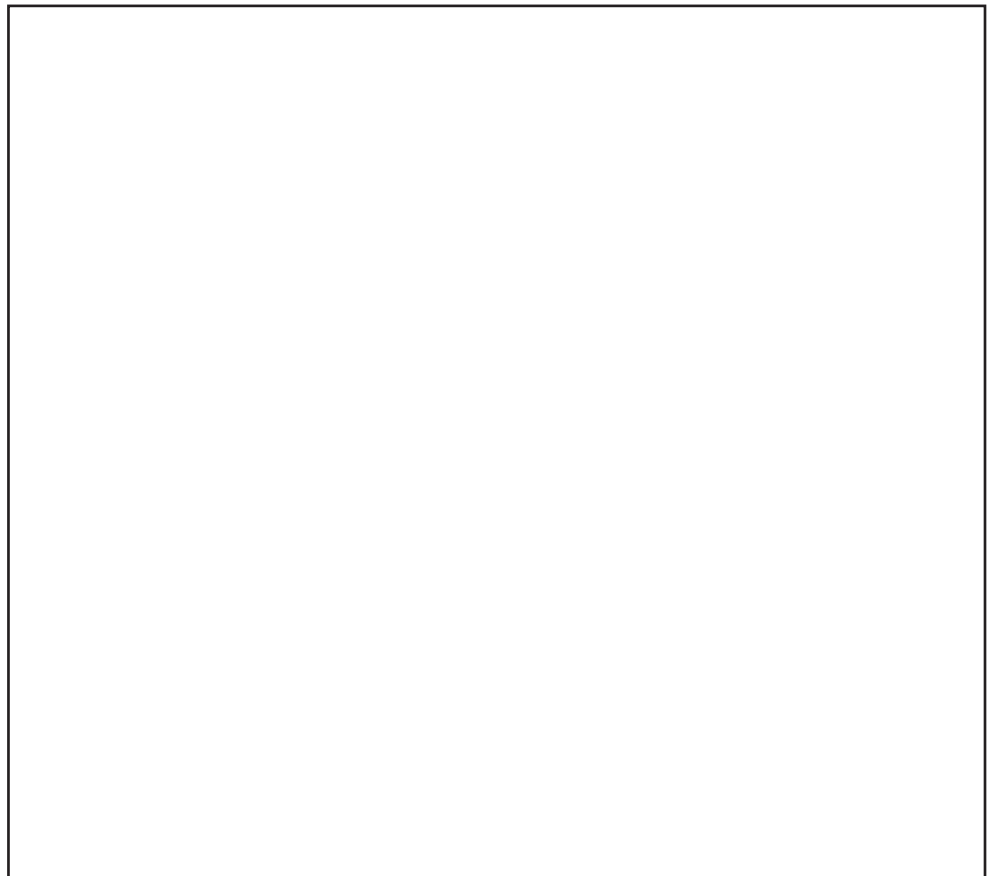




Eurofound

Tackling undeclared work in Iceland



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Executive summary

Introduction

The aim of this report is to provide a systematic overview of the extent and nature of undeclared work, and how it is being tackled, in the EU candidate of Iceland. Iceland has been classified by the World Bank as a ‘high income’ country, having a GNI per capita of USD 33,870 in 2012. The objectives of the report are to analyse the prevalence and character of undeclared work in Iceland, to examine how the fight against undeclared work is organised, and to review relevant policy approaches and measures adopted. Throughout the report, the situation in Iceland is compared with the EU27 wherever feasible.

This report forms part of a research study into undeclared work in five countries: four candidate countries for EU membership (Iceland, Montenegro, Turkey and the former Yugoslav Republic of Macedonia) and one acceding country, Croatia.¹

Policy context

There are varying estimates regarding the size of the undeclared economy in Iceland. The common finding is that Iceland has a small undeclared economy relative to the EU27. Comparing Iceland with the EU27 using the Multiple Indicators Multiple Causes (MIMIC) method, Schneider (2011) found that the undeclared economy in Iceland is equivalent to 15% of GDP, which is relatively low among European countries. Similarly, Ásgrímsson (2012) estimates that, based on workplace visits, 12% of the active workforce operated undeclared in 2011. An earlier 2003 survey by Althing (2004) estimated that the undeclared economy caused a loss of income to the state of between 5% and 8%. On the whole, and compared with the four candidate countries included in this study, Croatia and the EU27, Iceland appears to have a comparatively small undeclared economy.

There are few surveys dealing with the undeclared economy in Iceland, addressing issues such as the sectors in which it is prevalent, who undertakes this work, the types of undeclared work and why it is conducted. The strong understanding is that undeclared work in Iceland is likely to largely involve paid favours made to close social relations, as is the case among Nordic countries generally. In order to identify the activities conducted, a 2003 survey of undeclared work found that 42.3% of all goods and services bought by customers on an undeclared basis related to home improvement and repair tasks, 20.6% were services, 15.4% involved car repair, 13.9% were manufactured goods and 7.8% were other goods and services (Althing, 2004). This clearly indicates that construction in general, home maintenance and improvement in particular, is the focus of much undeclared work in Iceland. In a 2010 study, involving interviews with key government stakeholders involved in efforts against undeclared work, similar sectors were identified: construction, including home improvement and repair; restaurants and tourism; and retail and personal services (Dekker et al, 2010).

The annual World Bank Doing Business surveys analyse how easy or difficult it is for a local entrepreneur to open and run a small-to-medium-sized business when complying with relevant regulations. Among 183 countries, Iceland was ranked ninth in 2012 in terms of the ease of doing business, up from 13th in 2011. In 2012, the EU27, as a composite, was ranked 38th.

Iceland was ranked 37th out of 183 countries in terms of ease of starting a business (the EU27 was ranked 66th). In Iceland, starting a business requires five procedures, takes five days, costs 3.3% of income per capita and requires paid-in minimum capital of 12.6% of income per capita.

¹ At the time of writing, Croatia was expected to become an EU Member State on 1 July 2013.

