country (i.e., Bulgaria, Croatia and North Macedonia).

There is no association between participation in undeclared work and deterrents (i.e., perceived risk of detection and perceived penalties), but there is a strong association between participation in undeclared work and the level of vertical trust [15, 41].

The above findings become more pronounced when analysing the results on country level aggregate data. As Table 2 displays, the association between the participation in undeclared work and the repressive measures of the rational economic actor approach (i.e., perceived level of detection or the perceived penalties) is very weak and not significant, while horizontal and vertical trust, which are the key determinants of undeclared work in the social actor approach, are both associated with the level of participation in undeclared work.

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**32%**

of EU citizens personally know people engaged in undeclared work

EU citizens find more acceptable for individuals rather than businesses to engage in undeclared work

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**Which measures reflect better the views and behaviour of European Union citizens?**

Investigating the views and behaviour of EU 27/28 citizens (2007 and 2013 Eurobarometer surveys), and controlling for their socio-economic and socio-economic characteristics, the finding is that there is an association between participation in undeclared work and the perceived level of deterrents (i.e., the perceived risk of detection and the perceived sanctions) as well as an association between participation in undeclared work and individual’s vertical trust (i.e., tax morale) and horizontal trust (i.e., personally knowing people engaged in undeclared work). However, in comparative perspective, the results show not only that the marginal effects of vertical and horizontal trust on undeclared work are larger than the marginal effects of the deterrents in 2013, but also that the association between participation in undeclared work and deterrents has become weaker in 2013 whilst by contrast, the association between the horizontal and vertical trust has become stronger in 2013 (Figure 3).

**FIGURE 3**

The association of the rational economic actor approach, social actor approach and participation in undeclared work

**TABLE 2**

The association between the share of people engaged in undeclared work and the variables related with social and rational economic actor approaches

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Note: The figure portrays the results obtained using a multilevel logistic regression applied on both Eurobarometer waves.

Note: Significant at: **p<0.01, ***p<0.05, *p<0.1

Source: [8], based on [40]
Continuing to investigate the two policy approaches, Figure 4 displays the interaction between the perceived level of deterrents (i.e., rational economic actor approach), and vertical trust (i.e. tax morale, belonging to social actor approach). As vertical trust worsens, the probability of a ‘representative’ citizen engaging in undeclared work is considerably higher. When tax morale is low, 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 morale is relatively high, an increased level of deterrents has only a minor impact on the probability of participating in undeclared work. As such, the Figure 4 reveals the usefulness of increasing the level of deterrence to prevent participation in undeclared work is in contexts where tax morale is low.

Reporting the results of the 2015 GREY data on Bulgaria, Croatia and Republic of North Macedonia, Figure 5 again displays that as vertical trust improves, the probability of the ‘representative’ citizen engaging in undeclared work is considerably smaller. However, at all levels of vertical trust those who have lower levels of horizontal trust (i.e., the perceived share of undeclared work at the society level) are more likely to engage in undeclared work. Indeed, the highest probability of engaging in undeclared work is when undeclared work is perceived as the norm in the society (i.e., when is perceived that 50% or more of citizens in the society are working undeclared). Again, 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 lower.

In sum, the results of all the survey data analysed suggest that if participation in undeclared work is to be tackled in a more effective manner, the rational economic actor approach needs at the very least be complemented by measures related to the social actor approach. Therefore, the repressive measures need to be complemented by fostering commitment measures aimed at improving citizens’ and employers’ tax morale by fostering trust, both at the horizontal and vertical level.

Due to the importance of vertical trust (i.e., tax morale) in explaining participation in undeclared work and in capturing the asymmetry between the formal and informal institutions, the attention turns to the narratives identified in the in-depth-interviews. This provide a more nuanced and deeper understanding of the determinants of their tax morale and how tax morale influences their decision to engage in undeclared work.

In sum, the results of all the survey data analysed suggest that if participation in undeclared work is to be tackled in a more effective manner, the rational economic actor approach needs at the very least be complemented by measures related to the social actor approach. Therefore, the repressive measures need to be complemented by fostering commitment measures aimed at improving citizens’ and employers’ tax morale by fostering trust, both at the horizontal and vertical level.

