

# The Role of Specific Legislation in Combating Undeclared Work and its Socio-Economic Effects

**Baciu Iacob**

*„Dimitrie Cantemir” Christian University*

*Faculty of Tourism and Commercial Management, Bucharest, Romania*

E-mail: baciu\_iacob@yahoo.com

## **Abstract**

*The present article shows some aspects regarding black and gray labor, components of underground economy in Romania and the way the work legislation and the ones called upon to apply it intend to contribute to fighting this phenomenon. Fiscal pressure is, in fact, the degree of taxation, i.e. the extent to which taxpayers as a whole, society, economy, bear - to the results obtained from their work - taxes as compulsory levies and charges imposed by the legal State. Tax burden is the ratio of the sum of all taxes, social contributions and other samples containing the tax collected from central or local level, and aggregate macroeconomic indicators (GDP, GNP, national income).*

**Key words:** underground economy, work legislation, tax burden, taxes, fiscality

**J.E.L. Classification:** H89, K40

## **1. “Black work” or “gray work” components of underground economy**

In order to define the two notions above mentioned, “black work” and “gray work”, I must specify that they are components of another phenomenon, well known by the specialists under the name “underground economy” or “shadow economy”. A comprehensive definition of the underground economy was given by Pierre Pestieau, according to who the underground economy represents a set of economical activities which take place outside the criminal, social or fiscal law or which escape (the measures) the inventory of national accounts.

Other authors state that the underground economy is in fact the “untaxed economy” which includes a variety of illegal activities which take place, omitting certain regulations. Regarding the underground economic sphere, it includes a series of illicit activities such as fraud and fiscal evasion, clandestine work (undeclared or “black work”) declaring smaller incomes, referring to businesses or unpaid incomes, drug traffic, gun traffic, traffic in people, cigarette smuggling, corruption, prostitution, some domestic activities which can provide unregistered incomes, etc.

In general the causes of an underground economy can be found in excessive taxing, tough regulations for some types of activities, the fear of some employers of not losing the social facilities given by the state, flexibility in using the workforce, the prohibition of some types of activities, economic crises, etc.

Also, resorting to the underground economy may lead to the imposition of some legal restrictive regulations on the work market, commercial barriers, some work restrictions imposed to strangers, etc. which can determine the growth of the number of authorizations necessary for carrying out some activities and which can finally reduce employees' freedom of action in the real economy. All this leads to important growth of the working costs in the official economy, which are true stimulants for the underground work and economy that obviously can be avoided.

A profoundly negative effect of underground economy can be found in the way it affects the fiscal health of a state. In this way, it has been determined that if a state is capable of controlling the forms of manifestation of underground economy, many fiscal problems of the public sector, for example public debt, could be reduced.

Without a doubt we can say that the underground economy has an important impact on the social scale, causing a variety of antisocial phenomenon such as: corruption, all kind of crimes, drug abuse, mafia-like organizations, labor exploitations by means of the black market, dirty money laundry, violation of human rights, environmental pollution, etc.

Regarding the influence of underground economy on the political life, it has been established that the stability and efficiency of the act of government depends largely on the quality and quantity of information that substantiates the political, economical and social objectives. The underground economy sends the wrong signals to the decision makers and leads to poor macroeconomic policy formulation in the fiscal system, unemployment, inflation, welfare, productivity or competitiveness.

## **2. What are “black work” and “gray work”?**

To define these terms, we first have to define legal work. Legal work is that activity of a physical persona who performs work under an individual work contract and in the requirements of the labor legislation.

In the specialized literature the individual work contract has been defined as being “that convention under which a person, known as an employee, obliges himself to provide a service, for and under the authority of an employer, individual or company, who in turn obliges himself to pay a remuneration, known as a salary and to insure him the adequate conditions to develop his activities, maintaining the health and safety at work”. Undeclared work or “black work” is considered to be any type of work conducted outside the legal framework, without drawing an individual work contract, or in the case of failure to pay on a payroll.