In terms of ease of paying taxes, Iceland stands at 35th out of 183 countries in 2012, compared with the EU27 as a composite, which was ranked 71st. On average, firms in Iceland make 29 tax payments a year, spend 140 hours a year filing, preparing and paying taxes and the total tax rate amounts to 31.8% of profit. In Iceland, both starting and doing business are easier than they are in the EU27 as a whole.

Key findings

Organisation of efforts against undeclared work

A study of 31 European countries revealed that only eight countries (26%) had either a single agency responsible for the drive against undeclared work or a central coordinating committee responsible for ensuring coordinated action by the multifarious departments involved in tackling undeclared work (Dekker et al, 2010). In Iceland, no single compliance body is responsible for tackling undeclared work. However, as with other Nordic nations, the Internal Revenue Directorate (IRD) has tended to take lead responsibility, although it has no formal responsibility to tackle undeclared work beyond conducting periodic and limited on-site inspections. Currently, limited cross-agency cooperation takes place, although in 2011 and 2012 the IRD took the lead in a special taskforce to tackle undeclared work composed of the IRD, the Directorate of Labour (*Vinnumálastofnun*) and the Iceland Confederation of Employers.

Involvement of social partners occurs through the Icelandic Confederation of Labour and the Confederation of Icelandic Employers in the form of cooperation on specific policy measures such as the introduction of ID cards and awareness-raising campaigns such as the ‘fair play’ campaign.

Policy approaches

Tackling undeclared work has been traditionally dominated in the EU27 by a repressive approach that seeks to stamp it out. Recently, however, there has been a call from the European Commission for Member States to pursue more enabling measures that seek to pursue more positive interventions to prevent people entering the undeclared economy and help those already in the undeclared economy to legitimise their operations. Despite this, most Member States remain entrenched in a repressive approach that seeks to eradicate undeclared work, although Nordic nations have tended to pursue enabling measures to a greater extent than governments in other EU regions.

This is the case in Iceland. Although deterrence is widely used, many preventative measures have been introduced and there are a wide range of measures to improve commitment to tax morality, especially around awareness-raising campaigns. At present, however, Iceland remains relatively weak on pursuing curative measures that seek to enable those already working in the undeclared economy to move into the declared realm. This is particularly the case in terms of providing incentives to suppliers of undeclared work. Although Schneider (2011) provides evidence of the usefulness of curative measures, perhaps a lack of political understanding that such measures are required remains.

Policy pointers

Better coordination needs to occur in the campaign against undeclared work across government agencies. Measures here might include pursuing more joined-up strategy and operations and establishing common goals and targets. A more formal institutional framework for tripartite social dialogue on undeclared work is needed. Further empirical research needs to be conducted, in the form of direct surveys, into the sectors in which undeclared work occurs, who does it, the types of undeclared work they conduct and their motives for doing so, in order to enable more efficient and effective efforts against undeclared work.

Introduction

Europe's struggle with economic recession and historically high unemployment levels have put the issue of undeclared work high on the political agenda, not least due to the significant impact it has on public finances and employment participation rates. This report forms part of a research study into undeclared work in five countries: four candidate countries for EU membership (Iceland, the former Yugoslav Republic of Macedonia, Montenegro and Turkey) and one acceding country, Croatia.

Aims of the report

The aim of this report on Iceland is to provide a systematic overview of the extent and nature of undeclared work, and how it is being tackled, in Iceland. The objectives are to analyse the prevalence and character of undeclared work in Iceland, to examine how the fight against undeclared work is organised, and to review the relevant policy approaches and measures adopted. Throughout this report, the intention is to compare the extent and nature of undeclared work and how it is being tackled in Iceland with the situation in the EU27. The main questions being addressed are:

- What is the extent and nature of undeclared work in Iceland and how does this compare with the EU27?
- What institutional structures and policy approaches are employed to tackle undeclared work and how does this compare with the EU27?
- Which specific policy measures adopted have been effective in tackling undeclared work?
- What lessons might be learnt from the EU27 in terms of policy measures when tackling undeclared work in Iceland?
- What lessons can the EU27 learn from practices in Iceland?

Methodology and data collection

First, a comprehensive literature review was conducted, which included academic sources, literature published by the government and social partners, and statistical research. The completed review comprises three elements, outlined below.

- **A review of surveys of undeclared work in Iceland:** As with other EU27 and EU candidate countries, Iceland is included in cross-national databases such as the World Bank Doing Business surveys, and in many cross-national surveys using indirect measurement methods (see Schneider, 2011; European Commission, 2009). National-level surveys and 'grey literature' reporting the extent and nature of undeclared work are also available, and where feasible, these are compared with the situation in the EU27.
- **A desk-based survey of the institutional approach to tackling undeclared work in Iceland:** This includes both published and grey literature on the organisation of efforts against undeclared work in Iceland. Findings are compared with approaches taken in the EU27, using typologies developed for comparing the Member States (Dekker et al, 2010).
- **Desk-based survey of policy measures initiatives:** The range of policy instruments used in Iceland, including those undertaken by social partners and sector-specific organisations, are reported, and compared with the EU27.

Second, to provide up-to-date information and to fill gaps in understanding, a senior government official involved in the campaign against undeclared work was commissioned to provide a review of the Icelandic situation. This review sought information on the extent and nature of undeclared work in Iceland, the organisation of efforts against undeclared work and information on the policy approaches and measures used, along with their perceived effectiveness. A questionnaire

recently applied across the EU27 (Dekker et al, 2010) enabled comparative data to be collected. Third, a validation workshop took place in November 2012 with experts and representatives of key stakeholders in the four candidate countries and Croatia.

The outcome is a wide-ranging review of the extent and nature of undeclared work in Iceland and how undeclared work is being tackled compared with the situation in the EU27.

Research background

As a member of the European single market through the European Economic Area (EEA) agreement, Iceland became one of the first and hardest hit victims of the global financial crisis in the autumn of 2008. The EEA European Free Trade Area (EFTA) states are fully integrated into the internal market through the EEA agreement. In accordance with the agreement, all EEA legal acts that have been adopted by the EU apply equally to Iceland. For this reason, the intentions of the European Commission in relation to undeclared work also apply to Iceland.