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FIGURE 4
Predicted probability of engaging in undeclared work of a ‘representative’ EU citizen: by expected penalties, detection risk and vertical trust

FIGURE 5
Predicted probability of engaging in undeclared work of a ‘representative’ citizen in Southeast Europe: by vertical trust and societal-level horizontal trust

Source: own calculations based on data from Eurobarometer 79.2 (2013)

Source: [42]
Why undeclared work is deemed as acceptable and what are the main reasons given for participating in undeclared work?

In order to explore how citizens explain their participation in undeclared work and how (if) the formal institutional failures and imperfections influence their tax morale and thus, participation in undeclared work, the results of 40 in-depth interviews are here reported (see details in the methodology section). To enable the identification of the main narratives used to explain institutional asymmetry and participation in undeclared work (i.e., to identify what formal institutional failures generated their views on the acceptability of undeclared work), the interviewees were asked the following questions:

- Under what circumstances they think it is okay if people do not declare their income for tax purposes and when they think it is not okay.
- Whether they perceive that they themselves and other people paying taxes in their country receive the public goods and services they deserve in return for the taxes paid.

The spontaneous responses of the interviewees, underlined issues related with all four categories of formal institutional failure and imperfection identified in previous studies, namely, formal institutional resource misallocations and inefficiencies; formal institutional voids and weaknesses; formal institutional powerlessness; and formal institutional instability and uncertainty.

Figure 6 displays the occurrence of these categories of failures and imperfections varies. As such, the most dominant motive making undeclared work acceptable in the eyes of citizens is represented by the resource misallocations and inefficiencies, revealing issues related to both, lack of modernization of the government and corruption. These issues were mentioned by both British and Romanian citizens, but to different extents. The narratives of lack of redistributive justice and lack of procedural justice were brought into discussion mainly by the Romanian respondents, while narratives related to the lack of procedural fairness were mentioned mainly by the British respondents.

Lack of procedural justice

“There is a general lack of respect in Romanian public institutions.”

“And ... you are treated, I don’t know ... I don’t see the respect. It should be more respect as all the salaries and what is happening in the country is made with the taxpayers’ money. [...] And then they should show more respect to the taxpayers. This is what I think.”

Lack of procedural fairness

“The tax authorities in this country definitely tend to have a very strong focus on easy targets. [...] They don’t tend to pick the big tax evaders because it is harder work and (pausing) it looks like a big number but in fact it is much easier sometimes to get a thousand small people to jump on (laughing).”

“The more you work the more you pay. I paid more in tax in a week than my girlfriend paid in a month. I just don’t understand that. Where is this going?”

Lack of modernization of the government

Lack of redistributive justice

“No. Actually we do not in fact receive anything for the taxes we pay. What do I pay for? For using a road that destroys my car? I go on my alley and it is dark. Let us continue, at hospital, you break your finger (personal experience mentioned previously in the interview) and you have 50-100 BON (about 20 EUR) in your pocket and you look around to whom to offer it to get some attention. No. What do we receive?”

“You don’t receive what you deserve. For example, if you need medical services you go private because in public hospitals there is no available place or you have to pay anyway.”

Corruption

“Definitely society is losing, that ... if we’d stick together, right? Can you imagine how good things would go? Including the people running the state. Yes, including the people running the state ... It would go. I think things would be better. The problem is for them to be correct too. And the state to be (correct), or those running it. Those who make some rules, laws and so on ... They elaborate those based on their interest. Mostly you, unfortunately, that is the case.”

“Uh ... if you think on how much money in this country is just in wrong pocket ... So I think we should pay a little bit more and the 30 per cent should be spent a bit more wisely. So, beside the expenses I mentioned in military that I do not agree with ... well, for example the health, the way that National Health System is structured means that the drug companies can dictate how much they sell the drugs for. So I think that can be a lot more emphasis on spending tax money more wisely.”

Misuse of public office for private gain

“Local, everybody is trying to do their jobs. [...] Areas I do not trust are the government because of the power. Because power corrupts.”

“When inspectors make a control? You provide them a fuel tank full of diesel and give them a free service for their car, oil change, and everything is perfect. It does not matter that all the mechanics have the minimum wage on their formal working contract.”

State capture

“Regarding the government, I do not think that they are really really a bad government but ... I think that there is a lot of corruption in this country, at high level. And maybe the government isn’t as corrupt as some Eastern countries but (pause) how the contracts are awarded to, construction companies ... it takes more ... longer, it costs much more money ... It is always the same three people getting these contracts or their companies.”

“If you go to hospitals you need connections and money.”