“Gray” work is that activity performed by a person, under an individual work contract, in which the parts consent to register in the contractual clauses a minimum wager, and the difference up to the real value of the employee is not highlighted and is divided between the employer and the employee; the payment of contributions owed to the state is considerably reduced.

In general, undeclared work, as it results from the activities of the territorial units of the Labor Inspection, manifests itself in many forms such as:

- in the form of a totally inconspicuous and untaxed activity, conducted outside the existence of an individual work contract, unremunerated on the basis of a payroll,

free of obligations to the state budget, without documents related to the person who works there.

- in the form of a partially conspicuous, untaxed activity, realized through a double evidence named “envelope wages”;
- in the form of a dishonest evidence of production achieved through overtime;
- in the form of the a trial period, not highlighted in documents.

Usually, such illicit activities appear in the sectors of the economy where money is handled in cash. The commercial areas are the preferred ones.

The causes of such an activity are numerous, with a multifunctional determination depending on the economic situation of the employer and the employee at a certain time, on their educational, on the legal framework and sanction regime of this kind of facts.

In principle this causes are considered to be:

- discrepancy between high demand and low supply of jobs for the labor market;
- excessive taxation;
- existence of a very active underground economy.

In the latter case, particularly interesting are the findings outlined in a newspaper in the capital, according to which, based on a Visa Europe study realized by the consulting company A.T. Kearney and Friedrich Schneider (quoted by the author of the article), Romania ranks 5th in Europe, depending on the percentage of underground economy, with a GDP of 33% after Latvia and Bulgaria with rates of 36% of GDP and Estonia and Croatia with 35%.

Other causes that lead to the creation of black labor are:

- the employers decision to choose a policy of obtaining substantial profits in the short term at the expense of the company's development strategy in the medium and long;
- the vulnerability of a large socio-professional category which results from the fact that they hardly find a job according to their preparation;
- the large number of different forms of university graduates looking for work because of inconsistency between the number of scholars and the labor market demand;
- a sanction regime for violating labor laws, discrimination, only for the employer and less or non for the employee who perform black work.

Without a doubt that a job performed in illegal conditions brings about many disadvantages for both employers and employees.

In terms of the employees the disadvantages may relate to:

- the lack of the minimum wagger's benefit, of the wage increases due to seniority, working conditions, etc.;
- the deprivation of entitlement to statutory paid annual leave and other type of leave (form marriage, in case of family death, the birth of a child, for studies, etc.);
- the lack of insurance benefit for predictable and unpredictable risks such as: invalidity, work related accidents, professional illnesses, maternity, death of the employee, etc.;

- the a lack of assistance benefits for illness prevention and the recovery of work ability, such as: allowance for temporary switch to another job, to reduce work time, for a free of charge balneal treatment and work rehabilitation;
- deprived of the benefit of allowance for maternity, parental or childcare until the age of 2 years or in case of a sick child;
- the deprivation of benefit entitlement to old-age pension, early retirement, partial early retirement, invalidity, survivor;
- the lack of benefit for free healthcare, free or offset drugs;
- the deprivation of the right to receive unemployment compensation and support allowance;
- the persons who work on the “black” market cannot benefit from the exercise of collective constitutional rights such as: the right to join a union, to negotiate the collective work contract;
- the to take a bank loan is limited, etc.

All the disadvantages above presented are caused by the provision of an activity without an individual work contract, under which labor legislation and social security ensures those rights to the employee.

For the employers the disadvantages are encountered in the three forms of legal liability which are applied namely: liability offense for the facts qualified as contraventions by Law no. 130/1999, Law no. 19/2000, Law no. 76/2002, criminal liability, for the facts qualified as being crimes stipulated by the labor law and the Criminal Code, civil liability in tort for those damages caused by tertiary works, as well as the material liability consisting in payment of contributions to the state budget with delay increases, penalties and interests.