Although there is no official definition of undeclared work in the EU27, the widely accepted definition is that it covers, ‘any paid activities that are lawful as regards their nature, but are not declared to the public authorities, taking into account the differences in their regulatory systems between Member States’ (European Commission, 2007a, p. 2).

There is now a considerable body of research and policy documents on undeclared work in the EU27. These reports aim to understand, conceptualise, measure and tackle undeclared work in these countries. Since the turn of the millennium, important research has been commissioned by the European Commission on both the extent and nature of undeclared work in the EU27, on how it is being tackled and what can be done in the future. The situation in Iceland can be compared to these data.

The studies *Undeclared labour in Europe* (Mateman and Renooy, 2001) and *Undeclared work in an enlarged Europe* (Renooy et al, 2004) provide some of the first estimates of the extent and character of undeclared work in the Member States. The European Employment Observatory (2004) published a further overview, entitled *Fighting the immeasurable? Addressing the phenomenon of undeclared work in the European Union*. More recently, in order to gain a better understanding of the phenomenon, the European Commission instigated both a direct survey (European Commission, 2007b) and a review of indirect survey methods (European Commission, 2009).

During the same period, significant policy shifts occurred. Following the 2003 recommendation in Employment Policy Guideline No. 9 to shift away from a deterrence approach and towards the transformation of undeclared work into regular work (rather than simply eradicating it), and the reiteration of this stance in the Commission’s second Communication on undeclared work, ‘Stepping up the fight against undeclared work’ (European Commission, 2007a), a number of initiatives have taken place. Eurofound commissioned studies in both 2007 and 2009 to identify how this might be achieved (Eurofound 2008, 2009), as well as compiling a knowledge bank of good practice policy measures (see <http://www.eurofound.europa.eu/areas/labourmarket/tackling/search.php>); this was fully updated in 2013 to include cases from Croatia, Iceland, the former Yugoslav Republic of Macedonia, Montenegro and Turkey. The Commission evaluated the feasibility of developing a European platform to better coordinate the fight against undeclared work across the EU27 (Dekker et al, 2010). All this research provides a solid evidence base against which the extent of undeclared work in Iceland, and various strategies for tackling it, can be compared.

With a population of 318,450, 63% of whom live in the capital region of Reykjavík and adjacent municipalities, Iceland is defined by the World Bank as a ‘high income’ OECD country with a GNI per capita of USD 33,870 (World Bank, 2012). Two of the major characteristics of the Icelandic labour market are the high labour force activity rates and low unemployment levels. In 2005 the activity rate was 81.9% for those aged 16–74 (86% for men and 77.8% for women). Similar levels have been recorded since Statistics Iceland began carrying out labour market surveys in 1981 (see <http://www.statice.is>). As well as having the highest labour market activity rate of all OECD countries, a distinctive feature of the Icelandic labour market is the high proportion of people holding more than one job; in 2002, 17.2% of employed people held two or more jobs (Johannesson, 2006).

