

1. Introduction

Across the world, many earn monetary income that they do not declare to the state for tax, social security and/or labour law purposes. This work in the shadows is not some minor practice. According to an OECD report, of the global working population of some three billion, nearly two-thirds (1.8 billion) have their main employment in jobs that are not wholly in the declared economy (Jütting and Laiglesia, 2009). However, the prevalence of such work varies across global regions. In South Asia, 82 per cent of the workforce have their main employment in the shadow economy, 66 per cent in sub-Saharan Africa, 65 per cent in East and South-East Asia (excluding China), 51 per cent in Latin America and 10 per cent in Eastern Europe and Central Asia (ILO, 2013a). Moreover, work in the shadow economy takes many forms. Although traditionally seen as largely exploitative, waged employment conducted under 'sweatshop-like' conditions for unscrupulous employers, this is but one facet of the shadow economy. Not only are there many forms of waged employment in the shadow economy, ranging from wholly off-the-books, low-paid, sweatshop-like, waged work to more highly-paid forms in which declared employees receive from their declared employer an undeclared ('envelope') salary in addition to their declared wage, but there are also a multiplicity of forms of own-account work in the shadow economy. Indeed, the proportion of the shadow workforce who work on an own-account basis varies from 31 per cent in North Africa, 32 per cent in Asia, 38 per cent in Latin America and the Caribbean and 53 per cent in sub-Saharan Africa (ILO, 2013a) to 77 per cent in the European Union (Williams and Renooy, 2013). Such own-account work ranges from those operating unregistered businesses on a wholly off-the-books basis, through those owners of registered businesses doing a portion of their transactions off-the-books, to people conducting paid favours for kin, friends, neighbours and acquaintances.

Indeed, in recent years, recognition that the shadow economy is extensive and composed of diverse types of endeavour has led to a major rethinking of how to tackle it. When viewed as a minor practice largely composed of sweatshop-like, exploitative, waged employment, few questioned the pursuit of an eradication approach towards such work. However, the recognition first that so many are employed in the shadow economy, second,

that many businesses start up by operating in the shadow economy and, third, that in ever more market-oriented economies many of the favours previously conducted on an unpaid basis are now monetized and conducted as paid favours, has led to a rethinking of this eradication approach. It is increasingly recognized that if governments continue to pursue the eradication of the shadow economy, then governments will not only leave a huge swathe of the population bereft of a means of livelihood but will also with one hand stamp out precisely the enterprise culture and active citizenship that with other hands they are so desperately seeking to nurture. The outcome of the recognition of the prevalence and multifarious types of work in the shadow economy, therefore, has been a rethinking of how to combat the shadow economy. Rather than seek to eradicate the shadow economy, a policy turn has begun to occur towards facilitating the formalization of such endeavours.

The aim of this book is to review this paradigmatic shift in how the shadow economy is conceptualized and to evaluate the range of policy approaches and measures available for confronting the shadow economy. To achieve this, the major focus will be upon how this conceptual and policy shift is occurring in a European context. The lessons learned about how to conceptualize the shadow economy and the range of policy approaches and measures available for combating the shadow economy, however, are more widely applicable. In this introductory chapter, the scene will be set for the rest of the book by, first, defining what is meant by the shadow economy, second, documenting the rationales for tackling work in the shadow economy and, third, outlining the structure and arguments of this book.

DEFINING THE SHADOW ECONOMY

What this book terms the 'shadow economy' has been alternatively denoted using more than 45 different adjectives and ten different nouns. It has been variously called the 'black', 'cash-in-hand', 'informal', 'irregular', 'hidden', 'invisible', 'subterranean', 'undeclared', 'underground', 'unobserved', 'unorganized' or 'unregulated' economy, sector, work, employment, activity, sphere or realm, to name but a few of the adjectives and nouns employed. Examining these adjectives, what is immediately apparent is that all seek to describe what is absent, insufficient or missing with regard to work in the shadow economy relative to work in the declared economy.

Indeed, this is the core feature of all definitions of the shadow economy. Reviewing the multitude of definitions of such work, three broad types

can be identified, namely enterprise-, jobs- and activity-based definitions. All define the shadow economy in terms of what is absent from, missing or insufficient about this realm relative to the declared economy. However, enterprise-based definitions denote what is insufficient or absent in shadow economy enterprises compared with declared enterprises, jobs-based definitions show what is insufficient or absent in shadow jobs relative to declared jobs, and activity-based definitions demonstrate what is absent or insufficient in shadow economic activities compared with declared economic activities.