Turning to formal institutional voids and weaknesses, the views of citizens underline that undeclared work is the resort used by people for making a living due to the inadequate protection from the state. Even if in both countries the motives related to the over-regulative excesses and high taxes were mentioned, they were brought into discussion rather to underline the difficulties of making a living due to the high level of taxation and, furthermore, the respondents find undeclared work acceptable in these instances (i.e., when people are struggling).

Lack of worker protection

“Obviously. Nobody wants to cheat the state. Out of necessity. If we had a decent salary, things would be different.”

“I suppose it’s never okay to not declare it but (pause) it is a way to live life. You have to do it. It is not legal, it’s very illegal. You can go to prison for it but you know if it’s (pause) in some cases is making sure your family is alright ... I mean ...”

Burdensome regulatory environment

“And then, there are also the pretty high taxes that skin you alive. I do not know how you should work to be able to pay all the taxes.”

“Yeah ... I suppose it’s like ... with like a lot of jobs, people maybe don’t think that they have to declare it because ... maybe just make me clear what you should declaring and what you don’t have to ... And it needs to be really simple to do ... so just like a form that would be easy to learn ... didn’t seem too complicated. So just making it like a process very simple ... and also like ... disseminate it out to the public.”
The **formal institutional powerlessness** as an explanation of the acceptability of undeclared work appeared to a lesser extent in the respondents’ narratives. In general, in both countries, the level of deterrence is not perceived as necessarily low. However, the respondents’ narrative is that, as shown above, people have to do it when struggling to make a living despite the deterrence level. Indeed, the lack of perceived benefits of operating in declared economy was more often stated by the respondents than the weak level of deterrents. This narrative is highly related with the lack of redistributive justice and how the citizens perceive that there is no benefit of working declared because the public goods and services they receive in return to the taxes they pay are not at the expected level.

**Low benefits of operating in declared economy**

“What can you lose? (performing undeclared work) I don’t know. I don’t know if you lose anything.”

“The negative part ... to be honest, I don't see any negative part for the individual.”

“I don’t think that people who ... Yeah, I think the people have a … have a second or third job, yeah? Those people have no conscience on paying taxes. Because they are already paying it at their main job. They are making a contribution already, yeah?”

**Weak deterrence measures**

“I do not even know what the fiscal agents or labour inspectors can do at the moment to be able to control everybody (pause) or to reduce undeclared work.”

“I do not think that there is anything that they could do to incentive all these people to pay their taxes.”

Finally, issues related to the **institutional instability and uncertainty** (e.g., continuous changes in laws and regulations) were used to explain the acceptability of undeclared work by a reduced number of respondents, mainly Romanians.

“And there are so many laws and all the time they are amended. You, as a consultant, never know whether the way you work is correct or not.”

In sum, interviewees spontaneously explain the acceptability of undeclared work and the participation in such behaviour to result from formal institutional failures belonging to all four categories (see Table 1).

Motives related to formal institutional resource misallocations and inefficiencies as well as formal institutional voids and weaknesses were evoked by the respondents to a much higher extent for explaining why undeclared work is acceptable.

<table>
<thead>
<tr>
<th>Lack of modernization of the government</th>
<th>Corruption</th>
<th>Resource misallocations and inefficiencies</th>
</tr>
</thead>
</table>

![FIGURE 6. Formal Institutional Failures](image-url)
What citizens believe that governments should do for reducing the acceptability of and participation in undeclared work?

To identify what citizens consider would reduce the acceptability of undeclared work and the participation in such behaviour, respondents were asked their opinion on what the authorities could do to determine people to fully declare their income or to declare their income in a more honest manner. The spontaneous responses of the respondents underlined policy measures related not only to rational economic actor (i.e., repressive measures) and social actor (i.e., fostering commitment measures) but also from other categories of measures aimed at transforming undeclared work to declared work, namely, preventative measures and curative measures.

As Figure 7 displays, the most common narrative is related with the prevention of undeclared work. As such, issues related with the difficulties encountered by citizens for making a living, the necessity of increasing the minimum wage, the need to provide tax incentives for certain groups of population or to reduce the tax level were brought into discussion most often by the respondents.

Simplifying regulations and reducing changes in law

“Hmm (pause). And to eliminate the bureaucracy a little. And what else they should do, they should avoid the monthly change of laws.”

“I think the clear thing is that you make the rules clearer and simpler for people that are at the bottom end of the system.”