Extent and nature of undeclared work

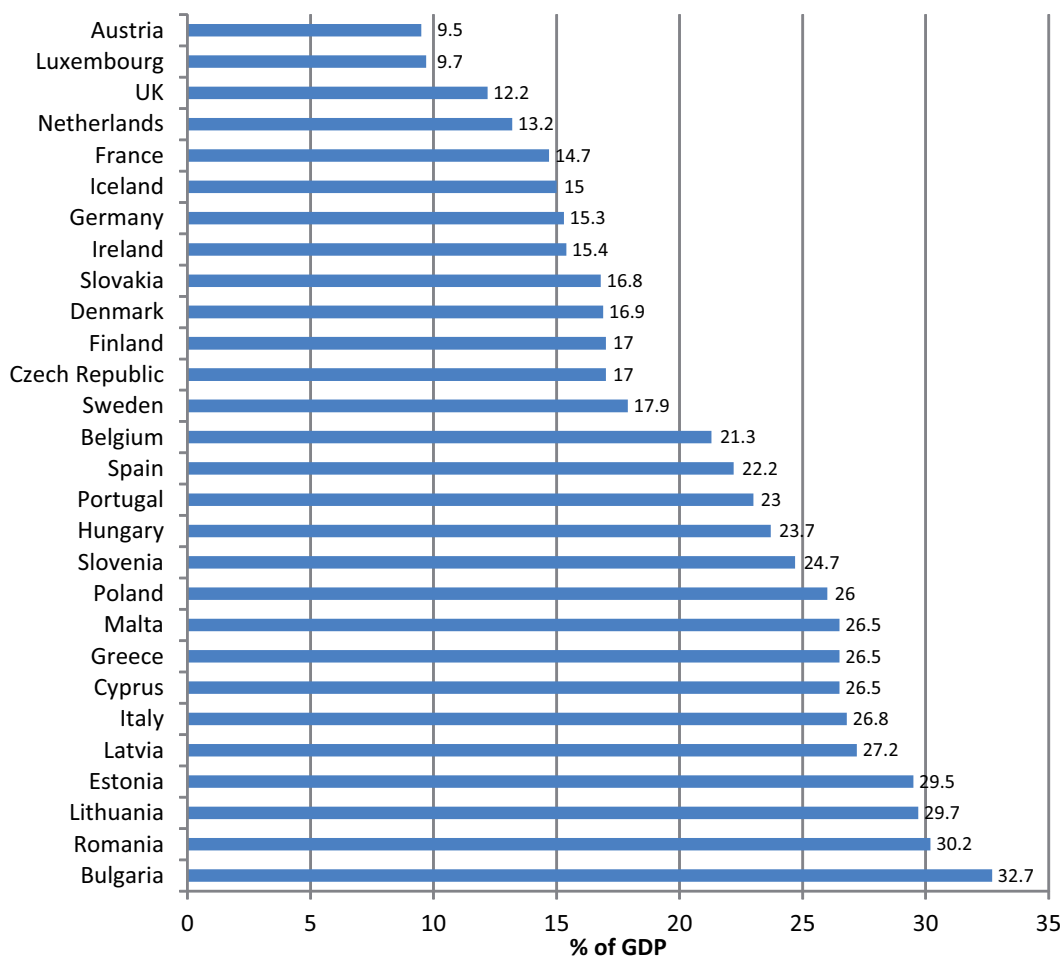
Extent of undeclared work

In Iceland, as in other countries, estimates of the size of the undeclared economy vary greatly, depending on the measurement methodology employed. It is important, therefore, to be aware of the measurement methods that underpin any estimate. To illustrate this point, it is often the case that a written employment contract is used as a proxy of employment status. In the EU-SILC household survey covering European OECD countries, for example, undeclared work is analysed by examining the share of employed persons not covered by legal employment requirements, such as social security, pension coverage or a written employment contract (OECD, 2012). It found that in Iceland, some 25% of respondents were undeclared workers. However, this is unreliable as a measure of the extent of undeclared work. As Andrews et al (2011) point out, in Iceland a written employment contract is not a legal requirement (see International Labour Organization NATLEX database), unlike in other countries where this is required by law (for example, Hungary, the Czech Republic, Estonia and Sweden). Great care is required, therefore, when using indicators to provide cross-national comparisons of undeclared work.

Figure 1 reports the results of the Multiple Indicators Multiple Causes (MIMIC) method of Schneider (2011). With the MIMIC estimation procedure one gets only relative values, with the help of the currency demand approach for a few countries, namely Austria, Germany, Poland and Switzerland. (These values have been calibrated into absolute ones.) It reveals that compared with other European countries, Iceland, with a shadow economy equivalent to 15% of GDP, is towards the lower end of European countries in terms of the size of its undeclared economy.

Turning to national-level surveys, the Icelandic parliament, the Althing, established a committee to look into tax fraud, tax evasion and undeclared work. The committee finished its report in December 2004 (Althing, 2004). It was estimated that these issues caused a loss of income to the state of between 8.5% and 11.5% of total government and commune tax revenues, of which 5%–8% involves undeclared work. This resulted in close to ISK 30 billion (€188 million) in lost tax revenues every year. According to the report, some decrease in undeclared work had occurred. This was largely attributed to a reduction in the small and medium-sized enterprise (SME) sector, which is generally associated with higher levels of participation in undeclared work. In 2003, an associated survey was carried out among Icelanders on tax evasion. It found that 15.8% of respondents had paid for goods or services that they believed had not been declared for tax during the 12 months prior to the survey.

Figure 1: Size of undeclared economy as percentage of GDP by country



Source: *Schneider (2011)*

Ásgrímsson (2012) reports the results of 2,136 workplace visits to 2,024 legal entities during 2011. In total, 6,167 individuals were interviewed, of whom 737 (12%) were found to be working undeclared. On this basis, the size of the undeclared economy in Iceland is estimated to amount to some €87.7 million.

Nature of undeclared work

Sector variations

The Althing survey examined the types of goods and services sourced by customers on an undeclared basis. It found that 42.3% of all undeclared goods and services bought came from the construction sector, 20.6% came from service industries, 15.4% involved car repair, 13.9% involved manufactured goods and 7.8% involved other goods and services. This clearly indicates that the construction business in general, home maintenance and improvement in particular, is the focus of much undeclared work in Iceland. This survey also found that services sourced on an undeclared basis tend to be those services where SME activity is concentrated, such as hotels and restaurants (Althing, 2004).

In a more recent study, involving interviews with key government stakeholders involved in the campaign against undeclared work, similar sectors were identified: construction; restaurants and tourism; and retail and personal services (Dekker et al, 2010, p. 186). Ásgrímsson (2012) found that 44% of all undeclared goods and services bought were within

the repair and manufactured goods sectors, 27.7% were in restaurants and bars, 14.8 % involved tourism, 11.9% were from construction and 1.6% involved other goods and services. It has to be taken into account that, due to the financial crisis in autumn 2008, the economy in Iceland in 2011 was very different than it was in 2003. This is especially true for the construction industry.

Socioeconomic, business and spatial variations

Dekker et al (2010) found that undeclared work performed by immigrants without a work permit has been a problem in Iceland. However, the stakeholders interviewed raised doubts about whether this continues to be a problem, at least concerning work permits.

Types of undeclared work

Until now, no known surveys have been conducted on the proportion of the undeclared economy involving informal waged employment, informal self-employment and paid favours. Neither has any survey focused on whether there is a tendency for formal employers to pay their formal employees an additional undeclared ‘envelope’ wage, such as for overtime or extra time worked. Such research on the configuration of work in the undeclared economy would be useful, not least when considering what needs to be done about the undeclared economy. Research conducted in Iceland’s Nordic neighbours and into sectors in which undeclared work is concentrated suggests that the vast majority of undeclared work is own-account work, probably conducted as paid favours for close social relations. Empirical research is required to confirm that this is the case in Iceland.