### **3. Tackling undeclared work in the European Union**

Undeclared work is not a phenomenon typical for Romania; it greatly affects all states of the European Union.

The study conducted by Visa Europe, the consulting company A.T. Kearney and Friedrich Schneider, the European underground economy in 2008 reached a considerable level of about 2000 billion euro, rating between 10% of gross domestic product (GDP) in Great Bretagne and almost 40% in some countries in Central and Eastern Europe.

These and other issues that accompany the underground economy have led the 27 member states of the European Union to think about finding measures to combat the undeclared work phenomenon.

According to the second Communication of the European Commission on undeclared work, entitled “Accelerating the fight against undeclared work” in 2007 shows that although all the member states adopt disincentive, curative and preventive measures, only few countries seek to encourage fiscal ethics and it is recommended the application of a larger number of initiatives to raise awareness with the purpose of changing the mentalities in this regard.

In the same context we mention a resolution of the European Parliament from 2008, in which the member states were asked to accelerate the efforts to tackle undeclared work. Through this resolution the Commission was asked to consider the setting up of a

data base on various methods and measures applied at a national level by each member state in order to evaluate the feasibility and transfer them to other sectors or domain of activity in other member states.

Also, very important in terms of the measures of tackling undeclared work are a series of conclusions that are detached from the rapport – “Measures in tackling undeclared work in the European Union” of the “European Foundation for improvement of Living and Working Conditions”.

According to the document above quoted, undeclared work does not present everywhere the same characteristics, such as the type of undeclared work, its spreading and notions of employment in such of activity, fact which does not determine a universal approach to the fight against undeclared work and adopting measures and policies in specific circumstances that are prevalent in certain countries and regions.

The report, presented above, points out the fact that “the assessments of the vast selection of approaches and politic measures which are being implemented across the UE and Norway, provides a perception of good practice and gives some practical examples in the area. The initiatives taken include measures of deterrence, persuasive measures, curative measures, through which they seek to legitimize undeclared work, and measures meant to change people’s mind and to determine the creation of a commitment for payment of taxes. A key finding is that the best practices involve not only the choice of individual policy measures, which prove successful in the tackling of undeclared work, but also identifying the most effective ways to meet these policy measures in various combinations and sequences”

#### **4. Some measures regarding the tackling of undeclared work reflected in the labour legislation**

According to the Memorandum of Understanding from 23.06.2009 between the European Community and Romania, the Council of the European Union adopted a decision referring to the allocation to Romania of a medium-term financial assistance amounting to 5 billion euros.

In the Memorandum it is provided, among other things that the tackling of undeclared work is to be done “by significantly increasing the intensity of controls and application of administrative fines discouraging enough in a noncompliance case.

According to legal regulations in force, the Labor Inspectorate, which was founded and is operating in accordance with Law no. 108/1999, is the specialized organ of central public administration; its attributes are those of control in what regards the appliance of legal provisions in labor relations, safety and health.

Following the provisions of the Memorandum, between July-December 2009, the Labor Inspectorate has intensified the fight against undeclared work thus, compared to the same period in 2008, they found increases in all indicators, as follows:

- the number of the employees verified increased by 9,07% (from 37195 in 2008 to 40570 in 2009);
- the number of employees found providing undeclared work increased by 32,29 (from 3806 in 2008 to 5035 in 2009);

- the number of persons found without legal forms of employment increased by 29.46% (from 7917 in 2008 to 10,249 in 2009);
- the number of sanctions imposed for undeclared work increased by 28.23% (from 3975 in 2008 to 5097 in 2009);
- the value of the fine's imposed increased by 31.88% (from 11,259,650 lei in 2008 to 14,848,900 in 2009);
- the number of individual work contracts registered at the Inspectorate for the employees found without legal forms increased by 14.33% (from 4341 in 2008 to 4963 in 2009).