Support for those struggling

“Most people that do it are parents. They could communicate with the parents. I’m not asking them to raise my children, but I’m asking them to listen. When my children … my children come first … if my children are sick I’m out work for a week. […] So, with hills being so high nowadays … when people are out of work, losing 200 pounds for a week, whatever they earn … then it’s not as easy than it’s listen … ok will give you … will work with you rather than against you. And people feel confident and phone them up and say: I’m in a tight spot … I’m struggling … This is what I’ve got going on. Can you help me slightly? For a couple of months. And then people wouldn’t then work illegally because they’ve got the support of the Government. It’s like … give us a little time, we’ll get there.”

“And I think that you got to be a bit more flexible. Because it is not about tracking people and following them on how not to do something. Maybe have a look at the problem and see why that mother is doing that. Is that can we give them more allowance? Can we increase those 15 hours per week? Because it seems like everybody can do more and maybe still allow them some benefits.”

Beside the instances where respondents proposed more support from the government or a reduced level of taxation, the more prevalent narrative is related with the measures of the social actor approach, namely measures aiming at fostering commitment. The main type of measures were mentioned by the respondents, exemplified below starting with the one occurring most frequent.

Tax incentive or reducing the tax level

“I talk about measures to support the persons to have a second activity. Yes. The state doesn’t have to provide to you after all. But yet not to come and take from you with two hands.”

“So if they reduce the taxes and stuff for … maybe people would be … wouldn’t need to do it as much. They will remain with enough money after they declare …”

Increasing the minimum wage

“To increase the standard of living so that the additional activities are not necessary anymore.”

“To offer to the people a better living standard. If we would have enough money for a decent living, we would not act like this. Who is happy to be scared all the time and to have no experience in a formal working contract? But there is no job, or they are very poorly paid and you have no choice than to do some extra (undeclared) work.”

“Well, they should raise the minimum wage I think. So, the people are earning a decent wage. And then they wouldn’t be so poor and then they won’t be like: oh … I need to work extra.”

Educational campaigns and measures aimed at fostering trust

“Hmm … As I said, I think that the biggest problem connected to this undeclared work is trust or lack of trust. And … even it seems some kind of a utopia, especially considering that the services have been very diversified and are difficult to track; aad … I think they could increase trust by: higher transparency on the manner in which they spend the money, through … I don’t know … Investments near, I don’t know, near the places in which people live to actually see how the money is spent and things like that.”

“But I think … Yeah … Maybe it should be a part of education. To understand. As you could be educated in your school years, you know? So when you are 15-16-17 years old, you know? That you should understand that when you leave school and you go and get a job what the responsibilities are. What your social responsibilities are for the country? […] Where their money goes is the question, isn’t it? Oh, do actually people understand where the money goes? So, if they declare their work, how can they see any benefits? What are the benefits? You can only see the negative side of it, can’t you, a lot of people. […] Education to actually persuade, to educate people that paying the taxes is the right thing to do. Showing them what the benefits are either for them or for their children or for their grandchildren, for the future. […] If you got to change something, you’ve got to make people believe that start paying their taxes is a good thing. You cannot say: well, I am gonna put you in jail if you don’t pay. And then they’re going to say: well, I am not going to work then. (Laughing) Yeah!”

Reducing the perceived level of corruption

“Aaa … First of all they should act in a way to prove that the money is used correctly. This is the first thing. So it can be seen that money is really used. And two: to prove that the money isn’t stolen anymore. Because now too many people are convinced just like I am, that too much money is stolen. Service improvement and a correct information on the spent money and of the mechanism based on which the money is spent: and three: aad, to prove they don’t steal anymore, in reality. To convince people that the system of … aad … spending the public money is working. But in our country everybody is convinced that it is not working.”

“As I said, more transparency from my point of view and fairness.”

Offering a good conduit example

“To be honest. To offer a good example.”

“Normally it all needs to start somewhere, right? It would determine me to see that all the state institutions and all the services work. To have good roads, not to pay the doctors, the police to be just, the teachers to be just. Everybody to be correct and then you are obligated to pay everything as you should.”
Curative measures focusing on helping the non-compliant citizens to move to declared economy were mentioned to a much lesser extent.

Finally, the repressive measures appeared as recommended only marginally, in a very few instances. Indeed, there were more instances when these measures were brought into discussion only to underline why they would rather not work.