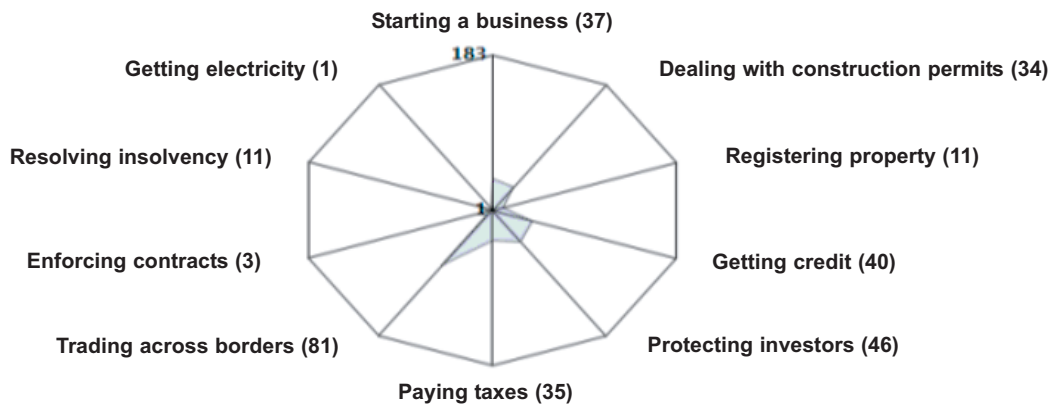
Barriers to formalisation

The annual World Bank Doing Business surveys are one of the few data sources on the barriers to formalisation in Iceland. These provide data on how easy or difficult it is for a local entrepreneur to open and run a small-to-medium-sized business when complying with relevant regulations. As the survey is conducted annually in 183 countries, these data can be compared with the situation in other countries. The survey measures and tracks changes in regulations affecting 10 areas in the life cycle of a business: starting a business, dealing with construction permits, getting electricity, registering property, getting credit, protecting investors, paying taxes, trading across borders, enforcing contracts and resolving insolvency. Iceland was ranked ninth out of 183 in 2012 in terms of ease of doing business, up from 13th place in 2011. In the same year, the EU27 as a composite was ranked 38th. Iceland performs better on some aspects of doing business indicators than others relative to other countries (see Figure 2).

In relation to ease of starting a business, Iceland was ranked 37th out of 183 countries compared with 66th for the EU27 as a composite. Starting a business requires five procedures, takes five days, costs 3.3% of income per capita and requires paid-in minimum capital of 12.6% of income per capita. This survey identified no reforms needed to further improve the ease of starting a business over the period 2009–2012 in Iceland.

Iceland was ranked 35th out of 183 countries in 2012 regarding ease of paying taxes, compared with 71st for the EU27 as a composite. On average, firms make 29 tax payments a year, spend 140 hours a year filing, preparing and paying taxes, and the total tax rate amounts to 31.8% of profit. Over the past few years, however, this survey identified several reforms to further improve the ease of paying taxes. In 2010, the tax burden was eased on companies by reducing the corporate income tax rate from 18% to 15%. In 2011, Iceland increased the corporate income tax rate from 15% back to 18% and raised social security and pension contribution rates, while in 2012 Iceland again made paying taxes easier and less costly for firms by abolishing a tax.

Figure 2: Iceland's ranking on aspects of doing business



Source: *World Bank Doing Business (2012: Figure 1.3)*

Despite ranking 35th out of 183 countries on the ease of paying taxes, the widespread perception in Iceland is that the Icelandic tax system helps prevent undeclared work. As Escolano et al (2010) state, it is reasonably simple with relatively low rates and broad tax bases, resulting in the state collecting a comparatively large amount of revenue while minimising adverse effects on employment, economic activity and compliance costs. Indeed, according to OECD Revenue Statistics, Iceland has had a high revenue ratio in comparison with other OECD countries, and even among other Nordic countries, suggesting that its tax system is not a major barrier to formalisation.

Organisation of efforts against undeclared work

Cross-government cooperation

Analysing how the drive against undeclared work is organised in 31 European countries, Dekker et al (2010) found that eight countries (26%) had established one body dedicated to tackling undeclared work. This was either a single agency responsible for combating undeclared work or a central coordinating committee responsible for ensuring coordinated action by the multifarious departments who have a stake in tackling undeclared work.

In Iceland, no single agency, central coordinating committee or department is responsible for coordinating efforts against undeclared work. No state department is officially responsible for tackling undeclared work either, although the IRD undertakes workplace inspections to detect undeclared work, albeit with limited resources. The IRD has no formal responsibility to address undeclared work beyond conducting these periodic and limited on-site inspections as part of regular tax inspections seeking to detect tax evasion. The absence of a single agency responsible for addressing undeclared work causes a lack of continuity and coordination in tackling the issue.

As Table 1 shows, tax offices, social security administrations and labour inspectorates can take this central role, depending on the country concerned. In Nordic countries, local tax offices tend to take this role, not least because much of the undeclared work is conducted as self-employment, a type of undeclared work that is of less interest to labour inspectorates. In much of southern and east-central Europe, waged work is a more prominent type of undeclared work and the focus is therefore on employer–employee relations; in these countries, the labour inspectorate has greater responsibility.

Table 1: *Main authority for tackling undeclared work in 31 countries*

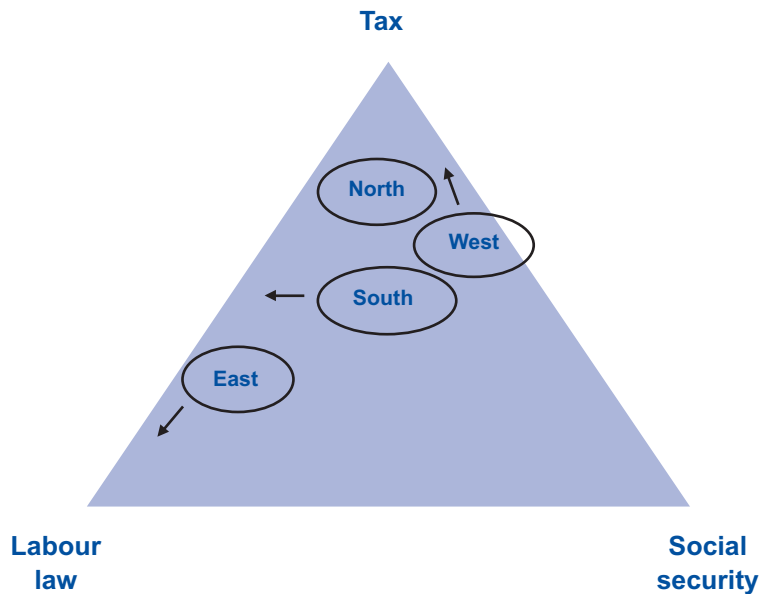
Labour inspectorate	Social security administration	Tax administration
Bulgaria, Cyprus, Czech Republic, Greece, Hungary, Italy, Iceland, Latvia, Lithuania, Malta, Luxembourg, Poland, Portugal, Romania, Slovakia, Slovenia, Spain	Belgium, France, Switzerland, Liechtenstein	Austria, Denmark, Estonia, Germany, Finland, Ireland, Netherlands, Norway, Sweden, United Kingdom

Source: Dekker et al (2010)

Figure 3 summarises where the balance lies between the various authorities in different European regions. In northern European countries, it is predominantly the tax authorities who take the leading role in formulating policy on undeclared work. In western European countries, although the tax authorities take the leading role, greater contributions are made by the social security authorities. In southern European countries, a more equal contribution is made by all three bodies while in east-central Europe, most responsibility lies with the labour inspectorates.