The most commonly used enterprise-based definition is that adopted by the 15th International Conference of Labour Statisticians (ICLS) in 1993 (Hussmanns, 2005; ILO, 2011, 2012), which defines enterprises in the shadow economy as ‘private unincorporated enterprises that are unregistered or small in terms of the number of employed persons’ (ILO, 2012: 1). The most widely used jobs-based definition, meanwhile, is that adopted by the 17th ICLS in 2003, which defines jobs in the shadow economy as those jobs lacking basic social or legal protections or employment benefits. Shadow jobs thus cover employment relationships that, in law or in practice, are not covered by national labour legislation, income taxation, social protection or entitlement to certain employment benefits, such as notice of dismissal, severance pay, paid annual or sick leave (ILO, 2011: 12). Indeed, these enterprise- and jobs-based definitions have been the dominant definitions of the shadow economy used in a third (majority) world context.

In developed nations, however, such enterprise- and/or jobs-based definitions have been less popular. This is because they view enterprises and jobs dichotomously as either shadow or declared. In the developed world, nevertheless, the growing recognition is that much work in the shadow economy is concurrently both. On the one hand, and on enterprises, there is a burgeoning literature that a considerable proportion of shadow work is in declared enterprises that undertake a portion of their work in the shadow economy (Small Business Council, 2004; Williams, 2006f, 2009b, 2010d). On the other hand, and with regard to jobs, there is a growing recognition that many declared employees receive from legitimate employers part of their wage as a declared salary and part cash-in-hand as an undeclared (‘envelope’) salary (Karpuskiene, 2007; Meriküll and Staehr, 2010; Neef, 2002; Sedlenieks, 2003; Williams, 2008e, 2008g, 2009e, 2009f, 2009g, 2009i, 2009l, 2010a, 2012a, 2012b, 2013c, 2013d; Woolfson, 2007; Žabko and Rajevska, 2007). These prominent types of shadow economic activity are not included in enterprise-based definitions since this work is in a formal enterprise and not in jobs-based definitions since the worker is in a declared job (Hussmanns, 2005).

The result is that developed nations have largely adopted activity-based definitions of the shadow economy (Eurofound, 2013; European Commission, 1998, 2007b; Renooy et al., 2004; Sepulveda and Syrett, 2007; Thomas, 1992; Vanderseyphen et al., 2013; Williams 2006a; Williams and Windebank 1998). The most frequently adopted is the activity-based definition published in 2002 by the Organisation for Economic Co-operation and Development (OECD), International Monetary Fund (IMF), International Labour Organization (ILO) and Interstate Statistical Committee of the Commonwealth of Independent States (CIS STAT) as a supplement to the System of National Accounts (SNA) 1993. This defines ‘underground production’ (or what is here termed the ‘shadow economy’) as:

All legal production activities that are deliberately concealed from public authorities for the following kinds of reasons: to avoid payment of income, value added or other taxes; to avoid payment of social security contributions; to avoid having to meet certain legal standards such as minimum wages, maximum hours, safety or health standards and so on.

(OECD, 2002: 139)

Indeed, other activity-based definitions of the shadow economy used in developed nations align closely with this OECD definition. For example, Schneider et al. (2010) similarly define the shadow economy as all market-based legal production of goods and services that are deliberately concealed from public authorities to avoid either payment of taxes, social security contributions or legal labour market standards (for example, minimum wages, maximum working hours, safety standards). Likewise, although no official definition of the shadow economy exists across the 28 Member States of the European Union (EU-28), the most widely used definition is the activity-based definition adopted by the European Commission. This defines the shadow economy as ‘any paid activities that are lawful as regards their nature but not declared to the public authorities, taking into account the differences in the regulatory system of Member States’ (European Commission, 2007b: 2).

There is thus a broad consensus on what should be included and excluded when discussing economic activities in the shadow economy. The only absence or insufficiency is that shadow economic activities are not declared to the authorities for tax, social security and/or labour law purposes when they should be declared. If activities possess additional absences or insufficiencies, they are not defined as the shadow economy. For example, if the economic activity is also illegal (for example,

drug-trafficking), then these activities are viewed as separate from the shadow economy and defined as ‘criminal’ activities, while if the economic activity is unpaid, it is defined as belonging to the ‘unpaid’ sphere rather than the shadow economy.