Increase the risk of detection and penalties

“In my case, to check the employers to ensure that they are fair with their employees or … I do not know.”

“They could even issue … like get their licenses taken away say for like 6 months, like a driver license for example. Whereas they could get … the construction tickets taken away for 6 months so whatever … or you could get your coaching badge taking away for … you now like kind of being banned from driving. Maybe that would make people second … second think … for declaring it … So it will make people think twice, if they will risk to get off the business for few months … But this could only be applied in some sectors, where you need a license or a badge …”

In sum, although only exploratory and by its qualitative nature not representative, the findings reveal that the respondents spontaneously propose preventative measures and measures aiming at fostering commitments. Not surprisingly, these responses mirror the views of the respondents on issues related with the formal institutions failure and imperfection. The policy measures proposed by the respondents reflect to a high extent the solutions for reducing the shortcomings of the formal institutions which make citizens to find undeclared work as an acceptable behaviour.

Formalisation advice and support

“People do not know what to do to make their company formal.”

“Who should collect taxes from that guy? And he wants to declare his intellectual work. How? How? How is it with intellectual work? How do you quantify it?”

Providing legal options

“It depends on the activity, as a retired babysitter there are not too many options to do it (declare work) for example.”

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Providing legal options

“It depends on the activity, as a retired babysitter there are not too many options to do it (declare work) for example.”

FIGURE 7
Policy measures

Preventative measures (detailed)

Fostering commitment measures (detailed)

Curative measures (detailed)

Repressive measures (detailed)
Turning to the business environment, and analysing countries with a large share of undeclared work (Bulgaria, Croatia, and North Macedonia), the finding is a low level of vertical and horizontal trust.

As Figure 8 displays, only 68% of business owners or managers in Croatia and North Macedonia and 49% in Bulgaria find it unacceptable to underreport the annual revenue or turnover in order to evade taxes. Even lower percentages are reported for the necessity of doing so in order to ensure the company survival (28% in North Macedonia, 37% in Bulgaria, and 59% in Croatia).

Figure 9 reveals which types of undeclared work are perceived by the business owners or managers as more prevalent in their competitors’ activity. Overall, a low level of horizontal trust is displayed, with 17% to 30% of the business owners or managers reporting that their competitors use always or almost always undeclared practices. This suggests that businesses in these three countries feel pressure to use undeclared practices. This might be a result of a low level of vertical trust (Figure 8) or a low level of horizontal trust (Figure 9). Indeed, business owners and managers might consider that their competitors gain competitive advantages by using undeclared practices [4].

**FIGURE 8**
Vertical trust: acceptability of undeclared work (% scored completely unacceptable)

**FIGURE 9**
Horizontal trust: Informal practices in South-East European countries occurring within direct competitor businesses
Therefore, what policy approaches should be pursued in the eyes of businesses in order to tackle undeclared work? To answer this, Table 3 examines the share of businesses in three South-East European countries supporting different repressive, preventative, curative policy measures and measures fostering commitment. Marked in dark red are the top three supported policy measures (% of businesses agreeing with them as a policy approach).

The pattern is similar when analysing different sectors or when analysing the views of those asserting that they are affected by undeclared work undertaken by competitors compared to those who are not. Businesses rather support preventative measures, underlining the need to make easier to legitimately hire workers on small or occasional jobs and to simplify and consolidate several tax liabilities of micro- and small firms into one fixed payment.

Another measure considered effective by business owners and managers is to reduce the entitlements of non-compliant businesses in terms of banning them from participating in public tenders and receiving subsidies.

In none of the sectors is enforcing stricter penalties viewed as the most effective measure for tackling undeclared work. However, in transport and communications and information technology, businesses rank in the top three most effective measures the need of enforcing stricter sanctions. Therefore in these service sectors targeted inspections could be effective [43].