Dekker et al (2010) found that the balance of responsibility in each European region is shifting over time. Although little if any change has occurred in northern European countries, with the tax authorities remaining predominantly responsible for tackling undeclared work, in western European countries, the dominance of the tax authorities is growing. In southern European countries, a shift is occurring away from an equal role played by all three bodies and towards greater responsibility being taken by the tax and labour authorities.

Figure 3: Responsibility for undeclared work in the regions of Europe



In Iceland, although no official government department takes lead responsibility, the IRD tends to take the lead in organising efforts against undeclared work, as noted above. This is also the case in other Nordic nations. However, the IRD has no formal responsibility to tackle undeclared work beyond conducting its periodic and limited on-site inspections. In practice, the fight against undeclared work involves both the IRD and the Directorate of Labour (*Vinnumálastofnun*).

Although the IRD is responsible for tax evasion in general, including the tax gap that results from undeclared work, the Directorate of Labour, under the Ministry of Welfare, deals with contraventions of labour law. It is also responsible for the management of the employment service in the country as well as the daily operation of the Unemployment Benefit Fund, the Wage Guarantee Fund, the Childbirth Leave Fund and payments to parents of children with long-term illness, as well as benefit fraud associated with these funds, such as when people are claiming benefits and not declaring income from unregistered employment.

Role of social partners

In Iceland, the Icelandic Confederation of Labour and the Confederation of Icelandic Employers are involved in tackling undeclared work, and both have taken a prominent role in many specific initiatives. Although numerous government agencies are involved in tackling undeclared work, up until now limited cross-agency cooperation has taken place. Examples are detailed below.

Cooperation on workplace ID cards and workplace monitoring

Cooperation between the Icelandic Confederation of Labour and the Confederation of Icelandic Employers led to a law being passed in August 2010 on the issuing of ID cards in the workplace, specifically for the building and construction industries, and the hotel and restaurants sector. These industries are obliged to supply their employees with ID cards from the first day that they start work so as to make investigation and control activities against undeclared work more effective. On behalf of these two social partners, an inspectorate unit has been formed to visit workplaces and check IDs,

thus taking positive action against undeclared work. This law came into effect on 15 September 2010. At the time of writing, plans were in place to issue ID cards for other sectors. The law stipulates that inspectors should send the information stated on workplace ID cards to the tax authorities, the Directorate of Labour, the State Social Security Administration, chiefs of police and, when relevant, the Directorate of Immigration and the National Registry, so that it is possible to check whether the employer or employee is working in accordance with the relevant laws for which each institution is responsible.

'Fair play'

'Fair play' is a cooperative initiative between the Icelandic Confederation of Labour and the Confederation of Icelandic Employers to promote fair competition within industries. This awareness-raising campaign aims to combat undeclared work and to enable unions to better safeguard employees' rights. In 2009, the Federation of Icelandic Industries launched a campaign, using television and printed flyers, highlighting how undeclared work is a threat to the welfare of Icelandic society. The aim was to encourage people to perceive undeclared work as unacceptable. This campaign, which was very well received, was followed by workplace visits.

Directorate of Labour and Internal Revenue Directorate

Among other duties, the Directorate of Labour and the IRD both have an obligation to tackle undeclared work. In July 2009, in an initiative between the Ministry of Finance and the Ministry of Welfare, an agreement was made to pursue cooperation between the Directorate of Labour and the Internal Revenue Directorate. This led to the sharing of information on developments in the workplace concerning undeclared work. As a result, tip-offs have been shared and some joint on-site inspections have taken place involving inspectors from both directorates. Up to now, the departments have pursued shared or common strategies and targets in relation to tackling undeclared work.

Existing cross-national cooperation on undeclared work

The existing Nordic Tax Treaty between Sweden, Norway, Finland, Denmark and Iceland involves cooperation between these countries on matters involving cross-border aspects of undeclared work.

Policy approaches to undeclared work

A typology of policy approaches

In the EU27, tackling undeclared work has been traditionally dominated by a repressive approach that seeks to stamp it out through increasing the costs associated with working undeclared. This is achieved by increasing the penalties and/or perceived or actual likelihood of being caught. Since the turn of the millennium, however, calls have been made by the European Commission for governments to transform undeclared work into declared work rather than simply repress it and to do so by adopting measures that change the benefits side of the equation, making it more beneficial and easier to engage in declared work (European Commission, 2003a, 2003b, 2003c). At the 2003 Lisbon Summit of the European Council, Employment Policy Guideline No. 9 was published on ‘transforming undeclared work into regular work’, which states:

Member States should develop and implement broad actions and measures ... which combine simplification of the business environment, removing disincentives and providing appropriate incentives in the tax and benefits system, improved law enforcement and the application of sanctions.

(European Commission 2003b, p. 9)

Further stimulation to move in this direction was provided by the European Commission (2007a) in its second Communication on undeclared work, which explicitly called for Member States to transform undeclared work into declared work. There are three types of approach: preventative measures that stop from the outset occurrences of non-compliance; curative measures to help those already working undeclared to move into the declared realm; and commitment measures that foster an allegiance to tax morality (Eurofound, 2009).