Of course, and as with any definition, blurred edges exist regarding what constitutes the shadow economy. Some economic activities are neither reimbursed with monetary income nor are they unpaid. Rather, they are recompensed in-kind, using reciprocal labour or via gifts for the work conducted. In this book, wherever feasible, all economic activities remunerated, either with money or in-kind, are included. As such, barter and the in-kind exchange of services are included wherever possible since these are often supposed to be declared, albeit usually only above a certain threshold. Indeed, including these activities is particularly important in those countries where payment in-kind is a common practice.

Given this definition of the shadow economy as any remunerated activities not declared to the authorities for tax, social security and/or labour law purposes when they should be, attention now turns to why there is so much attention paid to this type of economic activity and how it should be tackled.

RATIONALES FOR TACKLING THE SHADOW ECONOMY

To understand the reasons for confronting the shadow economy, it is necessary to highlight the consequences of this sphere for various groups, namely wholly declared businesses, those working in the shadow economy, customers and governments.

For wholly declared businesses, the rationales for tackling the shadow economy are that it causes:

- an unfair competitive advantage for businesses operating on a wholly or partially shadow basis over wholly declared enterprises (Andrews et al., 2011; Bajada and Schneider, 2005; Evans et al., 2006; Grabiner, 2000; Karlinger, 2013; Renooy et al., 2004; Small Business Council, 2004); and
- deregulatory cultures that entice wholly declared businesses to start operating in the shadow economy, and businesses already conducting a portion of their trade off-the-books to conduct an even greater proportion on such a basis (Gallin, 2001; Grabiner, 2000; Mateman and Renooy, 2001; Small Business Council, 2004; Williams and Windebank, 1998).

Businesses and individuals working on their own account in the shadow economy meanwhile, want to legitimize because they:

- are unable to gain access to capital to develop their business (ILO, 2013b; Kempson, 1996; Leonard, 1998; Llanes and Barbour, 2007);
- cannot advertise their business to attract new customers (Williams et al., 2012a);
- need to keep their business small in order to stay ‘under the radar’ of the authorities (Barbour and Llanes, 2013; Polese, 2014; Williams et al., 2012a);
- cannot secure formal intellectual property rights to process and product innovations (De Beer et al., 2013); and
- lack the ability to develop and grow due to the lack of support available compared with legitimate businesses (ILO, 2002a, 2002b; Karjanen, 2014; Llanes and Barbour, 2007; Williams et al., 2012a).

Workers employed in the shadow economy furthermore, want such work tackled because they:

- do not have employment rights such as annual and other leave, sickness pay, redundancy and training (Evans et al., 2006; ILO, 2013b; TUC, 2008; Williams and Lansky, 2013);
- lack access to a range of other legal rights such as the minimum wage, tax credits and the working hours directive (Dellot, 2012; Renooy et al., 2004; TUC, 2008; Vanderseypen et al., 2013; Williams and Windebank, 1998);
- cannot build-up rights to the state pension and other contributory benefits, and access occupational pension schemes (Dellot, 2012; Gallin, 2001; ILO, 2002a; Williams and Lansky, 2013);
- lack access to health and safety standards in the workplace (Evans et al., 2006; Gallin, 2001; ILO, 2002a, 2013b; TUC, 2008);
- have low job security (Katungi et al., 2006; Kovács, 2014; Williams, 2001);
- lack bargaining rights (ILO, 2002a, 2013b);
- lose employability due to their lack of evidence of engagement in employment (Barbour and Llanes, 2013; Dellot, 2012);
- are unable to gain access to credit such as for mortgages or loans if they are shadow employees since they have no evidence of their income (Kempson, 1996; Williams, 2014a);
- are unable to get an employer’s reference (ILO, 2002a; TUC, 2008); and
- suffer a constant fear of detection and risk of prosecution (Grabiner, 2000).

For customers using the shadow economy, the rationales for tackling the shadow economy are that they find themselves without:

- legal recourse if a poor quality job is undertaken (Eurofound, 2013; Small Business Council, 2004);
- insurance cover (Llanes and Barbour, 2007; Small Business Council, 2004);
- guarantees in relation to the work undertaken (Williams et al., 2012a); and
- certainty that there has been adherence to health and safety regulations (Dellot, 2012; Williams et al., 2012a).