### TABLE 3

Policy measures to reduce undeclared work in South–East European countries (% of businesses in BG, CR and MK agreeing the policy measure)

<table>
<thead>
<tr>
<th>Policy measure</th>
<th>ALL SECTORS</th>
<th>Agriculture</th>
<th>Industry</th>
<th>Construction</th>
<th>Services</th>
<th>Hotels and restaurants</th>
<th>Transport and communications</th>
<th>Trade</th>
<th>Retail</th>
<th>Information technology</th>
<th>Education</th>
<th>Health</th>
<th>Professional services</th>
<th>Other services</th>
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<tbody>
<tr>
<td><strong>REPRESSIVE MEASURES</strong></td>
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<tr>
<td>• Firms that employ undeclared workers, under-report salaries should be banned from participating in public tenders and receiving subsidies.</td>
<td>83.3</td>
<td>83.4</td>
<td>83.0</td>
<td>84.2</td>
<td>78.5</td>
<td>82.3</td>
<td>83.8</td>
<td>69.5</td>
<td>80.5</td>
<td>89.2</td>
<td>81.0</td>
<td>79.5</td>
<td>61.1</td>
<td>80.3</td>
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<tr>
<td>• Enforcing stricter sanctions for firms engaged in undeclared work would be an efficient strategy to increase compliance.</td>
<td>71.8</td>
<td>69.4</td>
<td>72.7</td>
<td>69.1</td>
<td>61.2</td>
<td>68.4</td>
<td>73.4</td>
<td>64.4</td>
<td>80.3</td>
<td>70.2</td>
<td>65.8</td>
<td>83.1</td>
<td>68.4</td>
<td>86.8</td>
</tr>
<tr>
<td>• Publicly exposing and stigmatising concrete examples of undeclared work and tax evasion would make companies more reluctant to engage in such activities.</td>
<td>62.7</td>
<td>61.8</td>
<td>62.2</td>
<td>69.1</td>
<td>55.8</td>
<td>58.3</td>
<td>63.7</td>
<td>53.6</td>
<td>67.1</td>
<td>70.2</td>
<td>60.9</td>
<td>65.2</td>
<td>41.2</td>
<td>69.4</td>
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<td><strong>PREVENTATIVE MEASURES</strong></td>
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<tr>
<td>• Making it easier to legitimately hire workers on small or occasional jobs would reduce undeclared work.</td>
<td>82.7</td>
<td>80.1</td>
<td>84.6</td>
<td>87.5</td>
<td>74.4</td>
<td>86.4</td>
<td>83.1</td>
<td>80.2</td>
<td>88.8</td>
<td>83.5</td>
<td>75.7</td>
<td>87.5</td>
<td>83.3</td>
<td>82.5</td>
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<tr>
<td>• Simplifying and consolidating several tax liabilities of micro- and small firms into one fixed payment would result in higher tax compliance.</td>
<td>79.7</td>
<td>78.3</td>
<td>80.8</td>
<td>85.3</td>
<td>76.0</td>
<td>77.4</td>
<td>80.2</td>
<td>79.5</td>
<td>78.6</td>
<td>82.9</td>
<td>76.3</td>
<td>79.3</td>
<td>76.5</td>
<td>74.0</td>
</tr>
<tr>
<td>• Simpler administrative procedures for paying taxes and social security contributions would increase compliance among firms.</td>
<td>76.3</td>
<td>73.1</td>
<td>78.2</td>
<td>78.6</td>
<td>65.3</td>
<td>75.8</td>
<td>77.4</td>
<td>77.3</td>
<td>74.4</td>
<td>78.6</td>
<td>67.8</td>
<td>75.0</td>
<td>83.3</td>
<td>69.4</td>
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<td><strong>CURATIVE MEASURES</strong></td>
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<tr>
<td>• Creating a “white list” of compliant firms which would be entitled to preferential administrative services (faster VAT refunds, etc.) would encourage a culture of commitment among businesses.</td>
<td>75.5</td>
<td>74.9</td>
<td>74.5</td>
<td>79.0</td>
<td>61.9</td>
<td>73.6</td>
<td>77.1</td>
<td>70.2</td>
<td>81.2</td>
<td>78.7</td>
<td>77.8</td>
<td>70.8</td>
<td>60.0</td>
<td>72.5</td>
</tr>
<tr>
<td>• Specialised support and advice for those entrepreneurs who are considering moving from undeclared to formal work would reduce undeclared work.</td>
<td>71.8</td>
<td>69.2</td>
<td>73.7</td>
<td>77.5</td>
<td>60.5</td>
<td>67.5</td>
<td>73.3</td>
<td>69.5</td>
<td>79.3</td>
<td>73.9</td>
<td>69.3</td>
<td>75.0</td>
<td>61.1</td>
<td>74.5</td>
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<td><strong>MEASURES FOSTERING COMMITMENT</strong></td>
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<tr>
<td>• Ensuring a sense of fairness in how companies are treated by the tax authorities would reduce evasion of taxes and social contributions.</td>
<td>77.7</td>
<td>74.6</td>
<td>79.9</td>
<td>79.5</td>
<td>67.5</td>
<td>78.3</td>
<td>78.6</td>
<td>74.4</td>
<td>77.3</td>
<td>77.7</td>
<td>72.4</td>
<td>73.9</td>
<td>88.2</td>
<td>76.0</td>
</tr>
<tr>
<td>• Raising awareness campaigns of the negative consequences of operating unregistered (e.g., restricted access to market, limited growth prospect) would reduce undeclared practices among firms.</td>
<td>65.1</td>
<td>63.8</td>
<td>65.7</td>
<td>75.0</td>
<td>55.6</td>
<td>57.5</td>
<td>66.7</td>
<td>59.5</td>
<td>72.4</td>
<td>71.7</td>
<td>65.0</td>
<td>62.5</td>
<td>55.6</td>
<td>71.7</td>
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</table>