Policy approach: Comparison with 31 other European countries

As Table 2 shows, 57% of stakeholders in the EEA and Switzerland state that repressive measures are accorded the most importance in their country when tackling undeclared work, with just 43% deeming measures that transform undeclared work into declared employment as being accorded the most importance. When asked to identify policy measures accorded the least importance, some 84% cited those seeking to transform undeclared work into declared employment, with only 16% citing repressive measures. The clear indication is that despite the call by the European Commission to transform undeclared work into declared employment most countries remain entrenched in a repressive approach that seeks to stamp out undeclared work. The view that undeclared work needs to be transferred into the declared realm is far from being widely accepted.

Table 2: Stakeholders' views on the importance of different policy approaches to tackling undeclared work in the EEA and Switzerland compared with four candidate countries and Croatia

Types of measures	Most important (%)	Second most important (%)	Least important (%)
Repressive	57 (80)	17 (20)	16 (0)
Preventative	19 (20)	46 (60)	23 (0)
Curative	14 (0)	19 (20)	32 (60)
Fostering commitment to declared work	10 (0)	18 (0)	29 (40)

Note: Figures for the four candidate countries and Croatia are provided in brackets.

Source: Dekker et al (2010)

This is also the case in the four candidate countries and Croatia, where the widespread view is that repression measures to tackle undeclared work are accorded most importance. Iceland is no exception. Interviews with government officials and social partners strongly confirmed that deterrence remains the dominant policy approach, although enabling measures are also being widely used, combined with a deterrence approach. Most stakeholders are interested in trying

new approaches that would deliver better results in the campaign against undeclared work and are looking more towards curative measures and developing tax morality rather than repressive measures. Indeed, stakeholder opinion is that over 80% of the population would respond positively to curative and commitment measures, while others will respond to repressive measures, with the exception of about 5% who will not comply. The obstacle seems to be the absence of a formal body or committee with lead responsibility in tackling undeclared work in Iceland.

Iceland is similar to many of the 30 EEA countries and Switzerland in terms of policy measures used to tackle undeclared work. As Table 3 shows, all 31 countries continue to use repressive measures aimed at stamping out undeclared work, with all seeking to improve detection and 93% using penalties and/or sanctions. However, countries have also started to employ policy measures to transfer undeclared work into the declared realm that change the ‘benefits’ side of the equation, making it easier and more beneficial to operate in the declared economy, as called for by the European Commission. In total, 90% of these countries have adopted at least one preventative policy measure, although the range of measures used is relatively narrow beyond simplifying compliance; 64% use one or more curative measures, although again the range used is narrow beyond the use of targeted direct tax incentives (for example, income tax relief, tax reduction and subsidy schemes). Moreover, recognition has been made of the need to shift from a purely ‘harder’ policy approach, which changes the cost/benefit ratio confronting suppliers and purchasers, and towards a ‘softer’ approach that seeks to move away from compliance and towards engendering a commitment to tax morality, with 69% of the 31 countries adopting some commitment measure.

Table 3: *Policy measures used in Iceland and 31 other European countries to tackle undeclared work*

Measures	Used in Iceland	% of 31 other European countries using measure
Repressive measures		
Penalties		93
Administrative sanctions for purchasers/companies	✓	87
Administrative sanctions for suppliers/employees	✓	83
Penal sanctions for purchasers/companies	✓	74
Penal sanctions for suppliers/employees	✓	52
Measures to improve detection		100
Data matching and sharing	✓	83
Workplace inspections	✓	100
Registration of workers prior to starting work or on first day of work		74
Coordinating strategy across government		57
Certification of business, certifying payments of social contribution and taxes	✓	65
Use of peer-to-peer surveillance (e.g. telephone hotlines)	✓	39
Coordination of operations across government	✓	61
Coordination of data sharing across government	✓	65
Mandatory ID in the workplace	✓	65
Measures enabling compliance		
Preventative measures		90
Reduce regulations		48
Simplify compliance procedures	✓	87
Technological innovations (e.g. certified cash registers)		43
New categories of work (e.g. for small or mini-jobs)		35
Direct tax incentives (e.g. exemptions, deductions)	✓	61
Social security incentives	✓	35
Ease transition from unemployment into self-employment		65
Ease transition from employment into self-employment		44

Measures	Used in Croatia	% of 31 EEA countries using measure
Measures enabling compliance		
Preventative measures		90
Changing minimum wage upwards	✓	48
Changing minimum wage downwards		9
Training and support to business start-ups	✓	61
Micro-finance to business start-ups	✓	52
Advice on how to formalise	✓	61
Connecting pension schemes to formal labour		61
Introducing supply chain responsibility	✓	17
Restricting free movement of (foreign) workers		43
Curative measures		64
Stimulate purchasers to buy declared		
Service vouchers	✓	26
Targeted direct tax incentives	✓	61
Targeted indirect taxes	✓	17
Stimulate suppliers to formalise		
Society-wide amnesties		9
Individual-level amnesties for voluntary disclosure		17
Formalisation advice to business		30
Formalisation support services to businesses		30
Targeted VAT reductions		17
Free record-keeping software to businesses		13
Fact sheets on record-keeping		22
Free advice/training on record-keeping		22
Gradual formalisation schemes		13
Fostering commitment to declared work		69
Campaigns to inform undeclared workers of risks and costs of working undeclared	✓	61
Campaigns to inform undeclared workers of benefits of formalising their work	✓	57
Campaigns to inform users of undeclared work of the risks and costs	✓	61
Campaigns to inform users of undeclared work of the benefits of declared work	✓	52
Use of normative appeals to people to declare their activities		52
Measures to change perceived fairness of the system		26
Measures to improve procedural justice of the system (i.e. degree to which people believe government has treated them in a respectful, impartial and responsible manner)		17
Measures to improve knowledge of tax, social security and labour law	✓	65
Adoption of commitment rather than compliance approach (e.g. 'responsive regulation')		30
Campaigns to encourage a culture of commitment to declaration	✓	39

Source: *Derived from Williams et al, 2013 (Table 3)*

In Iceland, as in other EEA countries and Switzerland, repression measures dominate the policy approach, although preventative measures have been combined with repressive measures and there is a range of commitment measures around awareness-raising campaigns. Iceland is relatively weak, however, on pursuing curative measures that seek to

enable those already working in the undeclared economy to make the transformation to the declared realm, probably due to the small numbers involved in the undeclared economy in Iceland.