Finally, and for governments, the rationales for tackling the shadow economy are that this activity:

- causes a loss of revenue for the state in terms of non-payment of direct and indirect taxes (Bajada and Schneider, 2005; Evans et al., 2006; Grabiner, 2000; Müller and Miggelbrink, 2014; Vanderseypen et al., 2013; Williams and Windebank, 1998);
- has knock-on effects on efforts to forge social cohesion at a societal level by reducing the money available to governments to pursue social integration and mobility (Andrews et al., 2011; Eurofound, 2013; Vanderseypen et al., 2013; Williams and Windebank, 1998);
- results in weakened trade union and collective bargaining (Gallin, 2001; TUC, 2008);
- leads to a loss of regulatory control over the quality of jobs and services provided in the economy (ILO, 2013b; Vanderseypen et al., 2013; Williams and Lansky, 2013); and
- if a significant segment of the population is routinely engaged in such activity, it may result in a more casual attitude towards the law more widely (Andrews et al., 2011; Dong et al., 2012; Karjanen, 2014; Morris and Polese, 2014; Ojo et al., 2013; Sasunkevich, 2014; Williams et al., 2012a).

In sum, clear reasons exist for confronting the shadow economy. How to achieve this is therefore the subject matter of this book.

STRUCTURE OF THE BOOK

The intention in this book is to evaluate the range of approaches and measures available for tackling the shadow economy. To do this, Part I

provides a background context to the evaluation of the policy approaches and measures by reviewing how the magnitude of the shadow economy varies geographically (Chapter 2) and by documenting the diverse forms of economic activity that constitute the shadow economy along with how its character varies geographically (Chapter 3). This will reveal that the shadow economy is not everywhere the same and therefore that policy approaches and measures that may be important and useful in one nation and/or region for tackling the shadow economy may be less important and useful in another.

Part II then seeks to understand the gap between the various approaches and measures hypothetically available and the approaches and measures currently used. To achieve this, Chapter 4 reviews the various policy options available to governments, namely: doing nothing about the shadow economy; eradicating the shadow economy; moving declared work into the shadow economy; and transforming work in the shadow economy into the declared economy. This identifies that solely doing nothing leaves intact the existing negative impacts on declared and shadow businesses, customers and governments. Solely pursuing an eradication of the shadow economy, meanwhile, leads governments to repress precisely the enterprise culture and active citizenship that they wish to foster. Pursuing solely a shift of work from the declared to the shadow economy, furthermore, causes a levelling down rather than up of working conditions. Facilitating formalization, therefore, is deemed the only viable policy option if solely one approach had to be adopted. However, facilitating the formalization of the shadow economy on its own would leave governments without any teeth to tackle those refusing to legitimize and would also result in governments seeking to legitimize forms of shadow work not perhaps susceptible to formalization. Here, therefore, the overarching approach advocated is to move shadow work into the declared economy, not least so that governments can achieve their wider objectives of employment creation, enterprise development and social cohesion. However, the other approaches have an important additional supporting role such as doing nothing in relation to paid favours, eradication when tackling those who refuse to formalize and deregulation when seeking to make it easier to formalize. Grounded in this recognition, Chapter 5 then sets out a typology of the potential approaches and measures available for tackling the shadow economy and uses this as a baseline for assessing the current policy approaches and measures and the direction of change.

To do this, two broad sets of measures are distinguished. On the one hand, there are direct controls that use deterrence measures to detect and punish businesses and workers for their bad (non-compliant) behaviour and/or incentives that make it easier to, and that reward, good (compliant)

behaviour. On the other hand, there are indirect controls that develop the psychological contract between the state and its citizens by fostering a high-trust, high-commitment culture and pursue wider economic and social developments in recognition that the shadow economy is in large part a by-product of broader economic and social conditions.

In Parts III and IV, attention then turns to providing a detailed up-to-date review of the array of different policy measures adopted across European countries to tackle the shadow economy, particularly their effectiveness and transferability. Part III critically reviews the direct controls available. Chapter 6 reviews the deterrence measures to detect and punish businesses and workers for their bad (non-compliant) behaviour. Turning to measures that make good (compliant) behaviour easier and/or more rewarding, Chapter 7 then reviews the supply-side incentives targeted at businesses, Chapter 8 the supply-side incentives targeted at individuals working in the shadow economy and Chapter 9 the demand-side incentives targeted at purchasers of goods and services produced in the shadow economy.

Part IV then reviews the rather newer use of indirect controls to encourage compliant behaviour. Chapter 10 evaluates commitment measures that seek to change the hearts and minds of citizens and businesses so that they voluntarily comply without the need for deterrents and incentives. Chapter 11 reviews the broader social and economic policy interventions correlated with the size of the shadow economy, highlighting how tackling the shadow economy requires the pursuit of a broader array of economic and social policies. Finally, Chapter 12 then draws together the arguments to reach some conclusions on the way forward. The outcome will be not only a call for a shift in how the shadow economy is conceptualized, but also for a rethinking of the policy approaches and measures used for tackling the shadow economy.