Source: own calculations based on GREY data

More support is given to preventive and curative measures or to simply reducing the entitlements of non-compliant businesses. Deterrents are not supported even by businesses affected by competitors performing undeclared work.
SECTION IV

What do Policy Makers Say about Tackling Undeclared Work?

Analysing the policy approaches employed by governments across the European Union, the finding is that deterrents are the most common used policy approach. Comparing the results of two surveys in 2010 and 2017 amongst policy-makers, Figure 10 shows that the importance attributed by the governments to this approach has increased over time [8].

Indeed, compared with 2010, in 2017 the measures of the rational economic actor approach (i.e., increasing risk of detection and penalties) are perceived as the top two most effective policy measures for tackling undeclared work. Meanwhile, measures related to the social actor approach are considered less effective in 2017 compared with 2010 (e.g., incentives to operate in the declared economy, awareness raising campaigns) [8,44,45].

Important to note is the fact that the 2017 survey also reveals that ex-ante and ex-post evaluation of these policy measures are seldom used by governments [4]. Therefore, it seems that the policy makers’ views on what is most effective to tackle undeclared work do not reflect the behaviour and the views of the citizens and employers and the variables influencing their decision to engage in undeclared work.

Figure 10: The views of policy makers regarding the most effective measures for tackling undeclared work: 2010 vs. 2017

- Risk of detection
- Curative measures
- Penalties
- Preventive measures
- Measures aimed to foster commitment to declared work
- Measures to improve detection
- Awareness raising campaigns (i.e., fostering commitment to declared work)
- Incentives to operate in the declared economy (i.e., curative measures)
- Measures related to changing the formal institutions (i.e., preventive measures)

Source: based on [8] – using data from [44,45]
Conclusions

In this report we have examined the institutional failures which lead to a low tax morale and, consequently, to a high participation in undeclared work as well as the effectiveness of different policy approaches in tackling undeclared work.

This evidence-based evaluation confirms the need for the adoption of different policy approaches when tackling undeclared work by moving beyond the rational economic actor approach that seeks to deter citizens and businesses by increasing the penalties and risk of detection. Participation in undeclared work is associated to a higher extent with a low level of vertical trust (between citizens and government) and horizontal trust (between citizens) than with the perceived risk of detection or penalty. The effectivenss of the repressive measures is rather minor at a high level of vertical trust, revealing the usefulness of increasing the level of deterrents to prevent participation in undeclared only when there is a low level of vertical trust.

Furthermore, citizens explain participation in undeclared work as generated mainly due to formal institutional resource misallocations and inefficiencies (i.e., lack of redistributive justice, lack of procedural justice and fairness, and high perceived level of corruption) and formal institutional voids and weaknesses (i.e., lack of worker protection and burdensome regulatory environment). As such, they make a call for policy measures that address these failures, namely, preventative measures and measures aiming at improving vertical trust in order to encourage greater self-regulation and a culture of commitment to compliance. Similarly, businesses, including those who feel threatened by the undeclared work practices of their competitors, support to a higher extent preventative, curative measures or to simply reduce the entitlements of non-compliant businesses rather than enforcing stricter sanctions to deter participation.

In sum, if participation in undeclared work is to be tackled in a more effective manner, the repressive measures need at the very least to be complemented by preventative measures and measures aimed to foster trust and to encourage voluntary compliance.

References


SHADOWS: Tackling Undeclared Work in the European Union