After these checks it was found that only increasing the number of specialized controls is insufficient and in compliance with the provisions of the Memorandum a number of measures were taken to harden the sanctions of normative documents containing provisions whose breach can lead to promoting self-employment. Thus the Labor Code, Law no 53/2003, penalized in Art. 276 letter e the undeclared work. If the employees are found without an individual work contract the firm for which they are working for could be fined from 1500 to 2000 lei for each person identified, without exceeding the aggregate amount of 100.000 lei.

Considering the contravention sanctions provided in this case are not severe enough and taking into account the recommendation of the Memorandum, art. 276 letter e of the Labor Code was amended, establishing for the offense charged in this article a fine of between 3000 and 4000 lei for each person identified, without exceeding the value of 100,000 lei.

As stated in Art. 1 of Law n. 130/1999, republished, with regard to certain measures for the protection of persons employed, employers are required to register contracts of employment to Labor Inspectorates within 20 days. Also according to the regulations contained in Government Decision no. 161/2006, for establishing and expanding the register of records of employees, employers were required to transmit the register in electronic form to the Labor Inspectorate in whose territorial area are located or domiciled, within 20 days from the date the first employee is hired. Subsequently, they are required to report any changes within 5 days.

In the same context it was found that the labor inspectors' possibility to detect undeclared work in relation to these regulations is diminished by the employers' practices, extremely common in recent years. They conclude written contracts with workers, but do not record them to the territorial labor inspectorates only when they are detected during a control.

Certainly, the employer's practice is facilitated by the complicity with the worker, who agrees not to register the contracts and in case of a control he stated under signature that he's been working there for only a few days (under the 20 days limit time to register the individual work contract at the Territorial Labor Inspectorates).

It is clear that the efficiency of the controls is not proportional to the increase of the controls' numbers. It was found necessary to adopt a normative act to amend certain statutory provisions.

In this sense Government Decision no. 37/2010 was adopted to amend and complete Government Decision no. 161/2006 on establishing and expanding the general register of evidence of employees.

The amendments brought to this normative act have in view the followings:

- the obligation of the employer to record in the general register of evidence of employees the identification elements of all the employees no later than the day before the commencement of work;
- enter in the register the date and basis when the individual work contract was terminated on the date it terminated;
- the obligation to transmit the register to the Territorial Labor Inspectorate in whose territorial jurisdiction they have their headquarters or domicile, not later than one business day prior to commencement of work by the first employee and afterwards for each new employee;
- expanding the provisions relating to contraventions with two new wrongdoing facts, namely: not registering the individual work contract in the general register of evidence of employees prior to the beginning of work and expanding the register of employees clearly with erroneous data;
- setting the fine of 1,500 lei for each individual working contract is not shown in the general register of evidence of employees prior to the beginning of work without exceeding the aggregate amount of 20,000 lei;
- setting a fine from 3500 to 5000 lei for completing the register of records of employees with inaccurate data.

## Conclusions

I believe that this legislation may create a significant social impact in the fight against undeclared work, in the integration of as many undeclared employees as possible into the formal economy and in reducing the dangers that illegal working creates for all economic and social fields.

These normative acts, presented above, as well as other edicts expected in the virtue of the Agreement between Romania, the International Monetary Fund and the European Union have as a consequence the mitigating effects of the economical crisis that has passed and still passes over our country, but to tackle underground economy a variety of measures is necessary at all microeconomic and social levels. Some measures that must not be encountered in every act are:

- creation of many jobs through investment in the infrastructure;
- introduction of mandatory electronic payment of all wages. In countries that frequently use the electronic payment (UK, Netherlands etc.) the percentage of the underground economy is much smaller compared to countries where the system is in an early stage or even inexistent;
- punishment of the workers who provide undeclared work, thought to be accomplices of their employers;
- the decrease of the high level of social contributions paid by both employer and employee;
- fight more vigorously against the other components of the underground economy (tax evasion, drug trafficking, arms trafficking, trafficking in people, dirty money laundering, etc.).

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