Workplace inspections have been an integral part of the IRD's operations. The introduction of employee ID cards has created an opportunity to check an employee's existence against tax records. This allows for a quicker and more efficient inspection regarding whether or not an employee is fully registered. If failings are noticed the IRD responds to any incorrect behaviour. In such cases, follow-up checks are made to ensure that instructions have been complied with and corrections have been carried out. This approach is also supported by social partners who often carry out inspections independently. There are many independent labour unions, small and large, operating under the umbrella of the Icelandic Confederation of Labour. The larger unions within some industries have their own inspectorates (composed of one to three people), who take on the responsibility of carrying out workplace inspections to address undeclared work as well as other issues. These inspectorates help the unions to better safeguard their members' rights.

Peer-to-peer surveillance has been introduced as a deterrence measure in Iceland. Tip-offs and whistle-blowing have been used by the IRD, the Directorate of Tax Investigations, the Directorate of Labour and the Icelandic Confederation of Labour. All have conduits for accepting tip-offs whether anonymous or not. The investigation unit of the Icelandic Confederation of Labour and the Confederation of Icelandic Employers has also taken action when tip-offs about situations in the workplace are reported.

Iceland has continued to give prominence to repressive measures when tackling undeclared work. Nevertheless, and akin to its Nordic neighbours, enabling measures are increasingly used, albeit mostly preventative measures and initiatives to engender a culture of commitment to tax morality. Enabling measures to help suppliers transform their undeclared work into the declared economy, especially incentives for those who currently supply undeclared work, have been notable by their absence. This, however, can perhaps be explained by the low number of such suppliers in Iceland. In consequence, in terms of the extent and character of undeclared work and its approach to undeclared work, Iceland seems to be very much aligned with its Nordic neighbours. Not only is the undeclared economy relatively small compared with the EU27 as a composite, and undeclared work mostly composed of own-account work, it has also complemented its existing repressive measures with an array of enabling policy measures so as to make it easier and more beneficial to operate in the declared economy.

Conclusions

This report has provided a systematic overview of the extent and nature of undeclared work, and how it is being tackled, in the EU candidate country of Iceland, a ‘high income’ OECD country with a GNI per capita of USD 33,870. The objectives have been to analyse the prevalence and character of undeclared work in this country, to analyse how efforts against undeclared work are organised and to examine the policy approaches and measures being adopted. Throughout the report, the situation in Iceland has been compared with the EU27 wherever feasible.

The report has shown that Iceland has a small undeclared economy relative to the EU27. It has also revealed that, akin to its Nordic neighbours, much undeclared work is likely to be composed of paid favours for close social relations and that much of this endeavour takes place in the home improvement and maintenance sector and the personal services sector, among others.

In the World Bank Doing Business survey, Iceland was ranked 9th out of 183 countries in 2012 in terms of the ease of doing business, up from 13th place in 2011. In relation to the ease of starting a business, Iceland was ranked 37th out of the 183 countries. Starting a business there requires five procedures, takes five days, costs 3.3% of income per capita and requires paid-in minimum capital of 12.6% of income per capita. In terms of ease of paying taxes, Iceland stood at 35th out of 183 countries in 2012. On average, firms make 29 tax payments a year, spend 140 hours a year filing, preparing and paying taxes, and the total tax rate amounts to 31.8% of profit.

Dekker et al (2010) found that only eight out of 31 European countries (26%) had established one body dedicated to tackling undeclared work. This was either a single agency responsible for combating undeclared work or a central coordinating committee responsible for ensuring coordinated action by the multifarious departments involved in tackling undeclared work. In Iceland, no single compliance body is responsible for tackling undeclared work. However, one department does have main responsibility. In Nordic nations the tax office usually takes main responsibility. In Iceland, in practice the Internal Revenue Directorate (IRD) tends to take responsibility here. It is responsible for tax evasion in general, and for tackling the tax gap that results from the persistence of undeclared work. The Directorate of Labour (*Vinnumálastofnun*), under the Ministry of Welfare, also plays a role. Currently, limited cross-departmental cooperation takes place and shared targets on tackling undeclared work are the exception rather than the rule. The involvement of social partners occurs through the Icelandic Confederation of Labour and the Confederation of Icelandic Employers and comes in the form of cooperation on specific policy measures such as the introduction of ID cards and awareness-raising campaigns such as the ‘fair play’ campaign.

Tackling undeclared work in Iceland, as is the case in the EU27 as a whole, is still dominated by a repressive approach. However, as in the Nordic countries, an array of enabling measures have been adopted to complement the repressive measures. Many preventative measures have been introduced, as well as a range of commitment measures, especially around awareness-raising campaigns. Despite this, Iceland is relatively weak on pursuing curative measures that seek to enable those already working in the undeclared economy to make the transformation to the declared realm. This is particularly the case in terms of providing incentives to suppliers of undeclared work to make the transformation to the declared realm. This is perhaps due to the low numbers of suppliers of undeclared work.

Iceland has a relatively small undeclared economy, which seems likely to be composed largely of own-account work for close social relations. It has complemented its traditional repressive measures with ‘harder’ enabling measures and also ‘softer’ commitment measures to improve tax morality. Areas for improvement include better coordination of efforts to tackle undeclared work across government agencies such as by pursuing more joined-up strategy and operations and establishing common goals and targets; creating a more formal institutional framework for tripartite social dialogue on undeclared work; and conducting empirical research into the sectors in which undeclared work occurs, who does it, the types of undeclared work they conduct and their motives for doing so, in order to enable more efficient and effective action against undeclared work.

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Colin C. Williams, Marijana Barić and Piet Renooy

